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STATE OF WASHINGTON  
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NO. 96383-5

SUPREME COURT  
OF THE STATE OF WASHINGTON

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LOWE'S HOME CENTERS, LLC,

Petitioner,

v.

DEPARTMENT OF REVENUE,  
STATE OF WASHINGTON,

Respondent.

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MEMORANDUM OF AMICUS CURIAE COUNCIL ON STATE  
TAXATION IN SUPPORT OF PETITION FOR REVIEW

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## **I. STATEMENT OF INTEREST OF AMICUS CURIAE**

The Council On State Taxation (“COST”) is a nonprofit trade association based in Washington, D.C. Its membership consists of approximately 550 of the largest multistate corporations engaged in interstate and international business and represents industries doing business in every state across the country. Its objective is to preserve and promote the equitable, non-discriminatory state and local taxation of multijurisdictional business entities.

COST is interested in this case because of its potential impact on sellers’ ability to fairly obtain credit for sales taxes remitted to the State that ultimately were not paid by a purchaser and for which the seller remains responsible. Since Washington is also a full member of the Streamlined Sales and Use Tax Agreement (“SSUTA”), this case could create a precedent for how the other 22 full-member states will provide bad-debt relief in cases with similar facts. COST’s members, many of whom conduct a substantial amount of business in Washington, seek this Court’s review—especially considering the well-reasoned dissent below.

As amicus, COST has participated in numerous significant federal and state tax cases over the past 40 years, including many filings in Washington. In this memorandum, COST highlights the importance of the

State's bad-debt provision and why this Court should review the Court of Appeals' decision to reject a bad-debt deduction—even though the seller was entitled to claim it under the federal Internal Revenue Code. *See* 26 U.S.C. Sec. 166 (“IRC § 166”).

## **II. STATEMENT OF ISSUE PRESENTED FOR REVIEW**

COST supports the Statement of Issue as framed by Petitioner Lowe's Home Centers, LLC (“Lowe's”).

## **III. STATEMENT OF THE CASE**

COST generally adopts the Statement of the Case in the Petition.

COST asserts the plain reading of Washington's bad-debt law under RCW 82.08.037 in effect for the tax periods at issue clearly allows a seller to claim a bad debt for sales tax. A complimentary provision, RCW 82.04.4284, similarly allows a bad-debt deduction for the State's B&O tax. Specifically, in part, RCW 82.08.037(1) provides:

A seller is entitled to a credit or refund for sales taxes previously paid on bad debts, as that term is used in [IRC § 166], as amended or renumbered as of January 1, 2003.

Lowe's was the “seller” that “previously paid” the sales tax on which it realized a bad debt pursuant to IRC § 166.

Importantly, this provision also conforms with Section 320 of the SSUTA<sup>1</sup> which, in part, provides:

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<sup>1</sup> *See* Streamlined Sales and Use Tax Agreement (as amended May 3, 2018), available at <http://www.streamlinedsalestax.org/index.php?page=modules>.

Each member state shall use the following to provide a deduction for bad debts to a seller. To the extent a member state provides a bad debt deduction to any other party, the same procedures will apply. Each member state shall:

A. Allow a deduction for taxable sales for bad debts. Any deduction taken that is attributed to bad debts shall not include interest.

B. Utilize the federal definition of “bad debt” in [IRC § 166] as the basis for calculating bad debt recovery. However, the amount calculated pursuant to [IRC § 166] shall be adjusted to exclude: financing charges or interest; sales or use taxes charged on the purchase price; uncollectable amounts on property that remain in the possession of the seller until the full purchase price is paid; expenses incurred in attempting to collect any debt, and repossessed property.

C. Allow bad debts to be deducted on the return for the period during which the bad debt is written off as uncollectable in the claimant’s books and records and is eligible to be deducted for federal income tax purposes.

Nothing in this section of the SSUTA implies or requires the debt for each specific debtor be on the actual books and records of the seller. Rather, consistent with RCW 82.08.037, it merely requires that the claimant has written off the debt on its books and records to be eligible for a bad-debt deduction. Lowe’s has, as a guarantor of the debt, complied with the statute and is eligible to claim a bad-debt deduction for federal income tax purposes. Providing such a deduction for bad debts realized by sellers also comports with good sales tax policy.

#### IV. ARGUMENT

Review of the decision below is important because the Court of Appeals’ decision misconstrues its holdings in *Home Depot USA, Inc. v. State Dep’t of Revenue*, 151 Wn. App. 909, 215 P.3d 222 (2009) (“*Home*

*Depot*”), and threatens inconsistent application of the B&O tax deduction among different classifications of business. Additionally, the Court of Appeals’ decision is contrary to the SSUTA, of which Washington is an important full-member state dedicated to pursuing simplification and enhanced uniformity of the states’ sales and use tax laws. Finally, reviewing the case will allow this Court to consider the sound sales tax policy reasons for providing a bad-debt credit that fully recognizes purchaser defaults on payments for taxable products and services.

**A. The Court of Appeals’ Rationale for its Decision is Contrary to the Plain Meaning of the Statute.**

COST agrees with the Dissent in the Court of Appeals that the majority’s holding conflicts with the plain meaning of the law. That court’s decision gives improper weight to the dicta used in the *Home Depot* case—a case with critical facts that are very different from those at issue in *Lowe’s*. The Court of Appeals also appears to misunderstand the key facts in the relationships of Lowe’s with GE Capital Financial Inc. and Monogram Credit Bank of Georgia (collectively “the Banks”), as discussed below.

As stated above, Washington’s sales tax laws governing bad debts under RCW 82.08.037 provide relief to sellers that remit sales tax on a transaction that ultimately fails to be fully paid.

Further, RCW 82.04.4284(1), as in effect for the periods at issue in this case, also provides a B&O tax deduction “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.” This deduction applies not just to retailers but to all classifications of business subject to B&O tax, and the Court of Appeals’ insertion of extra-statutory requirements for the sales tax credit threatens to undermine uniformity in application of the B&O tax deduction across classifications.

Under the plain, unambiguous meaning of these statutes, Lowe’s should be entitled to retail sales tax credits and B&O tax deductions based on payments made as the guarantor of debt obligations arising from Lowe’s credit card accounts. There is no question that Lowe’s promptly remitted to the Department of Revenue all Washington sales and B&O taxes on the private label credit card transactions. And there is no question that Lowe’s properly deducted “bad debts” under IRC § 166.

The lower court, relying on the *Home Depot* dicta, asserts the bad debts for which Lowe’s was responsible were not debts on “sales tax previously paid” because Lowe’s initially received payment on the gross proceeds for retail sale private label credit card (PLCC) transactions. In doing so, the lower court arbitrarily bifurcated the initial payment from what it refers to as “profit-sharing bad debts.” *Lowe's Home Ctrs., LLC v. Dep't of Revenue*, 5 Wn. App. 2d 211, 225, 425 P.3d 959, 966 (2018).

It is important to point out, however, that the key facts in this case are different from the facts in *Home Depot*. As summarized by the Dissent in the Court of Appeals decision:

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.

*Id.*, 5 Wn. App. at 243-44, 425 P.3d at 975 (Maxa, C.J., dissenting)

Importantly, Home Depot did not guarantee the debt on Home Depot credit cards. Since the *Home Depot* facts did not involve a guarantee of debt, the *Home Depot* court limited its analysis to the fact Home Depot was paid in full on Home Depot credit card transactions. No continuing debt existed for the *Home Depot* court to consider in determining whether debt on sales taxes previously paid existed.<sup>2</sup>

In the current case, however, Lowe's continued, at all relevant times, to remain responsible for bad-debt losses for transactions on which sales tax was previously remitted by Lowe's. These debts were not from an unrelated profit-sharing agreement between Lowe's and the Banks. Instead, the debts were related to transactions between Lowe's and its customers that included the remittance of both sales taxes and B&O taxes. Thus, according to the plain meaning of the statute, the taxes "previously paid" on Lowe's bad debt entitles Lowe's to credits for those paid taxes.

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<sup>2</sup> While amicus fully supports a bad-debt deduction in the *Home Depot* fact pattern as a matter of sound tax policy, it is understood that an expansion of the State's bad-debt credit under the *Home Depot* case circumstances will likely require legislative action by the Legislature.

**B. Granting the Petition Will Allow This Court to Interpret Washington's Sales and Use Tax Bad Debt Provision Consistently with SSUTA's Bad Debt Provision**

Washington has been a full member of the SSUTA since July 1, 2008.<sup>3</sup> As written, Washington's bad-debt law, RCW 82.08.037, is in compliance with Section 320 of the SSUTA. However, the Court of Appeals' decision casts doubt on Washington's compliance with the SSUTA by stating a contractual arrangement with a third-party always prevents a seller from obtaining a bad-debt credit.

The SSUTA bad-debt provision has two key provisions for a seller to claim a sales and use tax deduction: 1) the deduction meets the criteria of a bad debt pursuant to IRC § 166, with some exclusions that are not relevant to this case (*see* SSUTA § 320(A) & (B)); and 2) the deduction must be written off as uncollectable in the claimant's books and records (SSUTA § 320(C)). *Id.*

In addition to conforming to the bad debt requirements in Washington's law, Lowe's has met the SSUTA § 320 requirements to claim a bad-debt deduction. It is not disputed that: 1) the deductions can be claimed by Lowe's as an IRC § 166 deduction for a bad debt; and 2) as a contractual guarantor of the bad debt it is liable for that debt up to an agreed-upon cap, which was written off as uncollectable in its books and records.

Granting review in this case will afford this Court the opportunity to interpret Washington's bad-debt provision consistently with the SSUTA

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<sup>3</sup> See <https://www.streamlinedsalestax.org/index.php?page=washington>.

bad-debt provision and avoid causing a disruption in the multistate uniformity that Washington’s legislature has supported. Indeed RCW 82.08.037(6) requires allocation of bad debts among member states, and the decision below would disrupt that uniform allocation by establishing an outlier criterion for eligibility.<sup>4</sup> Uniformity is even more important now following the U.S. Supreme Court’s decision in *South Dakota v. Wayfair, Inc.*, 138 S. Ct. 2080 (2018), which removed a physical presence requirement before states could require out-of-state sellers to collect and remit sales and use taxes. The Supreme Court noted with approval that “more than 20 States [] have adopted the Streamlined Sales and Use Tax Agreement. This system standardizes taxes to reduce administrative and compliance costs . . . .” *Id.* at 2100.

While Washington, per the express terms of the SSUTA, remains sovereign to impose and interpret its sales and use tax laws (and B&O tax laws), the State could be subject to sanctions if it is determined that that Washington is not in substantial compliance with the SSUTA’s bad-debt provision. Initial sanctions are usually set to encourage the State’s

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<sup>4</sup> Oklahoma is another full-member SSUTA state. While the underlying calculation of a bad-debt credit is still disputed in Oklahoma, *see Sales and Use Tax Protest of Lowe’s Home Centers, Inc.*, No. P-09-195-H (Okla. Tax Comm’n May 18, 2018), *appeal docketed*, No. 117119 (Okla. Sup. Ct. June 18, 2018), an administrative law judge in Oklahoma affirmatively rejected the argument that Lowe’s was not entitled to a bad-debt credit, noting that “[i]f the Legislature had intended to limit the Bad Debt Deduction to *only* vendors who finance their customer’s credit purchasers (without third parties, such as the Banks) . . . , it would not have based eligibility for the Bad Debt Deduction on IRC § 166.” *See id.*, Findings, Conclusions and Recommendations at 30 (Aug. 21, 2013), *adopted*, Order No. 2013-10-17-03 (Okla. Tax Comm’n Oct. 17, 2013) (copy attached as Appendix A).

legislature to put Washington back into compliance with the SSUTA's terms, and they can progressively lead to a state being expelled as a member state to the SSUTA.<sup>5</sup> This possibility highlights the importance of this Court's agreeing to accept the petition to review this case.

**C. Allowing Sellers to Claim Bad-Debt Deductions is Sound Sales Tax Policy.**

In January 2015, COST's non-profit research affiliate, the State Tax Research Institute ("STRI"), published a report on the sales tax policy considerations for allowing bad debt deductions relating to private label credit card defaults.<sup>6</sup> As noted in the report, "Best practice structures sales taxes in all states so that the tax base approximates *paid* consumption, though states differ legally whether the sales tax is levied on consumer expenditures or business receipts." *Id.* at p. 2 (emphasis in original). The report discusses four sound tax policy rationales for the application of refunding sales taxes remitted by sellers on behalf of customers when a purchase-financing arrangement results in a bad debt.

First, sales tax should be based on paid consumption, and a default on a taxable payment includes a sales tax component. Second, seller-issued credit cards should not be afforded preferential treatment over other third-party credit cards; both should be treated neutrally by the law and

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<sup>5</sup> See SSUTA §§ 320 (bad debt provision), 803 (state annual recertification of compliance with the SSUTA), 805 (substantial compliance requirement), 805.1 (compliance review process), 809 (sanctions of member states), 1101 (cooperating sovereigns), 1002 (state law controls), and 1003 (limited binding and beneficial effect).

<sup>6</sup> William F. Fox, State Tax Research Institute, *Sales Tax Policy Considerations for Private Label Credit Card Defaults* (2015), available at <https://cost.org/globalassets/cost/state-tax-resources-pdf-pages/cost-studies-articles-reports/sales-tax-policy-considerations-for-private-label-credit-card-defaults.pdf>.

permitted the deduction. Third, the state should not reap the benefit of a tax when a purchaser fails to repay the credit it was afforded by a seller. Fourth, allowing such refunds creates a more level playing field, and does not arbitrarily provide certain sellers advantages based on the type of purchaser financing they choose to use. *Id.*

This case is ripe for review to determine if the State's bad-debt credit should be further limited by denying Lowe's claim for extra-statutory reasons inconsistent with sound tax policy.

#### V. CONCLUSION

In this case, unlike the *Home Depot* fact pattern, Lowe's, as the guarantor, booked the bad debt, which it was then allowed to claim under IRC § 166. This method of booking debt complies with RCW 82.08.037 for sales and use tax purposes and RCW 82.04.4284 for B&O tax purposes—highlighting this Court's need to review the Court of Appeals' unsound decision.

For the foregoing reasons, COST respectfully requests that the Court grant the Petition for Review.

RESPECTFULLY SUBMITTED this 3<sup>rd</sup> day of December, 2018.

Davis Wright Tremaine LLP  
Attorneys for Amicus Curiae  
Council On State Taxation

By   
Dirk Giseburt, WSBA No. 13949

BEFORE THE OKLAHOMA TAX COMMISSION  
STATE OF OKLAHOMA

IN THE MATTER OF THE SALES TAX )  
AND USE TAX PROTEST OF LOWE'S )  
HOME CENTER, INC. )

CASE NO. P 09 195 H


ORDER NO. 2013 10 17 03

The above matter comes on for entry of a final order of disposition by the Oklahoma Tax Commission. Having reviewed the files and records herein, the Commission hereby adopts the Findings of Fact, Conclusions of Law and Recommendation made and entered by the Administrative Law Judge on the 19th day of August, 2013, appended hereto, together herewith shall constitute the Order of the Commission.

SO ORDERED OCT 17 2013

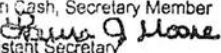
  
ASSISTANT SECRETARY

OKLAHOMA TAX COMMISSION

  
THOMAS E. KEMP, JR., CHAIRMAN

  
JERRY JOHNSON, VICE-CHAIRMAN

  
DAWN CASH, SECRETARY-MEMBER

I do hereby certify that the above and foregoing is a true copy of the original document now on file in my office. Witness my hand and official seal of The Oklahoma Tax Commission, this OCT 17 2013  
Dawn Cash, Secretary Member  
By   
Assistant Secretary  
Oklahoma Tax Commission

BEFORE THE ADMINISTRATIVE LAW JUDGE

OKLAHOMA TAX COMMISSION

STATE OF OKLAHOMA

FILED  
OKLAHOMA TAX COMMISSION  
AUG 21 2013  
OFFICE OF ADMINISTRATIVE  
LAW JUDGES

IN THE MATTER OF THE SALES AND )  
USE TAX PROTEST OF LOWE'S ) CASE NO. P-09-195-H  
HOME CENTERS, INC. )

ERRATA SHEET

NOW on this 21<sup>st</sup> day of August, 2013, the above-styled and numbered cause comes on for consideration of errors appearing in the *Findings, Conclusions and Recommendations* issued on August 19, 2013. The ALJ finds the following errors, which appear as strike-through, and corrections appear underlined:

Page 4, Paragraph 2 should read as follows:

On February 11, 2013, Mr. Smith filed a Notice of Leave of Absence, pursuant to Georgia Uniform Court Rule 16.<sup>1</sup> Mr. Smith advised the ~~leave~~ leave of absence was from March 2-9, 2013. On February 14, 2013, at 10:00 a.m. the ALJ held a teleconference with Counsel to clarify issues, stipulations, and exhibits. On February 15, 2013, the ALJ issued an Order (Issue No. 1), which states as follows, to-wit:

Page 28, Paragraph 1 should read as follows:

*Home Depot* provides a good starting point in analyzing this matter, by comparing and contrasting the two (2) cases.

<sup>1</sup> The ALJ is omitting all of the corresponding footnotes herein.

Protestant's BDD

HOME DEPOT CASE

Division disallowed BDD reported on STS Reports filed during Assessment Period	Claim For Refund (Home Depot did not report BDD on STS Reports)
Protestant wrote off PLCC Bad Debts in its books and records during Assessment Period	Bank wrote off PLCC Bad Debts in its Books and records during Refund Period
Protestant reported BDD on Line 15 of Federal Returns for the Assessment Period	Home Depot reported Credit Card Discount on Line 26, Other Deductions, of Federal Returns (Bank reported BDD on Line 15 of Federal Returns)
Protestant's BDD eligibility pursuant to IRC § 166 via Treas. Reg. § 1.166-9(d) (Guarantor)	Home Depot's eligibility to BDD pursuant to IRC § 166 fell under Treas. Reg. § 1.166-1(c) (Bona fide debt required/Debtor-Creditor relationship)

OKLAHOMA TAX COMMISSION

  
\_\_\_\_\_  
JAY L. HARRINGTON  
ADMINISTRATIVE LAW JUDGE



CERTIFICATE OF SERVICE OR MAILING

This is to certify that on this 21st day of August, 2013, true and correct copies of the above and foregoing *Errata Sheet* of the Administrative Law Judge were delivered to Marjorie L. Welch, First Deputy General Counsel, and Judy Burdg, Assistant General Counsel, Oklahoma Tax Commission, and mailed with proper postage prepaid to:

E. Kendrick Smith  
John M. Allan  
JONES DAY  
1420 Peachtree Street, N.W., Suite 800  
Atlanta, GA 30309-3053

David Kutik  
JONES DAY  
901 Lakeside Avenue  
Cleveland, OH 44114

VIA Hand

JLH:rah

P-09-195-H/rah  
Errata Sheet to FCR

BEFORE THE ADMINISTRATIVE LAW JUDGE

OKLAHOMA TAX COMMISSION

STATE OF OKLAHOMA

FILED  
OKLAHOMA TAX COMMISSION  
AUG 19 2013  
OFFICE OF ADMINISTRATIVE  
LAW JUDGES

IN THE MATTER OF THE SALES TAX )  
AND USE TAX PROTEST OF LOWE'S )  
HOME CENTERS, INC. )

CASE NO. P-09-195-H

FINDINGS, CONCLUSIONS AND RECOMMENDATIONS

(ISSUE NO. ONE)

NOW on this 19<sup>th</sup> day of August, 2013, the above-styled and numbered cause comes on for consideration pursuant to assignment regularly made by the Oklahoma Tax Commission to Jay L. Harrington, Administrative Law Judge. Lowe's Home Centers, Inc. ("Protestant") appears through attorneys, John M. Allan, E. Kendrick Smith, and David Kutik, JONES DAY. The Compliance Division ("Division") of the Oklahoma Tax Commission appears through Marjorie L. Welch, First Deputy General Counsel, and July Burdg, Assistant General Counsel,<sup>1</sup> Office of General Counsel, Oklahoma Tax Commission.

PROCEDURAL HISTORY

On November 20, 2009, the protest file was received by the Office of Administrative Law Judges for further proceedings consistent with the *Uniform Tax Procedure Code*<sup>2</sup> and the *Rules of Practice and Procedure Before the Office of Administrative Law Judges*.<sup>3</sup> On

<sup>1</sup> On August 6, 2013, Ms. Burdg filed an Entry of Appearance of Additional Counsel for the Division.

<sup>2</sup> OKLA. STAT. ANN. tit. 68, § 201 *et seq.* (West 2001).

<sup>3</sup> OKLA. ADMIN. CODE §§ 710:1-5-20 through 710:1-5-47.

2013 10 17 03

P-09-195-H

November 23, 2009, the Court Clerk<sup>4</sup> ("Clerk") mailed a letter to Protestant's Counsel that this matter had been assigned to Jay L. Harrington, Administrative Law Judge ("ALJ"), and docketed as Case Number P-09-195-H. The letter also advised Counsel that a Notice of Prehearing Conference would be sent by mail and enclosed a copy of the *Rules of Practice and Procedure Before the Office of Administrative Law Judges*.<sup>5</sup> On November 23, 2009, the ALJ advised Protestant's Counsel of the Tort Reform Act ("Act") requiring out-of-state attorneys to register and comply with the Act.

On December 2, 2009, Ms. Welch filed an Entry of Appearance as Counsel for the Division. On December 8, 2009, the Clerk mailed the Notice of Prehearing Conference to Counsel, setting the prehearing conference for January 11, 2010, at 2:30 p.m. On December 21, 2009, Protestant filed a Motion to Associate Counsel (Mr. Allan), with Exhibits A through C, attached thereto. On December 22, 2009, the ALJ issued an Order Admitting to Practice.

On January 6, 2010, the Division, on behalf of the parties, filed a Request for Scheduling Order in Lieu of Scheduled Prehearing Conference, along with a proposed scheduling order. On January 8, 2010, the Protestant filed a Motion to Associate Counsel (Mr. Smith), with Exhibits A through C, attached thereto. On January 11, 2010, the ALJ issued an Order Admitting to Practice. On January 11, 2010, the ALJ issued a Scheduling Order and Notice of Alternative Hearing Date.

On February 12, 2010, the Division filed its Preliminary Witness and Exhibit List.

On March 22, 2010, the parties filed a Joint Request to Suspend Scheduling Order in order to address and resolve discovery issues and potential resolution of issues in this matter. On

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<sup>4</sup> OKLA. ADMIN. CODE § 710:1-5-10(c)(2) (June 25, 1999).

<sup>5</sup> *Id.* Unless otherwise noted, the ALJ notified the parties by letter.

March 23, 2010, the ALJ issued an Order Granting Joint Request to Suspend Scheduling Order, with a revised proposed schedule to submit on or before May 6, 2010.

The ALJ omits the Procedural History from April 28, 2010 to June 19, 2011. On June 20, 2011, Mr. Kutik filed an Entry of Appearance as Co-Counsel for the Protestant.<sup>6</sup>

The ALJ omits the Procedural History from August 12, 2011 to November 16, 2011. On November 17, 2011, the parties filed a Joint Status Report requesting the issues in this matter be bifurcated,<sup>7</sup> as more fully set forth therein.

On November 22, 2011, the ALJ issued an Order Bifurcating Proceedings as follows, to-wit:

Issue No. One (1)

Whether Protestant properly took sales tax deductions on its Oklahoma sales tax returns during the period of November 12, 2004 through October 31, 2007 for purchases made on private label credit cards ("PLCC") when the PLCC accounts were written off as worthless and deducted on LHC's federal corporate income tax returns, will be submitted on stipulations and briefs in accordance with the *Amended Scheduling Order* dated September 28, 2011.

Issue No. Two (2)

Whether and to what extent Protestant is acting as a "contractor" under Oklahoma law when it contracts to affix tangible personal property to real property owned by its customers, is hereby bifurcated from Issue No. 1. On or before February 17, 2012, a status report regarding Issue No. 2 is to be submitted to the undersigned.<sup>8</sup>

The ALJ omits the Procedural History from November 23, 2011 to October 2, 2012. On October 3, 2012, the ALJ issued the Last Amended Scheduling Order (Issue No. 1), as more

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<sup>6</sup> Mr. Kutik is admitted to practice in the State of Oklahoma. See Entry of Appearance filed herein.

<sup>7</sup> The parties filed the Joint Status Report pursuant to a Teleconference with the ALJ on November 15, 2011.

<sup>8</sup> On November 29, 2012, the ALJ issued an Amended Scheduling Order on Issue No. 2, as more fully set forth therein.

fully set therein. On October 15, 2012, the parties filed Stipulated Facts and Issue, limited to "Issue No. 1," with Exhibits A through V in a two (2)-volume set.

On November 21, 2012, the Protestant filed its Brief on Issue No. 1.<sup>9</sup> On December 21, 2012, the Division filed its [Response] Brief on Issue No. 1. On January 17, 2013, the Protestant filed its Reply Brief on Issue No. 1. The ALJ advised the parties the record closed and this matter submitted for decision on January 22, 2013.

On February 11, 2013, Mr. Smith filed a Notice of Leave of Absence, pursuant to Georgia Uniform Court Rule 16.<sup>10</sup> Mr. Smith advised the lease of absence was from March 2-9, 2013. On February 14, 2013, at 10:00 a.m. the ALJ held a teleconference with Counsel to clarify issues, stipulations, and exhibits. On February 15, 2013, the ALJ issued an Order (Issue No. 1), which states as follows, to-wit:

Pursuant to the *Teleconference* held on February 14, 2013, at 10:00 a.m., the undersigned hereby withdraws the above-styled and numbered cause from decision and the record is re-opened to allow the parties to supplement the record as discussed during the *Teleconference* outlined hereinafter, as follows, to-wit:

- To file an Errata Sheet as to Stipulation 5, correcting the date.
- Supplement Exhibit B to include copies of the corporate assessment and assessment against the President of Protestant.
- Provide copies of the deposition pages in Exhibit V copied sideways in the original filing.
- The parties are to file Supplemental Stipulations, with any additional exhibits on or before February 25, 2013, regarding any Internal Revenue Service audits of the Protestant's Federal Returns for the Assessment Period. Should the parties be unable to stipulate to any relevant facts by the date given, the parties are to advise the undersigned immediately and request additional time, or a teleconference if needed.

Upon the filing of Supplemental Stipulations and any additional exhibits, the undersigned will provide the parties will a briefing schedule to file briefs and response briefs related to the two (2) issues discussed during the Teleconference, which are summarized as follows, to-wit:

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<sup>9</sup> The parties submitted this matter on stipulations and briefs pursuant to Tax Commission Rule 710:1-5-38(a), not subsection (b). OKLA. ADMIN. CODE § 710:1-5-38(a) (June 25, 2009).

<sup>10</sup> See Note 14, *infra*.

- Why the Division is or is not bound by the Protestant's claiming the "bad debt deduction" on Line 15 of its Federal Returns for the Assessment Period?
- Expand briefing on the "judicial estoppel" argument raised in the Protestant's Reply Brief.

On February 25, 2013, by facsimile,<sup>11</sup> the parties filed a *Joint Motion to Amend Order February 15, 2013* ("Joint Motion") to revise the date for filing supplemental stipulations regarding Internal Revenue Service audits to March 1, 2013. On February 25, 2013, the ALJ issued the Order granting the *Joint Motion* as filed herein. On February 25, 2013, the parties filed the *Errata Sheet to Stipulated Facts for Issue No. 1* ("Errata Sheet") to the Stipulated Facts and Exhibits filed on October 15, 2012, as follows,<sup>12</sup> to-wit:

1. The date of December 9, 2009 in Stipulation 5 should be deleted and the date December 31, 2009 should be inserted in its place.
2. The initial Exhibit B should be deleted and replaced with the attached substitute Exhibit B.
3. The replacement pages for Exhibit V are enclosed as provided below:

REQUESTED DEPOSITION PAGES	ENCLOSED COPIES
McKay Depo. – Bates Numbers ALJ-OK-LHC 5876-5877	Enclosed
McKay Depo. – Bates Numbers ALJ-OK-LHC 5889-5902	Bates page ALJ-OK-LHC_5889 is enclosed. The remaining bates numbered pages are not enclosed because the deposition testimony addresses installed sales (Issue No. 2).
McKay Depo. – Bates Numbers ALJ-OK-LHC_5903-5904	Bates page ALJ-OK-LHC_5904 is enclosed. Bates page ALJ-OK-LHC_5903 is not enclosed because the deposition testimony addresses installed sales. Please note that the requested page ALJ-OK-LHC_5903 is actually ALJ-OK-LHC_5889, which is enclosed.
McKay Depo. – Bates Numbers ALJ-OK-LHC 5908-5930	Not Enclosed. The deposition testimony is not enclosed because it addresses installed sales (Issue No. 2).
McKay Depo. – Bates Numbers ALJ-OK-LHC 5931-5932	Enclosed. Please note that the requested page ALJ-OK-LHC_5931 is actually ALJ-OK-LHC_5908.
Tracie Taylor – Bates Number ALJ-OK-LHC 5952	Enclosed.
Tracie Taylor – Bates Number ALJ-OK-LHC 5964-5968	Not Enclosed. The deposition testimony is not enclosed because it addresses installed sales (Issue No. 2).
Tracie Taylor – Bates Numbers ALJ-OK-LHC 5969	Enclosed. Please note that only lines 23-25 of ALJ-OK-LHC_5969 are included because only this portion leads to the questioning on ALJ-OK-LHC_5970 regarding bad debts (Issue No. 1).
Tracie Taylor – Bates Numbers ALJ-OK-LHC 5970-6004	Bates pages ALJ-OK-LHC_5970-5971 are enclosed. The remaining pages are not enclosed because the deposition testimony addresses installed sales (Issue No. 2).
Tracie Taylor – ALJ-OK-LHC_Bates Numbers 6005	Enclosed.

<sup>11</sup> On March 1, 2013, the Clerk received the hard copy for filing.

<sup>12</sup> See *Errata Sheet* filed herein.

On February 28, 2013, the Division filed a Motion to Extend Date to File Supplemental Stipulations. The Protestant did not object to the Division's motion.

On March 1, 2013, the ALJ issued an Order (Issue No. 1) extending the date to file supplemental stipulations to March 20, 2013. On March 20, 2013, the Division filed its Second Motion to Extend Date to File Supplemental Stipulations. The Protestant did not object to the Division's motion. On March 21, 2013, the ALJ issued an Order (Issue No. 1) extending the date to file supplemental stipulations to April 1, 2013.

On April 1, 2013, the parties filed Stipulated Facts and Issue,<sup>13</sup> with Exhibits 1 through 18, in a three (3) ring binder. On April 9, 2013, at 2:00 p.m. the ALJ requested a Teleconference to discuss the stipulations and exhibits concerning the IRS Audits. Protestant's Counsel confirmed that the Audit Adjustments to Line 15 of LCI's Federal Consolidated Return did not affect the dollar amount of the Bad Debt Deduction at issue in this matter. On April 10, 2013, by letter, the ALJ confirmed the April 9<sup>th</sup> Teleconference, and in particular, that "...Protestant's representatives indicated that the Line 15 audit adjustments to the federal returns do not affect the bad debt deduction amount claimed by the Protestant in this matter." On April 16, 2013, the parties filed the Proposed Scheduling Order on Issue No. 1 (Bad Debts). On April 17, 2013, the ALJ issued the Scheduling Order on Issue No. 1 (Bad Debts), as follows, to-wit:

May 17, 2013	Opening Briefs due
June 17, 2013	Response Briefs due

Briefs and Response briefs to address the following issues:

- Why the Division is or is not bound by the Protestant's claiming the "bad debt deduction" on Line 15 of its Federal Returns for the Assessment Period?
- Expand briefing on the "judicial estoppel" argument raised in the Protestant's Reply Brief

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<sup>13</sup> See Procedural History herein, specifically the February 15, 2013 Order, which specifies the issues.

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On April 26, 2013, Mr. Smith filed a Notice of Leave of Absence, pursuant to Georgia Uniform Court Rule 16,<sup>14</sup> as follows, to-wit:

1. The period of leave during which time Applicant will be away from the practice of law is from: September 8-15, 2013.
2. All affected Judges and opposing counsel shall have ten (10) days from the date of this notice to object to it. If no objections are filed, the leave shall be granted.

On May 17, 2013, the Protestant filed its Supplemental Brief – Issue No. 1 (Bad Debts), with Exhibits 1 through 4, attached thereto. On May 17, 2013, the Division filed its Opening Brief – Issue 1.<sup>15</sup>

On June 17, 2013, the Protestant filed its Response Brief – Issue No. 1 (Bad Debts).<sup>16</sup> On June 17, 2013, the Division filed its Response Brief – Issue 1. By letter, the ALJ acknowledged the filing of the Response Briefs, closed the record, and submitted this case for decision on June 18, 2013.

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<sup>14</sup> See Georgia Uniform Superior Court Rule 16.1:

An attorney of record shall be entitled to a leave of absence for thirty days or less from court appearance in pending matters which are neither on a published calendar for court appearance, nor noticed for a hearing during the requested time, by submitting to the clerk of the court at least thirty (30) calendar days prior to the effective date for the proposed leave, a written notice containing:

- (a) a list of the actions to be protected, including the action numbers;
- (b) the reason for leave of absence; and
- (c) the duration of the requested leave of absence.

A copy of the notice shall be sent, contemporaneously, to the judge before whom an action is pending and all opposing counsel. Unless opposing counsel files a written objection within ten (10) days with the clerk of the court, with a copy to the court and all counsel of record, or the court responds denying the leave, such leave will stand granted without entry of an order. If objection is filed, the court, upon request of any counsel, will conduct a conference with all counsel to determine whether the court will, by order, grant the requested leave of absence.

The clerk of the court shall retain leave of absence notices in a chronological file two (2) calendar years; thereafter, the notices may be discarded

<sup>15</sup> The Division did not attach exhibits to its Opening Brief.

<sup>16</sup> The Protestant filed by facsimile and UPS.



## STIPULATED FACTS AND ISSUE

On October 15, 2012, the parties filed Stipulated Facts and Issue, with Exhibits A through V, in a two (2) volume set,<sup>17</sup> as follows, to-wit:

Pursuant to the current Scheduling Order, the parties hereby submit this joint Stipulated Facts and Issue, limited to "Issue No.1" (Taxpayer's protest of the assessment of state and local sales tax (and any corresponding interest and penalties) resulting from the Oklahoma Tax Commission's denial of sales tax deductions for bad debt losses taken by the Taxpayer on its Oklahoma sales tax returns):

### STIPULATED FACTS

#### Background

1. Lowe's Home Centers, Inc. ("LHC") is a corporation organized under North Carolina law with a principal place of business in Wilkesboro, North Carolina. LHC was at all times registered to conduct business in Oklahoma during the assessment period of November 1, 2004 through October 31, 2007 (the "Assessment Period") at issue in this protest.

2. LHC is a retailer of home improvement products and services, including lumber, electrical and plumbing supplies, and other items for improving and maintaining residences and businesses.

3. LHC operates retail store locations in Oklahoma, each employing dozens of individuals.

#### Procedural Facts

4. The Compliance Division, formerly the Audit Division, of the Oklahoma Tax Commission ("Division") conducted a sales and use tax audit of LHC for the Assessment Period.

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<sup>17</sup> The text of the stipulated facts is set out verbatim, unless otherwise noted.

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5. LHC executed Statute of Limitation Waiver Agreements on or about December 12, 2007 and July 24, 2008 extending the time to assess until December [31], 2009.<sup>18</sup> True and correct copies of the Statute of Limitation Waiver Agreements are attached hereto as Exhibit A.

6. Division, by letters dated May 7, 2009, proposed to assess LHC and, as officers and individuals, Larry D. Stone, President, and David R. Green, Vice President, sales tax, penalty and interest accrued through June 30, 2009 in the amount of \$6,899,999.63. True and correct copies of the proposed assessments are attached hereto as Exhibit B.

7. LHC requested, and was granted, an extension of time to respond to Division's letters of assessment until October 4, 2009. True and correct copies of LHC's request for extension and Division's letter granting LHC's extension request are attached hereto as Exhibit C.

8. LHC's timely protest to the assessments was dated October 1, 2009 and received by Division on October 2, 2009. A true and correct copy of LHC's protest is attached hereto as Exhibit D.

9. Based on documentation submitted by LHC subsequent to filing its protest, Division has revised its audit workpapers [sic]. With respect to "Issue No. 1," LHC and Division agree the amount of sales tax at issue, exclusive of penalty and interest, is \$804,332.84. A true and correct copy of the revised audit workpapers [sic] related to "Issue No. 1" is attached hereto as Exhibit E.<sup>19</sup> See also Exhibit V (Deposition Transcripts & Exhibits).

#### Bad Debt Deductions For Corporate Income Tax Purposes

10. A true and correct copy of the Oklahoma Corporation Income Tax Return and attachments filed by LHC for the taxable year beginning January 31, 2004 and ending January

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<sup>18</sup> [See Note 12, *supra*.]

<sup>19</sup> [Exhibit E is a "CD" of the Division's revised audit work papers, consisting of 1273 pages.]

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28, 2005 (the "2004 Tax Year") is attached hereto as Exhibit F. LHC timely filed its Oklahoma Corporation Income Tax Return for the 2004 Tax Year.

11. LHC deducted, for federal corporate income tax purposes, a total of \$247,888,025 as bad debt expenses for the 2004 Tax Year, including bad debt expenses related to private label credit cards ("PLCCs"). A true and correct copy of the 2004 United States Corporation Income Tax Return and Eliminations Schedule itemizing the deductions is attached hereto as Exhibit G. LHC timely filed its 2004 United States Corporation Income Tax Return.

12. A true and correct copy of the Oklahoma Corporation Income Tax Return and attachments filed by LHC for the taxable year beginning January 29, 2005 and ending February 3, 2006 (the "2005 Tax Year") is attached hereto as Exhibit H. LHC timely filed its Oklahoma Corporation Income Tax Return for the 2005 Tax Year.

13. LHC deducted, for federal corporate income tax purposes, a total of \$244,223,839 as bad debt expenses for the 2005 Tax Year, including bad debt expenses related to PLCCs. A true and correct copy of the 2005 United States Corporation Income Tax Return and Eliminations Schedule itemizing the deductions is attached hereto as Exhibit I. LHC timely filed its 2005 United States Corporation Income Tax Return.

14. A true and correct copy of the Oklahoma Corporation Income Tax Return and attachments filed by LHC for the taxable years beginning February 4, 2006 and ending February 2, 2007 (the "2006 Tax Year") is attached hereto as Exhibit J. LHC timely filed its Oklahoma Corporation Income Tax Return for the 2006 Tax Year.

15. LHC deducted, for federal corporate income tax purposes, a total of \$25,766,267.00 as bad debt expenses on line 15 of its United States Corporation Income Tax Return as originally filed for the 2006 Tax Year, which did not include bad debt expenses related to PLCCs. Bad debt expenses related to PLCCs were reported on line 26 of the original United States

Corporation Income Tax Return for the 2006 Tax Year. On its amended United States Corporation Income Tax Return filed for the 2006 Tax year, LHC deducted on line 15, for corporate income tax purposes, \$172,783,727 as bad debt expenses related to PLCCs. A true and correct copy of the amended 2006 United States Corporation Income Tax Return and Eliminations Schedule itemizing the deductions is attached hereto as Exhibit K. LHC timely filed its original 2006 United States Corporation Income Tax Return.

16. A true and correct copy of the Oklahoma Corporation Income Tax Return and attachments filed by LHC for the taxable year beginning February 3, 2007 and ending February 1, 2008 (the "2007 Tax Year") is attached hereto as Exhibit L. LHC timely filed its Oklahoma Corporation Income Tax Return for the 2007 Tax Year.

17. LHC deducted, for federal corporate income tax purposes, a total of \$209,438,637 as bad debt for the 2007 Tax Year, including bad debt expenses related to PLCCs. A true and correct copy of the 2007 United States Corporation Income Tax Return and Eliminations Schedule itemizing the deductions is attached hereto as Exhibit M. LHC timely filed its 2007 United States Corporation Income Tax Return.

18. LHC took the position that PLCC accounts written off as worthless during the Assessment Period were deductible pursuant to IRC § 166.

#### Bad Debt Deductions For Sales Tax Purposes

19. LHC deducted bad debts on its Oklahoma sales tax returns filed during the Assessment Period (the "Sales Tax Returns"), including bad debts related to PLCC accounts. LHC timely filed the Sales Tax Returns on which the bad debts were taken as deductions.

20. Division reviewed and allowed all bad debt deductions related to bad checks and third-party credit card chargebacks. Division has disallowed the bad debt deductions related to

PLCC accounts taken by LHC during the Assessment Period in the total principal sum of \$9,984,481.60 (the "Disallowed Claims"). See Exhibit N.

The Private Label Credit Card Agreements

21. LHC executed four separate private label credit card agreements (collectively, the "Agreements") that were effective during the Assessment Period. The Agreements provided that GE Capital Financial, Inc., Monogram Credit Bank of Georgia, and GE Money Bank (collectively, the "Banks") would extend credit to LHC's customers.

22. A true and correct copy of the "Lowe's Prox Program Agreement by and between Lowe's Companies, Inc., Lowe's Home Centers, Inc., Lowe's HIW, Inc., and GE Capital Financial, Inc." dated as of April 12, 2004 and amendments thereto (the "First Corporate Account Agreement") is attached hereto as Exhibit O. The First Corporate Account Agreement was in effect throughout the Assessment Period.

23. A true and correct copy of the "Second Amended and Restated Consumer Credit Cards Program Agreement," dated December 19, 2002, by and between Monogram Credit Card Bank of Georgia, Lowe's Companies, Inc., Lowe's Home Centers, Inc., The Contractor Yard and Lowe's HIW, Inc. and amendments thereto (the "Consumer Account Agreement") is attached hereto as Exhibit P. The Consumer Account Agreement was in effect throughout the Assessment Period.

24. A true and correct copy of the Amended and Restated Business Revolving Charge Program Agreement By and Between Lowe's Companies, Inc., Lowe's Home Centers, Inc., The Contractor Yard, Inc., Lowe's HIW, Inc. and GE Capital Financial, Inc. dated as of January 31, 2003 and amendments thereto (the "Second Corporate Account Agreement") is attached hereto as Exhibit Q. The Second Corporate Account Agreement was in effect throughout the Assessment Period.

25. A true and correct copy of the Project Card Program Agreement By and Between Lowe's Companies, Inc., Lowe's Home Centers, Inc., Lowe's HIW, Inc. and GE Money dated as of November 8, 2005 and amendments thereto (the "Project Card Agreement") is attached hereto as Exhibit R. The Project Card Agreement was in effect from November 8, 2005 through the remainder of the Assessment Period.

26. During the Assessment Period, a customer seeking to purchase goods from LHC could submit a PLCC application with the Banks at an LHC store location. The Banks reviewed the credit application and determined whether to establish a credit account. If the credit application was approved, LHC's customer (the "Cardholder") acquired a PLCC from the Banks. The Cardholder could then purchase goods from LHC stores using his PLCC.

27. Within a day or two of the PLCC transactions, the Banks remitted to LHC by electronic means payment for the credit card purchases made by Cardholders. LHC collected and remitted Oklahoma sales tax during the Assessment Period on the retail sale of its products to Cardholders who paid for the products using a PLCC.

28. PLCC Cardholder payments made to Banks were applied to the Cardholder's account balance in the following order: (1) debt cancellation insurance, (2) fees (such as late fees), (3) interest, and (4) principal.

29. Subsequent to the retail sale of products to PLCC customers and the payment and remittance of the sales tax thereon by LHC, certain PLCC customers defaulted on their PLCC accounts. The Banks determined that certain PLCC accounts constituted bad debts and the unpaid balances due on the accounts were uncollectible. Pursuant to contractual obligation, LHC remitted payment to the Banks for all of the PLCC accounts that were determined to constitute bad debts during the Assessment Period.

30. LHC wrote off in its books and records all of the bad debt related to PLCCs that were determined to be uncollectible by the Banks during the Assessment Period and for which LHC reimbursed the Banks pursuant to contractual obligation.

31. After LHC remitted payment to the Banks for PLCC accounts determined to be uncollectible during the Assessment Period, amounts subsequently recovered from Cardholders on PLCC accounts previously deemed worthless were credited to LHC.

32. After LHC remitted payment to the Banks for PLCC accounts determined to be uncollectible during the Assessment Period, any proceeds from the sale to third parties of such accounts were credited to LHC.

33. The Agreements mandate that the Banks retain detailed information on actual PLCC bad debt and provide a summary of the information to LHC on a state-by-state basis. During the Assessment Period, LHC deducted on its Sales Tax Returns the Oklahoma PLCC bad debt amounts provided LHC by the Banks, less amounts subsequently recovered.

34. Division has not verified the bad debt deductions related to PLCCs taken on LHC's Sales Tax Returns during the Assessment Period and disallowed by Division. Should LHC's protest be sustained, LHC and Division agree that the amount of the PLCC bad debt deductions will have to be verified by a reasonable sampling method to be agreed upon by the parties. If the bad debt deductions cannot be verified, or a sampling method cannot be agreed upon, LHC and Division agree to submit the issue(s) to the Court for determination.

35. Attached hereto as Exhibit S is a sworn affidavit of Craig Price, Director of Sales and Use Tax at Lowe's Companies, Inc. Mr. Price would present testimony included in the affidavit at hearing if one were held. The Division does not stipulate to the veracity or accuracy of any statement made by affiant, but simply acknowledges that affiant's testimony, if taken at hearing, would be as contained in the affidavit.

36. Attached hereto as Exhibit T is a sworn affidavit of Kyle Reger, Director of Credit Financing at Lowe's Companies, Inc. Mr. Reger would present testimony included in the affidavit at hearing if one were held. The Division does not stipulate to the veracity or accuracy of any statement made by affiant, but simply acknowledges that affiant's testimony, if taken at hearing, would be as contained in the affidavit.

37. Attached hereto as Exhibit U is a sworn affidavit of William McConnell, Manager-Sales, Use & Excise Taxes, at General Electric Company. Mr. McConnell would present testimony included in the affidavit at hearing if one were held. The Division does not stipulate to the veracity or accuracy of any statement made by affiant, but simply acknowledges that affiant's testimony, if taken at hearing, would be as contained in the affidavit.

#### STIPULATED ISSUE

Whether LHC properly took sales tax deductions on its Oklahoma Sales Tax Returns during the Assessment Period for (1) purchases made by PLCC Cardholders who did not pay the Banks the amounts owed, and which (2) were deducted by LHC on its U.S. Corporation Income Tax Returns.

#### DECISION TO BE APPLIED TO SUBSEQUENT PERIODS

LHC and Division agree that the determination made with respect to this issue in this proceeding will be applied to subsequent periods provided the parties agree that the facts are substantially similar to the facts herein and there has been no change in applicable law.

#### ISSUE PURSUANT TO ORDER DATED FEBRUARY 15, 2013

Why the Division is or is not bound by the Protestant's claiming the "bad debt deduction" on Line 15 of its Federal Returns for the Assessment Period?



SUPPLEMENTAL  
STIPULATED FACTS AND ISSUES

On April 1, 2013, the parties filed Stipulated Facts and Issue, with Exhibits 1 through 18, in one (1)-volume,<sup>20</sup> as follows, to-wit:

1. The Internal Revenue Service (the "IRS" or the "Service") audited Lowe's Companies, Inc. and its subsidiaries, including Lowe's Home Centers, Inc. (hereafter, "LHC"), for the tax years ended January 28, 2005; February 3, 2006; February 2, 2007; and February 1, 2008 (the "Audit Period"). The IRS's audit included an investigation of the bad debt expenses reported on Line 15 of each U.S. Corporation Income Tax Return (the "Federal Return") filed by LHC during the Audit Period.

The First Audit Cycle (Tax Years Ending January 28, 2005 & February 3, 2006)

2. By Information Document Request ("IDR") Number 11, dated December 12, 2007, the IRS inquired about amounts re-classed from miscellaneous deductions to bad debt expense. A true and correct copy of IDR No. 11 is attached as Exhibit 1.

3. By memorandum dated January 16, 2008 (the "Memorandum"), LHC responded to questions posed in IDR Number 11. A true and correct copy of the Memorandum is attached hereto as Exhibit 2.

4. By IDR Number 15 dated January 14, 2008, the IRS requested a copy of Lowe's "contract with GE." A true and correct copy of IDR Number 15 is attached hereto as Exhibit 3.

5. By Memorandum dated January 24, 2008, LHC produced a copy of the requested contract to the IRS. A true and correct copy of the Memorandum is attached hereto as Exhibit 4.

6. By IDR Number 25 dated January 31, 2008, the IRS posed questions related to "sale to GE." A true and correct copy of IDR Number 25 is attached hereto as Exhibit 5.

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<sup>20</sup> See Note 17, *supra*. The Protestant provided all information. The Supplemental Stipulated Facts and Issues, with Exhibits 1 through 18, do not contain Federal Tax Information.

7. By Memorandum dated June 16, 2008, LHC responded to questions posed in IDR Number 25. A true and correct copy of the Memorandum is attached hereto as Exhibit 6.

8. By IDR Number 55 dated July 1, 2008, the IRS asked for a description of "credit card net portfolio income" referred to in LHC's answer to IDR Number 11. A true and correct copy of IDR Number 55 is attached hereto as Exhibit 7.

9. By Memorandum dated July 2, 2008, LHC responded to to [sic] IDR Number 55. A true and correct copy of the Memorandum is attached as Exhibit 8.

10. On May 4, 2009, the IRS issued Notice of Proposed Adjustment ("NOPA") No. 24 proposing an adjustment of \$4,256,191 to Line 15 of the Federal Returns filed by LHC for the tax years ended January 28, 2005 and February 3, 2006. A true and correct copy of the August 19, 2009 NOPA is attached hereto as Exhibit 9.

11. On August 19, 2009, the IRS issued NOPA No. 19 proposing an adjustment of \$1,276,347 to Line 15 of the Federal Returns filed by LHC for the tax years ended January 28, 2005 and February 3, 2006. A true and correct copy of the August 19, 2009 NOPA is attached hereto as Exhibit 10.

12. On August 19, 2009, the IRS issued Revenue Agent Report ("RAR") consolidating all of the IRS' proposed adjustments to LHC's Federal Returns for the tax years ended January 28, 2005 and February 3, 2006, including all adjustments to Line 15 of the Federal Returns. A true and correct copy of the August 19, 2009 RAR is attached hereto as Exhibit 11.

The Second Audit Cycle (Tax Years Ending February 2, 2007 & February 1, 2008)

13. The IRS commenced the second audit cycle prior to resolution of the first audit cycle. In the second audit cycle, the IRS issued IDRs and NOPAs related to Line 15 issues not resolved in the first audit period. The IRS did not issue IDRs on the subjects contained in the first audit cycle IDR numbers 11, 15, 25 and 55.

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14. On September 13, 2010, the IRS issued NOPA No. 4 proposing a reduction of \$4,930,322 to Line 15 of the Federal Returns filed by LHC for the tax years ended January 2007 and January 2008. A true and correct copy of the September 13, 2010 NOPA is attached hereto as Exhibit 12.

15. On September 22, 2010, the IRS issued NOPA No. 3 proposing that the bad debt expense would be determined after resolution of prior audit cycle. A true and correct copy of the September 22, 2010 NOPA is attached hereto as Exhibit 13.

16. On November 17, 2010, the IRS issued NOPA No. 2 proposing an increase of \$2,000,000 to Line 15 of the Federal Returns filed by LHC for the tax years ended January 2007 and January 2008. A true and correct copy of the November 17, 2010 NOPA is attached hereto as Exhibit 14.

17. On March 11, 2011, the IRS issued an RAR consolidating all of the IRS' proposed adjustments to LHC's Federal Returns for the tax years ended February 2, 2007 and February 1, 2008, including all adjustments to Line 15 of the Federal Returns. A true and correct copy of the May 11, 2011 RAR is attached hereto as Exhibit 15.

#### IRS Appeals

18. The IRS issued an "Audit Statement" and a "Statement – Income Tax Changes" (collectively, the "Audit Statement") on July 24, 2012, consolidating the tax assessments and overpayments (the "Adjustments") for the Audit Period. A true and correct copy of the Audit Statement is attached hereto as Exhibit 16.

19. In August 2012, LHC and the IRS agreed to a consolidated listing of tax assessments and overpayments for the Audit Period in an "Offer to Waiver [sic] Restrictions on Assessment and Collection of Tax Deficiency and to Accept Overassessment" (the "Offer"). A true and correct copy of the Offer is attached hereto as Exhibit 17.

20. On July 19, 2012, Lowe's Companies, Inc. and subsidiaries, including LHC, signed a Consent to Extend the Time to Assess Tax (the "[Extension]") relating to tax periods ending January 28, 2005, February 3, 2006, February 2, 2007 and February 1, 2008, a true and correct copy of which is attached as Exhibit 18. Under the Extension, the time in which the IRS could assess additional income tax for any of these time periods expired as of March 31, 2013.

#### CONCLUSIONS OF LAW

1. The Oklahoma Legislature vested the Tax Commission with jurisdiction over the parties and subject matter of this proceeding.<sup>21</sup>

2. Section 1366 of Title 68 ("Bad Debt Statute"),<sup>22</sup> states as follows, to-wit:

A. There is herein provided a deduction to the vendor from taxable sales for bad debts. Any deduction taken that is attributed to bad debts shall not include interest.

B. The federal definition of "bad debt" in 26 U.S.C., Section 166 shall be the *basis* for calculating bad debt recovery. However, the amount calculated pursuant to 26 U.S.C., Section 166, shall be adjusted to exclude:

1. Financing charges or interest;
2. Sales or use taxes charged on the purchase price;
3. Uncollectible amounts on property that remain in the possession of the seller until the full purchase price is paid; and
4. Expenses incurred in attempting to collect any debt and repossessed property.

C. Bad debts may be deducted on the return for the period during which the bad debt is written off as uncollectible in the claimant's books and records and is *eligible* to be deducted for federal income tax purposes if the taxpayer kept accounts on a cash basis or could be *eligible* to be claimed if the taxpayer kept accounts on an accrual basis. For purposes of

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<sup>21</sup> OKLA. STAT. ANN. tit. 68, § 221(C) (West Supp. 2013) and OKLA. ADMIN. CODE § 710:1-5-38(a) (June 25, 2009). See OKLA. STAT. ANN. tit. 68, § 203 (West Supp. 2013). See also OKLA. ADMIN. CODE § 710:1-5-38(a) (June 25, 2009). In its Brief, the Protestant mistakenly indicates this matter submitted as a Motion for Summary Disposition under subsection (b), but this matter submitted for decision on Stipulations and Briefs under subsection (a). Protestant's Brief at 1. See Note 9, *supra*.

<sup>22</sup> OKLA. STAT. ANN. tit. 68, § 1366 (West 2008).

this subsection, a claimant who is not required to file federal income tax returns may deduct a bad debt on a return filed for the period in which the bad debt is written off as uncollectible in the claimant's books and records and would be *eligible* for a bad debt deduction for federal income tax purposes if the claimant was required to file a federal income tax return.

D. 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 so collected must be paid and reported on the return filed for the period in which the collection is made.

E. When the amount of bad debt exceeds the amount of taxable sales for the period during which the bad debt is written off, a refund claim may be filed within the statute of limitations for refund claims provided in Section 227 of this title; however, the statute of limitations shall be measured from the due date of the return on which the bad debt could first be claimed.

F. Where filing responsibilities have been assumed by a certified service provider, the certified service provider may claim, on behalf of the seller, any bad debt allowance provided by this section. The certified service provider must credit or refund the full amount of any bad debt allowance or refund received to the seller.

G. For the purposes of reporting a payment received on a previously claimed bad debt, any payments made on a debt or account 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.

H. In situations where the books and records of the party claiming the bad debt allowance support an allocation of the bad debts among the states which are members of the Streamlined Sales and Use Tax Agreement, the allocation will be permitted. (Emphasis added.)

3. The Tax Commission has promulgated rules as provided by law for the purpose of compliance with the Oklahoma Administrative Procedures Act<sup>23</sup> and to facilitate the administration, enforcement, and collection of taxes under the Oklahoma Sales Tax Code.<sup>24</sup>

4. The rules promulgated pursuant to the Administrative Procedures Act are presumed to be valid and binding on the persons they affect and have the force of law.<sup>25</sup>

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<sup>23</sup> See Note 25, *infra*.

<sup>24</sup> OKLA. STAT. ANN. tit. 68, §§ 1351 *et seq.* (West 2008).

5. Tax Commission Rule 710:65-11-2 ("Bad Debt Rule")<sup>26</sup> states as follows, to-wit:

(a) A vendor may take a deduction for bad debts on the return for the period during which the bad debt is written off as uncollectible in the vendor's books and records and is eligible to be deducted for Federal Income Tax purposes, if the vendor kept accounts on a cash basis, or could be eligible to be claimed if the vendor kept accounts on an accrual basis. For purposes of this Section a vendor who is not required to file Federal Income Tax Returns may deduct a bad debt on a return filed for the period in which the bad debt is written off as uncollectible in the vendor's books and records and would be eligible for a bad debt deduction if the vendor were required to file a Federal Income Tax Return.

(b) The fact that a deduction has been taken against the current month must be so indicated on the face of the sales tax report. If the accounts are thereafter collected, the amount received shall be included in the gross receipts for the period in which the account is collected.

(c) The "bad debt" deduction is calculated based upon the federal definition provided in 26 U.S.C. § 166 and the amount should be adjusted to exclude:

- (1) *Financing charges or interest;*
- (2) *Sales or use taxes charged on the purchase price;*
- (3) *Uncollectible amounts on property that remain in the possession of the seller until the full purchase price is paid;*  
*and,*
- (4) *Expenses incurred in attempting to collect any debt and repossessed property.* [68 O.S.Supp.2003, § 1366(B)]

(d) The burden of establishing the right to, and the validity of a bad debt deduction is on the vendor. In order to verify each deduction taken for a bad debt, the vendor must retain and make available:

- (1) The name of the purchaser/debtor;
- (2) The date of the sale or sales giving rise to the bad debt;
- (3) The price of the property and the amount of sales tax charged thereon;
- (4) The amount of interest, finance and service charges charged to the debt or account;
- (5) Whether the property was retained by the vendor or repossessed;

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<sup>25</sup> OKLA. STAT. ANN. tit. 75, § 250 *et seq.* (West 2002).

<sup>26</sup> OKLA. ADMIN. CODE § 710:65-11-2 (June 25, 2004).

(6) Any amounts charged to the debt or account representing costs of collection;

(7) The dates and amounts of any payments made on the debtor's account;

(8) Any portion of the debt or account which represents a charge that was not subjected to the tax in the original transaction; and

(9) Records documenting that the account has been or will be written off or could be eligible to be claimed if taxpayer kept accounts on a cash basis or could be eligible to be claimed if taxpayer kept records on the accrual basis on the Federal Income Tax Return for the year, or that the item was repossessed.

(e) The information in subsection (d) may be requested by the Commission at any time.

(f) The deduction for bad debts is limited to the amount shown on the invoice that is being or will be charged off as a bad debt. This tax deduction is allowable only to the person who remitted and reported the tax to the Commission. Subsequent recoveries of bad debts that have been taken as a deduction are to be reported in the month of the recovery. [See: 68 O.S. §1366]

*(g) When the amount of bad debt exceeds the amount of taxable sales for the period during which the bad debt is written off, a refund claim may be filed within the statute of limitations for refund claims provided in Section 227 of this title; however, the statute of limitations shall be measured from the due date of the return on which the bad debt could first be claimed.*

*(h) Where filing responsibilities have been assumed by a certified service provider, the certified service provider may claim, on behalf of the seller, any bad debt allowance provided by this section. The certified service provider must credit or refund the full amount of any bad debt allowance or refund received to the seller.*

*(i) For the purposes of reporting a payment received on a previously claimed bad debt, any payments made on a debt or account 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.*

*(j) In situations where the books and records of the party claiming the bad debt allowance support an allocation of the bad debts among the states which are members of the Streamlined Sales and Use Tax Agreement, the*

*allocation will be permitted.* [68 O.S.Supp.2003, § 1366] (Emphasis original.)

6. IRC Section 166(a)(1) ("IRC § 166"),<sup>27</sup> states as follows, to-wit:

(a) General rule.—

(1) Wholly worthless debts.--There shall be allowed as a deduction any debt which becomes worthless within the taxable year.

7. Treas. Reg. § 1.166-1(c), states in pertinent part,<sup>28</sup> as follows, to-wit:

*Bona fide debt required.* Only a bona fide debt qualifies for purposes of section 166. A bona fide debt is a debt which arises from a debtor-creditor relationship based upon a valid and enforceable obligation to pay a fixed or determinable sum of money. A debt arising out of the receivables of an accrual method taxpayer is deemed to be an enforceable obligation for purposes of the preceding sentence to the extent that the income such debt represents have been included in the return of income for the year for which the deduction as a bad debt is claimed or for a prior taxable year. ... (Emphasis original.)

8. Treas. Reg. § 1.166-9(d),<sup>29</sup> states as follows, to-wit:

*Certain payments treated as worthless debts.* A payment in discharge of part or all of taxpayer's agreement to act as *guarantor*, endorser, or indemnitor of an obligation is to be treated as a worthless debt only if--

(1) The agreement was entered into in the course of the taxpayer's trade or business or a transaction for profit;

(2) There was an enforceable legal duty upon the taxpayer to make the payment (except that legal action need not have been brought against the taxpayer); and

(3) The agreement was entered into before the obligation became worthless (or partially worthless in the case of an agreement entered into in the course of the taxpayer's trade or business). See §§1.166-2 and 1.166-3 for rules on worthless and partially worthless debts. *For purposes of this paragraph (d)(3), an agreement is considered as entered into before the obligation became worthless (or partially*

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<sup>27</sup> 26 U.S.C.A. § 166.

<sup>28</sup> 26 C.F.R. § 1.166-1(c).

<sup>29</sup> 26 C.F.R. § 1.166-9(d).



worthless) if there was a reasonable expectation on the part of the taxpayer at the time the agreement was entered into that the taxpayer would not be called upon to pay the debt (subject to such agreement) without full reimbursement from the issuer of the obligation. (Emphasis added.)

9. Great weight is accorded an agency's construction of a statute when the administrative interpretation is made contemporaneously with the enactment of the statute and the construction is longstanding and continuous by the agency charged with its execution.<sup>30</sup>

10. Where the Legislature is made repeatedly aware of the operation of the statute according to the construction placed upon it by an agency and the Legislature has not expressed its disapproval with the agency's construction, the Legislature silence may be regarded as acquiescence in the agency's construction,<sup>31</sup> and the agency's construction is given controlling weight and will not be disregarded except in cases of serious doubt.<sup>32</sup>

11. The rules and regulations of an administrative agency which implement the provisions of a statute are valid unless they are beyond the scope of the statute, are in conflict with the statute, or are unreasonable.<sup>33</sup> Generally, it is presumed that administrative rules and regulations are fair and reasonable and that the complaining party has the burden of proving the contrary by competent and convincing evidence.<sup>34</sup>

12. The goal of any inquiry into the meaning of a legislative act is to ascertain and give effect to the intent of the legislature. The law-making body is presumed to have expressed its intent in a statute's language and to have intended what the text expresses. Hence, where a statute is plain

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<sup>30</sup> *Schulte Oil Co., Inc. v. Oklahoma Tax Commission*, 1994 OK 103, 882 P.2d 65.

<sup>31</sup> *R.R. Tway, Inc. v. Oklahoma Tax Commission*, 1995 OK 129, 910 P.2d 972.

<sup>32</sup> *Cox v. Dawson*, 1996 OK 11, 911 P.2d 272.

<sup>33</sup> *Arkansas Louisiana Gas Co. v. Travis*, 1984 OK 33, 682 P.2d 225. See *Boydston v. State*, 1954 OK 327, 277 P.2d 138.

<sup>34</sup> *State ex rel. Hart v. Parham*, 1966 OK 9, 412 P.2d 142.

and unambiguous, it will not be subject to judicial construction, but will be given the effect its language dictates. Only where the intent cannot be ascertained from a statute's text, as occurs when ambiguity or conflict (with other statutes) is shown to exist, may rules of statutory construction be employed.<sup>35</sup>

13. The legislature will not be presumed to have intended a *vain or absurd* result.<sup>36</sup>

14. Tax statutes are penal in nature. Where there is reasonable doubt about the taxing act's meaning, all ambiguity must be resolved in favor of the taxpayer. Legislative intention—ascertained from a general consideration of the entire act—must be given effect. Nonetheless, courts cannot enlarge the taxing act's ambit to make its provision's applicable to cases not clearly within the Legislature's contemplation or to fill lacunae in the revenue law in a manner that would distort the enactment's plain language.<sup>37</sup>

15. The Tax Commission is bound by the changes made by the IRS, except in those circumstances where an IRS revision affects items or matters relating to allocation or apportionment between the State of Oklahoma and some other state or the federal government.<sup>38</sup>

16. The burden of establishing the right to, and the validity of a bad debt credit is on the vendor.<sup>39</sup>

17. In all proceedings before the Tax Commission, the taxpayer has the burden of proof.<sup>40</sup>

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<sup>35</sup> *Blitz U.S.A., Inc. v. Oklahoma Tax Com'n*, 2003 OK 50, ¶ 14, 75 P.3d 883. (Citations omitted).

<sup>36</sup> *Strelecki v. Oklahoma Tax Com'n*, 1993 OK 122, 872 P.2d 910. (Citations omitted.)

<sup>37</sup> *Globe Life and Acc. Ins. Co. v. Oklahoma Tax Commission*, 1996 OK 39, ¶¶ 11-14, 913 P.2d 1322. (Citations omitted).

<sup>38</sup> OKLA. ADMIN. CODE § 710:50-3-8(d) (June 11, 2005).

<sup>39</sup> See Note 26, *supra*.

<sup>40</sup> OKLA. ADMIN. CODE § 710:1-5-47 (June 25, 1999):

In all administrative proceedings, unless otherwise provided by law, the burden of proof shall be upon the protestant to show in what respect the action or proposed action of the Tax

18. A proposed assessment is presumed correct and the taxpayer bears the burden of showing that it is incorrect and in what respects.<sup>41</sup>

PART ONE

STIPULATED ISSUE

Whether LHC properly took sales tax deductions on its Oklahoma Sales Tax Returns during the Assessment Period for (1) purchases made by PLCC Cardholders who did not pay the Banks the amounts owed, and which (2) were deducted by LHC on its U.S. Corporation Income Tax Returns.

DISCUSSION

A. THE HOME DEPOT CASE

The Protestant's position succinctly stated is "This controversy exists because the [Division] has failed to distinguish the [Protestant's] Agreements from the PLCC agreements that were the subject of the Home Depot's lawsuits, both in Oklahoma and nationwide."<sup>42</sup> In support of its position, the Protestant asserts, "...[Protestant] – unlike Home Depot – had the following rights and obligations under the PLCC agreements at issue in this case: (1) it remained directly liable as guarantor for paying the bad debts arising out of defaulted PLCC accounts, (2)

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Commission is incorrect. If, upon hearing, the protestant fails to prove a prima facie case, the Administrative Law Judge may recommend that the Commission deny the protest solely upon the grounds of failure to prove sufficient facts which would entitle the protestant to the requested relief.

OKLA. ADMIN. CODE § 710:1-5-77(b) (June 25, 1999), provides in pertinent part:

"preponderance of the evidence" means the evidence which is of greater weight or more convincing than the evidence which is offered in opposition to it; evidence which as a whole shows that the fact sought to be proved is more probable than not.

<sup>41</sup> See *Enterprise Management Consultants, Inc. v. State ex rel. Oklahoma Tax Com'n*, 1988 OK 91, 768 P.2d 359.

<sup>42</sup> Protestant's Brief filed November 21, 2012, at 7-11, 17-22, and 24. See *In re Sales Tax Claim for Refund of Home Depot*, 2008 OK CIV APP 101, 198 P.3d 902.

it actually wrote off the bad debts on its books and records, and (3) it expressly retained the right to deduct, and in fact deducted, the bad debt payments on its U.S. Corporation Income Tax Returns pursuant to Section 166 of the Internal Revenue Code (the 'IRC')."<sup>43</sup>

The Division does acknowledge the following, to-wit:

- "Pursuant to [Protestant's] agreement with the Banks, [Protestant] remitted payment to the Banks for the accounts the Banks determined constituted bad debts."<sup>44</sup>
- That the Banks provided the Protestant, on a state-by-state basis, the amount of PLCC accounts that were declared by the Banks to be uncollectible, including the amount of recoveries previously reported as uncollectible, and that these amounts were netted on a state-by-state basis.<sup>45</sup>

The Division's point of contention is that the Protestant's PLLC payments to the Banks do not constitute bad debt under IRC § 166 and therefore are not "eligible" to be deducted for federal income tax purposes.

In support of its position, the Division states, "The U.S. Treasury Regulations provide, 'Bona fide debt required. Only a bona fide debt qualifies for purposes of Section 166. A bona fide debt is a debt which arises from a debtor-creditor relationship based upon a valid and enforceable obligation to pay a fixed sum of money.'"<sup>46</sup> The Division goes on to state, "In the instant case, the debtor-creditor relationship with respect to the tangible personal property purchased at [Protestant] is between the Banks and the PLCC cardholders, or the Banks and

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<sup>43</sup> *Id.* at 2.

<sup>44</sup> Division's Brief filed December 21, 2012, at 2. *See* Stipulations 11, 13, 15, 17, and 29-30.

<sup>45</sup> *Id.* at 3. The Division also acknowledges that during the Assessment Period the Protestant deducted on its sales tax reports, bad debts, including bad debts related to PLLC accounts (Stipulation 19). *See* Exhibit R. The Division notes, "With the exception of the [Protestant's] Proxy Program Agreement, Exhibit O ..., each of [Protestant's] agreements provide at Section 3.02 Ownership of Accounts, paragraph (a), the following: Bank is and shall be the sole and exclusive owner of all Accounts..." *See also* Exhibits P and Q.

<sup>46</sup> *Id.* at 7.

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[Protestant].”<sup>47</sup>

*Home Depot*<sup>48</sup> provides a good starting point in analyzing this matter, by comparing and contrasting the two (2) cases.

Protestant’s BDD

HOME DEPOT CASE

Division disallowed BDD reported on STS Reports filed during Assessment Period <sup>49</sup>	Claim For Refund (Home Depot did not report BDD on STS Reports)
Protestant wrote off PLCC Bad Debts in its books and records during Assessment Period <sup>50</sup>	Bank wrote of PLCC Bad Debts in its Books and records during Refund Period
Protestant reported BDD on Line 15 of Federal Returns for the Assessment Period <sup>51</sup>	Home Depot reported Credit Card Discount on Line 26, Other Deductions, of Federal Returns (Bank reported BDD on Line 15 of Federal Returns)
Protestant’s BDD eligibility pursuant to IRC § 166 via Treas. Reg. § 1.166-9(d) (Guarantor) <sup>52</sup>	Home Depot’s eligibility to BDD pursuant to IRC § 166 fell under Treas. Reg. § 1.166-1(c) (Bona fide debt required/Debtor-Creditor relationship)

The comparison of *Home Depot* to this matter illustrates the Protestant’s initial point; the Division fails to distinguish this case from *Home Depot*.<sup>53</sup> The Court in *Home Depot* held, “There is no evidence that Home Depot could deduct the Service Fee, or a portion of the Service Fee, as a bad debt pursuant to Section 166 of the Internal Revenue Code. Rather, Home Depot stipulated the Service Fee was deducted on its federal return as a ‘credit card discount.’ That

<sup>47</sup> *Id.* 7. The Division also states, “Neither has it been demonstrated by [Protestant] that the obligation is for a fixed sum of money.”

<sup>48</sup> See Note 42, *supra*.

<sup>49</sup> See Stipulations 20-21.

<sup>50</sup> See Stipulation 30.

<sup>51</sup> See Stipulations 10-17.

<sup>52</sup> See Stipulation 18. See also Protestant’s Brief filed November 21, 2012, at 11-16 and Protestant’s Reply Brief filed January 17, 2013, at 2-9.

<sup>53</sup> *Id.* See Note 42, *supra*.

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being so, Home Depot could not satisfy its burden of proving a right to a refund of sale tax under that statute. Section 1366 implicitly requires the owner of the bad debt account to be the entity allowed the deduction where it also requires the owner to report subsequent collections of bad debt accounts as income.”<sup>54</sup>

In stark contrast to *Home Depot*,<sup>55</sup> the Protestant (1) wrote off PLCC Bad Debts in its books and records during Assessment Period, (2) claimed the Bad Debt Deduction on Line 15 of its Federal Returns for the Assessment Period; and (3) claims its eligibility to the Bad Debt Deduction pursuant to IRC § 166 via Treas. Reg. § 1.166-9(d), as a Guarantor.<sup>56</sup>

**B. THE BAD DEBT STATUTE MUST BE STRICTLY CONSTRUED AGAINST THE ALLOWANCE OF THE BAD DEBT DEDUCTION**

In its Brief, the Division takes an unexpected position, “There is no clearly expressed deduction for the debt claimed by [Protestant] despite the fact that [Protestant] has agreed to the certain payments in its Agreements with the Banks. Without an express provision providing for a credit for the type of arrangement [Protestant] has with Banks, the payments made to the Banks are is [sic] not eligible for the credit. ...Based solely on the grounds that [Protestant] has failed to prove the debt on which the claim is based is ‘bad debt’ as defined by statute and rule, Division asserts [Protestant’s] protest to the assessment on the issue of bad debt related to PLCC accounts taken on the face of [Protestant’s] sales tax returns during the Assessment Period

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<sup>54</sup> *Id.* See Note 42, *supra*. See also OTC Order No. 2012-10-18-05 (October 18, 2012).

<sup>55</sup> *Id.*

<sup>56</sup> See Notes 49-52, *supra*. See also Protestant’s Brief filed November 21, 2012, at 8 and 12. “Upon payment by guarantor of debt, debtor’s obligation to creditor becomes an obligation to the guarantor through subrogation and not a new debt.” *Putnam v. C.I.R.*, 352 U.S. 82. “A party who has equitable right to step into shoes of another in respect to rights against a third party is subject to all legal and equitable defenses which third party may have against party into whose shoes subrogee steps.” *Moore v. White*, 1979 OK 159, 603 P.2d 1119. (Citations omitted.)

should be denied.”<sup>57</sup>

The Protestant points out, “The Bad Debt Statute specifically provides every vendor with a deduction ‘from taxable sales for *bad debts*. And a *bad debt*, for Oklahoma sales tax purposes, is identical to a *bad debt* under IRC § 166. Moreover, IRC § 166 expressly provides guarantors with a deduction for payments made on bad debts pursuant to a guaranty arrangement.”<sup>58</sup> (Emphasis original.)

The language of the Bad Debt Statute is plain and unambiguous, so it will not be subject to judicial construction, but will be given the effect its language dictates.<sup>59</sup> The Division’s argument appears to stem from its constricted reading of the Bad Debt Statute. If the Legislature had intended to limit the Bad Debt Deduction to *only* vendors who finance their customer’s credit purchases (without third parties, such as the Banks) or whose customers write uncollectible “hot checks,”<sup>60</sup> it would not have based eligibility for the Bad Debt Deduction on IRC § 166. The Treasury Regulations clearly contemplate circumstances outside the traditional examples. If the Division’s interpretation were correct, it would render the Subsection B of the Bad Debt Statute as superfluous or a surplusage.<sup>61</sup> The legislature will not be presumed to have intended a *vain or absurd* result.<sup>62</sup>

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<sup>57</sup> Division’s Brief filed December 21, 2012, at 11-12. Tax exemptions are strictly construed against the Claimant. See Note 35, *supra*.

<sup>58</sup> Protestant’s Reply Brief filed January 17, 2013, at 13. (Citations omitted.)

<sup>59</sup> See Note 37, *supra*.

<sup>60</sup> These are only two (2) examples, not an inclusive list.

<sup>61</sup> Division’s Opening Brief filed May 17, 2013, at 7. See *State, ex rel. Dept. of Public Safety v. Gurich*, 2010 OK 56, 238 P.3d 1. See also Note 22, *supra*.

<sup>62</sup> See Note 36, *supra*.

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C. TREAS. REG. § 1.166-9(d)(3)  
(GUARANTOR)

The Protestant responds that “IRC § 166(a)(1) plainly states ‘there shall be allowed as a deduction any debt which becomes worthless within the taxable year.’ The U.S. Treasury Regulations further explain that ‘a payment of principal or interest made...in discharge of part or all of the taxpayer’s obligation *as a guarantor*, endorser, or indemnitor *is treated as a business debt* becoming worthless in the taxable year in which the payment is made.”<sup>63</sup> (Emphasis original.)

The Division does not dispute that the Protestant entered into the Agreements with the Banks in the course of the Protestant’s business or as a transaction for profit, nor does the Division dispute the Agreements require the Protestant to “make certain payments” to Net Write-Offs.<sup>64</sup>

The Division does dispute that the Protestant entered into the Agreements before the obligations became worthless, as defined in § 1.166-9(d)(3), which requires “a reasonable expectation on the part of the taxpayer at the time the agreement was entered into that the taxpayer would not be called upon to pay the debt (subject to such agreement) without full reimbursement from the issuer of the obligation.”<sup>65</sup>

The Protestant replies, “As noted in [Protestant’s] opening Brief, all of the PLCC Agreements were executed – and [Protestant] became contractually liable as a guarantor – before the PLCC accounts even existed, and long before they were declared worthless and

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<sup>63</sup> Protestant’s Brief filed November 21, 2012, at 11.

<sup>64</sup> Division’s Brief filed December 21, 2012, at 8. (Citations omitted.)

<sup>65</sup> *Id.* at 8-9. The Division states, “The agreements clearly establish that [Protestant], at the time [Protestant] entered into the four PLCC agreements, had no reasonable expectation of full reimbursement from the PLCC cardholders for amounts [Protestant] agreed to pay the Banks. Stipulations 21 through 25 and Exhibits P, Q, R, and S to Stipulated Facts and Issue.” *See also* Note 29, *supra*.



written off for federal income tax purposes.<sup>66</sup> (Emphasis original.)

As noted by the U.S. Supreme Court in *Pulnam*<sup>67</sup>, “Upon payment by guarantor of debt, debtor’s obligation to creditor becomes an obligation to the guarantor through subrogation and not a new debt.” “The familiar rule is that, 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. Thus, the loss sustained by the guarantor unable to recover from the debtor is by its very nature a loss from the worthlessness of a debt.” (Citations omitted.)

The Division’s reading of Treas. Reg. § 1.166-9(d)(3) is not supported by the facts, or case law on the state and federal levels.<sup>68</sup>

## PART TWO

### SUPPLEMENTAL ISSUE

Why the Division is or is not bound by the Protestant claiming the “bad debt deduction” on Line 15 of its Federal Returns for the Assessment Period?<sup>69</sup>

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<sup>66</sup> Protestant’s Reply Brief filed January 17, 2013, at 3-4.

<sup>67</sup> See Note 56, *supra*. See also *Mid-Continent Cas. Co. v. First Nat. Bank & Trust Co. of Chickasha*, 1975 OK 18, 531 P.2d 1370.

<sup>68</sup> *Id.* See Notes 29, and 49-52, *supra*.

<sup>69</sup> See Procedural History herein, specifically, the Scheduling Order issued April 17, 2013, at 6. In the April 17<sup>th</sup> Scheduling Order the ALJ directed the parties to expand briefing on the “judicial estoppel” argument raised in the Protestant’s Reply Brief. Based upon Parts I and II, the ALJ has omitted any discussion of the Protestant’s “judicial estoppel” argument.

## DISCUSSION

The Protestant states "The Oklahoma Code provides a deduction 'from taxable sales for bad debts,' and specifically states that the 'definition of 'bad debt' in 26 U.S.C., Section 166 shall<sup>70</sup> be the basis for calculating bad debt recover.'" (Emphasis original.) In support of its position, the Protestant states "Under Oklahoma law, '[t]axation is an exclusively legislative function that can be exercised only under statutory authority and in the manner specified by statute. ... Within the income tax context, it is well established that the OTC must follow the taxpayer's federal calculations for state tax purposes."<sup>71</sup>

The Division responds with two (2) arguments: (1) That the question posed to the parties by the ALJ substitutes the word "claimed" for "eligible" in the Bad Debt Statute, and (2) That the Protestant may argue that the "eligible" is ambiguous.<sup>72</sup>

As to the first argument, the Division responds, in pertinent parts,<sup>73</sup> as follows, to-wit:

The Court presents the question "Why the Division is or is not bound by the Protestant[] claiming the 'bad debt deduction' on Line 15 of its Federal Returns

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<sup>70</sup> Generally, when the legislature uses the term "shall," it signifies a mandatory directive or command. See *Keating v. Edmondson*, 2001 OK 110, 37 P.3d 882.

<sup>71</sup> Protestant's Supplement Brief filed May 17, 2013, at 3-5. See *State ex rel. Oklahoma Tax Com'n v. Texaco Exploration & Production, Inc.*, 2005 OK 52, 131 P.3d 705. "Regardless of the correctness of the IRS actions in accepting protestant's proposed changes in her amended federal return, the Oklahoma Tax Commission is bound by the IRS determination in such matter." OTC Order No. 2010-04-06-02 (April 6, 2010) and OTC Order No. 2007-11-03-03 (November 3, 2007). The Protestant acknowledges the exception in Section 2375(H) of Title 68 and Tax Commission Rule 710:50-3-8. Both provide that the Oklahoma Tax Commission is bound by the determination of the IRS when the IRS changes the federal income tax return by issuing its final determination except where such item of income, deduction, credit or any other matter related to the return relate to allocation or apportionment between the State of Oklahoma and some other state or federal government.

In its Response Brief filed June 17, 2013, the Division takes issue with the Protestant's citation of two (2) Non-Precedential Commission Orders. See Response Brief at 1. The distinction between a Commission Order designated as "Precedential" or "Non-Precedential" has been blurred because all Commission Orders resulting from cases heard by the Office of Administrative Law Judges are now published, not just "Precedential" Commission Orders. See OKLA. STAT. ANN. tit. 68, § 221(G) (West Supp. 2013) and OKLA. STAT. ANN. tit. 75, § 302 (West 2002).

<sup>72</sup> Division's Brief filed May 17, 2013, at 11. See Note 35, *supra*.

<sup>73</sup> Division's Opening Brief May 17, 2013, at 6-7. See *State, ex rel. Dept. of Public Safety v. Gurich*, 2010 OK 56, 238 P.3d 1 and *Comer v. Preferred Risk Mutual Ins. Co.*, 1999 OK 86, 991 P.2d 1006.

for the Assessment Period?" in its Order of February 15, 2013. Division submits that the answer is found in the language of the statute and the corresponding rule. While the statute could have been drafted to require a vendor report the bad debt on Line 15 of the Federal Return as a prerequisite to the credit, the legislature used the word "eligible".

Claimed on Line 15 cannot be substituted for "eligible" as this would render the term superfluous or as surplusage. No portion of a statute may be considered superfluous or as surplusage."

Based upon the Division's prior position in *Home Depot*,<sup>74</sup> its dismissal of two (2) critical facts is contradictory and confusing: (1) Protestant wrote off PLCC Bad Debts in its books and records during Assessment Period, and (2) Protestant claimed the Bad Debt Deduction on Line 15 of its Federal Returns for the Assessment Period. It was the absence of these facts in *Home Depot*, which was crucial to the Division's position that *Home Depot* was not "eligible" to claim/report the Bad Debt Deduction on the Federal level pursuant to IRC § 166, and therefore ineligible to claim the Bad Debt Deduction on the state level, pursuant to the Bad Debt Statute.

If there was any doubt, whether the Protestant was "eligible," pursuant to IRC § 166, to claim/report the Bad Debt Deduction, the IRS conducted a comprehensive audit of the Protestant's Federal Returns for the Assessment Period, including the Bad Debt Deduction the Protestant claimed/reported on Line 15. The Division stipulated that the IRS audited LCI and its subsidiaries, including the Protestant, for the Assessment Period, including an investigation of the bad debt expenses reported on Line 15 of each Federal Return,<sup>75</sup> and that the IRS did not adjust income for Protestant's PLCC transactions.<sup>76</sup> As noted herein, the Legislature based eligibility on IRC § 166, and the Division is hard-pressed to ignore the stipulated facts in this matter.

As to the secondary argument, the Division states, "Protestant may argue that the term

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<sup>74</sup> See Notes 42 and 54, *supra*.

<sup>75</sup> Supplemental Stipulation 1.

<sup>76</sup> Supplemental Stipulations 17-20. On March 31, 2013, pursuant to the Extension, the time in which the IRS could assess additional income tax for any of the periods expired.

eligible is ambiguous. To the extent this language presents an ambiguity in the statute it must be strictly construed against the Protestant. While an ambiguous tax statute which *levies* the tax may be strictly construed against the taxing authority, the corollary to this rule is that an ambiguous tax *exemption* statute is always construed against the taxpayer claiming the exemption.”<sup>77</sup> (Emphasis original.)

The Protestant has never argued that the word “eligible” is ambiguous. The Protestant is not trying to substitute the word “claimed” in place of the word “eligible” in the Bad Debt Statute.<sup>78</sup> The Division’s argument stems solely from the ALJ’s imprecise framing of the question to the parties.

### PART THREE

#### CALCULATION OF THE BAD DEBT DEDUCTION

In its Brief, the Division states in pertinent part, “As this is a case of first impression, the issue of payments received and applied by a lender prior to determining an account was uncollectible and advising the retailer of the uncollectible amount has not been addressed by any other state by statute, rule or case.” The Division argues the stipulated sales tax, exclusive of penalty and interest (\$804,332.84)<sup>79</sup> must be adjusted for PLCC cardholder payments applied by the Banks to debt cancellation insurance, fees, and interest, in accordance with the Bad Debt Statute and Rule.<sup>80</sup> In its Briefs, the Protestant strenuously objects and counters with its argument.

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<sup>77</sup> Division’s Response Brief filed June 17, 2013, at 4. *See R.R. Twcoy, Inc. v. Oklahoma Tax Com’n*, 1995 OK 129, 910 P.2d 972.

<sup>78</sup> If the Protestant claimed/reported the Bad Debt Deduction on Line 15 of its Federal Returns, then does it not follow that it is “eligible,” until the IRS disallows or adjusts the Bad Debt Deduction? *See Note 71, supra*.

<sup>79</sup> *See Stipulation 9.*

<sup>80</sup> Division’s Brief filed December 21, 2012, at 9-12.

The parties stipulated,<sup>81</sup> as follows, to-wit:

Division has not verified the bad debt deductions related to PLCCs taken on LHC's Sales Tax Returns during the Assessment Period and disallowed by Division. Should LHC's protest be sustained, LHC and Division agree that the amount of the PLCC bad debt deductions will have to be verified by a reasonable sampling method to be agreed upon by the parties. If the bad debt deductions cannot be verified, or a sampling method cannot be agreed upon, LHC and Division agree to submit the issue(s) to the Court for determination.

Based upon the stipulation, the parties' arguments regarding the calculation of the Bad Debt Deduction are premature.

### CONCLUSION

Based upon a review of the record, the Protestant has met its burden of proof, by preponderance of the evidence, that the Division's disallowance of the Bad Debt Deduction claimed by the Protestant on its sales tax reports during the Assessment Period was incorrect and in what respects.

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<sup>81</sup> See Stipulation 34.

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RECOMMENDATIONS

It is the recommendation of the undersigned Administrative Law Judge, based upon the facts and circumstances of this case that the protest should be granted, as more fully set forth herein.

OKLAHOMA TAX COMMISSION



JAVL HARRINGTON  
ADMINISTRATIVE LAW JUDGE

CERTIFICATE OF SERVICE OR MAILING

This is to certify that on this 19th day of August, 2013, true and correct copies of the above and foregoing *Findings, Conclusions and Recommendations* of the Administrative Law Judge were delivered to Marjorie L. Welch, First Deputy General Counsel, and Judy Burdg, Assistant General Counsel, Oklahoma Tax Commission, and mailed with proper postage prepaid to:

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**December 03, 2018 - 3:08 PM**

**Transmittal Information**

**Filed with Court:** Supreme Court  
**Appellate Court Case Number:** 96383-5  
**Appellate Court Case Title:** Lowe's Home Centers, LLC v. Department of Revenue, State of Washington  
**Superior Court Case Number:** 15-2-02994-8

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