IN THE SUPREME COURT
OF THE STATE OF WASHINGTON

Supreme Court No. 96383-5

(Court of Appeals No. 50080-9-II)

---

LOWE'S HOME CENTERS, LLC

Petitioner

v.

DEPARTMENT OF REVENUE, STATE OF WASHINGTON

Respondent

---

# PETITION FOR REVIEW OF LOWE'S HOME CENTERS, LLC

---

A. Troy Hunter
WSBA # 29243
Justin P. Walsh
WSBA # 40696
ISSAQUAH LAW GROUP, PLLC
410 Newport Way Northwest
Suite C
Issaquah, Washington 98027
Tel: (425) 313-1184
Fax: (425) 313-1858

John M. Allan
(*pro hac vice* application pending)
E. Kendrick Smith
(*pro hac vice* application pending)
JONES DAY
1420 Peachtree Street NE
Suite 800
Atlanta, Georgia 30309
Tel: (404) 581-8012
Fax: (404) 581-8330

*Attorneys for Appellant Lowe's Home Centers, LLC*

## TABLE OF CONTENTS

## TABLE OF AUTHORITIES

**Page**

**CASES**



**STATUTES**

**REGULATIONS AND RULES**

## I. IDENTITY OF PETITIONER

The Petitioner is Lowe's Home Centers, LLC ("Lowe's").

## II. INTRODUCTION

This is a case of first impression, involving unambiguous statutes and undisputed facts, that asks whether a seller, like Lowe's, can ever claim Washington sales tax credits and business and occupation (B&O) tax deductions for taxes it remitted on worthless private label credit card ("PLCC") accounts if the transactions were initially financed by a third party bank.[1] Under the law, including this Court's decision in *Puget Sound National Bank v. Department of Revenue*,[2] the mere fact that a bank initially owned and managed the PLCC accounts before they were written off does not affect whether Lowe's was entitled to a credit or deduction for taxes it remitted on the accounts after it performs on its guaranty.

RCW 82.08.037 permits a retailer to claim a credit for sales taxes it has previously remitted if its customer, on whose behalf the retailer remitted the taxes, buys goods on credit and later defaults. Similarly, RCW 82.04.4284 permits a retailer to take a bad debt deduction for B&O tax on the same basis.[3] The corresponding regulation explains that such credits and

---

[1] Lowe's HIW, Inc. ("HIW") initially claimed the credits and deductions at issue in this Petition, but Lowe's is the successor-in-interest to HIW and party to this appeal. For ease of discussion, this Petition will use Lowe's throughout to refer to both HIW and Lowe's.

[2] 123 Wn.2d 284, 868 P.2d 127 (1994) (*en banc*) (hereinafter "*Puget Sound*").

[3] This Petition will refer to these two statutes as the "Bad Debt Statutes". App. 48-52.

deductions "are based on ***federal standards for worthlessness under section 166 of the Internal Revenue Code.***"[4]

In *Puget Sound*, this Court identified only three requirements a retailer must satisfy to claim a credit/deduction for bad debt losses: "(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." 123 Wn.2d at 287. Respondent, the Washington Department of Revenue ("DOR"), concedes that Lowe's satisfied the first two requirements. DOR also acknowledges that Lowe's properly deducted the PLCC bad debts on its federal corporate income tax returns for the relevant years, pursuant to section 166 of the Internal Revenue Code of 1986, as amended ("IRC"), thereby satisfying the third requirement. These conceded facts entitle Lowe's to take the corresponding Washington sales tax credits and B&O tax deductions.

DOR, however, denied Lowe's claim, contending that: (1) the PLCC financing arrangement here (the "PLCC Agreement") was identical to the arrangement at issue in *Home Depot*[5]; and (2) retailers who participate in PLCC arrangements with third party banks can never qualify for bad debt credits or deductions in Washington.

---

[4] WAC 458-20-196(1)(d) (emphasis added) (the "Bad Debt Regulation"). App. 53-58.
[5] *Home Depot USA, Inc. v. State Dep't of Revenue*, 151 Wn. App. 909, 215 P.3d 222 (2009) (hereinafter "*Home Depot*").

However, the PLCC Agreement Lowe's entered into with third-party financing companies (the "Bank") was materially different from the PLCC agreement analyzed in *Home Depot*. Under the *Home Depot* template, the seller: (1) contracts away its right to take the loss on defaulted PLCC accounts; (2) is fully paid for the purchase prices and corresponding tax; (3) bears no risk of loss; and (4) is ineligible to take PLCC bad debt deductions on its federal income tax returns under IRC § 166. In contrast, under the PLCC Agreement at issue here, Lowe's: (1) remains directly liable, as guarantor, and bears the economic loss for all bad debts arising from the PLCC accounts (up to a specified cap); (2) remits sales taxes it cannot recover from its buyers; (3) reflects the PLCC bad debt losses in its books and records; and (4) deducts, and is entitled to deduct, the losses as bad debts on its federal income tax returns under IRC § 166.

As guarantor of worthless PLCC accounts, Lowe's made payment to the Bank (including all previously-remitted taxes), thereby stood in the shoes of the original creditor, and became the sole party eligible to deduct the PLCC bad debts for federal income tax purposes. Since (1) Washington bases bad debt credits/deductions solely on "federal standards for worthlessness" under IRC § 166; and (2) the Bad Debt Statutes do not require a taxpayer to have originated and owned the account, then Lowe's was entitled, as a matter of law, to take corresponding credits/deductions.

The trial court agreed with Lowe's, but felt obliged by its reading of *dicta* in *Home Depot* to go against its inclination to go Lowe's direction:

> Lowe's has a significant number of persuasive arguments in this case as to why this situation is different than the *Home Depot* situation for the reasons articulated in their briefing, particularly the plain text of the statute that appears to link this directly to the federal income tax provisions . . . . What the court struggles with, however, is the *Home Depot* decision's language, which appears at the urging of the Department of Revenue in that case to have been originally focused on the issue of whether or not the bad debt could be taken as a deduction from federal income tax returns, but then goes on to use very firm language about the debt must be held or owned by the party seeking to take the state deduction or credit or whatever.
>
> * * *
>
> So if I were sitting *de novo* without any authority that was binding me from the Court of Appeals in *Home Depot*, I would feel much more inclined to go Lowe's direction.[6]

Likewise, the dissent in the Court of Appeals' opinion agreed with Lowe's:

> Lowe's payments were made to discharge the obligation Lowe's had as the guarantor of those bad debts, and therefore under 26 C.F.R. § 1.166-9(a) those payments are treated as worthless debts for purposes of 26 U.S.C. § 166. Lowe's also met the requirements of 26 C.F.R. § 1.166-9(d). And because those guaranteed payments constitute bad debts as that term is used in 26 U.S.C. § 166, Lowe's is entitled to a sales tax credit under RCW 82.08.037(1) and a B&O tax deduction under RCW 82.04.4284(1).[7]

This Court should accept review of this Petition for two reasons:

---

[6] Verbatim Report of Proceedings ("VRP") at 3:18-4:11; 4:23-5:1; 5:12-19.

[7] *Lowe's Home Ctrs., LLC v. Dep't of Revenue*, ___ Wn. App. 2d ___, ___ P.3d ___, 2018 Wash. App. LEXIS 2082, at *39-40, ¶88, 2018 WL 4214266 (2018) (hereinafter "*Lowe's I*") (Maxa, C.J., dissenting).

***First***, the majority's opinion conflicts with Washington law, including *Puget Sound*, which merits review under RAP 13.4(b)(1). This Court should clarify that the Bad Debt Statutes do not require retailers to initiate and own the defaulting accounts in order to claim Washington bad debt credits and deductions. Further, this Court should clarify that *Home Depot* does not and cannot support DOR's position that only the originator and owner of bad debt accounts, and not a guarantor, can take the credits and deductions for taxes remitted on the accounts.

***Second***, the Court should also accept review under RAP 13.4(b)(4). No Washington court decision has addressed a PLCC arrangement like the one at issue here and none has held that a seller who has guaranteed a bad debt and is entitled to a deduction under IRC § 166 is nevertheless barred from taking corresponding Washington credits and deductions for taxes previously remitted on defaulted PLCC accounts. The proper interpretation of the Bad Debt Statutes is of substantial public interest.

## III. COURT OF APPEALS DECISION

Lowe's seeks review of the published decision filed on September 5, 2018, by Division II of the Court of Appeals, wherein the majority affirmed the trial court's Order denying Lowe's claim. *See* App. 1-36.

## IV. ISSUES PRESENTED FOR REVIEW

1. Whether the majority erred in concluding, contrary to *Puget*

*Sound*, that a retailer who guarantees worthless customer debts and ultimately bears the risk of loss for all bad debts from PLCC accounts is nevertheless ineligible to take a corresponding bad debt sales tax credit and B&O tax deduction in Washington.

2. Whether the majority erred in purporting to rely on *Home Depot* to hold that Lowe's can never be eligible to claim a sales tax credit or B&O tax deduction on bad debts arising from PLCC accounts it does not initiate and own.

3. Whether the majority erred in concluding that the Bad Debt Regulation imposes a condition that a retailer must write off as uncollectible the specific bad debt accounts in its books in order to claim corresponding sales tax credits and B&O tax deductions, and that Lowe's did not do so.

4. Whether the majority and dissent erred in holding the denial of Lowe's claim did not violate its constitutional equal protection rights.

## V. STATEMENT OF THE CASE

### A. PROCEDURAL HISTORY

DOR rejected Lowe's claims for PLCC bad debt credits/deductions and assessed Washington sales and B&O taxes, interest, and penalties in the principal sum of $2,218,507.63 (the "Refund Amount") for the period of April 1, 2001 through December 31, 2009 (the "Assessment Period").[8]

[8] CP 450, 464-87 (Decl. ¶3 & Exs. A & B).

Lowe's paid this amount in full and, on February 11, 2016, filed suit, seeking to recover the Refund Amount, plus interest.[9]

On February 10, 2017, the trial court conducted a hearing on the parties' cross motions for summary judgment, during which it concluded there was no genuine issue of material fact and its decision was controlled by its reading of language in *Home Depot* that it suggested may have been *dicta*.[10] On March 3, 2017, the trial court entered an Order denying Lowe's motion and granting DOR summary judgment.[11]

Lowe's appealed the decision. On September 5, 2018, the Court of Appeals issued an opinion wherein the majority affirmed the trial court. The majority erroneously held that, even though the bad debts for which Lowe's made guarantee payments included Washington sales and B&O taxes, Lowe's was still not entitled to a refund of the remitted taxes.[12] The majority purported to rely on *Home Depot* as grounds for imposing an extra-statutory requirement that Lowe's must have initiated the financing and owned the PLCC accounts when they became worthless in order to claim bad debt credits and deductions. *Id.* It further erred in ruling the Bad Debt Regulation imposes a condition that Lowe's write off as uncollectible the specific

---

[9] CP 450-51 (Decl. ¶4).
[10] CP 1154-55 (Notice of Hearing); VRP at 3:15-5:1; 29:20-25.
[11] CP 2800-02 (Order).
[12] *See generally, Lowe's I*, 2018 Wash. App. LEXIS 2082.

PLCC accounts and that Lowe's did not do so.[13] Finally, the court held that the denial of Lowe's claim did not violate its equal protection rights. *Id.* at ¶¶68-78. The Chief Judge dissented but agreed with the majority's constitutional analysis.[14]

## B. FACTUAL BACKGROUND

Lowe's owns and operates retail stores in Washington.[15] Prior to the Assessment Period, Lowe's executed the PLCC Agreement, which provided that the Bank would, in certain circumstances, extend credit to customers to make purchases at Lowe's stores. Lowe's entered into this arrangement in the ordinary course of business.[16]

A customer seeking to buy items from Lowe's could submit an application with the Bank at any Lowe's store. If the Bank approved the application, it granted the customer a line of credit that could be used to buy items at Lowe's. Within a day or two after the transaction, the Bank would forward to Lowe's full payment for the purchases and corresponding taxes. Lowe's, as the retailer, would promptly remit Washington sales and B&O tax on the PLCC transactions in the state.[17]

---

[13] It is undisputed that Lowe's wrote off in its books and records the losses it bore in paying the Bank on the defaulted PLCC accounts. Lowe's, however, did not own the specific accounts, and therefore could not reflect them in its books and records. As a matter of tax and accounting law, the distinction is irrelevant. Blasi Dep. 31:14-32:9 (App. 44).
[14] *Lowe's I*, 2018 Wash. App. LEXIS at *37-44, ¶¶80-98, & *37, n.12.
[15] CP 450-51 (Decl. ¶¶2, 6).
[16] CP 451-52, 488-844 (Decl. ¶¶7-9 & Exs. C-F).
[17] CP 453 (Decl. ¶10).

After Lowe's remitted tax on the purchases, some Cardholders failed to pay in full, resulting in bad debt losses ("PLCC Bad Debts"). Though the Bank initiated and technically owned and managed the accounts while they were current, the PLCC Agreement required Lowe's to assume responsibility (on a dollar-for-dollar basis) for all PLCC Bad Debts up to a specified cap (the "Cap"). In other words, Lowe's guaranteed that the Bank would receive all payments due on PLCC accounts, up to the Cap (the "Bad Debt Guarantee").[18] Thus, Lowe's "steps into the creditor's shoes" with respect to these accounts.[19] When recoveries were made on PLCC accounts that had been written off as worthless, the proceeds went to Lowe's, not the Bank.[20] Lowe's added these sales back and reported sales taxes thereon. The benefits Lowe's received by entering into the PLCC Agreement provided reasonable consideration for assuming the Bad Debt Guarantee.[21]

In honoring the Bad Debt Guarantee, Lowe's paid the Bank the full unpaid balances due on the written-off PLCC accounts, which included any related taxes that Lowe's had previously remitted to DOR. Consequently, with respect to PLCC Bad Debts, Lowe's had remitted taxes that it could

---

[18] CP 453 (Decl. ¶¶10, 11). Lowe's was subject to recourse on all PLCC Bad Debts, except for certain amounts that ran over the Cap during 2008 and 2009. CP 455 (Decl. ¶15). Lowe's did not claim bad debt credits or deductions for amounts exceeding the Cap.
[19] *Putnam v. Comm'r*, 352 U.S. 82, 85, 77 S. Ct. 175, 176, 1 L. Ed. 2d 144 (1956).
[20] CP 454-55 (Decl. ¶¶13-14).
[21] CP 454 (Decl. ¶12).

not recover from its customers. Thus, Lowe's, not the Bank, was the party who had advanced and was out of pocket as to sales and B&O taxes paid on the worthless PLCC transactions.[22] The PLCC Agreement explicitly gave Lowe's the right to take corresponding credits and deductions for the resulting losses at both the federal and state levels.[23] Significantly, Lowe's books and records reflected all PLCC Bad Debt losses that it had incurred.[24]

Throughout the Assessment Period, Lowe's filed consolidated federal corporate income tax returns ("Federal Returns"). Pursuant to IRC § 166, Lowe's deducted the PLCC Bad Debts, along with its other bad debts, as "Bad Debts" on Line 15 of the returns.[25] The Internal Revenue Service ("IRS") regularly audited the Federal Returns and, for tax years 2004 through 2007, focused on the bad debt deductions claimed on Line 15, including the PLCC arrangement with the Bank. The IRS ultimately accepted and proposed no adjustments to the PLCC Bad Debts claimed by Lowe's.[26] Lowe's timely claimed corresponding Washington sales tax credits and B&O tax deductions on the principal amounts of the written-off PLCC Bad Debts.[27]

---

[22] CP 2668 (Decl. ¶2).
[23] CP 454, 523, 613, 696, 782 (Decl. ¶13 & Exs. C-F); 1137-38 (Decl. ¶12).
[24] CP 455 (Decl. ¶16).
[25] CP 455-57, 845-98 (Decl. ¶¶17-18 & Exs. G-1 to G-9).
[26] CP 457-59 (Decl. ¶¶19-25).
[27] CP 459 (Decl. ¶¶26-27).

## VI. ARGUMENT

### A. THIS COURT SHOULD GRANT REVIEW TO CORRECT THE MAJORITY'S DECISION WHICH (1) MISREADS AND MISAPPLIES THE BAD DEBT STATUTES AND BAD DEBT REGULATION AND (2) CONFLICTS WITH *PUGET SOUND*

As the dissent states, "the majority unnecessarily complicates what should be a straightforward analysis"; the Bad Debt Statutes "unambiguously show that [Lowe's] is entitled to retail sales tax credits and [B&O] tax deductions."[28] In affirming the trial court, the majority misread and misapplied the Bad Debt Statutes and the Bad Debt Regulation.

#### 1. The Requirements Under Washington Law

During the Assessment Period, RCW 82.08.037(1) clearly provided:

> A seller is entitled to a credit or refund for sales taxes previously paid on bad debts, as that term is used [for federal income tax purposes] in 26 U.S.C. Sec. 166.

RCW 82.04.4284(1) permits a similar deduction for B&O tax:

> 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 . . . on which tax was previously paid.

The Bad Debt Regulation clarifies that, for both taxes, "Washington credits, refunds, and deductions for bad debts ***are based on federal standards for worthlessness under section 166 of the Internal Revenue Code.***"[29] No other standard is specified.

---

[28] *Lowe's I*, 2018 Wash. App. LEXIS at *37, ¶80.
[29] WAC 458-20-196(1)(d) (emphasis added).

Thus, under the Bad Debt Statutes in effect throughout the Assessment Period, Washington looked exclusively to federal law and standards relating to bad debt losses under IRC § 166, along with TREAS. REG. § 1.166-9, to determine whether a retailer, like Lowe's, was eligible to claim a sales tax credit or B&O tax deduction for taxes previously paid on bad debts. Except for a timing requirement that the credit be taken in "the tax reporting period in which the bad debt is written off as uncollectible" and "would be eligible for a bad debt deduction for federal income tax purposes," WAC 458-20-196(2), neither the Bad Debt Statutes nor Bad Debt Regulation imposed any additional conditions or restrictions on a seller's right to claim a credit or deduction for tax paid on bad debts.

*Puget Sound* controlled throughout the Assessment Period. The majority acknowledged that, in *Puget Sound*, this Court identified only three requirements a retailer must satisfy to take a bad debt credit/deduction: "(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."[30] Significantly, this Court did not even suggest that the taxpayer must have also initiated the financing and

[30] *Lowe's I*, 2018 Wash. App. LEXIS at *8, ¶19. When the Washington Legislature amended RCW 82.08.037, effective July 1, 2004, it did so while expressly preserving the requirements established in *Puget Sound*. 2004 Wash. Legis. Serv. Ch. 153 (S.B. 6515), § 301 (CP 1269 (Decl. at Ex. C)).

then owned the account when it became worthless.

### 2. Lowe's Satisfied the *Puget Sound* Requirements

Lowe's plainly satisfies the first two requirements of *Puget Sound*: (1) it is a "person",[31] and (2) it made taxable retail sales in Washington.[32] Further, there is no dispute that Lowe's Bad Debt Guarantee payments were "deductible as worthless for federal income tax purposes": "[T]he DOR agrees that [Lowe's Bad Debt Guarantee payments] qualified as federal debts arising from a ***guarantor loss*** under 26 C.F.R. § 1.166-9(a)."[33] However, DOR argued and the majority erred in agreeing that Lowe's payments were not debts on "sales taxes previously paid."[34]

The majority's focus on language in the Bad Debt Statutes that a credit/deduction is allowed for taxes "previously paid" as grounds for denying Lowe's claim is at odds with this Court's reasoning in *Puget Sound.* Specifically, *Puget Sound* confirmed that a person (in that case a bank) who

---

[31] A "person" is defined to include a corporation. RCW 82.04.030, 82.08.010(6).

[32] *See* CP 1255 (Decl. at Ex. B (Barrett Dep. at 58:13-25; 59:17-22)).

[33] *Lowe's I*, 2018 Wash. App. LEXIS at *12-13, ¶28 (emphasis added). Under the federal standards (IRC § 166 and TREAS. REG. § 1.166-9) to which the Bad Debt Statutes are tied, a guarantor of a worthless debt, who neither initiated the account nor owned it when it defaulted, is still entitled to claim a bad debt deduction. *See* CP 1235 (Decl. at Ex. A (Jones Dep. at 86:1-25)). By its express terms, TREAS. REG. § 1.166-9(d) allows bad debt deductions to be claimed by "a guarantor, endorser, or indemnitor" – persons who neither initiated nor owned the accounts when they became worthless. *See also Putnam*, 352 U.S. at 85-86 (acknowledging the right of guarantors to deduct, as bad debts, payments made to creditors in satisfaction of their guaranties) (CP 1284 (Smith Decl. at Ex. F)).

The IRS itself verified that Lowe's PLCC Bad Debts met the federal standards for deductibility. The trial court expressly acknowledged that Lowe's Federal Returns were "audited and have been found to be satisfactory." VRP at 3:18-4:2.

[34] *Lowe's I*, 2018 Wash. App. LEXIS at *13, ¶30.

acquired through assignment the outstanding accounts receivables originated by a seller satisfied the requirements of the Bad Debt Statute, even though the bank was not the original seller. This Court reasoned that, as a result of the assignment, the bank became the party that actually fronted the sales tax and thereby "step[ped] into the shoes" of the seller for purposes of claiming sales tax credits for accounts that later defaulted.[35] The reasoning applies equally here with Lowe's.

The parties and the Court of Appeals agree that Lowe's was a "guarantor" of the PLCC accounts, as that term is defined for purposes of IRC § 166.[36] Also, all agree that in honoring the Bad Debt Guarantee, Lowe's paid the unpaid balances due on the written-off PLCC accounts, which included any corresponding taxes Lowe's had previously remitted to DOR.[37] In concluding that Lowe's was entitled to claim sales tax credits and B&O tax deductions, the dissent emphasized this undisputed fact:

> [T]he Banks' credit card bad debts for which Lowe's acted as guarantor *included sales taxes and B&O taxes*. Lowe's *initially* received reimbursement for sales taxes and B&O taxes. But because of the guarantee, that reimbursement was negated and Lowe's became responsible for the amounts of the sales taxes and B&O taxes relating to the bad debts.[38]

Lowe's struggles to understand the majority's contention that, "No

---

[35] 123 Wn.2d at 292-93.
[36] CP 1137-38 (Decl. ¶12); *Lowe's I*, 2018 Wash. App. LEXIS at *12, ¶28.
[37] *Lowe's I*, 2018 Wash. App. LEXIS at *5, ¶10.
[38] *Id.* at *40, ¶9 (emphasis in original).

legal authority supports the dissent's position that Lowe's can 'negate' the buyer-cardholders' satisfaction of the retail sales tax and circumvent the obligation to pay DOR sales taxes under RCW 82.08.050(2)-(3) after the buyers' tax obligation was satisfied."[39] The dissent explained that the Bank initially forwarded to Lowe's payment for the purchases and all corresponding taxes and Lowe's, as the retailer, promptly remitted the tax to DOR. But by operation of the Bad Debt Guarantee, Lowe's paid off the balances due on the written-off PLCC accounts, which included taxes previously remitted to DOR. Consequently, with respect to these PLCC Bad Debts, Lowe's had remitted taxes it could not recover from its customers. In other words, Lowe's – and not the Bank – was the party out of pocket as to taxes paid on worthless PLCC transactions. As such, its Bad Debt Guarantee payments were payments for sales and B&O taxes previously paid, thereby satisfying the third *Puget Sound* requirement.[40]

### 3. The Majority Misapplied the Bad Debt Regulation in Denying Lowe's Claim

The Bad Debt Regulation specifies the time during which a taxpayer may claim a bad debt credit/deduction: during "the tax reporting period in

---

[39] *Id.* at *28, ¶60.

[40] In interpreting statutes, this Court seeks to ascertain and give effect to the intent and purpose of legislature. *Welch v. Southland Corp.*, 134 Wn.2d 629, 633, 952 P.2d 162 (1998). Here, the legislative purpose of the Bad Debt Statutes "is to allow sellers to recover sales taxes they were required to remit to the State but could not collect from the buyer." CP 2673 (Dep't Opp'n at 4). Lowe's falls within the scope and purpose of the statutes.

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."[41] The majority misapplied this language in adopting DOR's claim that (1) writing off the specific accounts is a prerequisite to taking a sales tax credit and B&O tax refund; and (2) as a matter of law, Lowe's did not satisfy this requirement.[42]

As the dissent explained, the Regulation "does not somehow create a new requirement for claiming the credit or refund."[43] Rather, the cited language is merely descriptive, ***not*** prescriptive. It describes ***when*** a taxpayer may take the credit/deduction; it neither creates nor implies any additional, extra-statutory requirement.[44] Moreover, the record shows that Lowe's in fact reflected in its books and records the losses it suffered related to the PLCC Bad Debts.[45] Ronald W. Blasi, an expert in the field of federal corporate income tax law, testified that there is no specific manner in which the bad debt losses must be recorded:

> A: There should be some type of accounting entry that indicates Lowe's is fulfilling its obligation as a guarantor. It doesn't have to follow any fixed pattern. There's nothing in the law or in the regulations that requires any fixed pattern to be followed. It just has to be demonstrated that it has had

---

[41] WAC 458-20-196(2)(a).
[42] *See generally, Lowe's I*, 2018 Wash. App. LEXIS 2082.
[43] *Id.* at *43, ¶96.
[44] Neither IRC § 166 nor the corresponding regulations requires a write off of a specific account for a taxpayer to be eligible for a bad debt deduction for wholly worthless debts.
[45] *See* CP 455 (Decl. ¶16).

> a debt, in this case, a debt that arises as a result of the guarantee, and that debt is bad.[46]

DOR did not challenge Mr. Blasi's expert testimony.

Because the majority's decision misinterprets the Bad Debt Statutes and Regulation and conflicts with *Puget Sound* on an issue of substantial public interest, this Court should accept review under RAP 13.4(b)(1)&(4).

### B. THE DECISION THAT LOWE'S CAN NEVER CLAIM A REFUND BECAUSE IT DID NOT INITIATE AND OWN THE PLCC ACCOUNTS CONFLICTS WITH THE LAW AND PRESENTS AN ISSUE OF SUBSTANTIAL PUBLIC INTEREST

DOR claims Lowe's can never claim sales tax credits or B&O tax deductions on worthless PLCC accounts it did not initiate and own. But, DOR also admits that neither the Bad Debt Statutes nor the Bad Debt Regulation imposes this precondition.[47] DOR further admits that it lacks authority "to create its own laws or to ignore, alter, or add to the laws enacted by the Legislature."[48]

Because the Bad Debt Statutes, Regulation, and federal standards to which Washington law is linked contain no language requiring that Lowe's must have initiated the financing and owned the PLCC accounts in order to claim a state bad debt credit or deduction, DOR insists that *Home Depot*

---

[46] Blasi Dep. 31:14-32:9 (App. 37-47) (also at CP 2714-24).
[47] *See* CP 1259 (Decl., Ex. B (Dep., pp. 75:22-76:9, 76:16-19)). This testimony is a binding admission regarding a key material fact that has "substantial weight." *Raborn v. Hayton*, 34 Wn.2d 105, 108, 208 P.2d 133 (1949).
[48] CP 1215 (Decl. at Ex. A (Jones Dep. at 9:1-25)); CP 1244 (Decl. at Ex. B (Barrett Dep. at 14:21-25; 15:8-10; 17:5-13)).

implicitly imposes the requirement. The majority erred in agreeing:

> *Home Depot* supports the DOR's position that a bad debt "directly attributable" to a retail sale and thus eligible for the state tax refund must be ***owned*** by the taxpayer and ***initiated*** by a seller. The *Home Depot* court emphasized that "the party seeking the [state] deduction must be the one ***holding*** the bad debt [on the retail sale] as well as the one to whom repayment on such a debt would be made."[49]

But the referenced *Home Depot* language merely states that "the party seeking the deduction must be the one ***holding*** the bad debt."[50] *Home Depot* does not state the party had to ***initiate*** and ***own*** the account. There is a fundamental difference between ***holding*** a debt and ***initiating*** and **owning** the account. Although Lowe's did not initiate or own the PLCC accounts, by operation of its Bad Debt Guarantee payments, Lowe's stepped into the Bank's shoes and held the PLCC Bad Debts when it claimed the deduction under IRC § 166 and corresponding Washington credits and deductions.

When a PLCC Cardholder purchases merchandise from Lowe's, his initial debtor-creditor relationship is with the Bank. But once Lowe's fulfills its obligation as guarantor of the PLCC Bad Debts, it assumes the Bank's role as the Cardholder's creditor. The record establishes that the Bank recovered from Lowe's, as guarantor, the unpaid balances due on the written-off PLCC accounts, which included any related taxes. Accordingly,

---

[49] *Lowe's I*, 2018 Wash. App. LEXIS at *18, ¶40 (emphasis added, internal citations omitted).
[50] 151 Wn. App. at 922 (emphasis added).

by operation of law, Lowe's became "the one holding the debt" and the "one to whom repayment on such debt would be made".[51]

The majority erred in concluding that "Lowe's *did not incur a bad debt loss 'directly attributable' to a retail sale*".[52] *In Putnam*, the U.S. Supreme Court explained the effect of guarantees like Lowe's Bad Debt Guarantee:

> instanter upon the payment by the guarantor of the debt, ***the debtor's obligation to the creditor becomes an obligation to the guarantor, not a new debt, but by subrogation, the result of the shift of the original debt from the creditor to the guarantor who steps into the creditor's shoes.***[53]

Washington has recognized the same for 118 years:

> It is a well-settled principle that a surety or guarantor who pays the debt of his principal will be substituted in the place of the creditor of such principal, as to all securities for the debt held by the creditor, and will be entitled to the same benefit from them as the creditor himself might have had.[54]

Because Lowe's stepped into the Bank's shoes, the PLCC Bad Debts were not attributable to the cost of doing business or a collateral debt as the majority suggests. Rather, as the U.S. Supreme Court emphasized, the guarantor's obligation is "not a new debt," but "the shift of the original debt from the creditor to the guarantor."[55] Further, Lowe's subsequently

---

[51] CP 453-57 (Decl. at ¶¶11, 14-15, 17-18); CP 2668 (Decl. ¶2).
[52] *Lowe's I*, 2018 Wash. App. LEXIS at *21, ¶46.
[53] 352 U.S. at 85-86 (emphasis added).
[54] *Blewett v. Bash*, 22 Wash. 536, 543-44, 61 P. 770 (1900).
[55] *Putnam*, 352 U.S. at 85-86.

received recoveries on PLCC accounts that had previously been written off as worthless, and paid sales tax on these amounts. These are the critical and determinative distinctions between this case and *Home Depot*.[56]

### C. EQUAL PROTECTION

The equal protection clause requires that tax law must "apply alike to all persons within [a] designated class" and "reasonable ground must exist for making a distinction between those who fall within the class and those who do not."[57] Here, the Bad Debt Statutes provide a statutory remedy for retailers that pay taxes they cannot recover from defaulted buyers. Lowe's, as guarantor, falls within this class of retailers. DOR's unauthorized imposition of an extra-statutory requirement that Lowe's must have initiated and owned the worthless PLCC accounts in order to claim bad debt credits/deductions violates Lowe's equal protection rights.[58]

Respectfully submitted this 4th day of October, 2018.

ISSAQUAH LAW GROUP, PLLC

A. Troy Hunter, WSBA No. 29243
Justin P. Walsh, WSBA No. 40696

[56] *Home Depot* did not involve a similar guarantee and Home Depot was never out of pocket for sales tax remitted to Washington on accounts that became worthless. As a practical matter, Home Depot did not care if the PLCC customers ever paid on their accounts. The Court of Appeals denied the refund claim because Home Depot did not bear the economic loss and "could not deduct defaulted debt on its private label cards as bad debt under [the] federal income tax laws." 151 Wn. App. at 915.
[57] *State ex rel. N. Pac. Ry. Co. v. Henneford*, 3 Wn.2d 48, 54, 99 P.2d 616 (1940).
[58] *Allegheny Pittsburgh Coal Co. v. Cty. Comm'n of Webster Cty., W. Va.*, 488 U.S. 336, 345, 109 S. Ct. 633, 102 L. Ed. 2d 688 (1989).

APPENDIX TABLE OF CONTENTS

Filed
Washington State
Court of Appeals
Division Two

September 5, 2018

# IN THE COURT OF APPEALS OF THE STATE OF WASHINGTON

## DIVISION II

| | |
|---|---|
| LOWE'S HOME CENTERS, LLC,<br><br>Appellant,<br><br>v.<br><br>DEPARTMENT OF REVENUE, STATE OF WASHINGTON,<br><br>Respondent. | No. 50080-9-II<br><br>PUBLISHED OPINION |

JOHANSON, J. — In this state tax refund claim case, Lowe's Home Centers LLC appeals the superior court's order denying Lowe's a tax refund on cross motions for summary judgment filed by the Department of Revenue (DOR) and Lowe's. Lowe's customers made retail purchases using Lowe's credit cards issued by GE Capital Financial Inc. and Monogram Credit Bank of Georgia (collectively the Bank). The Bank paid Lowes in full for the cardholders' purchases within one to two days of each transaction. Some cardholders defaulted on their credit card payments to the Bank, and Lowe's profit-share amount under agreements with the Bank was reduced by the amount in which cardholders had defaulted, up to a specified cap. Lowe's argues that as a matter of law under the undisputed facts, it is entitled to a state retail sales tax and corresponding retailing business and occupation (B&O) tax refund on the reductions to its profit-

sharing income based on its guaranty of defaulted accounts under the profit-sharing agreements. And it argues that the superior court violated its due process and equal protection rights. We affirm.

## FACTS

Between April 1, 2001 and December 31, 2009, the relevant tax assessment period, Lowe's sold merchandise at its retail stores. Many customers paid for products using "private label credit cards" (PLCC) that could be used only at Lowe's stores. Clerk's Papers (CP) at 68. A PLCC is a customized credit card that may be used only at a particular retailer's outlets.

The PLCCs were issued under agreements between Lowe's and the Bank. The agreements provided (1) the terms under which the Bank extended credit to Lowe's customers and furnished cash payment to Lowe's for items purchased under the PLCC accounts, (2) the terms governing ownership and management of PLCC accounts, and (3) the terms by which Lowe's and the Bank jointly marketed the PLCCs to Lowe's customers and shared profits and losses resulting from the PLCC accounts.

### I. PAYMENT FOR PLCC PURCHASES

Under the PLCC agreements, the Bank would extend credit to qualified Lowe's customers for purchases at Lowe's stores. The cardholder could then purchase goods from Lowe's stores using the line of credit provided by the Bank.

When a cardholder made a purchase using a PLCC, the Bank forwarded full payment for the purchase and all corresponding taxes to Lowe's within one to two days. Lowe's promptly remitted to the DOR all Washington sales and B&O taxes on the PLCC transactions. Lowe's

accounted for PLCC transactions as "cash and cash equivalents," the same term used for customers' payments with cash, check, or other credit cards. CP at 60.

II. OWNERSHIP AND MANAGEMENT OF PLCC ACCOUNTS

Under the PLCC agreements, the Bank was the "sole and exclusive owner" and manager of all PLCC accounts and outstanding receivables. CP at 136. As such, credit sales generated through Lowe's PLCCs were not reflected in Lowe's accounts receivable.

In addition, the Bank had the "sole right to establish the finance charge rates" and "all other terms and conditions" related to the credit accounts. CP at 136. Lowe's had "no right, title or interest" in the credit accounts and transaction-related documentation. CP at 136. The Bank had the exclusive right to receive cardholder payments. And the Bank was "entitled to receive all payments made by or on behalf of Cardholders on Accounts. . . . Retailers acknowledge and agree that they have no right, title or interest in or to . . . any payments made by or on behalf of Cardholders on Accounts or any proceeds with respect to the accounts." CP at 136. All marketing and promotional materials given to customers had to "clearly disclose that Bank is the owner and creditor on all Accounts." CP at 134. All PLCC services were to be "performed and controlled directly" by the Bank. CP at 49.

III. JOINT MARKETING AND PROFIT AND LOSS SHARING

Lowe's and the Bank jointly marketed and promoted PLCCs. As an incentive to Lowe's to promote the use of the PLCCs, the Bank and Lowe's agreed to share profits and losses associated with the accounts.

Under the agreements' terms, Lowe's was entitled to additional profits generated by the PLCC portfolio once the Bank reached its target rate of return. Lowe's and the Bank settled the

profit-sharing obligations on a monthly basis after balancing the revenues generated by finance charges, fees, debt insurance premiums, and other services against program expenses, including net write-offs.

In exchange for the benefits Lowe's received from the PLCC agreements, including sharing profits and "giving its customers increased access and incentives to purchase additional merchandise," Lowe's agreed to "pay to the Bank[] any amounts that the Cardholders failed to pay on their PLCC accounts, up to" a specified cap.[1] CP at 453-54. The defaulted accounts Lowe's guaranteed under the profit-sharing agreements included the purchase prices and retail sales taxes for Lowe's products that cardholders had failed to repay the Bank. To satisfy Lowe's obligation under the profit-sharing agreements' guarantee provision, the Bank reduced Lowe's monthly share of profit distributions up to a specified percentage of anticipated average net receivables on the PLCC accounts. The Bank was responsible for losses on defaulted accounts exceeding the cap.

The agreements stated that Lowe's "and not Bank shall have the right to claim any available sales tax deductions related to Net Write-Offs borne by" Lowe's. CP at 454, 523, 613, 696, 782.

When a customer defaulted on its PLCC account, the Bank, not Lowe's, possessed the accounts receivable and had authority to write off the uncollectible debt on its books and records. CP at 113 ("[The Bank] has the receivables and liabilities, along with anything else on their books, and Lowe's does not have a receivable or liability on its books and records at all."); CP at 945 ("[The Bank] owns the receivable and [Lowe's] do[es] not make an entry when an account is

[1] Lowe's calls this clause the "Bad Debt Guarantee." Br. of Appellant at 9. For clarity, we use the term "profit-sharing reduction" to describe the amount that Lowe's profits were reduced under the profit-sharing agreements to cover a portion of Lowe's losses from defaulted PLCC accounts.

uncollectible."). Although Lowe's books and records reflected Lowe's profit-sharing reductions, Lowe's books and records did not reflect any accounts receivable on the PLCC accounts nor unpaid debt obligations owed to Lowe's by cardholders.

## IV. PROCEDURAL HISTORY

Throughout the relevant assessment period, Lowe's filed federal corporate income tax returns. Under 26 U.S.C. § 166, Lowe's deducted its profit-sharing reductions as "Bad Debts" on line 15 of the tax returns. CP at 846. The Internal Revenue Service (IRS) audited these returns and proposed no adjustments to Lowe's bad debt deductions.[2]

Lowe's also claimed a Washington retail sales tax credit under RCW 82.08.037[3] and retailing B&O tax deduction under RCW 82.04.4284[4] for Lowe's profit-sharing reductions. The DOR audited Lowe's and determined that Lowe's had improperly claimed bad debt sales tax credits and B&O tax deductions on the defaulted PLCC accounts.

---

[2] Our opinion refers to Lowe's bad debts from its profit-sharing reductions as "profit-sharing bad debts."

[3] Three versions of RCW 82.08.037 were in effect during the assessment period at issue here. *See* former RCW 82.08.037 (1982) (effective from 1982 to June 30, 2004); former RCW 82.08.037 (2004) (effective from July 1, 2004 to June 30, 2008); former RCW 82.08.037 (2007) (effective from July 1, 2008 to April 30, 2010) (The statute was also amended in 2003, but that amendment was replaced by the 2004 amendment.). The legislature amended this statute again in 2010. *See* LAWS OF 2010, ch. 23, § 1502. Because there is no relevant distinction between any of these versions of the statute, we cite to the current version of the statute.

[4] Two versions of RCW 82.04.4284 were in effect during the assessment period at issue here. *See* former RCW 82.04.4284 (1980); former RCW 82.04.4284 (2004). Because there is no relevant distinction between these two versions of the statute, we cite to the current version.

After these audits, the DOR assessed retail sales taxes and retailing B&O taxes against Lowe's. Lowe's paid in full both assessments. Lowe's filed an appeal under RCW 82.32.180 seeking a retail sales tax and retailing B&O tax refund.

The parties filed cross motions for summary judgment. The superior court ruled that under *Home Depot USA, Inc. v. Department of Revenue*,[5] the DOR properly denied Lowe's tax refund. Consequently, the superior court granted the DOR's summary judgment motion and denied Lowe's summary judgment motion. Lowe's appeals.

## ANALYSIS

### I. PRINCIPLES OF LAW

#### A. STANDARD OF REVIEW

We review a summary judgment order de novo, and we perform the same inquiry as the superior court. *Sheehan v. Cent. Puget Sound Reg'l Transit Auth.*, 155 Wn.2d 790, 796-97, 123 P.3d 88 (2005). We consider all the facts submitted to the superior court and all reasonable inferences from the facts in the light most favorable to the nonmoving party. *Keck v. Collins*, 184 Wn.2d 358, 370, 357 P.3d 1080 (2015). The moving party is entitled to summary judgment if it shows that the pleadings, affidavits, depositions, and admissions on file demonstrate the absence of any genuine issues of material fact and that the moving party is entitled to judgment as a matter of law. *Sheehan*, 155 Wn.2d at 797; CR 56(c).

[5] 151 Wn. App. 909, 215 P.3d 222 (2009).

B. RETAIL SALES TAX BACKGROUND

Washington imposes a 6.5 percent tax on each retail sale of tangible personal property. RCW 82.08.020(1)(a). The tax is based on the "'selling price,'" which means "the total amount of consideration" for which a good is sold, without deduction for the seller's overhead expenses or any other expenses whatsoever and without deduction on account of losses. RCW 82.08.010(1). The buyer has the primary obligation to pay the sales tax, but the seller has the duty to remit sales tax even if no tax is collected at the time of sale. RCW 82.08.050(1); *AARO Med. Supplies, Inc. v. Dep't of Revenue*, 132 Wn. App. 709, 716, 132 P.3d 1143 (2006). Sales taxes paid by the seller on the buyer's behalf but not paid from the buyer to the seller are a debt owed by the buyer to the seller. *Home Depot*, 151 Wn. App. at 917.

"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." RCW 82.08.037(1). In *Puget Sound National Bank v. Department of Revenue*, our Supreme Court stated that "RCW 82.08.037 has three requirements: (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." 123 Wn.2d 284, 287, 868 P.2d 127 (1994). The legislative purpose of RCW 82.08.037 is to provide a *remedy for sellers that paid taxes they could not collect from the buyer*. *Home Depot*, 151 Wn. App. at 917, 920-21.

In addition to recognizing tax credits and refunds for bad debts resulting from retail sales tax unpaid by consumers under RCW 82.08.037, Washington law separately recognizes tax credits and deductions for bad debts that result from *other sources*, including B&O tax bad debts (RCW 82.04.4284).

The B&O tax applies to "'virtually all business activities carried on within the state.'" *Steven Klein, Inc. v. Dep't of Revenue*, 183 Wn.2d 889, 896, 357 P.3d 59 (2015) (internal quotation marks omitted) (quoting *Simpson Inv. Co. v. Dep't of Revenue*, 141 Wn.2d 139, 149, 3 P.3d 741 (2000)). Various rates apply to different business activities. *Steven Klein, Inc.*, 183 Wn.2d at 897. For those making retail sales, the retailing B&O tax applies at the rate of .471 percent of "the gross proceeds of sales of the business." RCW 82.04.250(1). When computing B&O tax, a party may deduct "from the measure of tax bad debts, as that term is used in 26 U.S.C. Sec. 166 . . . on which tax was previously paid." RCW 82.04.4284(1).

Until 2018, the DOR's regulations governing bad debt credits, refunds, and deductions under RCW 82.08.037 and RCW 82.04.4284 include the following:

> Washington credits, refunds, and deductions for bad debts are based on federal standards for worthlessness under section 166 of the Internal Revenue Code [(IRC)]. . . .
>
> (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 [IRC]. . . . 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. . . .
>
> . . . .
>
> (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 [IRC], as amended or renumbered as of January 1, 2003, on which tax was previously paid.

Former WAC 458-20-196(1)(c)-(3) (2010) (emphasis added).[6] The unpaid debt obligation must have been reported as income, and debts from unpaid fees or unrealized profits do not qualify. 26 C.F.R. § 1.166-1(a), (c), (e).

"Taxes are presumed to be just and legal, and the burden is on the taxpayer to prove that the tax is incorrect." *AOL, LLC v. Dep't of Revenue*, 149 Wn. App. 533, 554, 205 P.3d 159 (2009) (citing *Ford Motor Co. v. City of Seattle*, 160 Wn.2d 32, 41, 156 P.3d 185 (2007)). The taxpayer seeking a refund has the burden of proving that the DOR incorrectly assessed the tax and it is entitled to a refund. RCW 82.32.180; *Wash. Imaging Servs., LLC v. Dep't of Revenue*, 171 Wn.2d 548, 555, 252 P.3d 885 (2011). Courts focus on substance rather than form when determining tax classifications. *First Am. Title Ins. Co. v. Dep't of Revenue*, 144 Wn.2d 300, 303, 27 P.3d 604 (2001).

## II. BAD DEBT TAX REFUND

The parties agree there are no genuine issues of material fact. The parties dispute whether, as a matter of law, Lowe's was entitled to a bad debt retail sales tax refund under RCW 82.08.037 and a corresponding retailing B&O tax refund under RCW 82.04.4284 for Lowe's profit-sharing bad debts. We agree with the DOR that Lowe's was not entitled to a sales or B&O tax refund.[7]

---

[6] Given the similarity between provisions governing the bad debt retail sales tax and bad debt B&O tax exemptions, Lowe's does not distinguish between them in its analysis.

[7] Lowe's refers to these provisions together as the "Bad Debt Statutes" throughout its briefing and argues that "Washington law requires uniform treatment of bad debts losses for purposes of sales tax and B&O tax." Br. of Appellant at 15. Lowe's primarily cites authority regarding the retail sales tax credit under RCW 82.08.037 and argues that the authority controls Lowe's B&O tax eligibility because the standards governing eligibility for the retail sales tax exemption and a retailing B&O tax deduction are substantially similar. Our analysis focuses on Lowe's retail sales tax exemption claim because the parties' briefing and legal authority focused almost exclusively

### A. BAD DEBT REFUND REQUIREMENTS

We first identify the requirements Lowe's must satisfy to be eligible for a tax refund under RCW 82.08.037. Lowe's argues that its profit-sharing reductions qualify for a tax refund under RCW 82.08.037 because the reductions were deductible under 26 U.S.C. § 166. The DOR asserts that in addition to qualifying for a bad debt deduction under 26 U.S.C. § 166, Lowe's must also show that its profit-sharing reductions are "sales taxes previously paid" and "written off as uncollectible" to obtain a tax refund under RCW 82.08.037(1); WAC 458-20-196(2)(a). We agree with the DOR.

#### 1. PRINCIPLES OF LAW

RCW 82.08.037(1) provides that "[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." (Emphasis added.) Taxpayers may claim a credit or refund under RCW 82.08.037 only "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." Former WAC 458-20-196(2)(a) (emphasis added). A party is eligible for a state tax refund under RCW 82.08.037 only when it has bad debt "directly attributable" to a retail sales tax payment. *Home Depot*, 151 Wn. App. at 922. In addition, the party seeking the state bad debt deduction must be the one holding the bad debt as well as the one to whom repayment on such debt would be made. *Home Depot*, 151 Wn. App. at 922.

---

on the retail sales tax issue. To the extent that Lowe's relies on its failed retail sales tax credit claim to support its eligibility for the B&O deduction, Lowe's arguments necessarily fail.

A deductible bad debt under 26 U.S.C. § 166 is defined broadly and must "arise[] from a debtor-creditor relationship based upon a valid and enforceable obligation to pay a fixed or determinable sum of money." 26 C.F.R. § 1.166-1(c). Bad debts under 26 U.S.C. § 166 can result from a variety of transactions, including losses on unpaid loans or payments on a guaranty. 26 C.F.R. §1.166-9(a); *see, e.g., Trent v. C.I.R.*, 291 F.2d 669, 671 (2d Cir. 1961); *First Trust & Sav. Bank of Davenport, Iowa v. United States*, 301 F. Supp. 194, 197 (S.D. Iowa, 1969).

2. FEDERAL DEDUCTIBILITY NOT SOLE REQUIREMENT

Contrary to Lowe's assertions, whether Lowe's qualified for a federal bad debt deduction is not at issue. Here, the DOR agrees that Lowe's profit-sharing reductions qualified as federal bad debts arising from a guarantor loss under 26 C.F.R. § 1.166-9(a). Wash. Court of Appeals oral argument, *Lowe's Home Centers, LLC, v. Dep't of Revenue*, No. 50080-9-II (Feb. 21, 2018), at 22 min., 40 sec. through 25 min., 24 sec. (on file with court). The core of the parties' disagreement is whether there are *additional* requirements to obtain a state tax refund and, if so, whether Lowe's has satisfied the requirements.

However, the fact that a bad debt is deductible under federal law is not itself sufficient to support a tax credit under RCW 82.08.037. Although there are many forms of federal bad debt that may be claimed under 26 U.S.C. § 166, 26 C.F.R. § 1.166-1(a), (c), and 26 C.F.R. § 1.166-9(a), only bad debts "on sales taxes previously paid" that are "written off as uncollectible" qualify for a retail sales tax refund. RCW 82.08.037(1); former WAC 458-20-196(2)(a). Thus, Lowe's has the burden to establish that its profit-sharing reductions are "sales taxes previously paid" and "written off as uncollectible." RCW 82.08.037(1); former WAC 458-20-196(2)(a). To the extent

Lowe's asserts that it qualifies for a state tax refund because its profit-sharing reductions were deductible as bad debts under 26 U.S.C. § 166, its claim fails.

### B. "SALES TAXES PREVIOUSLY PAID"

Lowe's attempts to frame its federal bad debts as debts on "sales taxes previously paid" because its profit-sharing reductions covered some of the Bank's losses on PLCC accounts that included charges for retail sales tax. RCW 82.08.037(1). The DOR asserts that Lowe's profit-sharing bad debts are not debts on "sales taxes previously paid" because (1) Lowe's received payment on the gross proceeds for retail sale PLCC transactions and (2) under *Home Depot*, Lowe's profit-sharing bad debts were not "directly attributable" to a retail sale but instead were attributable to its separate contractual agreements with the Bank. RCW 82.08.037(1); 151 Wn.2d at 922. We agree with the DOR.

#### 1. RETAIL SALE PROCEEDS RECEIVED

The parties dispute whether Lowe's receipt of gross proceeds on the PLCC retail sales eliminated any debt on "sales taxes previously paid" by Lowe's. RCW 82.08.037(1). We agree with DOR that because Lowe's received proceeds from the Bank for the PLCC retail sale transactions, Lowe's had no debts on "sales taxes previously paid." RCW 82.08.037(1).

RCW 82.08.037(1) provides that "[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." A bad debt under 26 U.S.C. § 166 must "arise[] from a debtor-creditor relationship based upon a valid and enforceable obligation to pay a fixed or determinable sum of money." 26 C.F.R. § 1.166-1(c). Importantly, courts focus on the substance of a transaction to determine how it is classified for tax purposes, rather than relying on the characterization of transactions provided in taxpayers' contracts with

third parties. *See First Am. Title Ins. Co.*, 144 Wn.2d at 303. Retail sales tax is based on the "'[s]elling price,'" which means "the total amount of consideration" for which a good is sold. RCW 82.08.010(1)(a)(i). Sales taxes paid by the seller on behalf of the buyer but not paid from the buyer to the seller are a debt owed by the buyer to the seller. *Home Depot*, 151 Wn. App. at 917.

Here, when a cardholder made a purchase using a PLCC, the Bank forwarded to Lowe's full payment for the purchase and all corresponding taxes within one to two days. Lowe's thus received the "'[s]elling price'" from the Bank. RCW 82.08.010(1)(a)(i). Lowe's accounted for PLCC transactions as "cash and cash equivalents," the same term used for customers' payments with cash, check, or other credit cards. CP at 60. In addition, Lowe's books and records did not reflect any unpaid debt obligations on defaulted credit card accounts, and Lowe's did not carry any of the cardholders' accounts on its books. Once the Bank paid Lowe's proceeds for the selling price including sales tax, any debt for sales tax by the customer to Lowe's was satisfied. *See Home Depot*, 151 Wn. App. at 921-22. Because Lowe's had actually collected the sales tax that it remitted to the State, it had no bad debt on sales tax paid to the DOR.

Lowe's profit-sharing reductions did not result in a bad debt on sales tax previously paid because the reductions did not cover sales tax that Lowe's remitted to the State that the buyer failed to repay but instead were profit-sharing reductions that covered some of the Bank's PLCC losses for credit it extended to cardholders. *See Home Depot*, 151 Wn. App. at 921-11; 26 C.F.R. § 1.166-9(a). As such, Lowe's profit-sharing bad debt resulted from the bargained-for profit-sharing agreements and not debts on sales tax owed to Lowe's on a retail sales transaction.

Although Lowe's correctly asserts that the PLCC agreements stated that Lowe's had the right to "'claim any available sales tax deductions related to'" its profit-sharing reductions, this contract provision does not control our characterization of the transactions for tax purposes. CP at 523. A private agreement does not disrupt a party's statutory tax obligations or the proper characterization of its transactions for tax purposes. *Wash. Imaging Services*, 171 Wn.2d at 556-57.

Because Lowe's profit-sharing reductions were not bad debts on "sales taxes previously paid," they did not qualify for a state sales tax refund under RCW 82.08.037(1).

2. *HOME DEPOT*

To further support its argument that Lowe's federal bad debts were not debts on "sales taxes previously paid," the DOR relies on *Home Depot*. We agree with the DOR that under *Home Depot*, Lowe's profit-sharing bad debts are not "directly attributable" to retail sales and thus not subject to a tax refund under RCW 82.08.037. 151 Wn. App. at 922.

a. *HOME DEPOT* HOLDING

Lowe's argues that *Home Depot* does not require a taxpayer to "own" and "initiate" the bad debt to obtain a state tax refund under RCW 82.08.037. Appellant's Reply Br. at 12, 16. The DOR asserts that under *Home Depot*, a retailer cannot obtain a state tax refund on bad debts arising from PLCCs it does not own and that the retailer did not initiate because such debts are not "directly attributable" to retail sales. 151 Wn. App. at 922. We agree with the DOR.

In *Home Depot*, we addressed whether a retailer, Home Depot, qualified for a sales tax refund under RCW 82.08.037 on service fees that the retailer Home Depot paid on bank-owned PLCCs. 151 Wn. App. at 912-13. Home Depot contracted with a bank to establish a PLCC

program. *Home Depot*, 151 Wn. App. at 913. The bank was the exclusive owner of the accounts and bore the risk of all credit losses, and the bank took a federal bad debt deduction while Home Depot did not. *Home Depot*, 151 Wn. App. at 913, 914. The bank paid Home Depot the sales proceeds on PLCC transactions daily and subtracted service fees, which were calculated in part to cover the bank's losses on uncollectible accounts. *Home Depot*, 151 Wn. App. at 914. Home Depot raised a similar argument to Lowe's, claiming that as long as it "actually bore the risk of loss from the defaulted debts" by paying the service fees, it was entitled to a state tax refund under RCW 82.08.037 for debts the bank claimed as bad debts. *Home Depot*, 151 Wn. App. at 915.

We held that Home Depot had no debt "directly attributable" to a retail sales tax payment and thus was not eligible for a state tax refund under RCW 82.08.037. *Home Depot*, 151 Wn. App. at 922. We explained that at the time a PLCC cardholder purchased an item on their PLCC, Home Depot paid the sales tax due to DOR and this created a statutory "debt" due from the buyer to the seller. *Home Depot*, 151 Wn. App. at 921-22. However, when the bank transmitted the purchase price to Home Depot, the debt between Home Depot and the buyer "ceased to exist." *Home Depot*, 151 Wn. App. at 922. At that point, Home Depot no longer held *any* debt "directly attributable" to the retail sale and thus could not qualify for the state bad debt deduction. *Home Depot*, 151 Wn. App. at 922.

Contrary to Lowe's and the dissent's assertions, *Home Depot* supports the DOR's position that a bad debt "directly attributable" to a retail sale and thus eligible for the state tax refund must be *owned* by the taxpayer and *initiated* by a seller. 151 Wn. App. at 922. The *Home Depot* court emphasized that "the party seeking the [state] deduction must be the one holding the bad debt [on

the retail sale] as well as the one to whom repayment on such a debt would be made." 151 Wn. App. at 922.

In addition, we stated that retailers that only extend credit to their customers and "finance their *own* retail sales" belong to the class of persons entitled to utilize Washington's bad debt tax statutes. *Home Depot*, 151 Wn. App. at 927 (emphasis added). The defaulted PLCC accounts that Home Depot's service fees helped to cover were *initiated* by the Bank rather than by Home Depot and therefore were not initiated by the seller. *See Home Depot*, 151 Wn. App. at 923.

Further, Home Depot did not own the debt, as evidenced by the fact that it had no interest in the PLCC debts, it had no right to collect any unpaid sums from the buyer, and it did not deduct bad debt on its federal tax returns.[8] *Home Depot*, 151 Wn. App. at 922. Because Home Depot did not own or initiate the PLCC accounts and resulting losses that Home Depot's service fees helped cover, Home Depot's payments were not "directly attributable" to a retail sale. *Home Depot*, 151 Wn. App. at 922.

As DOR asserts, the only Supreme Court decision that has addressed RCW 82.08.037 supports *Home Depot*'s holding that a bad debt must be owned by the taxpayer and initiated by the seller in a retail sales transaction to qualify for a tax refund under RCW 82.08.037.

In *Puget Sound*, our Supreme Court held that where a seller extends a loan to a buyer through an installment contract and later assigns the outstanding installment contract to a third party, the third party *assumes the seller's rights* under the contract, including the right to collect the sales contract debt from the buyer and claim any bad debt from the sales contracts on its state

[8] Lowe's argues that under *Home Depot*, the party that takes the federal bad debt deduction is entitled to a tax refund under RCW 82.08.037. For the reasons discussed below, this claim fails.

tax returns. *Puget Sound*, 123 Wn.2d at 293. The bank that owned the accounts in *Puget Sound* was allowed to claim a state bad debt refund on uncollectible sales contracts because it "stepped into the [seller's] shoes" and was thus entitled to the seller's tax benefits for the loans that were initiated by the seller and involved *debts owed by the buyer to the seller* from the retail sale. 123 Wn.2d at 293. *Puget Sound* supports that loans extended directly by the seller to a buyer in a retail sales transaction qualify for the state bad debt deduction. 123 Wn.2d at 293.

In light of *Puget Sound*'s reasoning, we agree with the DOR that *Home Depot* authorizes a tax refund under RCW 82.08.037 only where the bad debt is "directly attributable" to a retail sale, which requires that the debt be owned by the taxpayer and originated with the seller. 151 Wn. App. at 922.

b. *HOME DEPOT* APPLICABLE HERE

*Home Depot*'s reasoning is controlling in this case. Like Home Depot, Lowe's contracted with the Bank and established a PLCC program. As in Home Depot's agreements, Lowe's agreements with the Bank provided that the Bank was the exclusive owner of all PLCC accounts. In addition, just as Home Depot paid fees to cover the bank's bad debt losses from defaulted accounts, Lowe's, under the profit-sharing agreements, reduced its monthly share of profit distributions to cover a portion of the Bank's bad debt losses. And just as RCW 82.08.037 did not provide a retail sales tax refund for Home Depot's service fees paid to the bank, Lowe's is not entitled to such a deduction for its payments that covered the Bank's PLCC account losses. This is because, like Home Depot, Lowe's *did not incur a bad debt loss "directly attributable" to a retail sale*. *Home Depot*, 151 Wn. App. at 922 (emphasis added).

In Home Depot's and Lowe's cases, the buyer's "statutory debt" owed to Lowe's under RCW 82.08.050 as well as the underlying debt for the purchase price, was discharged when the banks transmitted payments for the PLCC transactions to the stores. *Home Depot*, 151 Wn. App. at 922. Like Home Depot, Lowe's "no longer held any 'debt' . . . directly attributable to its sales tax payment to DOR" because Lowe's did not initiate and own the PLCC accounts on which there were bad debts. *Home Depot*, 151 Wn. App. at 922.

The Bank, not Lowe's, extended credit to the cardholders. And the profit-sharing reductions that covered some of the Bank's losses on defaulted PLCCs were initiated by the Bank. Consequently, Lowe's bad debts resulted from its role as a guarantor-creditor of the Bank's PLCC accounts rather than from Lowe's role as a seller. *See Home Depot*, 151 Wn. App. at 922. Thus, under *Home Depot*, Lowe's guarantor bad debts under 26 C.F.R. § 1.166-9(a) are not "directly attributable" to a retail sale. 151 Wn. App. at 922.

In addition, Lowe's profit-sharing bad debt was not owned by Lowe's. The undisputed facts show that Lowe's had "no right, title or interest" in the PLCC accounts. CP at 136. The Bank had the exclusive right to the cardholder payments. All marketing and promotional materials given to customers stated that the Bank is the *owner and creditor on all accounts*. All PLCC services were to be "performed and controlled directly" by the Bank. CP at 49. When a customer defaulted on its PLCC account, the Bank, not Lowe's, wrote off the uncollectible debt on its books and records. Lowe's books and records did not reflect any *unpaid debt obligations owed to Lowe's* on the defaulted PLCC accounts. Based on these facts, Lowe's was not owed repayment by cardholders for its profit-sharing reductions and did not own the PLCC debt.

Lowe's profit-sharing bad debts, which it did not initiate or own, were attributable to its bargained-for profit-sharing agreements and not "directly attributable" to a retail sale. *Home Depot*, 151 Wn. App. at 922.

c. LOWE'S ARGUMENTS DISTINGUISHING *HOME DEPOT* FAIL

Lowe's argues that its situation is distinguishable from *Home Depot* because, unlike Home Depot, Lowe's bore the risk of loss on the credit accounts and took the federal bad debt deduction. Both arguments fail.

First, Lowe's claims that in contrast to Home Depot, Lowe's bore the risk of loss on the PLCC accounts because it ultimately held the debt and was owed repayment by cardholders. Lowe's argues that because it paid the Bank "the unpaid balances due on the written-off PLCC accounts, which included any related sales taxes incurred on the sale[,]" Lowe's, "by operation of law . . . became 'the one holding the debt' and the 'one to whom repayment on such debt would be made.'" Br. of Appellant at 37 (quoting CP at 453-57, 2668). It claims that as a "guarantor" that paid portions of cardholder's debts owed to the Bank, Lowe's stepped into the shoes of the Bank and had a right to be repaid for its payments on cardholders' accounts.

But this argument fails because, contrary to Lowe's assertion that it "by operation of law," became the party that held the debt and was owed repayment, the undisputed facts show that under the PLCC agreements, Lowe's did not own the PLCC account debt and cardholders did not owe repayment to Lowe's or provide payments directly to Lowe's. Br. of Appellant at 37. Notably, the profit-sharing agreements explicitly provided that the Bank exclusively owned the debt and had the exclusive right to be repaid. In addition, Lowe's disclosures to the federal government during its IRS audit state that "[the Bank] owns the receivable and does not remit cash to Lowe's"

and Lowe's does not "make an entry when an account is uncollectible." CP at 945. These undisputed facts establish that the Bank and not Lowe's owned the PLCC account debt and had the right to be repaid by cardholders.

Second, Lowe's claims that it took the federal bad debt deduction because its profit-sharing reductions qualify as "bad debts" under 26 C.F.R. § 1.166-9. Lowes asserts—and the dissent agrees—that Home Depot was ineligible for the federal bad debt deduction because Home Depot's payment of service charges did not qualify as bad debt, whereas Lowe's is eligible for the state tax refund under RCW 82.08.037 for its guarantor bad debt. Dissent at 33. Lowe's is correct that Home Depot did not take a federal bad debt deduction for the fees it paid to the bank, in contrast to Lowe's that took a federal bad debt deduction for its profit-sharing reductions that satisfied its guarantor obligation. And a party's failure to take a federal bad debt deduction is relevant to its eligibility for the state bad debt deduction. *Home Depot*, 151 Wn. App. at 922. But as discussed above, a party's federal bad debt deduction is not alone sufficient to obtain a state tax refund under RCW 82.08.037. There must be a nexus between the bad debt and the sale. Here, the buyer made a purchase using a PLCC. The Bank paid Lowe's in full for the sale. There is no bad debt from the sale. Instead, as discussed above, Lowe's bad debts resulted from its role as a guarantor-creditor rather than a seller, and Lowe's guarantor bad debts under 26 C.F.R. § 1.166-9(a) are not "directly attributable" to a retail sale. *Home Depot*, 151 Wn. App. at 922.

The *Home Depot* court noted a distinction between bad debts directly attributable to a retail sale and bad debts resulting from the cost of doing business, saying, "Simply because *someone* can deduct the unpaid sales tax as a bad debt does not transform an ordinary business expense or loss into a refundable sales tax debt under former RCW 82.08.037." 151 Wn. App. at 924. The

*Home Depot* court recognized that a party's federally deductible bad debt does not automatically qualify for a state tax refund under RCW 82.08.037 because a party's bad debt must be "directly attributable" to a debt on a retail sale to qualify for a state refund. 151 Wn. App. at 922. And as discussed above, Lowe's federal bad debts resulted from Lowe's profit-sharing reductions to cover some of the Bank's PLCC account losses and not from debts Lowe's owned and initiated that are "directly attributable" to a retail sale. *Home Depot*, 151 Wn. App. at 922.

Lowe's also discusses cases litigated by Home Depot in other states that addressed nearly identical claims as those at issue in our State's *Home Depot*. All other states' appellate courts concluded, as did our court, that Home Depot was not entitled to a state bad debt refund based on varied reasoning. But those cases are consistent with our *Home Depot* decision.[9] Although Home Depot's lack of federally deductible bad debt was relevant to some of those decisions, many state courts held that Home Depot had no bad debt attributable to PLCC retail transactions because the bank paid the store in full for the purchased goods. *See, e.g., Home Depot USA, Inc. v. Arizona Dep't of Revenue*, 230 Ariz. 498, 502, 287 P.3d 97 (2012).

[9] *See, e.g., Home Depot USA, Inc. v. Arizona Dep't of Revenue*, 230 Ariz. 498, 502, 287 P.3d 97 (2012) ("Because Taxpayer received the full amount it was owed, there were no debts—much less bad debts[—]that served to reduce the gross amount that it realized from its sales of goods."); *Magee v. Home Depot U.S.A., Inc.*, 95 So.3d 781, 793 (Ala. Civ. App. 2011) (holding that the state's bad debt regulations "'clearly envision that the retailer must extend credit to the customer and own the account, and that if the account is not paid, the retailer must be the party that deducts the debt as uncollectible'"); *In the Matter of Home Depot USA, Inc. v Tax Appeals Tribunal of the State of N.Y.*, 68 A.D.3d 1571, 1573, 893 N.Y.S.2d 313 (N.Y. App. Div. 2009) ("Notably, inasmuch as the debts in question were owed to the finance companies and petitioner was paid in advance by the finance companies, [Home Depot] did not actually have any uncollectible receipts. Indeed, [Home Depot] recorded accounts receivable from the finance companies, not from the individual customers.").

Because Lowe's received payment on the gross proceeds for retail sale PLCC transactions and because Lowe's profit-sharing bad debts were not "directly attributable" to a retail sale, Lowe's profit-sharing bad debts are not debts on "sales taxes previously paid" and thus do not qualify for a tax refund under RCW 82.08.037(1).[10] *Home Depot*, 151 Wn. App. at 922.

3. LOWE'S CANNOT "NEGATE" SALES TAX PAYMENT

The dissent would hold that Lowe's bad debts were on "'sales tax previously paid'" because Lowe's "*initially* received reimbursement for" sales taxes but that the sales tax payment was "negated" by Lowe's profit-sharing reductions when "Lowe's became responsible for the amounts of the sales taxes and B&O taxes." Dissent at 33. But as discussed above, the dissent overlooks that the bad debts Lowe's incurred through its profit-sharing reductions were from a guarantee of credit accounts and not "directly attributable" to the retail sale. *Home Depot*, 151 Wn. App. at 922. Furthermore, the dissent incorrectly assumes that sellers such as Lowe's have authority to "negate" a buyer's sales tax payment. Contrary to the dissent's position, once the buyer-cardholders satisfied their sales tax obligation, Lowe's did not "negate" their sales tax payment through its contract with the Bank.

Once the seller collects retail sales tax from the buyer, the collected tax,

[10] Lowe's also cites to an Oklahoma administrative decision as "persuasive authority" that Lowe's is entitled to a Washington State tax refund. Order, No. P-09-195-H, 2015 WL 1530422 (Okla. Tax Comm'n Feb. 26, 2015). The Oklahoma administrative law judge (ALJ) determined that Lowe's, in a case factually similar to this case, was entitled to an Oklahoma bad debt tax refund. But as the DOR asserts, this Oklahoma case is unpersuasive for numerous reasons. Most importantly, the Oklahoma ALJ held that the Oklahoma state tax refund statute did not require that a debt be directly attributable to a retail sale to be eligible for a refund. This is contrary to our State's statute and our court's decision in *Home Depot*, which, unlike the Oklahoma decision, has precedential value in this case.

> is deemed to be held in trust by the seller until paid to the [DOR]. Any seller who appropriates or converts the tax collected to the seller's own use or to any use other than the payment of the tax to the extent that the money required to be collected is not available for payment on the due date as prescribed in this chapter is guilty of a gross misdemeanor.

RCW 82.08.050(2). In addition, if any seller fails to collect the retail sales tax from the buyer or, having collected the tax, fails to pay it to the DOR, "whether such failure is the result of the seller's own acts or the result of acts or conditions beyond the seller's control, the seller is, nevertheless, personally liable to the state for the amount of the tax." RCW 82.08.050(3).

As discussed above, Lowe's, as the seller, collected the buyer-cardholders' sales tax when the Bank transmitted sale proceeds to Lowe's on behalf of the buyer-cardholders. *See* RCW 82.08.050(2). Once Lowe's received full payment for the retail transactions, the buyer-cardholders' obligation to pay sales tax was satisfied, and RCW 82.08.050(2)-(3) required Lowe's to provide the retail sales tax payment to the DOR. No legal authority supports the dissent's position that Lowe's can "negate" the buyer-cardholders' satisfaction of the retail sales tax and circumvent the obligation to pay DOR sales taxes under RCW 82.08.050(2)-(3) after the buyers' tax obligation was satisfied.

The bad debts Lowe's incurred from its profit-sharing reductions were bad debts on a guarantee under 26 C.F.R. § 1.166-9(a) resulting not from a retail sales but instead from the Bank's credit agreements with cardholders and profit-sharing agreements with Lowe's. As such, Lowe's was not eligible for a refund under RCW 82.08.037(1) because the profit-sharing reductions were not bad debts on "sales taxes previously paid" and were not "directly attributable" to a retail sale. *Home Depot*, 151 Wn. App. at 922.

C. "WRITTEN OFF AS UNCOLLECTIBLE"

The parties dispute whether, as a matter of law, Lowe's notations in its books regarding its profit-sharing reductions satisfy the requirement under RCW 82.08.037 that the bad debt be "'written off as uncollectible in the taxpayer's books and records.'" Appellant's Reply Br. at 4 (quoting WAC 458-20-196(2)(a)).. We agree with the DOR that as a matter of law, Lowe's did not write off its bad debts as uncollectible and thus does not qualify for a state bad debt refund. Former WAC 458-20-196(2)(a).

> 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 [IRC], 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;
>
> . . . .
>
> (iv) The value of repossessed property taken in payment of debt.

Former WAC 458-20-196(2)(a).

The dissent argues that the write-off provision merely states "*when* a taxpayer can claim a credit or refund" and does not establish a requirement for a refund. Dissent at 35. But that interpretation is contrary to the plain meaning of the rule. Former WAC 458-20-196(2)(a) provides the conditions under which a party may claim a retail sales tax bad debt refund or credit. The regulation states that taxpayers may claim a refund for the tax reporting period in which the "bad debt is written off as uncollectible in the taxpayer's books and records." Former WAC 458-20-196(2)(a). Even if, as the dissent asserts, the provision merely establishes the appropriate time to claim a bad debt refund, a party that never writes off bad debt as uncollectible in its books and

records would in turn never be eligible for the bad debt refund or credit under former WAC 458-20-196(2)(a).

Lowe's is not eligible for a refund because it never wrote off the bad debt as uncollectible in its books and records. Lowe's customers who paid with PLCCs owed no debt to Lowe's, so Lowe's had no debt to write off. The record shows that the Bank, and not Lowe's, wrote off the bad debts on the PLCC accounts in its books and records because the customers owed the Bank, not Lowe's, debts on outstanding PLCC accounts. Under its PLCC agreements with the Bank, Lowe's had "no right, title or interest in the Accounts (including the Indebtedness)." CP at 145. Lowe's stated in depositions and disclosures during an IRS audit that the Bank owns the accounts receivable and that Lowe's does not make an entry when an account is uncollectible nor carry customers' unpaid PLCC obligations as an asset on its books and records. "Lowe's does not have a receivable or liability on its books and records at all" relating to the unpaid credit card debts. CP at 113.

To support that it wrote off its bad debt as uncollectible, Lowe's cites to the declaration of John Norris Aultman. The relevant portion of the declaration provides only that Lowe's recorded the amounts of its profit-sharing reductions to compensate the Bank for losses on PLCC accounts and "reflected in its books and records the net bad debts on PLCC accounts that were determined to be *uncollectible by the Banks*." CP at 455 (emphasis added). These statements are consistent with those offered by the DOR and show that the Bank, not Lowe's, had uncollectible debts.

Lowe's books and records reflected *payments Lowe's made to the Bank* that were federally deductible bad debts as a guaranty payment. But Lowe's books and records *did not* reflect any bad

debt on a retail sales owed by customers to Lowe's because no such debt existed. As such, Lowe's did not satisfy the write-off requirement under former WAC 458-20-196(2)(a).

Lowe's does not qualify for the tax refund under RCW 82.08.037 because its profit-sharing bad debt did not result from "sales taxes previously paid," its bad debt was not "directly attributable" to a retail sale as required under *Home Depot*, and it did not write off the debt on its books and records.[11] 151 Wn. App. at 922.

## III. EQUAL PROTECTION

Lowe's argues that the superior court's denial of its summary judgment motion on its refund claim violated its right to equal protection. Lowe's asserts that the DOR arbitrarily imposed an "ownership requirement" that does not exist in the bad debt tax statutes and thus treated Lowe's differently from other retailers within its class who remitted sales tax that they cannot collect from the buyer. Br. of Appellant at 47. The DOR argues that Lowe's equal protection rights were not violated because Lowe's is not in the same class as retailers who are able to claim a refund under RCW 82.08.037. We agree with the DOR.

### A. PRINCIPLES OF LAW

"We review constitutional issues de novo." *City of Seattle v. Evans*, 184 Wn.2d 856, 861, 366 P.3d 906 (2015), *cert. denied*, 137 S. Ct. 474 (2016).

[11] The DOR argues that even if Lowe's can establish that its profit-sharing reductions are bad debts on retail sales, Lowe's is still not entitled to summary judgment because Lowe's cannot meet its burden to prove the correct amount of the sales tax refund. Lowe's argues that it established the correct amount of the refund and that the DOR's cited authority is inapplicable. Because, as discussed above, Lowe's' profit-sharing reductions are not bad debts on retail sales, we need not reach whether Lowe's can establish the correct amount of a hypothetical sales tax refund.

Under the Fourteenth Amendment of the United States Constitution, no state shall "deny to any person within its jurisdiction the equal protection of the laws." This amendment protects a person from "'state action which selects him out for discriminatory treatment by subjecting him to taxes not imposed on others of the same class.'" *Allegheny Pittsburgh Coal Co. v. County Comm'n of Webster County, W. Va.*, 488 U.S. 336, 345, 109 S. Ct. 633, 102 L. Ed. 2d 688 (1989) (quoting *Hillsborough v. Cromwell*, 326 U.S. 620, 623, 66 S. Ct. 445, 90 L. Ed. 2d 358 (1946)). A tax classification based on reasonable factual distinctions and policy preferences does not violate equal protection. *See Lehnhausen v. Lake Shore Auto Parts Co.*, 410 U.S. 356, 360, 93 S. Ct. 1001, 35 L. Ed. 2d 351 (1973).

Under article I, section 12 of the Washington Constitution, "[n]o law shall be passed granting to any citizen, class of citizens, or corporation . . . privileges or immunities which upon the same terms shall not equally belong to all citizens, or corporations." For legislation to comply with article I, section 12 it must "'apply alike to all persons within the designated class'" and "'reasonable ground must exist for making a distinction between those who fall within the class and those who do not.'" *State ex rel. N. Pac. Ry. Co. v. Henneford*, 3 Wn.2d 48, 54, 99 P.2d 616 (1940) (quoting *State ex rel. Bacich v. Huse*, 187 Wash. 75, 80, 59 P.2d 1101 (1936), *overruled on other grounds by Puget Sound Gillnetters Ass'n v. Moos*, 92 Wn.2d 939, 603 P.2d 819 (1979)). An equal protection challenge to disparate tax treatment fails when "'any state of facts can reasonably be conceived that would sustain the classification.'" *Home Depot*, 151 Wn. App. at 926 (quoting *United Parcel Serv., Inc. v. Dep't of Revenue*, 102 Wn.2d 355, 368, 687 P.2d 186 (1984)).

B. NO DISPARATE TREATMENT

DOR did not arbitrarily apply an "ownership requirement" to Lowe's that treated Lowe's differently than other parties within the same class as Lowe's asserts. Br. of Appellant at 47. Instead, it applied the standards provided in *Home Depot* that withstood Home Depot's equal protection challenge.

RCW 82.08.037 provides a tax benefit to retailers who extend credit to their customers and "finance their own retail sales"; RCW 82.08.037 does not extend the same tax benefits to a party who pays contractual fees to a third-party lender to finance PLCCs. *Home Depot*, 151 Wn. App. at 927. The *Home Depot* court concluded that the factual differences between these two methods of business amply support the distinction drawn by the legislature. 151 Wn. App. at 928. For example, "the two types of financing arrangements include different types of risks, in that . . . Home Depot receives instant (re)payment from [the bank] on all accounts, while a self-financing retailer does not." *Home Depot*, 151 Wn. App. at 928-29.

*Home Depot*'s equal protection analysis controls here. Contrary to Lowe's assertion, it is *not* in the same class as retailers who finance their own retail sales. As discussed above, Lowe's collected the sales tax owed by the buyer when the Bank transmitted the sale price within days of sale. Lowe's profit-sharing reductions, made as part of bargained-for agreements with the Bank, are not in the same class for taxation purposes as uncompensated losses a seller experiences when they themselves extend credit to customers. Thus, the superior court did not violate Lowe's equal protection rights.

## IV. DUE PROCESS

Lowe's next provides one sentence of argument that the superior court violated Lowe's due process rights by denying its summary judgment motion and granting the DOR's summary judgment motion. Specifically, Lowe's states, "Likewise, by imposing arbitrary requirements on [Lowe's] that are neither authorized by statute nor promulgated as regulations, the [DOR] has denied [Lowe's] its right to a refund of overpaid sales and B&O taxes without due process of law, in violation" of the state and federal due process clauses. Br. of Appellant at 48. The DOR argues that the due process argument is waived because it was not raised in Lowe's complaint to the superior court. We hold that Lowe's argument is waived.

"'[N]aked castings into the constitutional sea are not sufficient to command judicial consideration and discussion.'" *Kitsap County Consol. Housing Auth. v. Henry-Levingston*, 196 Wn. App. 688, 707, 385 P.3d 188 (2016) (alteration in original) (internal quotation marks omitted) (quoting *Crystal Ridge Homeowners' Ass'n v. City of Bothell*, 182 Wn.2d 665, 679, 343 P.3d 746 (2015)). In addition, we do not consider arguments raised for the first time on appeal unless the new argument raises a manifest error affecting a constitutional right. RAP 2.5(a)(3); *Booker Auction Co. v. Dep't of Revenue*, 158 Wn. App. 84, 90, 241 P.3d 439 (2010). Where a party, in raising its unpreserved argument, does not claim that the trial court committed a manifest error affecting a constitutional right, we will not address it. *Booker Auction Co.*, 158 Wn. App. at 90.

Lowe's single sentence in support of its due process argument does not warrant judicial consideration. *See Henry-Levingston*, 196 Wn. App. at 707. In addition, Lowe's fails to assert that its due process argument raises a manifest error affecting a constitutional right, so we address the argument no further. *Booker Auction Co.*, 158 Wn. App. at 90.

## CONCLUSION

As a matter of law, based on undisputed facts, Lowe's does not qualify for the tax refund because its bad debt did not result from "sales taxes previously paid," its bad debt was not "directly attributable" to a retail sale as required under *Home Depot*, and it did not write off the debt on its books and records. RCW 82.08.037(1); 151 Wn. App. at 922. In addition, the superior court did not violate Lowe's equal protection rights, and we do not address the inadequately briefed due process issue.

We affirm.

JOHANSON, J.

I concur:

MELNICK, J.

MAXA, C.J. (dissenting) – The majority unnecessarily complicates what should be a straightforward analysis of the applicable Washington statutes, federal statute, and federal regulations. Those provisions unambiguously show that Lowe's Home Centers, LLC (Lowe's) is entitled to retail sales tax credits and Business and Occupation (B&O) tax deductions based on payments it made as the guarantor of debt obligations arising from Lowe's credit card accounts. Accordingly, I dissent.[12]

A. BACKGROUND

Lowe's had agreements with GE Capital Financial Inc. and Monogram Credit Bank of Georgia (collectively the Banks) to issue Lowe's credit cards. The Banks entered into credit agreements with customers, who used the credit cards to make purchases at Lowe's stores. The Banks paid Lowe's for the amount of the purchases, including any sales tax and related B&O tax. The Banks then collected the amounts of the purchases from the customers.

Some of the customers defaulted on their credit card obligations, resulting in bad debts for the Banks. The bad debts included the amounts of sales taxes and B&O taxes the Banks had paid to Lowe's. Under its agreements with the Banks, Lowe's acted as the guarantor of those bad debts up to a capped amount. In other words, Lowe's had a contractual obligation to pay the Banks the amount of the Banks' bad debt losses, which included sales taxes and B&O taxes.

Lowe's claimed sales tax credits and B&O tax deductions for the payments it made as the guarantor of the Banks' bad debts. Lowe's also deducted those losses on its federal income tax returns. The Department of Revenue disallowed all credits and deductions relating to the payments Lowe's made as the guarantor of the Banks' bad debts.

[12] However, I agree with the majority's equal protection and due process analysis.

B. CREDIT/DEDUCTION FOR GUARANTOR'S PAYMENT OF BAD DEBTS

RCW 82.08.037(1) states, "A seller is entitled to a credit or a refund for sales taxes previously paid on bad debts, as that term is used in 26 U.S.C. Sec. 166." Regarding B&O taxes, RCW 82.04.4284(1) states, "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 . . . on which tax was previously paid." Former WAC 458-20-196(1)(c) clarifies that "Washington credits, refunds, and deductions for bad debts are based on *federal standards for worthlessness* under section 166 of the Internal Revenue Code." (Emphasis added.)

26 U.S.C. § 166(a)(1) states, "There shall be allowed as a deduction any debt which becomes worthless within the taxable year." The federal standards of worthlessness are set forth in 26 C.F.R. § 1.166.

The controlling federal regulation here is 26 C.F.R. § 1.166-9(a), which applies to taxpayers who enter into an agreement to act as a guarantor of a debt obligation. The regulation states that a taxpayer's payment "in discharge of part or all of the taxpayer's obligation as a guarantor . . . is treated as a business debt becoming worthless." 26 C.F.R. § 1.166-9(a). Subsection (d) of that regulation states that a guarantor's payment of an obligation is treated as a worthless debt only if the agreement was entered into in the course of the taxpayer's business, the taxpayer had an enforceable legal duty to make the payment, and the agreement was entered into before the obligation became worthless. 26 C.F.R. § 1.166-9(d).

Under the plain language of these provisions, Lowe's was entitled to a sales tax credit and a B&O tax deduction for the payments it made on the Banks' bad debts. Lowe's payments were made to discharge the obligation Lowe's had as the guarantor of those bad debts, and therefore under 26 C.F.R. § 1.166-9(a) those payments are treated as worthless debts for

purposes of 26 U.S.C. § 166. Lowe's also met the requirements of 26 C.F.R. § 1.166-9(d). And because those guaranteed payments constitute bad debts as that term is used in 26 U.S.C. § 166, Lowe's is entitled to a sales tax credit under RCW 82.08.037(1) and a B&O tax deduction under RCW 82.04.4284(1).

The majority believes that the plain language of these provisions does not control for three reasons. But these reasons reflect a misunderstanding of the applicable law.

First, the majority focuses on the statement in RCW 82.08.037(1) that a credit is allowed for "sales tax previously paid" on bad debts and the statement in RCW 82.04.4284(1) allowing deduction for bad debts "on which tax was previously paid." The majority claims that Lowe's did not previously pay any sales taxes or B&O taxes relating to the Banks' credit card bad debts because Lowe's received reimbursement for those taxes from the Banks.

However, the Banks' credit card bad debts for which Lowe's acted as guarantor *included sales taxes and B&O taxes*. Lowe's *initially* received reimbursement for sales taxes and B&O taxes. But because of the guarantee, that reimbursement was negated and Lowe's became responsible for the amounts of the sales taxes and B&O taxes relating to the bad debts.

Second, the majority relies on *Home Depot USA, Inc. v. Department of Revenue*, 151 Wn. App. 909, 215 P.3d 222 (2009), to hold that Lowe's cannot obtain a sales tax credit because its guarantee payments were not directly attributable to retail sales. *Id.* at 914. In *Home Depot*, General Electric Capital Corporation (GECC) issued Home Depot credit cards. *Id.* at 913. When a Home Depot customer used the credit card to make a purchase, GECC would reimburse Home Depot for the amount of the purchase, including retail sales taxes. However, deducted from those reimbursement payments was what the parties characterized as a "service fee," which was an amount based on a complex economic analysis that considered a number of factors,

including expected losses from uncollectable debts. *Id.* at 914. Home Depot sought a sales tax refund for the sales taxes it paid on defaulted transactions made on Home Depot credit cards. *Id.* at 912-13.

This court affirmed the Department of Revenue's denial of Home Depot's sale tax refund claim. *Id.* at 912. However, the key facts in *Home Depot* are completely different than the facts in this case. Most significantly, there was no agreement in which Home Depot agreed to act as the guarantor of GECC's bad debts. Instead, there was no question that GECC was completely responsible for those debts, and in fact GECC – not Home Depot – took a bad debt deduction on its federal income tax returns. *Id.* at 913. Therefore, unlike here, 26 U.S.C. § 166(a)(1) and 26 C.F.R. § 1.166-9(a) were inapplicable.

Home Depot argued that it actually suffered the loss for GECC's bad debts because the bad debt expenses were factored into the service fee that Home Depot paid. *Id.* at 923. The court rejected that argument, stating that the existence of some economic loss relating to another party's bad debts does not allow a tax refund under RCW 82.08.037. *Id.* at 923-24. But the court's holding is inapplicable here because Lowe's did not merely suffer some economic loss relating to the Banks' bad debts. Unlike Home Depot, Lowe's was the *guarantor* of the Banks' bad debt losses.

The analysis and holding in *Home Depot* is inapplicable here because Home Depot did not guarantee GECC's bad debts. Lowe's did guarantee the Banks' bad debts, and those guarantee payments are the "bad debts" under 26 C.F.R. § 1.166-9(a) allowing for a sales tax credit under RCW 82.08.037(1) and a B&O tax deduction under RCW 82.04.4284(1).

Third, the majority contends that Lowe's cannot claim a sales tax credit or a B&O tax deduction because it did not write off the bad debt as uncollectable on its books. The majority

believes that writing off the bad debt as uncollectable on a taxpayer's books is a requirement for the sales tax credit and B&O tax refund under WAC 458-20-196.

The majority misreads WAC 458-20-196, which does not contain any such requirement. Former WAC 458-20-196(2)(a) states the general rule that sellers are entitled to a sales tax credit for taxes previously paid on bad debts under 26 U.S.C. § 166. That subsection then states, "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." Former WAC 458-20-196(2)(a). This provision simply states *when* a taxpayer can claim a credit or refund; it does not somehow create a new requirement for claiming the credit or refund. Neither RCW 82.08.037, 26 U.S.C. § 166(1), nor related regulations contain such a requirement.[13]

In any event, WAC 458-20-196 clearly does not address the situation where the taxpayer's bad debt is a payment made as the guarantor of another person's debt obligation. A guarantor would not necessarily write off the other person's bad debt as uncollectible on its books. However, Lowe's presented evidence that its books and records did reflect the guarantee payments it had made, which should be sufficient to determine *when* Lowe's could claim the credit/deduction.

C. CONCLUSION

Lowe's made payments to the Banks as the guarantor of the Banks' bad debts relating to the Lowe's credit cards, and those payments included amounts for sales taxes and B&O taxes. Under federal law, those guarantee payments constituted bad debts. And under RCW

[13] The same analysis applies for a B&O tax deduction. Former WAC 458-20-196(3)(a), relating to B&O taxes, contains language nearly identical to subsection (2)(a).

82.08.037(1) and RCW 82.04.4284(1), Lowe's was entitled to a sales tax credit and a B&O tax deduction for those bad debts. I dissent from the majority's contrary holding.

Maxa, C.J.

MAXA, C.J.

Page 1

SUPERIOR COURT OF WASHINGTON
FOR THURSTON COUNTY

LOWE'S HOME CENTERS, LLC,
Plaintiff,
vs. NO. 15-2-02994-34
DEPARTMENT OF REVENUE, STATE OF WASHINGTON,
Defendant.

DEPOSITION OF
RONALD W. BLASI

November 30, 2016
9:00 a.m.

1420 Peachtree Street, N.E.
Suite 800
Atlanta, Georgia 30309

Piper L. Quinn, CCR B-2198

Page 2

APPEARANCES OF COUNSEL
On behalf of the Plaintiff:
E. KENDRICK SMITH, ESQ.
JOHN M. ALLAN, ESQ.
Jones Day
1420 Peachtree Street, N.E.
Suite 800
Atlanta, Georgia 30309
(404) 581-3939
eksmith@jonesday.com
jmallan@jonesday.com

On behalf of the Defendant:

ROSANN FITZPATRICK, ESQ.
Attorney General of Washington
7141 Cleanwater Drive, S.W.
Olympia, Washington 98501
(360) 586-4945
rosannf@atg.wa.gov

Also present:
Troy Hunter, Esq., by phone

Page 3

TABLE OF CONTENTS



---

INDEX TO EXHIBITS



(Original Exhibit D-1 has been attached to the original transcript.)

---

Page 4

(Reporter disclosure made pursuant to Article 10.B. of the Rules and Regulations of the Board of Court Reporting, Judicial Council of Georgia.)

RONALD W. BLASI,
having been first duly sworn, was examined and testified as follows:

EXAMINATION

BY MS. FITZPATRICK:

Q. Good morning, Mr. Blasi.

**A. Good morning.**

Q. I am Rosann Fitzpatrick, Assistant Attorney General, representing the Washington State Department of Revenue. Thank you for coming this morning.

To begin, would you please state your full name and spell your last name.

**A. Ronald W. Blasi, B-l-a-s-i.**

Q. And what county and state do you reside in?

**A. I reside in Fulton County in the state of Georgia.**

**(Defendant's Exhibit 1 was marked for identification.)**

Q. (By Ms. Fitzpatrick) Thank you. And I

Page 5

have handed you what has been marked as Exhibit 1. Have you seen that document before?

**A. Yes, I have.**

Q. What is it?

**A. This is a description, the first part of it, anyway, of what I'm prepared to opine on. And then I believe attached to this is my curriculum vitae.**

Q. Okay. Thank you. Can you tell me how it is that you became engaged as a witness in this litigation.

**A. I was contacted by Mr. Allen.**

Q. What did Mr. Allen ask you to do?

**A. He very briefly described the matter and asked me if I'd be interested in talking with them about possibly being an expert.**

Q. And have you been an expert in any other litigation involving state sales-tax controversy?

**A. No, I have not.**

Q. Have you been involved in any litigation involving state sales taxation?

**A. Litigation, no, I have not.**

Q. And what are the -- what's your understanding of the scope of the work that you have been asked to perform?

Page 6

**A. There are three items that I am prepared to opine on, described in your Exhibit 1. The first item I'm prepared to opine on is the arrangement between Lowe's and the banks entitles Lowe's to a bad debt deduction, because Lowe's satisfies the federal income tax definition of a guarantor, as that definition is used in the regulations under Section 166 of the Internal Revenue Code.**

**I'm also going to testify -- or prepared to testify, I should say, that, in this situation, the payments made by Lowe's to the banks satisfy the requirement that a guarantor fulfill its obligation, thereby entitling the guarantor to the deduction.**

**And, third, I'm prepared to testify with respect to the course of dealing of an agent who works for the Internal Revenue Service and how that agent and the tax department at a major corporation would interrelate in connection with an audit.**

Q. I'm sorry. Inter --

**A. Interrelate with respect to an audit.**

Q. Have you been asked to prepare any written report?

**A. No, I have not.**

Q. What is your understanding of the form in which you intend to provide testimony?

Page 7

**A. I'll take my guidance from Ken on that.**

Q. What documents have you been asked to review and have you reviewed in preparation --

**A. Yes. The documents that I looked at were the petition filed in this case.**

Q. Which petition?

**A. The petition filed in this case in the Superior Court and the various exhibits that were attached to that petition. I think they are sometimes referred to as supplemental filings. And then there were some exhibits. I looked at both of those.**

**In addition, I looked at a couple of schedules that were prepared, one by the banks and given to Lowe's and another schedule or form that was prepared by the bank and submitted to Lowe's sales-tax people.**

Q. Were you -- was there anything else that you were asked to review?

**A. Not that I can recall.**

Q. So I -- the petition that you described, it sounds to me like what you may be describing, in addition to the Superior Court Notice of Appeal, is the administrative appeal petition --

**A. It could be, yeah.**

Page 8

Q. -- and related filings --

**A. Sure.**

Q. -- that Lowe's submitted --

**A. Okay. Sure. And, of course, I did some independent, you know, research. I read some cases and took another look at the regulation and so forth.**

Q. Did you read any of the contracts between Lowe's and the banks?

**A. One of the exhibits -- I believe it's Exhibit 11 to the petition that I'm referring to -- is the consumer contract between the bank and Lowe's. Other exhibits, you know, are the federal income tax returns and so forth.**

Q. What's your understanding of the federal income tax definition of a guarantor?

**A. It's quite broad. The definition was added to the Treasury Regulations in the mid-1970s, and it's contained under Section 166, which is the general section that allows a bad debt deduction for all taxpayers.**

**When this provision was added, the first time it appeared, it was drafted very broadly. Although the word "guarantor," is used, so are the other words of like import.**

Page 9

**And then there's a catchall phrase which says something just to that effect, that any other party, you know, providing similar type of service. So the definition that we are referring to as a guarantor is quite broad, as contained in that Treasury Regulation.**

Q. As I recall, it says something like guarantor, surety, or insurer?

**A. And it keeps going. That's right. And then there's a catchall phrase, as I said, which indicates any other party performing a similar-type function.**

Q. And that function being?

**A. A function similar to that performed by a guarantor.**

Q. How would you characterize that?

**A. Oh, someone who then agrees or who has agreed to pay the debt owing in the first instance by another.**

Q. And is it necessary for the debtor to be aware of such guarantee?

**A. It's not necessary at all, no. There's no condition in the Treasury Regulations that the debtor be made aware.**

Q. Okay. And what's your understanding of

Page 10

why the definition is so broad?

**A. Well, the provision under which the Treasury Regulation is promulgated deals with bad debts. And if a party steps into the shoes of a guarantor, that party is becoming, in a sense, a creditor. And by making payment pursuant to the contract between the guarantor and the party to whom the guarantee runs, that party is then fulfilling the obligation of the debtor and then would be entitled to collect from the debtor.**

Q. Let's say the definition was more narrow, that it was tied to a more narrow understanding of a guarantor agreement that, for example, might require privity between the creditor and guarantor.

If that were true, how would someone in Lowe's position who doesn't have such privity with the debtor treat this expense for federal income tax purposes?

MR. SMITH: Object to form.

THE DEPONENT: I'm not sure I understand the question.

Q. (By Ms. Fitzpatrick) So say that under the federal regulation -- this agreement, this arrangement between Lowe's and the bank, simply did

Page 11

not qualify as a bona fide guarantee relationship. Just assume that to be true. In that case, what would be the appropriate way for Lowe's to characterize these purported payments to the bank for federal income tax purposes?

**A. You'd have to characterize them according to whatever agreement that they entered into. If it's not a guarantor agreement, what is it? You'd have to tell me.**

Q. Say it's just, okay, I agree for every -- I agree I'm going to reimburse you for your bad debt losses on these private label creditors.

**A. And that's an agreement between Lowe's and the banks?**

Q. Right.

**A. Not between Lowe's and the debtor?**

Q. Correct. So how would Lowe's characterize that on its federal income tax return, that expense?

**A. As a bad debt expense.**

Q. No. I just want you to assume -- let's say that the Court decides there was not really a payment here, it was just an -- that, essentially, the banks were paying itself by reducing their own revenues. Let's say that that were the conclusion.

Page 12

How, then, would this expense be characterized?

MR. SMITH: Object to form.

Q. (By Ms. Fitzpatrick) Let me ask you a different question.

Would you agree that a bad debt expense is -- it is a business expense -- a deductible business expense; correct?

**A. No. A business expense is something different. Ordinary and necessary business expense is deducted under another section of the code. That is Section 162. Just like, you know, interest expense is not, you know, an ordinary and necessary business expense. These are terms of art for Internal Revenue Service purposes.**

Q. Okay. Are you aware that in the years 2004 and 2005, Lowe's had deducted these bad debt reimbursements on its federal income tax returns as miscellaneous deductions on line 26?

**A. It's my understanding that under the software that Lowe's used to prepare its tax return, they transferred certain general-ledger accounts to that software and, as a result, started to prepare the return by placing those items on line 26.**

Q. And are you aware that they subsequently filed an amended return in which they

Page 13

recharacterized the reported bad debt reimbursements as --

**A. I was not aware of an amended return.**

Q. I'll represent to you that they did in fact file amended returns.

**A. Sure. I don't know why that's significant, but that's fine.**

Q. My question is: Was it an error, in your judgment, to have treated it as a miscellaneous deduction, or was it, rather, a matter of subjective judgment and appropriate exercise of discretion to have done so?

**A. You know, to be perfectly honest, you know, I've worked for a couple of very, very large corporations, and it is not uncommon at all for items to be placed on a particular line. But, perhaps, they should maybe, more appropriately, end up on another line.**

**The ultimate question is whether the item was properly treated, not whether it was placed on the appropriate line. And so it was properly treated as a deductible item. I wouldn't, frankly, call it an error.**

**You know, did they put it on the appropriate line? Perhaps not. But I don't -- my**

Page 14

**experience is, given the quantity of items that are being dealt with, that's not a significant fact.**

Q. Well, given the quantity of items that the corporation deals with in deciding how to report, would you agree that there's a certain amount of subjective judgment involved in how to characterize, ultimately, your transactions on your federal return?

**A. Each item, you know, that's considered is examined, determined whether -- how it should be treated for federal income tax purposes. Whether you use the word "subjective" or not, you know, I don't know what that word really means in this context. But, certainly, you look at an item and you say, well, is this salary expense? How should salary expense be treated?**

**Is that subjectivity, in your mind? I don't know if it is. A lot of subjectivity is involved in that.**

**If it's salary expense, you treat it as salary expense. If it's bad-debt expense, you treat it as bad debt expense. The ultimate question is: Was it treated properly, not, you know, what line it was put on. And, frankly, that's what an examining agent is going to be concerned with.**

Page 15

Q. Okay. What's your understanding of how -- in what sense do you understand Lowe's to have made payments to the banks in reimbursement of the bank's bad debt expenses?

**A. Sure. Well, first of all, the agreement is explicit. They have a contractual obligation to absorb the liability for net charge-offs up to -- I believe it was 7.2 percent in the years we're dealing with. So there's a legal obligation for them to fulfill that obligation. They have to do that.**

**How they mechanically did it, it's my understanding, was through a netting process that was managed by the banks.**

Q. What do you mean by "absorb"? You said that there was an agreement to absorb the expense.

**A. Yeah. They were liable for net charge-offs.**

Q. Were they required to take their own assets and transfer them to the banks?

**A. In order -- I'm not sure about assets. They would have an obligation to fulfill created under the contract. And it's my understanding they did fulfill that obligation. And that was fulfilled through this netting process that the banks managed.**

Page 16

Q. And what -- your understanding of the netting process is based upon your reading of the contracts; is that correct?

**A. The agreement describes -- under the economic section, the agreement describes this process in general terms. And then attached to the agreement is a schedule, and that schedule, you know, depicts, in a sense, how this netting process takes place.**

**It shows the income from this program, the expenses from the program, and it indicates that the net charge-offs that are Lowe's responsibility are subtracted from the income.**

Q. If the guaranteed party provides the funds that are used by the guarantor to make a payment in reimbursement, would that qualify as a payment in guarantee of a debt for federal income tax purposes?

MR. SMITH: Object to form.

THE DEPONENT: The guaranteed party is which party in this context?

Q. (By Ms. Fitzpatrick) If the banks give Lowe's the funds that Lowe's uses to reimburse the banks for their bad debt expenses --

**A. What do you mean "gives"? Certainly,**

Page 17

they are not making a gift.
Q. Well, let's say they do. Would --
A. That would --
Q. -- that --
A. -- be inconceivable they'd make a gift.
Q. Well, it wouldn't qualify as a payment; correct?
A. No. If I made a gift to you and you fulfilled your obligation, that certainly would qualify as a payment. Once I make a gift --
Q. Well, if Lowe's transfers its owns funds -- I'm sorry. If the banks transfers their own funds to Lowe's and Lowe's transfers a portion of those funds back to the bank, would that kind of arrangement qualify as a payment, for purposes of Section 166?
MR. SMITH: Object to form.
THE DEPONENT: It seems to me that, you know, there may be some confusion associated with some of the language you are using when you say "transfers its funds." If you look at the -- if you look at the agreement in its entirety, so we can be a little more specific, the netting process does not result in the

Page 18

bank transferring its funds.
Again, looking at the agreement in its entirety, Lowe's is entitled to a certain amount of income, and those funds which you are, I think, suggesting are being transferred as bank funds are not bank funds. Those are under the con -- in the context of the entire agreement, you know, entitled to be owned by Lowe's.
Q. (By Ms. Fitzpatrick) What is the difference between this agreement that they have where Lowe's says "I'm going to absorb your bad debt losses" and an agreement that would say that the bank promises to pay Lowe's X percent of the net profits from the Private Label Credit Card Program?
If that was way the language was writing -- the contract was written, the banks agree to pay Lowe's a specific percent of their net financing revenues, then how would you characterize the transaction?
A. Certainly, the parties are free to agree contractually to a whole variety of arrangements. If they chose to have a different arrangement, then I suspect that the federal income tax consequences could be very different.

Page 19

You know, but, again, I would have to look at the entire other agreement to see. But parsing one particular term out of a very lengthy and complex agreement can be misleading. You see?
Q. Uh-huh (affirmative).
A. So instead of going down that path, I think we ought to talk specifically about the agreement at hand.
Q. What's your understanding of the -- actually, switching topics for a moment.
Are you familiar with Washington State's sales tax -- are you familiar with the bad debt sales-tax deduction statute of Washington State?
A. Yeah. I think when I looked at the items that I described earlier, there was a discussion of the Washington State statute. There may even have been recitation of the statute itself. So to that extent, I'm familiar with it.
Q. I understand, from your resume, that you have extensive experiences in federal and state income tax and particularly with respect to taxation of banks.
A. Yeah.
Q. Can you explain to me what experience you have, if any, in dealing with issues of state

Page 20

sales and use taxes.
A. Sure. Sure. When I worked at Citibank and also at -- what's now JP Morgan Chase -- the predecessor was Chemical Bank -- we were engaged in quite a few acquisitions. And one in particular that I recall was a taxable asset purchase of a very large bank located in New York, and that caused us to look very carefully at the New York State sales and use tax laws.
In fact, my function with the bank at that time was to actually put together our sales and use tax position with respect to the items that we purchased from that bank, many of which were subject to New York sales tax.
Q. And are you familiar with the Streamlined Sales and Use Tax Agreement?
A. I'm not terribly familiar with that, no. I'm aware of it.
Q. Have you had any experience, apart from this litigation, dealing with issues of bad debt sales-tax refunds?
A. Certainly bad debts. That's been a very large portion of the activity that I engaged in over the years, professional activity, not personal, but not bad debt sales tax, no.

Page 21

Q. Do you have any understanding of the legislative purpose of Washington's bad debt sales-tax statute?

**A. I could speculate.**

Q. What is your understanding of --

**A. I haven't read the legislative history, though.**

Q. Pardon me?

**A. I have not read the legislative history. But it would seem to me that if -- first of all, the statute appears, on its face, to be pretty clear, the statute that I recall reading in these various documents that I mentioned to you.**

**And that statute allows for -- it's my recollection, now. You know it better than I -- a deduction of credit for bad debts that are allowable as such for federal income tax purposes.**

**And I assume the theory is that you really don't have a completed sale in that situation or something to that effect and it would be unfair, for example, for the State of Washington, in this case, to impose a sales tax on a seller who never receives payment for that sale. The State of Washington would be unjustifiably enriched.**

Q. Our statute does refer to bad debts as

Page 22

defined under Section 166. I'd like to go back to the regulation and ask you: What is your understanding of the federal definition of a bad debt?

MR. SMITH: Let me just object to form on the representation of what the statute says.

THE DEPONENT: So you are asking if I understand?

Q. (By Ms. Fitzpatrick) What is a bad debt --

**A. What is a bad debt?**

Q. -- bona fide bad debt?

**A. Sure. Well, first of all, there must be a debt, and then the debtor fails to pay. In a nutshell, that's a bad debt. And then, of course, the statute draws some distinction between business and nonbusiness bad debts. There are distinctions and treatment of bad debts by banks versus other taxpayers. There are special rules with respect to bad debts between or among members of a consolidated group. You can imagine Treasury Regulations would be very complicated.**

**But from the very -- of you are looking at this from a very high level of abstraction by the**

Page 23

**debt, that has gone bad. And that provision has been in the Internal Revenue Code probably since 1913.**

Q. I'm going to give a simple paraphrase of my understanding of the definition of a bed debt, and I'll ask you if you agree. A bad debt is an amount that arises from a debtor-creditor relationship previously reported as income that is uncollectible.

**A. There's nothing, either in Section 166 or in the regulations under 166, that contains the definition you just gave and this component of that, in particular, that I don't recall ever seeing in the statute of regulations. And that is that it was reported as income.**

**Now, the taxpayer has to have some type of, usually, basis in a debt.**

Q. Okay. What would you describe as Lowe's basis in the purported bad debt, sitting here?

**A. Well, under the agreement, as soon as Lowe's fulfills its obligation as a guarantor -- let's say that, you know, it's -- the agreement required Lowe's to pay the banks a hundred dollars. That creates a basis that would then entitle Lowe's to deduct as a bed debt because the debt is**

Page 24

**uncollectible.**

Q. Right. If Lowe's does in fact pay a hundred dollars to the bank; correct?

**A. Indeed.**

Q. Does the guarantor provision carve out an exception to the definition of bad debt?

**A. Not that I'm aware of. I don't know what you mean by "exception."**

Q. My understanding is subsection 1 of federal regulation defines what a bad debt is. In fact, it says, bad debt defined. And it talks about an amount that arises from a debtor-creditor relationship.

My understanding of subsection 9 is it, essentially, explains under what circumstances a person can take a bad debt deduction for a bad debt owed to a third party -- or for a debt obligation between a third party.

Rather, a third party can take a bad debt deduction for a bad debt incurred by another party; is that correct?

**A. No, I don't think so. Let me explain why I don't think that's so. And I know why you're struggling with this. It's not, perhaps, that clear.**

Page 25

**Once a guarantor fulfills its obligation under a contract, it becomes a creditor. That creditor then ends up either collecting on the debt or, if it fails to do so, taking a bad debt deduction. You see?**

Q. Well, I believe you are referring to probably the doctrine of subrogation in the Putnam case -- is that correct -- whereby --

**A. There doesn't have to be any subrogation.**

Q. It doesn't -- why not?

**A. There is no requirement in Section 166.**

Q. Didn't you just say that the rationale for the guarantor -- allowing a guarantor to take a bad debt deduction is that they do stand in the shoes of a creditor?

**A. They become a creditor. That doesn't mean they have a right of subrogation or they have to have that right of subrogation. That is not a requirement in the Treasury Regulations.**

**Theoretically, they become a creditor. That's how the debt, you know, arises. And that debt is bad. There's no requirement in the Treasury Regulations -- in fact, by inference, it's clear that there doesn't have to be -- that the guarantor**

Page 26

**then is subrogated to the rights of, in this case, the banks.**

Q. So in your view, it doesn't matter, as in this case, if the purported guarantor contractually waives the right of subrogation; nevertheless, they should still be able to qualify for the bad debt deduction?

**A. I'm sorry. I misunderstood.**

Q. I'll just represent you to that in the contracts between Lowe's and the banks, Lowe's specifically and repeatedly waives any right of subrogation --

**A. Sure.**

Q. -- at the outset. So they know at the outset, they're not going to have --

**A. That's irrelevant. For federal income tax purposes, that is irrelevant.**

Q. So they'd still be entitled --

**A. Absolutely.**

Q. -- to take a deduction?

**A. And I think it's pretty clear on the regulations, if you look at it.**

Q. What's your understanding of the rationale for calling it a bad debt deduction as opposed to other kind of expense, even under these

Page 27

circumstances when there is no right of subrogation?

**A. Because there's a debt. I mean, that's the very reason why the guarantee provision is contained under Section 166.**

Q. But it's not a debt owed to Lowe's; correct?

MR. SMITH: Object to form.

THE DEPONENT: What debt is not owed to Lowe's.

Q. (By Ms. Fitzpatrick) The unpaid debt obligation of the consumer, Lowe's doesn't have any -- Lowe's does not own that outstanding debt obligation; correct?

**A. Lowe's does not own the accounts that are transferred to the banks. You're absolutely right. But, theoretically, you see, what takes place, then, is once Lowe's fulfills its contractual obligation as a guarantor, it becomes a creditor.**

Q. Have you worked for Lowe's in any other capacity?

**A. No, I have not.**

Q. According to the witness disclosure, you are prepared to testify that it would be inappropriate for the banks to take a bad debt deduction on the amounts Lowe's purportedly

Page 28

reimbursed the banks? Do I have that correct?

**A. To the extent that Lowe's fulfills its guarantee, the bank would not be entitled to a bad debt deduction because the bank is then made whole. It has no loss. That's correct.**

Q. And the -- would you agree the underlying rationale of that is you can't deduct, essentially, a loss that has been reimbursed or you recovered proceeds to make you whole, as you just said?

**A. If you haven't incurred a loss, in this case, a bad debt loss, you are not entitled to a bad debt deduction.**

Q. Does it necessarily follow if the banks are not entitled to a bad debt deduction because they have been made whole by Lowe's -- does it necessarily follow that the banks -- it would be improper for the banks to have charged off the unpaid consumer debt obligation on their own books and records?

MR. SMITH: Object to form.

THE DEPONENT: Banks -- the banks in this case, it's my understanding, own the receivables in the first instance. And so it would be appropriate for them

Page 29

to charge off any worthless receivable. It's that that probably triggers the guarantee of Lowe's.

Q. (By Ms. Fitzpatrick) So the act of charging off the bad debt, that's a different issue than whether or not the bank could subsequently or ultimately claim the bad debt for federal income tax purposes?

**A. I don't know what you mean by "a different issue."**

Q. I just mean – so, actually, you just – I think you answered my question. You said that it is perfectly appropriate for the bank to charge off the unpaid debt obligations of the customer on their own books and records?

**A. It should.**

Q. Because the banks own –

**A. Correct.**

Q. Is there a difference between – what's your understanding of what it means to charge off that amount?

**A. The term "charge-off" is not defined in Section 166 or in any other place in the Internal Revenue Code. It's generally understood that the term means to eliminate the items in some way from**

Page 30

**your books and records.**

Q. Eliminate what items?

**A. The item of – the item that is charged off. The item is the debt in this case.**

Q. Just more specifically, would you agree that a charge-off is to eliminate – I'm not sure what the proper term is, but you have an asset or –

**A. Yes.**

Q. You have an asset or an expectation of payment, and you have to – and you charge it off, and that eliminates the expectation. Can you put it in your own words?

**A. Well, the act of charging something off is to eliminate it on your books and records, now, eliminate it as an asset. That doesn't mean that, you know, the debtor is somehow forgiven. It just means, for your own accounting purposes, that does not any longer appears as an asset.**

**Now, that's the case in a wholly worthless bad debt situation. If the debt is partially worthless, then it's to the extent of the partial worthlessness.**

Q. Given that the banks charged off the unpaid consumer debt obligations, would it be appropriate for Lowe's to charge off the same

Page 31

obligations on its own books?

MR. SMITH: Object to form.

THE DEPONENT: You see, we have to be careful. Remember what happens. You have a creditor. The creditor has a debt that goes bad. The guarantee then is trigged. Another debt is then created.

So we're talking about two different debts, in theory. You see? So the bank charges off, in the first instance, the receivable from the customer. Lowe's then becomes the creditor to the extent of the guarantee.

Q. (By Ms. Fitzpatrick) How is that going to be reflected on Lowe's books and records?

**A. I don't know how – are you asking me how Lowe's has reflected that?**

Q. Yes. When this occurs, you said that by operation of law, that Lowe's becomes the creditor. What would be an appropriate entry on their own books and records to reflect the existence of this new obligation?

**A. There should be some type of accounting entry that indicates Lowe's is fulfilling its obligation as a guarantor. It doesn't have to**

Page 32

**follow any fixed pattern. There's nothing in the law or in the regulations that requires any fixed pattern to be followed. It just has to be demonstrated that it has had a debt, in this case, a debt that arises as a result of the guarantee, and that debt is bad.**

**And if you could just demonstrate that in some reasonable way, it's going to be accepted for federal income-tax purposes.**

Q. Would you agree that the new debt obligation that arises between Lowe's and the debtor – actually, withdraw that question.

In your experience – is it your understanding that GE Capital, now Synchrony Financial, is one of the largest private label credit card issuers in the United States?

**A. I guess so. I don't really –**

Q. Well, I see you have written articles about sales of credit card receivables among banks. So you're basically familiar –

**A. It's certainly a very big company that does this work. That's right.**

Q. Gosh, I just lost my train of thought. Sorry.

**A. Do you want to take a break?**

Page 33

Q. No. Is it your experience that banks that are in the business of issuing consumer credit cards are able to predict, with a reasonable amount of accuracy, the bad debt losses they will incur at any particular time?

**A. Under normal economic conditions. Now, as we know, you know, economic conditions don't stay normal for very longer periods of time. But, certainly, predictions are made, and sometimes those predictions hold true. Sometimes they don't. That's the reality of it.**

Q. Actually, large banks are required to file call reports -- correct -- with federal regulators?

**A. That is correct.**

Q. And from those call reports, is it possible to infer the portfolio-wide rate of bad debts incurred on credit card receivables?

**A. It's possible. Are you asking whether those call reports contain information about the losses that are being incurred on credit card receivables?**

Q. Yes. Actually, I'll just ask you to assume, as a hypothetical, we have ten years of reliable data that tells us there's going to be a

Page 34

bad debt between 4.5 and 5.2 percent next year. And each year, you can predict, within a certain margin of error, pretty much, what the bad debt experience is going to be.

So given that, if a person agrees that they're going to absorb your bad debt expense and they're not -- and they're going to waive their right of subrogation, under those circumstances, how is it possible, for purposes of the federal bad debt regulation, you can be viewed as having a reasonable expectation of repayment from the issuer of the debt that you purportedly guaranteed?

**A. Well, bear in mind --**

MR. SMITH: Object to form.

THE DEPONENT: Well, bear in mind, we're talking about thousands -- tens of thousands, maybe hundreds of thousands of individual debts. When those credit cards are issued, there's an expectation on the part of the issuer that the full amount charged is going to be paid.

Q. (By Ms. Fitzpatrick) By "issuer," you are referring to whom?

**A. The bank is the issuer. The issuer has an expectation that the full amount charged by the**

Page 35

**cardholder is going to be paid. You know, there's no way to predict -- I shouldn't say there's way to predict, but the gross bad debt experience can't be used to predict whether a cardholder -- a particular cardholder is going to repay the debt or not.**

Q. I'm going to move on to what you expect to testify with respect to examination and procedures of an IRS auditor.

**A. Sure.**

Q. According to the witness disclosure statement, you're expected to testify that to the extent the IRS requested documents on a particular topic from Lowe's relating to its bad debt claims and to the extent it made no adjustments to the claim deductions, the IRS, necessarily, allowed and found Lowe's entitled to claim the bad debt deductions.

Are you aware of what documents the IRS examiner requested of Lowe's in this instance?

**A. I have a general understanding that the IRS examiner asked to see accounting books and records, the work papers associated with the preparation of the federal income tax returns for the various years involved. Those work papers may be in the form of actual paper or in electronic**

Page 36

**form.**

**That is a customary way that an agent begins an audit, by requesting all of that data. And it's my understanding, the agent did that in this case as well.**

Q. And I'll just represent to you that the agent did in fact ask Lowe's about why it had filed amended returns to reclassify certain amounts from miscellaneous deductions to debt bad expense and --

**A. Is that the only reason the amended return was filed?**

Q. I don't know.

**A. There could have been other reasons?**

Q. Yes, there probably were.

**A. Many other reasons. And when you are filing an amended return, perhaps, you know, you make all kinds of adjustments, some that you wouldn't have made unless an amended return were filed for some other purpose.**

Q. Why would you make adjustments if it wasn't necessary?

**A. My experience is after we file the federal incomes tax return -- again, in a very, very large corporation -- you can think about this in your own case -- you come across things. You become**

Page 37

aware of things that, perhaps, could've been treated differently or should have been treated differently or whatever. And you keep a file to that effect.

And quite often, you provide that file to the agent when the agent comes in. If, instead, you are going to file an amended return, you just reflect that in an amended return.

Q. So in this case, the IRS made inquiries about the reason for the reclassification, and Lowe's informed the IRS agent it was for, quote, state presentation purposes and for purposes of isolating the amounts it wanted to claim as bad debt refunds from the states.

At the conclusion of the audit, there were a number of bad debt adjustments made but not with respect to that issue. There were bad debt adjustments made with respect to checks.

And yesterday, Mr. Aultman, Lowe's tax manager, testified that the reclassification decision had no impact on the federal income tax liability of Lowe's. Whether it was a bad debt deduction or a miscellaneous deduction, it had exactly the same impact.

Given that the reclassification had no impact, in your experience, typically, would an

Page 38

auditor require some adjustment be made at the conclusion of the audit on that particular issue?

A. If I understand your question -- let me kind of say it back to you to make sure I've got it. If the movement of an item from one line on the federal income tax return to another line on the federal income tax return has absolutely no effect on federal tax liability, I don't think that the IRS would be -- would take -- you know, would be terribly concerned about that.

Was that your question?

Q. Yes, it was exactly my question.

So the IRS auditor would not feel obligated to direct the taxpayer to change that characterization to what the IRS auditor viewed as more --

A. I have to be honest. I've done a lot of work for the IRS, and I've come in contact with scores of IRS agents that would examine corporations like Lowe's. They are not a homogeneous group.

An individual conducting an audit, the group chief, for example -- you know, one crew group chief may take a position different from another group chief.

But, in general, it's my impression that

Page 39

those examiners that handle large cases -- and Lowe's would be a large-case audit -- are not terribly concerned with what line and item appears on it, if it has absolutely no effect on federal income tax liability.

Now, would they prefer that it be on, you know, the correct line? Sure. But are they going to somehow write this up in a Revenue Agent's Report and make a deal about this? Absolutely not, in my opinion.

That doesn't mean that they don't observe it and look at it and study it and say "What's going on here? Let me understand." But once they understand it, that's the end of it.

Q. Thank you.

MS. FITZPATRICK: I think I'm about done. If I could just have a few minutes to review my notes.

(Recess from 10:04 a.m. to 10:10 a.m.)

(Deposition concluded at 10:10 a.m.)

Page 40

CERTIFICATE OF COURT REPORTER

STATE OF GEORGIA:
COUNTY OF CHEROKEE:

I hereby certify that the foregoing transcript was reported as stated in the caption and the questions and answers thereto were reduced to typewriting by me; that the foregoing transcript represents a true, correct, and complete transcript of the evidence given on November 30, 2016, by the witness, Ronald W. Blasi, who was first duly sworn by me.

I certify that I am not disqualified for a relationship of interest under O.C.G.A. §9-11-28(c); I am a Georgia Certified Court Reporter here as an independent contractor of Payne Court Reporting, LLC; I was contacted by Payne Court Reporting to provide court reporting services for this deposition; I will not be taking this deposition under any contract that is prohibited by O.C.G.A. §§ 15-14-37(a) and (b) or Article 7.C. of the Rules and Regulations of the Board; and by the attached disclosure form, I confirm that Payne Court Reporting is not a party to a contract prohibited by O.C.G.A. § 15-14-37 or Article 7.C. of the Rules and Regulations of the Board.

This, the 13th day of December 2016.

Piper L. Quinn, CCR B-2198
Certified Court Reporter

Page 41

DISCLOSURE OF NO CONTRACT

I, John P. Payne, do hereby disclose pursuant to Article 10.B. of the Rules and Regulations of the Board of Court Reporting of the Judicial Council of Georgia that Certified Court Reporters and Video, LLC, was contacted by the party taking the deposition to provide court reporting services for this deposition and there is no contract that is prohibited by O.C.G.A. §§ 15-14-37(a) and (b) or Article 7.C. of the Rules and Regulations of the Board for the taking of this deposition.

There is no contract to provide reporting services between Payne Court Reporting or any person with whom Payne Court Reporting has a principal and agency relationship nor any attorney at law in this action, party to this action, party having a financial interest in this action, or agent for an attorney at law in this action, party to this action, or party having a financial interest in this action. Any and all financial arrangements beyond our usual and customary rates have been disclosed and offered to all parties.

This 13th day of December, 2016.

JOHN P. PAYNE
Payne Court Reporting, LLC

Page 42

DEPOSITION OF RONALD W. BLASI

I do hereby certify that I have read all questions propounded to me and all answers given by me on November 30, 2016, taken before Piper L. Quinn, and that:

1) There are no changes noted.
2) The following changes are noted:

Pursuant to Rule 30(e) of the Federal Rules of Civil Procedure and/or the Official Code of Georgia Annotated 9-11-30(e), both of which read in part: Any changes in form or substance which you desire to make shall be entered upon the deposition...with a statement of the reasons given...for making them. Accordingly, to assist you in effecting corrections, please use the form below:

Page No. Line No. should read:

Page No. Line No. should read:

Page No. Line No. should read:

Page No. Line No. should read:

Page No. Line No. should read:

Page No. Line No. should read:

Page No. Line No. should read:

Page No. Line No. should read:

Page No. Line No. should read:

Page No. Line No. should read:

Page 43

DEPOSITION OF RONALD W. BLASI

Page No. Line No. should read:

Page No. Line No. should read:

Page No. Line No. should read:

Page No. Line No. should read:

Page No. Line No. should read:

Page No. Line No. should read:

Page No. Line No. should read:

Page No. Line No. should read:

If supplemental or additional pages are necessary, please furnish same in typewriting annexed to this deposition.

RONALD W. BLASI

Sworn to and subscribed before me,
This the day of , 20 .

Notary Public
My commission expires:

(2) The renting or leasing of mobile homes if the rental agreement or lease exceeds thirty days in duration and if the rental or lease of such mobile home is not conducted jointly with the provision of short-term lodging for transients.

[1986 c 211 § 2; 1979 ex.s. c 266 § 3.]

**RCW 82.08.034 Exemptions--Sales of used floating homes or rental or lease of used floating homes.**

The tax imposed by RCW 82.08.020 shall not apply to:

(1) Sales of used floating homes, as defined in RCW 82.45.032;

(2) The renting or leasing of used floating homes, as defined in RCW 82.45.032, when the rental agreement or lease exceeds thirty days in duration.

[1984 c 192 § 3.]

**RCW 82.08.035 Exemption for pollution control facilities.**

See chapter 82.34 RCW.

**RCW 82.08.036 Exemptions--Vehicle battery core deposits or credits--Replacement vehicle tire fees--"Core deposits or credits" defined.**

The tax levied by RCW 82.08.020 shall not apply to consideration: (1) Received as core deposits or credits in a retail or wholesale sale; or (2) received or collected upon the sale of a new replacement vehicle tire as a fee imposed under RCW 70.95.510. For purposes of this section, the term "core deposits or credits" means the amount representing the value of returnable products such as batteries, starters, brakes, and other products with returnable value added for the purpose of recycling or remanufacturing.

[1989 c 431 § 45.]

**Notes:**

**Severability--Section captions not law--1989 c 431:** See RCW 70.95.901 and 70.95.902.

**RCW 82.08.037 Credits and refunds--Debts deductible as worthless.**

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.

[1982 1st ex.s. c 35 § 35.]

**Notes:**

**Severability--Effective dates--1982 1st ex.s. c 35:** See notes following RCW 82.08.020.

**RCW 82.08.040 Consignee, factor, bailee, auctioneer deemed seller.**

**Severability—Effective dates—1982 1st ex.s. c 35:** See notes following RCW 82.08.020.

**82.08.037 Credits and refunds for bad debts.** *(Effective July 1, 2004.)* (1) A seller is entitled to a credit or refund for sales taxes previously paid on debts which are bad debts under 26 U.S.C. Sec. 166, as amended or renumbered as of January 1, 2003, except for:

(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.

(2) 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.

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

(4) If the seller uses a certified service provider to administer its sales tax responsibilities, the certified service provider may claim, on behalf of the seller, the credit or refund allowed by this section. The certified service provider must credit or refund the full amount to the seller. [2003 c 168 § 212; 1982 1st ex.s. c 35 § 35.]

**Effective dates—Part headings not law—2003 c 168:** See notes following RCW 82.08.010.

**Severability—Effective dates—1982 1st ex.s. c 35:** See notes following RCW 82.08.020.

**82.08.050 Buyer to pay, seller to collect tax—Statement of tax—Exception—Penalties—Contingent expiration of subsection.** *(Effective until July 1, 2004.)* (1) The tax hereby imposed shall be paid by the buyer to the seller, and each seller shall collect from the buyer the full amount of the tax payable in respect to each taxable sale in accordance with the schedule of collections adopted by the department pursuant to the provisions of RCW 82.08.060. The tax required by this chapter, to be collected by the seller, shall be deemed to be held in trust by the seller until paid to the department, and any seller who appropriates or converts the tax collected to his or her own use or to any use other than the payment of the tax to the extent that the money required to be collected is not available for payment on the due date as prescribed in this chapter shall be guilty of a gross misdemeanor.

(2) In case any seller fails to collect the tax herein imposed or having collected the tax, fails to pay it to the department in the manner prescribed by this chapter, whether such failure is the result of his or her own acts or the result of acts or conditions beyond his or her control, he or she shall, nevertheless, be personally liable to the state for the amount of the tax, unless the seller has taken from the buyer in good faith a properly executed resale certificate under RCW 82.04.470 or a copy of a direct pay permit issued under RCW 82.32.087.

(3) The amount of tax, until paid by the buyer to the seller or to the department, shall constitute a debt from the buyer to the seller and any seller who fails or refuses to collect the tax as required with intent to violate the provisions of this chapter or to gain some advantage or benefit, either direct or indirect, and any buyer who refuses to pay any tax due under this chapter shall be guilty of a misdemeanor. The tax required by this chapter to be collected by the seller shall be stated separately from the selling price in any sales invoice or other instrument of sale. On all retail sales through vending machines, the tax need not be stated separately from the selling price or collected separately from the buyer. For purposes of determining the tax due from the buyer to the seller and from the seller to the department it shall be conclusively presumed that the selling price quoted in any price list, sales document, contract or other agreement between the parties does not include the tax imposed by this chapter, but if the seller advertises the price as including the tax or that the seller is paying the tax, the advertised price shall not be considered the selling price.

(4) Where a buyer has failed to pay to the seller the tax imposed by this chapter and the seller has not paid the amount of the tax to the department, the department may, in its discretion, proceed directly against the buyer for collection of the tax, in which case a penalty of ten percent may be added to the amount of the tax for failure of the buyer to pay the same to the seller, regardless of when the tax may be collected by the department; and all of the provisions of chapter 82.32 RCW, including those relative to interest and penalties, shall apply in addition; and, for the sole purpose of applying the various provisions of chapter 82.32 RCW, the twenty-fifth day of the month following the tax period in which the purchase was made shall be considered as the due date of the tax.

(5) Notwithstanding subsections (1) through (4) of this section, any person making sales is not obligated to collect the tax imposed by this chapter if:

(a) The person's activities in this state, whether conducted directly or through another person, are limited to:

(i) The storage, dissemination, or display of advertising;

(ii) The taking of orders; or

(iii) The processing of payments; and

(b) The activities are conducted electronically via a web site on a server or other computer equipment located in Washington that is not owned or operated by the person making sales into this state nor owned or operated by an affiliated person. "Affiliated persons" has the same meaning as provided in RCW 82.04.424.

(6) Subsection (5) of this section expires when: (a) The United States congress grants individual states the authority to impose sales and use tax collection duties on remote sellers; or (b) it is determined by a court of competent jurisdiction, in a judgment not subject to review, that a state can impose sales and use tax collection duties on remote sellers. [2003 c 76 § 3; 2001 c 188 § 4; 1993 sp.s. c 25 § 704; 1992 c 206 § 2; 1986 c 36 § 1; 1985 c 38 § 1; 1971 ex.s. c 299 § 7; 1965 ex.s. c 173 § 15; 1961 c 15 § 82.08.050. Prior: 1951 c 44 § 1; 1949 c 228 § 6; 1941 c 71 § 3; 1939 c 225 § 11; 1937 c 227 § 7; 1935 c 180 § 21; Rem. Supp. 1949 § 8370-21.]

**Intent—2003 c 76:** See note following RCW 82.04.424.

**Finding—Intent—Effective date—2001 c 188:** See notes following RCW 82.32.087.

**Severability—Effective dates—Part headings, captions not law—1993 sp.s. c 25:** See notes following RCW 82.04.230.

**Effective date—1992 c 206:** See note following RCW 82.04.170.

**82.08.032 Exemption—Sales, rental, or lease of used park model trailers.** The tax imposed by RCW 82.08.020 shall not apply to:

(1) Sales of used park model trailers, as defined in RCW 82.45.032;

(2) The renting or leasing of used park model trailers, as defined in RCW 82.45.032, when the rental agreement or lease exceeds thirty days in duration. [2001 c 282 § 3.]

**Intent—2001 c 282:** "It is the intent of the legislature to promote fairness in the application of tax. Therefore, for the purposes of excise tax, park model trailers will be taxed in the same manner as mobile homes." [2001 c 282 § 1.]

**Effective date—2001 c 282:** "This act takes effect August 1, 2001." [2001 c 282 § 5.]

**82.08.033 Exemptions—Sales of used mobile homes or rental or lease of mobile homes.** The tax imposed by RCW 82.08.020 shall not apply to:

(1) Sales of used mobile homes as defined in RCW 82.45.032.

(2) The renting or leasing of mobile homes if the rental agreement or lease exceeds thirty days in duration and if the rental or lease of such mobile home is not conducted jointly with the provision of short-term lodging for transients. [1986 c 211 § 2; 1979 ex.s. c 266 § 3.]

**82.08.034 Exemptions—Sales of used floating homes or rental or lease of used floating homes.** The tax imposed by RCW 82.08.020 shall not apply to:

(1) Sales of used floating homes, as defined in RCW 82.45.032;

(2) The renting or leasing of used floating homes, as defined in RCW 82.45.032, when the rental agreement or lease exceeds thirty days in duration. [1984 c 192 § 3.]

**82.08.035 Exemption for pollution control facilities.** See chapter 82.34 RCW.

**82.08.036 Exemptions—Vehicle battery core deposits or credits—Replacement vehicle tire fees—"Core deposits or credits" defined.** The tax levied by RCW 82.08.020 shall not apply to consideration: (1) Received as core deposits or credits in a retail or wholesale sale; or (2) received or collected upon the sale of a new replacement vehicle tire as a fee imposed under RCW 70.95.510. For purposes of this section, the term "core deposits or credits" means the amount representing the value of returnable products such as batteries, starters, brakes, and other products with returnable value added for the purpose of recycling or remanufacturing. [1989 c 431 § 45.]

**Severability—Section captions not law—1989 c 431:** See RCW 70.95.901 and 70.95.902.

**82.08.037 Credits and refunds for bad debts.** (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.

(5) If the seller uses a certified service provider as defined in RCW 82.58.010 to administer its sales tax responsibilities, the certified service provider may claim, on behalf of the seller, the credit or refund allowed by this section. The certified service provider must credit or refund the full amount received to the seller.

(6) The department shall allow an allocation of bad debts among member states to the streamlined sales tax agreement, as defined in RCW 82.58.010(1), if the books and records of the person claiming bad debts support the allocation. [2004 c 153 § 302; 2003 c 168 § 212; 1982 1st ex.s. c 35 § 35.]

**Bad debts—Intent—2004 c 153 §§ 302-305:** "For the purposes of sections 302 through 305 of this act, the legislature does not intend by any provision of this act relating to bad debts, and did not intend by any provision of chapter 168, Laws of 2003 relating to bad debts, to affect the holding of the supreme court of the state of Washington in *Puget Sound National Bank v. the Department of Revenue*, 123 Wn. 2nd 284 (1994)." [2004 c 153 § 301.]

**Retroactive effective date—Effective date—2004 c 153:** See note following RCW 82.08.0293.

**Effective dates—Part headings not law—2003 c 168:** See notes following RCW 82.08.010.

**Severability—Effective dates—1982 1st ex.s. c 35:** See notes following RCW 82.08.020.

**82.08.040 Consignee, factor, bailee, auctioneer deemed seller.** Every consignee, bailee, factor, or auctioneer authorized, engaged, or employed to sell or call for bids on tangible personal property belonging to another, and so selling or calling, shall be deemed the seller of such tangible personal property within the meaning of this chapter and all sales made by such persons are subject to its provisions even though the sale would have been exempt from tax hereunder had it been made directly by the owner of the property sold. Every consignee, bailee, factor, or auctioneer shall collect and remit the amount of tax due under this chapter with respect to sales made or called by him: PROVIDED, That if the owner of the property sold is engaged in the business of selling tangible personal property in this state the tax imposed under this chapter may be remitted by such owner under such rules and regulations as the department of revenue shall prescribe. [1975 1st ex.s. c 278 § 46; 1961 c 15 § 82.08.040. Prior: 1939 c 225 § 8; 1935 c 180 § 18; RRS § 8370-18.]

**Construction—Severability—1975 1st ex.s. c 278:** See notes following RCW 11.08.160.

**82.08.050 Buyer to pay, seller to collect tax—Statement of tax—Exception—Penalties—Contingent expiration of subsection.** (1) The tax hereby imposed shall be paid by the buyer to the seller, and each seller shall collect from the buyer the full amount of the tax payable in respect to each taxable sale in accordance with the schedule of collections

**RCW 82.04.4284 Deductions--Credit losses of accrual basis taxpayers.**

In computing tax there may be deducted from the measure of tax the amount of credit losses actually sustained by taxpayers whose regular books of account are kept upon an accrual basis.

[1980 c 37 § 5. Formerly RCW 82.04.430(4).]

**Notes:**

**Intent--1980 c 37:** See note following RCW 82.04.4281.

**RCW 82.04.4285 Deductions--Motor vehicle fuel and special fuel taxes.**

In computing tax there may be deducted from the measure of tax so much of the sale price of motor vehicle fuel as constitutes the amount of tax imposed by the state under chapters 82.36 and 82.38 RCW or the United States government, under 26 U.S.C., Subtitle D, chapters 31 and 32, upon the sale thereof.

[1998 c 176 § 3; 1980 c 37 § 6. Formerly RCW 82.04.430(5).]

**Notes:**

**Rules--Findings--Effective date--1998 c 176:** See RCW 82.36.800, 82.36.900, and 82.36.901.

**Intent--1980 c 37:** See note following RCW 82.04.4281.

**RCW 82.04.4286 Deductions--Nontaxable business.**

In computing tax there may be deducted from the measure of tax amounts derived from business which the state is prohibited from taxing under the Constitution of this state or the Constitution or laws of the United States.

[1980 c 37 § 7. Formerly RCW 82.04.430(6).]

**Notes:**

**Intent--1980 c 37:** See note following RCW 82.04.4281.

**RCW 82.04.4287 Deductions--Compensation for receiving, washing, etc., horticultural products for person exempt under RCW 82.04.330--Materials and supplies used.**

In computing tax there may be deducted from the measure of tax amounts derived by any person as compensation for the receiving, washing, sorting, and packing of fresh perishable horticultural products and the material and supplies used therein when performed for the person exempted in RCW 82.04.330, either as agent or as independent contractor.

[1980 c 37 § 8. Formerly RCW 82.04.430(7).]

**Notes:**

**Intent--1980 c 37:** See note following RCW 82.04.4281.

*Sales and use tax exemption for materials and supplies used in packing horticultural products: RCW 82.08.0311 and 82.12.0311.*

**82.04.4282 Deductions—Fees, dues, charges.** In computing tax there may be deducted from the measure of tax amounts derived from bona fide (1) initiation fees, (2) dues, (3) contributions, (4) donations, (5) tuition fees, (6) charges made by a nonprofit trade or professional organization for attending or occupying space at a trade show, convention, or educational seminar sponsored by the nonprofit trade or professional organization, which trade show, convention, or educational seminar is not open to the general public, (7) charges made for operation of privately operated kindergartens, and (8) endowment funds. This section shall not be construed to exempt any person, association, or society from tax liability upon selling tangible personal property or upon providing facilities or services for which a special charge is made to members or others. If dues are in exchange for any significant amount of goods or services rendered by the recipient thereof to members without any additional charge to the member, or if the dues are graduated upon the amount of goods or services rendered, the value of such goods or services shall not be considered as a deduction under this section. [1994 c 124 § 3; 1989 c 392 § 1; 1980 c 37 § 3. Formerly RCW 82.04.430(2).]

**Intent—1980 c 37:** See note following RCW 82.04.4281.

**82.04.4283 Deductions—Cash discount taken by purchaser.** In computing tax there may be deducted from the measure of tax the amount of cash discount actually taken by the purchaser. This deduction is not allowed in arriving at the taxable amount under the extractive or manufacturing classifications with respect to articles produced or manufactured, the reported values of which, for the purposes of this tax, have been computed according to the provisions of RCW 82.04.450. [1980 c 37 § 4. Formerly RCW 82.04.430(3).]

**Intent—1980 c 37:** See note following RCW 82.04.4281.

**82.04.4284 Deductions—Bad debts.** (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. [2004 c 153 § 307; 1980 c 37 § 5. Formerly RCW 82.04.430(4).]

**Retroactive effective date—Effective date—2004 c 153:** See note following RCW 82.08.0293.

**Intent—1980 c 37:** See note following RCW 82.04.4281.

**82.04.4285 Deductions—Motor vehicle fuel and special fuel taxes.** In computing tax there may be deducted from the measure of tax so much of the sale price of motor vehicle fuel as constitutes the amount of tax imposed by the state under chapters 82.36 and 82.38 RCW or the United States government, under 26 U.S.C., Subtitle D, chapters 31 and 32, upon the sale thereof. [1998 c 176 § 3; 1980 c 37 § 6. Formerly RCW 82.04.430(5).]

**Rules—Findings—Effective date—1998 c 176:** See RCW 82.36.800, 82.36.900, and 82.36.901.

**Intent—1980 c 37:** See note following RCW 82.04.4281.

**82.04.4286 Deductions—Nontaxable business.** In computing tax there may be deducted from the measure of tax amounts derived from business which the state is prohibited from taxing under the Constitution of this state or the Constitution or laws of the United States. [1980 c 37 § 7. Formerly RCW 82.04.430(6).]

**Intent—1980 c 37:** See note following RCW 82.04.4281.

**82.04.4287 Deductions—Compensation for receiving, washing, etc., horticultural products for person exempt under RCW 82.04.330—Materials and supplies used.** In computing tax there may be deducted from the measure of tax amounts derived by any person as compensation for the receiving, washing, sorting, and packing of fresh perishable horticultural products and the material and supplies used therein when performed for the person exempted in RCW 82.04.330, either as agent or as independent contractor. [1980 c 37 § 8. Formerly RCW 82.04.430(7).]

**Intent—1980 c 37:** See note following RCW 82.04.4281.

*Sales and use tax exemption for materials and supplies used in packing horticultural products: RCW 82.08.0311 and 82.12.0311.*

**82.04.4289 Exemption—Compensation for patient services or attendant sales of drugs dispensed pursuant to prescription by certain nonprofit organizations.** This chapter does not apply to amounts derived as compensation for services rendered to patients or from sales of drugs for human use pursuant to a prescription furnished as an integral part of services rendered to patients by a kidney dialysis facility operated as a nonprofit corporation, a nonprofit hospice agency licensed under chapter 70.127 RCW, and nursing homes and homes for unwed mothers operated as religious or charitable organizations, but only if no part of the net earnings received by such an institution inures directly or indirectly, to any person other than the institution entitled to deduction hereunder. "Prescription" and "drug" have the same meaning as in RCW 82.08.0281. [2003 c 168 § 402; 1998 c 325 § 1; 1993 c 492 § 305; 1981 c 178 § 2; 1980 c 37 § 10. Formerly RCW 82.04.430(9).]

**Effective dates—Part headings not law—2003 c 168:** See notes following RCW 82.08.010.

**Findings—Intent—1993 c 492:** See notes following RCW 43.20.050.

**Short title—Severability—Savings—Captions not law—Reservation of legislative power—Effective dates—1993 c 492:** See RCW 43.72.910 through 43.72.915.

**Intent—1980 c 37:** See note following RCW 82.04.4281.

**82.04.4291 Deductions—Compensation received by a political subdivision from another political subdivision**

| | |
|---|---|
| FEDERAL— | |
| Tax on communications services (telephone and teletypewriter exchange services) | 26 U.S.C.A. Sec. 4251; |
| Tax on transportation of persons | 26 U.S.C.A. Sec. 4261; |
| Tax on transportation of property | 26 U.S.C.A. Sec. 4271; |
| STATE— | |
| Aviation fuel tax collected from buyers by a distributor as defined by RCW 82.42.010 | chapter 82.42 RCW; |
| Leasehold excise tax collected from lessees | chapter 82.29A RCW; |
| Oil spill response tax collected from taxpayers by marine terminal operators | chapter 82.23B RCW; |
| Retail sales tax collected from buyers | chapter 82.08 RCW; |
| Solid waste collection tax collected from buyers | chapter 82.18 RCW; |
| State enhanced 911 tax collected from subscribers | chapter 82.14B RCW; |
| Use tax collected from buyers | chapter 82.12 RCW; |
| MUNICIPAL— | |
| City admission tax | RCW 35.21.280; |
| County admissions and recreations tax | chapter 36.38 RCW; |
| County enhanced 911 tax collected from subscribers | chapter 82.14B RCW; |
| Local retail sales and use taxes collected from buyers | chapter 82.14 RCW. |

(5) **Specific taxes which are not deductible.** Examples of specific taxes which may be neither deducted nor excluded from the measure of the tax include the following:

| | |
|---|---|
| FEDERAL— | |
| A.A.A. compensating tax | 7 U.S.C.A. Sec. 615(e); |
| A.A.A. processing tax | 7 U.S.C.A. Sec. 609; |
| Aviation fuel | 26 U.S.C.A. Sec. 4091; |
| Distilled spirits, wine and beer taxes | 26 U.S.C.A. chapter 51; |
| Diesel and special motor fuel tax for fuel used for purposes other than motor vehicles and motor-boats | 26 U.S.C.A. Sec. 4041; |
| Employment taxes | 26 U.S.C.A. chapters 21-25; |
| Estate taxes | 26 U.S.C.A. chapter 11; |
| Firearms, shells and cartridges | 26 U.S.C.A. Sec. 4181; |
| Gift taxes | 26 U.S.C.A. chapter 12; |
| Importers, manufacturers and dealers in firearms | 26 U.S.C.A. Sec. 5801; |
| Income taxes | 26 U.S.C.A. Subtitle A; |
| Insurance policies issued by foreign insurers | 26 U.S.C.A. Sec. 4371; |
| Sale and transfer of firearms tax | 26 U.S.C.A. Sec. 5811; |
| Sporting goods | 26 U.S.C.A. Sec. 4161; |
| Superfund tax | 26 U.S.C.A. Sec. 4611; |
| Tires | 26 U.S.C.A. Sec. 4071; |
| Tobacco excise taxes | 26 U.S.C.A. chapter 52; |
| Wagering taxes | 26 U.S.C.A. chapter 35; |
| STATE— | |
| Ad valorem property taxes | Title 84 RCW; |
| Alcoholic beverages licenses and stamp taxes (Breweries, distillers, distributors and wineries) | chapter 66.24 RCW; |
| Aviation fuel tax when not collected as agent for the state | chapter 82.42 RCW; |
| Boxing, sparring and wrestling tax | chapter 67.08 RCW; |
| Business and occupation tax | chapter 82.04 RCW; |
| Cigarette tax | chapter 82.24 RCW; |
| Gift and inheritance taxes | Title 83 RCW; |
| Insurance premiums tax | chapter 48.14 RCW; |
| Hazardous substance tax | chapter 82.21 RCW; |
| Litter tax | chapter 82.19 RCW; |
| Pollution liability insurance fee | RCW 70.149.080; |
| Parimutuel tax | RCW 67.16.100; |
| Petroleum products - underground storage tank tax | chapter 82.23A RCW; |
| Public utility tax | chapter 82.16 RCW; |
| Real estate excise tax | chapter 82.45 RCW; |
| Tobacco products tax | chapter 82.26 RCW; |
| Use tax when not collected as agent for state | chapter 82.12 RCW; |
| MUNICIPAL— | |
| Local use tax when not collected as agent for cities or counties | chapter 82.14 RCW; |
| Municipal utility taxes | chapter 54.28 RCW; |
| Municipal and county real estate excise taxes | chapter 82.46 RCW. |

[Statutory Authority: RCW 82.32.300. 00-16-015, § 458-20-195, filed 7/21/00, effective 8/21/00; 99-13-053, § 458-20-195, filed 6/9/99, effective 7/10/99; 83-08-026 (Order ET 83-1), § 458-20-195, filed 3/30/83; Order ET 70-3, § 458-20-195 (Rule 195), filed 5/29/70, effective 7/1/70.]

**WAC 458-20-196 Credit losses, bad debts, recoveries.**

**Business and Occupation Tax**

In computing business and occupation tax there may be deducted by taxpayers whose regular books of accounts are kept upon an accrual basis, the amount of business credit losses actually sustained, providing that such deduction will be allowed only with respect to transactions upon which a tax has been previously paid and providing that the amount

thereof has not been otherwise deducted and that credits have not been issued with respect thereto.

Bad debt deductions must be taken by the taxpayer during the tax reporting period during which such bad debts were actually charged off on the taxpayer's books of account.

In cases where the amount of bad debts legitimately charged off in a particular reporting period exceeds the gross income for such period, the excess of the amount of the bad debts charged off during such period may be deducted from the gross income of the subsequent tax reporting period.

A dishonored (bad) check which proves to be uncollectible is a bad debt, to the extent it was taken as payment for goods or services on which business tax was previously reported and paid.

**Extracting or manufacturing, special application.** Bad debt deductions will be allowed under the extracting or manufacturing classifications only when the value of products is computed on the basis of gross proceeds of sales.

### Retail Sales Tax

A seller is entitled to a credit or refund for sales taxes previously paid on debts which are deductible, on and after January 1, 1983, as worthless for federal income tax purposes.

### Public Utility Tax

In computing public utility tax credit losses may be deducted under the same conditions set out under the business and occupation tax. However, the special provisions set out for the extracting and manufacturing classifications are not applicable to the public utility tax.

**Methods of determining credit losses.** The amount of credit losses actually sustained must be determined in accordance with one of the following methods:

(1) Specific charge-off method. The amount which is charged off within the tax reporting period with respect to debts ascertained to be worthless.

(a) Worthlessness of a debt is usually evidenced when all the surrounding and attending circumstances indicate that legal action to enforce payment would result in an uncollectible judgment.

(b) A "charge-off" of a debt, either wholly or in part, must be evidenced by entry in the taxpayer's books of account.

(2) Reserve method. In the discretion of the department of revenue a reasonable addition to a reserve for bad debts will be authorized to taxpayers who charge off credit losses at the end of their taxable year but who desire to apportion such losses on a monthly basis.

(a) This will be permitted, in lieu of the specific charge-off method, only to taxpayers who have established or are allowed by the Internal Revenue Service to use for federal income tax purposes, the reserve method of treating bad debts, or who, upon securing permission from the department adopt that method.

(b) 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. The addition to the 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.

If the taxpayer actually determines and charges off bad debts on a tax reporting period basis, the amount so charged off each period shall be considered prima facie as a proper deduction for such period.

When bad debt losses are ascertained annually upon specific charge-off method, the deduction must be taken against the gross amount reported for the period in which the bad debts were actually charged off.

When the reserve method is employed in taking deductions for bad debts on returns and the amount of debts actually ascertained to be wholly or partially worthless and charged against the reserve account during the taxable year and reported do not agree with the amount of reserve set up therefor, adjustment of the amount of loss deducted shall be made to make the total amount claimed for the tax year coincide with the amount of loss actually sustained.

**Recoveries.** Amounts subsequently received on account of a bad debt or on account of a part of such debt previously charged off and allowed as a deduction for business tax purposes, must be included in gross proceeds of sales (including value of products when measured by gross proceeds of sales) or gross income of the business reported for the taxable period in which received. This is true even though the recoveries during such period exceed the amount of the bad debt charge-off.

[Statutory Authority: RCW 82.32.300. 83-07-032 (Order ET 83-15), § 458-20-196, filed 3/15/83; Order ET 70-3, § 458-20-196 (Rule 196), filed 5/29/70, effective 7/1/70.]

**WAC 458-20-197 When tax liability arises.** (1) Gross proceeds of sales and gross income shall be included in the return for the period in which the value proceeds or accrues to the taxpayer. For the purpose of determining tax liability of persons making sales of tangible personal property, a sale takes place when the goods sold are delivered to the buyer in this state. With respect to leases or rentals of tangible personal property, liability for retail sales tax arises as of the time the rental payments fall due (see WAC 458-20-211).

(2) **Accrual basis.**

(a) When returns are made upon the accrual basis, value accrues to a taxpayer at the time:

(i) The taxpayer becomes legally entitled to receive the consideration, or,

(ii) In accord with the system of accounting regularly employed, enters as a charge against the purchaser, customer, or client the amount of the consideration agreed upon, whether payable immediately or at a definitely determined future time.

(b) Amounts actually received do not constitute value accruing to the taxpayer in the period in which received if the value accrues to the taxpayer during another period. It is immaterial if the act or service for which the consideration accrues is performed or rendered, in whole or in part, during a period other than the one for which return is made. The controlling factor is the time when the taxpayer is entitled to receive, or takes credit for, the consideration.

(3) **Cash receipts basis.**

(a) When returns are made upon cash receipts and disbursements basis, value proceeds to a taxpayer at the time the

party costs with respect to Taxpayer because X is responsible for providing the staff of the service center. The payments to X are specifically assigned to California.

(C) Taxpayer sells various manufacturers' products at wholesale on a commission basis. Taxpayer subcontracts with X, who agrees to act as Taxpayer's sales representative on the West Coast. Taxpayer has various other sales representatives working on as independent contractors, who are assigned territories, but may make sales from an office or through in-person visits, or a combination of both. Taxpayer does not maintain records sufficient to show the representatives' places of performance. Taxpayer may use sales records and the standards under (h) of this subsection to assign commissions by each subcontractor.

(h) **Costs assigned by formula.**

(i) Costs not specifically assigned under (e) through (g) of this subsection and not excluded from consideration by (c) of this subsection are assigned to Washington by formula. These costs are multiplied by the ratio of sales in Washington over sales everywhere. For example, if a business has one thousand dollars in other unassigned costs and sales of ten thousand dollars in each of the four states in which it has nexus under Washington standards (including Washington), twenty-five percent ($10,000/$40,000), or two hundred fifty dollars of the other costs are assigned to Washington.

(ii) Sales are assigned to where the customer receives the benefit of the service. If the location where the services are received is not readily determinable, the services are attributed to the location of the office of the customer from which the services were ordered in the regular course of the customer's trade or business. If the ordering office cannot be determined, the services are attributed to the office of the customer to which the services are billed.

(iii) If under the method described above a sale is attributed to a location where the taxpayer does not have nexus under Washington standards, the sale must be excluded from both the numerator and denominator of the sales ratio. For the purposes of this calculation only, the department will presume a taxpayer has nexus anywhere the taxpayer has employees or real property, or where the taxpayer reports business and occupation, franchise, value added, income or other business activity taxes in the state. The burden is on the taxpayer to demonstrate nexus exists in other states.

(i) **Alternative methods.**

(i) A taxpayer may report with, or the department may require, the use of one of the alternative methods of cost apportionment described below:

(A) The exclusion of one or more categories of costs from consideration;

(B) The specific allocation of one or more categories of costs which will fairly represent the taxpayer's business activity in Washington; or

(C) The employment of another method of cost apportionment that will effectuate an equitable apportionment of the taxpayer's gross income.

(ii) A taxpayer reporting under (i) of this subsection must notify the department at the time of filing that it is using an alternative method and provide a brief description of the method employed. If a taxpayer reports using an alternate method, the same method must be used for all subsequent tax reporting periods unless it is demonstrated another method is necessary under the standard in (i)(v) of this subsection.

(iii) If on review of a taxpayer's return(s) the department determines another method is necessary to fairly represent the extent of a taxpayer's business activity in Washington, the department may impose the method for all returns within the statute of limitations. Statutory interest applies to both balances due and refund or credit claims arising under this section. Further, applicable penalties will be imposed on balances due arising under this section. However, if the taxpayer reported using the cost apportionment method in (a) through (h) of this subsection and separate accounting is unavailable, the department may impose the alternate method for future periods only.

(iv) A taxpayer may request that the department approve an alternative method of cost apportionment by submitting a request for prior ruling pursuant to WAC 458-20-100. Such letter ruling may be subject to audit verification before issuance.

(v) The taxpayer or the department, in requesting or imposing an alternate method, must demonstrate by clear and convincing evidence that the cost apportionment method in (a) through (h) of this subsection does not fairly represent the extent of the taxpayer's business activity in Washington.

(5) **Effective date.** This amended rule shall be effective for tax reporting periods beginning on January 1, 2006, and thereafter.

[Statutory Authority: RCW 82.32.300 and 82.01.060(2). 05-24-054, § 458-20-194, filed 12/1/05, effective 1/1/06. Statutory Authority: RCW 82.32.300. 83-08-026 (Order ET 83-1), § 458-20-194, filed 3/30/83; Order ET 70-3, § 458-20-194 (Rule 194), filed 5/29/70, effective 7/1/70.]

**WAC 458-20-196 Bad debts.** (1) **Introduction.**

(a) **New laws effective July 1, 2004.** This rule provides information about the tax treatment of bad debts under the business and occupation (B&O), public utility, retail sales, and use taxes, and reflects legislation enacted in 2003 and 2004 conforming Washington law to provisions of the national Streamlined Sales and Use Tax Agreement. See chapter 168, Laws of 2003 and chapter 153, Laws of 2004. The new laws related to bad debts are effective July 1, 2004.

(b) **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 rule. 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.

(c) **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, is the same as the amount reported as a deduction or recovery under the retailing B&O tax classification.

(d) **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, 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.

(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 credit, 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) **Assigned debt and installment sales.**

(a) **General rule.** If a person makes a retail sale under an installment sales contract and then legally assigns his or her rights under the contract to another party, the assignee "steps into the shoes" of the person making the sale and may claim a bad debt credit or refund for unpaid retail sales tax to the extent a credit or refund would have been available to the original seller and to the extent that the assignee actually incurs a loss. The seller's B&O tax deduction for bad debt may not be claimed by an assignee. A retail sales tax bad debt credit or refund for unpaid sales tax is available only to the person who makes the retail sale or an assignee under the contract. For example, a bank that loans money to the purchaser of a vehicle may not claim a retail sales tax bad debt credit or refund. The bank did not sell the vehicle and is not an assignee of the dealer who made the retail sale.

(b) **Discounts.** A person who makes a retail sale on credit and then assigns the sales contract in exchange for less than the face value of the contract may not claim a bad debt credit, refund, or deduction for the difference between the face value and the amount received. The discount is a nondeductible cost of doing business, not a bad debt. An assignee of a retail sales contract that pays less than face value for the contract is not required to reduce the amount of a retail sales tax bad debt credit or refund in proportion to the amount of the discount. The assignee may take a credit or refund for the amount that would have been available to the original seller if the original seller had retained the contract and received the payments made by the buyer.

(c) **Recourse financing.** An assignee who receives payment on a bad debt from the assignor must reduce the sales tax credit in proportion to the payment. The assignor may claim a sales tax credit and retailing B&O tax deduction in proportion to the payment if obligated to make the payment and otherwise qualified under this rule.

(d) **Documentation.** All persons claiming a bad debt credit for installment contracts must retain appropriate documentation, including documentation establishing:

(i) The amount of the original sale by the seller, and component amounts necessary to determine that amount, such as credits for trade-ins, down payments, and individual amounts charged for different products;

(ii) The buyer's equity in any trade-in property;

(iii) The contract principal owed at the time of repossession, if any; and

(iv) The deductibility of the debt as worthless for federal income tax purposes.

(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) Seller 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 Seller at the time of sale. One and a half years later, no payment has been received by Seller, and the balance with interest is $627. Seller is entitled to claim a bad debt deduction on the federal income tax return. Seller is 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.

(b) The facts are the same as in (a) of this subsection, except that 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, Seller 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 is reduced to zero.

(c) Seller 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 Seller 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. Six months later the balance with interest and service fees is $413. Seller is entitled to claim a bad debt deduction on the federal income tax return. Seller is 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.

(d) The facts are the same as in (c) of this subsection, except that before Seller charges off the debt, Seller 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, Seller 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 Seller 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. Seller 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. If Seller later sells the repossessed goods, Seller 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, Seller 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.

(e) Seller sells a car at retail for $1000 and charges the buyer an additional $50 for license and registration fees. Seller accepts trade-in property with a value of $500 in which the buyer 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.) Seller properly bills the buyer for $40 of sales tax, for a total of $1090 owed to Seller by the buyer. Seller

pays the department the $40 in sales tax. No payment other than the trade-in is received by Seller at the time of sale. Eight months later, Seller has not received any payment. Seller 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. Seller 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.

(f) Seller sells a car at retail for $1000, and charges the buyer an additional $50 for license and registration fees. Seller properly bills the buyer for $80 of sales tax and remits it to the department. No money is received from the buyer at the time of sale. Eight months later Seller is entitled to claim a bad debt deduction on the federal income tax return. Seller 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. Six months after that, Seller receives a $200 payment from the buyer. 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, Seller 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.

(g) Seller sells a car at retail for $1000, and charges the buyer an additional $50 for license and registration fees. Seller accepts trade-in property with a value of $500 in which the buyer has $300 of equity. Seller properly bills the buyer for $40 of sales tax for a total of $1090 owed to Seller by the buyer. No payment other than the trade-in is received by Seller at the time of sale. Eight months later, no payment has been received by Seller. Seller 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. Seller 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. Six months after that, Seller receives a $200 payment from the buyer. 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, Seller 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.

(h) The facts are the same as in (e) of this subsection, except that immediately after the sale, Seller assigns the contract to a finance company without recourse, receiving face value for the contract. The finance company may claim the retail sales tax credit or refund of $29. The finance company may not claim any deductions for Seller's B&O tax liability. No bad debt deduction or credit is available to Seller.

(i) The facts are the same as in (h) of this subsection, except that the Seller receives less than face value for the contract. The result is the same as in (h) of this subsection for both parties. The finance company may claim a $29 retail sales tax bad debt credit or refund, but may not claim a B&O bad debt deduction for Seller's B&O tax liability. No bad debt deduction or credit is available to Seller.

[Statutory Authority: RCW 82.32.300 and 82.01.060(2). 06-01-005, § 458-20-196, filed 12/8/05, effective 1/8/06. Statutory Authority: RCW 82.32.300, 82.01.060(1), and 34.05.230. 05-04-048, § 458-20-196, filed 1/27/05, effective 2/27/05. Statutory Authority: RCW 82.32.300. 83-07-032 (Order ET 83-15), § 458-20-196, filed 3/15/83; Order ET 70-3, § 458-20-196 (Rule 196), filed 5/29/70, effective 7/1/70.]

**WAC 458-20-198 Installment sales, method of reporting.** (1) **Introduction.** This rule explains the tax-reporting responsibilities of persons making installment sales of tangible personal property under the business and occupation (B&O), retail sales, and use taxes.

(2) **How is income from installment sales of tangible personal property reported?** The seller must report the full selling price of installment sales of tangible personal property in the tax-reporting period during which the sale is made. This is true even when the buyer pays the tax to the seller in installments over time.

(a) **Leases not taxable as installment sales.** A lease under WAC 458-20-211 (Leases or rentals of tangible personal property, bailments) is not taxable as an installment sale.

(b) **Interest income.** Persons who receive interest or finance charges from an installment sale must pay B&O tax under the service and other business activities classification on receipt of these amounts. Retail sales and use taxes do not generally apply to these amounts. Refer to WAC 458-20-109 (Finance charges, carrying charges, interest, penalties) for further information.

(c) **Assignment of rights to receive payments.** A seller may sell or assign the right to receive payments on an installment sale to another business. The assignee should not report any sales or use taxes on such payments because the seller is responsible for remitting the full amount of sales tax. For information on how to report a buyer's default on an installment obligation, refer to WAC 458-20-196 (Bad debts).

[Statutory Authority: RCW 82.32.300, 82.01.060(1), and 34.05.230. 05-04-048, § 458-20-198, filed 1/27/05, effective 2/27/05. Statutory Authority: RCW 82.32.300. 83-07-032 (Order ET 83-15), § 458-20-198, filed 3/15/83; Order ET 70-3, § 458-20-198 (Rule 198), filed 5/29/70, effective 7/1/70.]

**WAC 458-20-216 Successors, quitting business.** (1) **Introduction.** RCW 82.32.140 requires a taxpayer to remit any outstanding tax liability to the department of revenue (department) within ten days of quitting business. If this tax is not paid by the taxpayer, any successor to the taxpayer becomes liable for the outstanding tax. This rule explains under what circumstances a person is considered a successor to a person quitting business. It explains the successor's responsibility for payment of an outstanding tax liability owed by the taxpayer quitting business, whether that liability is known at the time of purchase or not. This rule also pro-

**CERTIFICATE OF SERVICE**

THIS IS TO CERTIFY that on the 4th day of October, 2018, I caused to be served a true and correct copy of the foregoing via Legal Messenger and addressed to the following:

Robert W. Ferguson
Rosann Fitzpatrick
Attorney General of Washington
Revenue & Finance Division
7141 Cleanwater Drive SW
Olympia, WA 98504-0123

Eva M. Lee
Legal Assistant

## ISSAQUAH LAW GROUP, PLLC

## October 04, 2018 - 3:56 PM

## Filing Petition for Review

## Transmittal Information

| | |
|---|---|
| **Filed with Court:** | Supreme Court |
| **Appellate Court Case Number:** | Case Initiation |
| **Appellate Court Case Title:** | Lowe's Home Centers, LLC, Appellant v. Dept. of Revenue, State of WA, Respondent (500809) |

**The following documents have been uploaded:**

- PRV_Petition_for_Review_20181004155243SC012215_7254.pdf
  This File Contains:
  Petition for Review
  *The Original File Name was Petition for Review.pdf*

**A copy of the uploaded files will be sent to:**

- eksmith@jonesday.com
- eva@issaquahlaw.com
- jmallan@jonesday.com
- revolyef@atg.wa.gov
- rosannf@atg.wa.gov
- troy@issaquahlaw.com

**Comments:**

---

Sender Name: Eva Lee - Email: Eva@issaquahlaw.com
**Filing on Behalf of:** Justin Patrick Walsh - Email: justin@issaquahlaw.com (Alternate Email: Kathleen@Issaquahlaw.com)

Address:
410 Newport Way Northwest, Suite C
Issaquah, WA, 98027
Phone: (425) 313-1184 EXT 425

**Note: The Filing Id is 20181004155243SC012215**