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**COURT OF APPEALS, DIVISION II**
**OF THE STATE OF WASHINGTON**

HOME DEPOT, USA, INC.,

Appellant,

v.

STATE OF WASHINGTON, DEPARTMENT OF REVENUE,

Respondent.

# BRIEF OF RESPONDENT

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## I. INTRODUCTION

This tax refund case presents a question of statutory interpretation. Under RCW 82.08.037, a seller is entitled to a refund of sales taxes it paid on a retail sale when it cannot collect the proceeds of the sale from the buyer. Most of the 46 states with a retail sales tax have a similar provision, commonly referred to as a "bad debt statute." The purpose of the bad debt statute is to limit a seller's personal liability for sales taxes it cannot collect from the buyer.

Washington's bad debt statute, like that of other states, ties a seller's eligibility for a refund to the Internal Revenue Code's criteria for a bad debt deduction. During the tax periods at issue,[1] RCW 82.08.037 provided: "A seller is entitled to a credit or refund for sales taxes previously paid on debts which are deductible as worthless for federal income tax purposes." The federal bad debt deduction applies to a narrow type of business loss: amounts the taxpayer reported as income and remains legally entitled to collect, but which prove uncollectible. Business losses or expenses that are otherwise deductible cannot be claimed as a bad debt for federal income tax purposes.

Home Depot claims it is entitled to a sales tax refund for bad debts its customers owe to a third party credit card issuer. Home Depot reasons

[1] Unless stated otherwise, the statutes referred to in this brief are those in effect in 2002.

it is entitled to a sales tax refund because it "actually bore the loss" on defaulted credit card debts.

Courts and administrative tribunals in other jurisdictions have rejected Home Depot's argument, as did the trial court here, on the same undisputed facts, and for similar reasons.[2] A seller is not entitled to a bad debt sales tax refund unless it incurs a bad debt loss on a retail sale.

Home Depot points to a contractual fee it pays to the credit card issuer. It argues that this fee arrangement compensates the lender for unpaid consumer debts. The contractual agreement, however, does not meet the requirements or purpose of the statute. RCW 82.08.037 requires the refund claimant to prove it sustained a deductible bad debt loss on a retail sale: proof of some other form of economic loss does not satisfy the statutory standard. Home Depot, the refund claimant, did not incur a bad

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[2] Home Depot has filed a similar refund claim in other states that allow a bad debt tax credit or refund. CP 51. Home Depot's bad debt refund claim has been rejected in administrative or judicial opinions in Alabama, Indiana, Ohio, New York, and New Jersey. *See Home Depot USA, Inc. v. State of Alabama*, Docket No. S. 06-1079 (June 6, 2008); *Home Depot USA, Inc. v. Indiana Dep't of Revenue*, 891 N.E.2d 187 (July 28, 2008); *Home Depot USA, Inc. v. Director, Division of Taxation*, 24 N.J.Tax 23 (March 14, 2008); *In re Home Depot USA, Inc.*, Det. No. 821034, State of New York, Division of Tax Appeals, (May 17, 2007), *affirmed by*, N.Y. Tax Appeals Tribunal, November 6, 2008; *Home Depot USA, Inc. v. Wilkins*, Case Nos. 2006-M-206, 207, Order, Ohio Board of Tax Appeals (June 18, 2008), *appeal docketed*, 119 Ohio St.3d 1501, 895 N.E.2d 564 (2008). Home Depot's arguments have been rejected by other tribunals in determinations redacted to conceal the taxpayer's identity. *See, e.g.*, Order, Case No. 200500034-S (Ariz. Dep't of Revenue, July 26, 2006), *available at*, http://www.revenue.state.az.us/researchstats/Decisions/03q06/200500034-S.pdf (last viewed, 11/19/2008); *Petitioners v. Taxpayer Services Div.*, Appeal No. 04-0919 (Utah St. Tax Commission, 11/13/2006), *available at*, http://tax.utah.gov/research/decisions/04-0919sanqc.pdf (last viewed, 11/19/2008).

debt loss. Separate financial institutions financed the credit sales, owned the credit accounts, and actually sustained the bad debt losses. Home Depot is therefore not entitled to a bad debt sales tax refund under former RCW 82.08.037. The trial court properly granted summary judgment to the Department, and this court should affirm.

## II. RESTATEMENT OF THE ISSUES

1. Must a seller incur a bad debt loss on a retail sale to qualify for a sales tax refund under former RCW 82.08.037 (2002)?

2. Is a tax statute that distinguishes retailers that incur a bad debt loss on a retail sale from those that do not consistent with the equal protection guarantee of the state and federal constitutions?

## III. STATEMENT OF THE CASE

Home Depot sold home improvement products at retail stores in Washington during the relevant tax periods.[3] When a customer purchased a product, Home Depot accepted payment in the form of cash, check, debit card, or credit card. CP 213. For credit card purchases, a customer could use either a general-use credit card or a Home Depot-labeled credit card. CP 213. Such store-branded credit cards are known in the credit industry

[3] Home Depot's recitation of the facts contains numerous argumentative assertions unsupported by the record, in violation of RAP 10.3(5). For example, Home Depot asserts it "bore the risk of loss" on the credit sales, an argumentative assertion plainly contradicting the undisputed evidence that GE Capital, not Home Depot, was bore the risk of loss on the credit sales. CP at 93, 153, 160, 217. Appellant's Br. at 9, 11. This court should disregard Home Depot's unsupported, argumentative assertions.

as a "private label credit card." A private label credit card is a customized credit card that may be used only at a particular retailer's outlets. CP 37, 211. Contrary to appearances, the Home Depot credit card was issued, administered, and owned by third party financial institutions, not Home Depot. CP 37. Home Depot did not, itself, extend credit to its customers on the retail sales for which it claims a refund. CP 37, 48.

### A. Contracts

Subsidiaries of the General Electric Capital Corporation (GE Capital) contracted with Home Depot for the exclusive right to extend credit under the Home Depot brand to Home Depot's customers. CP 99, 161, 227. Operating under a license to use the Home Depot logo on its credit cards, advertising materials, and communications with cardholders, GE Capital offered three types of credit accounts to Home Depot customers: commercial credit accounts, consumer credit accounts, and business credit accounts. CP 47, 102, 164-64, 229-30.

GE Capital paid Home Depot $6.5 million as a signing bonus on the consumer revolving credit program, and $500,000 for the business revolving credit program. CP 213. In addition, Home Depot was entitled to bonus payments for exceeding GE Capital's credit sales goals. CP 28, 223, 255. GE Capital supplied Home Depot with marketing materials and credit applications. CP 214.

GE Capital and Home Depot executed a separate contract for each type of credit account. CP 30, 124, 189, 252. The contracts provided:

> Bank is and shall be the sole and exclusive owner of all Accounts, Account Documentation, credit information, Cardholder data, Charge Transaction Data, Charge Slips, Credit Slips and receipts or evidence of payment or Purchases by Cardholders and shall be entitled to receive all payments made by Cardholders on Accounts. Retailer acknowledges and agrees that it has no right, title or interest in any of the foregoing and no right to any payments made by Cardholders on Accounts or any proceeds in respect of the Accounts. All collection procedures shall be under the sole control and discretion of Bank and may be modified from time to time by Bank.
>
> . . .
>
> All credit losses on Accounts shall be solely borne at the expense of Bank and shall not be passed on to Retailer with the exception of allowed charge-backs.
>
> . . .
>
> Retailer has no interest in the Accounts or Indebtedness created in connection with the Program.

CP 93 (business accounts), 153, 160 (commercial accounts), 217 (consumer accounts).

GE Capital determined the finance charge rates, annual fees, late fees, and any other terms of the credit agreements with its cardholders, and reserved the right to modify the terms. CP 213, 218. GE Capital had sole authority to determine the credit-worthiness of a customer. CP 89, 91, 95, 216.

At the end of each day, Home Depot electronically transmitted that day's credit sales to GE Capital. CP 96, 222. Within 48 hours, GE

Capital paid Home Depot the proceeds on the sales, including any applicable retail sales taxes, minus any applicable charge-backs and service fees. CP 96, 222. Charge-backs applied to returns, refunds, mistakes, disputed amounts, and other voided sales transactions. CP 106, 128, 257.

Home Depot remitted the applicable retail sales taxes to the State with its monthly excise tax returns.

**B. Service Fees**

The service fees Home Depot paid on the credit sales ranged from 0% to 13.80%, depending on the type of account. CP 253-54. As a general matter, the service fees depended on the amount of profit GE Capital expected to earn on particular categories of credit sales in the form of interest, late fees, and other financing charges, taking into account all anticipated costs, including, but not limited to, bad debt losses. CP 32-33, 40, 342.

In addition to bad debt losses, GE Capital's costs included the costs of borrowing money, marketing the credit programs, evaluating credit-worthiness, processing the credit sales--including billing and collection--and other overhead expenses associating with administering the accounts. CP 32-33, 37, 43. After projecting its earnings and costs, GE Capital determined the amount of desired profit for the credit card program and negotiated the service fees accordingly. CP 33.

Home Depot paid no service fee for "regular" purchases made by ordinary consumers unless the amount of the purchase exceeded $2,000. CP 254. On ordinary consumer purchases exceeding $2,000, Home Depot paid a service fee of .95%. CP 254.

A more complex formula determined the service fees on "promotional" credit sales. CP 253. A promotional sale was a credit sale marketed to customers as "interest free" for a specified period. CP 38-39. The ordinary interest rate accrued on the account each month, but GE Capital reversed the financing charges if the customer paid the entire balance within the promotional period. CP 205. The service fees for promotional sales ranged from 0% to 13.80%. CP 253.

The service fees on promotional sales varied, based on the extent to which a customer actually took advantage of the financing discount. Home Depot paid the highest service fee, 13.80%, on a credit sale promoted as "12 months interest free" if the customer paid the entire balance during the final month of the promotional period. CP 205, 253. Home Depot paid a lower service fee if the customer paid down the balance earlier during the promotional period. CP 253. The lowest service fees applied when a customer did not pay its balance within the promotional period, and thus remained liable for the accrued financing charges. CP 253. Every six months, GE Capital adjusted the service fees on promotional sales based on the payment history on the accounts. CP 223.

The service fees for business revolving credit accounts ranged from 2.06%, in the first year, to 1.84%, in the fourth year. CP 126. The service fees for commercial credit accounts were somewhat higher. GE Capital ordinarily would not collect interest on the commercial credit accounts because full payment was due within 30 days, before interest accrued. The service fees on commercial credit accounts ranged from 3.49%, in the first year, to 3.08% in the fourth year. CP 190. The fees decreased over time as GE Capital improved its ability to project profits and losses based on historical experience with Home Depot's customers.

Home Depot deducted the service fees it paid to GE Capital as an ordinary business expense on line 26 of its federal income tax returns. CP 269 (1995), 271 (1996), 273 (1997), 275 (1998), 277 (1999), 279 (2000), 286 (2002).

**C. Credit Losses**

On the whole, GE Capital profited from the financial services it provided to Home Depot's customers. CP 41. However, some of Home Depot's customers defaulted on their credit card debts. CP 36, 41. GE

Capital took a bad debt deduction for those losses on its federal income tax returns. CP 36, 292-302. GE Capital paid Home Depot the same amount on a credit sale, regardless of whether the customer ultimately defaulted. CP 40-41.

**D. Refund Action**

Home Depot filed a refund petition with the Department of Revenue, claiming it was entitled to recover the sales taxes from the sales transactions for which GE Capital sustained bad debt losses. CP 51, 264. The Department denied the petition. Home Depot appealed the Department's decision to the Thurston County Superior Court. CP 4-6. The Department moved for summary judgment on the ground Home Depot is not entitled to a sales tax refund, under RCW 82.08.037, because it did not incur a deductible bad debt loss on the credit sales financed by GE Capital. CP 7-15. The trial court granted the Department's summary judgment motion. CP 375. Home Depot timely appealed. CP 372.

## IV. SUMMARY OF ARGUMENT

RCW 82.08.037, Washington's bad debt refund statute, is a tax preference that should be construed no more broadly than necessary to fulfill its legislative purpose. Home Depot's novel theory of entitlement requires an unreasonably broad interpretation of the tax preference, and is based on the flawed premise that "no sales actually occurred" when its customers defaulted on their credit card debts.

RCW 82.08.037 provides an exception to the general rule that a seller is personally liable to the State for failing to collect retail sales taxes from the buyer, without allowance for any business losses the seller sustains on the transaction. The tax preference relieves a seller from personal liability for the sales tax portion of a retail sale when the seller cannot collect the sale proceeds from the buyer. Under the plain terms of the statute, Home Depot is not entitled to a refund because it actually collected the sales taxes from the buyers when it accepted payment by credit card. That some buyers subsequently defaulted on their credit card debts to the credit card issuers is of no consequence for purposes of RCW 82.08.037.

## V. ARGUMENT

### A. Standard Of Review

This court reviews a summary judgment order de novo. *Western Telepage v. City of Tacoma*, 140 Wn.2d 599, 607, 998 P.2d 884 (2000). Summary judgment is appropriate in the absence of a genuine issue of material fact when the only issue to be decided is a question of law. *S. Martinelli & Co., Inc. v. Dep't of Revenue*, 80 Wn. App. 930, 934, 912

P.2d 521 (1996). Statutory interpretation is a question of law, subject to de novo review. *Martinelli*, 80 Wn. App. at 934.

When interpreting a tax statute, the "paramount consideration" is to interpret it consistently with the underlying policy. *Impecoven v. Dep't of Revenue*, 120 Wn.2d 357, 362-3, 841 P.2d 752 (1992); *Automobile Club v. Dep't of Revenue*, 27 Wn. App. 781, 786, 621 P.2d 760 (1980). A taxpayer has the burden of establishing its entitlement to a tax refund. RCW 82.32.180; *Deaconess Medical Center v. Dep't of Revenue,* 58 Wn. App. 783, 788, 795 P.2d 146 (1990). A tax preference[4] is a matter of legislative grace that should be read no more broadly than necessary to fulfill its legislative purpose. *Automobile Club,* 27 Wn. App. at 786. In the case of doubt or ambiguity, a tax preference should be strictly construed in favor of the taxing authority. *Simpson Inv. Co. v. State*, 141 Wn.2d 139, 149-50, 3 P.3d 741 (2000); *Group Health Co-op of Puget Sound, Inc. v. Dept' of Revenue*, 106 Wn.2d 391, 401, 722 P.2d 787 (1986); *Sacred Heart Medical Center v. Dep't of Revenue*, 88 Wn. App. 632, 636-7, 946 P.2d 409 (1997); 3A Sutherland, STATUTES AND STATUTORY CONSTRUCTION, § 66:9, 77, 87 (6th ed. 2003).

The purpose of strictly construing tax preferences is "to minimize differential treatment and foster impartiality, fairness, and equality of

[4] "Tax preference" refers to a tax statute that authorizes an exemption, deduction, credit, or refund. RCW 43.136.021.

treatment among taxpayers." STATUTES AND STATUTORY CONSTRUCTION, § 66:9, at 85. *See also Daimler Chrysler Services North America, LLC v. Commissioner of Revenue*, 274 Conn. 196, 875 A.2d 28, 32 (Conn. 2005) (explaining that "exemption from taxation is the equivalent of an appropriation of public funds, because the burden of the tax is lifted from the back of the potential taxpayer that is exempted and shifted to the backs of [other taxpayers]").

## B. The Legislature Adopted RCW 82.08.037 To Allow A Seller To Recover Sales Taxes The Seller Paid On Behalf Of The Buyer When The Seller Cannot Recover From The Buyer

Home Depot argues that denying its refund claim defeats the purpose of the statute, which it mischaracterizes as preventing the State's "unjust enrichment." Appellant's Br. at 2, 4. The purpose of RCW 82.08.037 is to provide limited relief to sellers that cannot collect the proceeds of a retail sale from the buyer.

Washington imposes a retail sales tax on "each retail sale." RCW 82.08.020(1). The measure of the tax is the "selling price," which is the "total amount of consideration" for which a good is sold, without deduction for the seller's overhead expenses or "any other expenses whatsoever . . . and without deduction on account of losses." RCW 82.08.010(1); *Klickitat County v. Jenner*, 15 Wn.2d 373, 382, 130 P.2d 880 (1942). Although the incidence of the tax falls on the buyer, the seller has the duty to remit the sales tax whether or not it collects the proceeds at the time of sale. RCW 82.08.050; *AARO Medical Supplies, Inc. v. Dep't of Revenue*, 132 Wn. App. 709, 717, 132 P.3d 1143 (2006). Sales taxes advanced by the seller on behalf of a buyer constitute a "debt" owed by the buyer to the seller. RCW 82.08.050.

A seller is personally liable to the State for any sales taxes it fails to collect, "whether such failure is the result of his or her own acts or conditions beyond his or her control." RCW 82.08.050; *AARO Medical Supplies*, 132 Wn. App. at 716. However, former RCW 82.08.037 provides an exception:

> A seller is entitled to a credit or refund for sales taxes previously paid on debts which are deductible as worthless for federal income tax purposes.

RCW 82.08.037. [5]

Our Legislature enacted RCW 82.08.037 in 1982. Laws of 1982, Ex. Sess., ch. 36, § 35.[6] Nearly all states with a retail sales tax have a

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[5] The legislature recently revised RCW 82.08.037 as part of the Streamlined Sales and Use Tax initiative, a multi-state effort to simplify and harmonize the sales tax laws nationwide. *See* Laws of 2004, c. 153, s. 302-305. *See, generally*, Walter Hellerstein and John A. Swain, STREAMLINED SALES AND USE TAX 2007/2008, ¶ 7.08, at 7-24 (2008) (member states must "allow a deduction from taxable sales for bad debts and [a]dopt the federal income tax definition of 'bad debt,'" subject to exclusions for financing charges or interest, and collection expenses).

As Home Depot correctly recognizes, the legislative purpose in amending RCW 82.08.037 was to clarify rather than change the substance of the statute. Appellant's Br. at 16, n 4. The legislature clarified that "debts which are deductible as worthless for federal income tax purposes" refers to "'bad debts,' as that term is used in 26 U.S.C. 166."

similar provision. *See generally* James Amdur, "*Recovery of Sales Taxes Paid on Bad Debts*," 38 A.L.R.6th 255 (2008). The purpose of the bad debt credit is to limit a seller's liability for the sales tax portion of a sale transaction when the seller cannot collect the proceeds from the buyer. Professor Hellerstein, the author of the leading treatise on state tax law, explains the prevailing view:

> The denial of a credit or deduction to retailers who suffer defaults or bad debts with respect to the purchase price (as well as the tax) is harsh and unwarranted...the overwhelming majority of states have abandoned the harsh rules articulated in the earlier cases, and virtually all states allow a credit or refund for bad debts. States typically allow such credits, deductions, or refunds ***when the debt becomes worthless and is charged off on the seller's books...***

*See* Jerome R. & Walter Hellerstein, STATE TAXATION, ¶ 17.11, at 17-53-4 (3d. ed. 2007) (emphasis added).

RCW 82.08.037 represents a legislative policy choice that as between the State and the seller, the State will bear the economic loss when the seller cannot collect sales taxes it advanced on behalf of the buyer. *See Household Retail Service, Inc. v. Commissioner of Revenue,*

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[6] Until 1982, Washington did not allow sellers to recoup sales taxes they paid on uncollectible consumer debts. In *Olympic Motors Inc. v. McCroskey,* 15 Wn.2d 665, 132 P.2d 355 (1942), the Washington Supreme Court declined to infer an allowance for an automobile dealer's credit losses on installment sales contracts, considering the clear legislative intent to disallow deduction for business losses from the sales tax base: "While one may sell his personal property under a conditional sales contract and waive his right to collect the full purchase price at the time of sale...that waiver has no effect on the sales tax liability." 15 Wn.2d at 669.

448 Mass. 226, 859 N.E.2d 837, 841 (2007) (describing Massachusetts's bad debt statute as "a statutory courtesy" for retailers that serve as the State's trustee in collecting sales taxes).

### C. RCW 82.08.037 Authorizes A Refund Only For Sellers That Incur A Deductible Bad Debt Loss On A Retail Sale

Viewed in the context of related statutory provisions, and considering the purpose of the statute, the only reasonable interpretation of RCW 82.08.037 is that "debts which are deductible as worthless for federal income tax purposes" refers to debts owed by the buyer to the seller, or the seller's assignee, not debts owed to a third party lender. Because GE Capital, not Home Depot, incurred deductible bad debts on the credit sales, Home Depot does not qualify for a sales tax refund.

#### 1. Home Depot's interpretation of RCW 82.08.037 is inconsistent with *Puget Sound National Bank*, 123 Wn.2d 284, 868 P.2d 127 (1994).

Relying on *Puget Sound Nat. Bank v. Dep't of Revenue,* 123 Wn.2d 284, 868 P.2d 127 (1994), Home Depot contends RCW 82.08.037 entitles a seller to recover sales taxes paid on deductible worthless debts, regardless of who incurs the bad debt loss. Appellant's Br. at 16. On the contrary, *Puget Sound* supports the proposition a refund claimant must incur a deductible bad debt loss on a sale to qualify for a sales tax refund.

*Puget Sound* involved an automobile dealer that sold cars on an installment sale basis. 123 Wn.2d at 285-6. The dealer subsequently assigned the installment sales contracts to a third party. When some of the buyers defaulted on their payment obligations, the seller's assignee filed a tax refund petition. The issue decided by the court was whether an assignee can be a "seller" within the meaning of RCW 82.08.037.

The *Puget Sound* court divided RCW 82.08.037 into three requirements: (1) the seller must be a person, (2) making sales at retail, and (3) entitled to a refund for sales taxes previously paid on debts which are deductible as worthless for federal income tax purposes. *Puget Sound*, 123 Wn.2d at 287.

Reasoning that the statutory definition of "seller" includes "person," and the statutory definition of "person," includes "assignee," the *Puget Sound* court held an assignee is a "seller" within the meaning of RCW 82.08.037. 123 Wn.2d at 287-88. Next, the court applied the common law principle that an assignee "stands in the shoes" of the assignor, acceding to all the assignor's rights and responsibilities, and concluded an assignee may be deemed the person "making sales at retail." *Puget Sound*, 123 Wn.2d at 288-89. Finally, the court held that the seller/assignee indisputably was entitled to a sales tax refund because it incurred a deductible bad debt loss on the sales transactions, having charged off the uncollectible consumer debt on its federal income tax returns. *Puget Sound*, 123 Wn.2d at 290-91. Thus, the court held the seller's assignee was entitled to a bad debt refund. *Puget Sound*, 123 Wn.2d at 293.

Following *Puget Sound*, a refund claimant is not entitled to a sales tax refund, under RCW 82.08.037, unless it incurs "debts which are deductible as worthless for federal income tax purposes." The *Puget Sound* court inferred the assignee qualified for a bad debt refund from the undisputed fact it had charged off the uncollectible consumer debts and qualified for the federal bad debt deduction. In so holding, the court impliedly concluded the original seller was not entitled to the bad debt refund because it did not incur bad debt losses on the credit sales.

Unlike the refund claimant in *Puget Sound*, Home Depot did not incur a bad debt loss, and thus does not satisfy the statutory requirements.

**2. By tying the refund to the federal bad debt statute, the legislature limited the refund amount to the statutory debt obligation owed by the buyer to the seller.**

The purpose of tying the seller's eligibility for a refund to the federal bad debt statute is to ensure a seller may recover any uncollectible sales taxes it advanced on behalf of the buyer, but no more. Reading the statutory language, "debts which are deductible as worthless," as referring to debts owed by the buyer to the seller harmonizes RCW 82.08.037 with

RCW 82.08.010(1), which generally disallows a seller from reducing its sales tax liability for its costs and "any other expense whatsoever." RCW 82.08.010(1).

The federal bad debt deduction applies only to amounts of a taxpayer's accounts receivable, previously reported as income, that are actually uncollectible. Moreover, the deduction only applies to debts the taxpayer reasonably expected to recover, when incurred, and remains legally entitled to collect. *See*, *generally*, 8 MERTENS LAW OF FED. INCOME TAX'N § 30:1, 4. *Zimmerman v. U.S.*, 318 F.2d 611, 612 (9th Cir. 1963); Regulation section 1.166-1(c). A seller who sells on credit is entitled to take a bad debt deduction when the buyer fails to pay. *Decker v. United States*, 244 F. Supp. 31, 32-33 (D.C. Iowa 1865); MERTENS § 30:55. But a seller who incurs any other kind of expense on a sale transaction is not entitled to a federal bad debt deduction. *Spring City Foundry Co. v. Commissioner of Internal Revenue*, 292 U.S. 182, 189, 54 S. Ct. 644, 78 L. Ed. 1200 (1934). The seller's expenses may be deductible under another provision of the Internal Revenue Code, but not as a bad debt.

When "debts which are deductible as worthless for federal income tax purposes" is read as applying to debts owed to the seller, the scope of the sales tax refund neatly corresponds to the scope of the statutory debt obligation created by RCW 82.08.050, which provides: "The amount of tax, until paid by the buyer to the seller or to the department, shall constitute a debt from the buyer to the seller . . .". This fulfills the purpose of the bad debt refund, which is to relieve the seller of personal liability for amounts it is required to collect on behalf of the State, to the extent the seller involuntarily fails to collect the proceeds from the buyer.

In contrast, reading the statute as permitting a seller to recover sales taxes paid on uncollectible debts owed to third party lenders would yield absurd results. *See Burns v. City of Seattle*, 161 Wn.2d 129, 151, 164 P.3d 475 (2007) ("In undertaking a plain language analysis, we avoid interpreting a statute in a manner that leads to unlikely, strained, or absurd results"); *Nationscapital Mortgage Corp. v. Dept. of Financial Institutions*, 133, Wn. App. 723, 737, 137 P.3d 78 (2006) (same).

When Home Depot accepted payment by credit card, it fully collected the sales taxes owed on a sales transaction, plus the selling price, minus any applicable service fees. Thus, it suffered no out-of-pocket loss on the sales taxes when its buyers defaulted on their credit card debts. Allowing a refund under such circumstances would not advance the legislative purposes of the bad debt statute. Because Home Depot collected the entire sales tax from the credit card issuer, on behalf of the buyer, there is no unrecovered sales tax debt obligation for Home Depot to claim.

For this reason, courts and administrative tribunals in other jurisdictions have rejected Home Depot's bad debt refund claim. As a Commissioner of the New York Tax Appeals Tribunal recently stated:

> When a retail customer brings a credit card to a store to pay for purchased goods, the nature of the transaction is much the same as if he instead brought his rich uncle. The customer pays the retailer in cash with funds borrowed by the customer from a third party, avuncular or commercial. If the customer fails to repay the borrowing from the lender, there is no basis for rescinding or otherwise recasting the sale of merchandise, since the customer paid and the merchant received the purchase price in cash.

Decision DTA No. 821034 (11/6/2008) (Comm. McDermott, concurring) (affirming administrative law judge's decision to deny Home Depot's refund claim based on bad debts incurred by GE Capital).

Returning the sales taxes to Home Depot would amount to a financial windfall by allowing it to recover the sales taxes twice: first from the credit card company and again from the State. The legislature did not intend such an absurd consequence when it enacted RCW 82.08.037.

Considering a refund statute must be interpreted no more broadly than necessary to fulfill its legislature purpose, with any doubts or ambiguities resolved against the refund claimant, RCW 82.08.037 should be interpreted as applying only to sellers that incur a deductible bad debt loss. Because GE Capital, not Home Depot, incurred a deductible bad debt loss, Home Depot is not entitled to a sales tax refund under RCW 82.08.037.

### D. Any Credit Card Service Fees Home Depot Paid On Credit Card Transactions Were Ordinary Business Expenses, Not Bad Debts

Home Depot contends the service fees GE Capital deducted from the proceeds of the credit sales constituted "prepayment" of the lender's bad debt losses and, through this contractual mechanism, Home Depot "bore the loss" for the accounts written off by the credit card issuer. Home Depot's theory assumes a seller may qualify for a refund by proving it actually "bore the loss," rather than by proving it satisfies the criteria for a federal bad debt deduction. Appellant's Br. at 21.

The legislature deliberately tied the bad debt refund to a seller's eligibility for a federal bad debt deduction. As stated by the Ohio Tax Appeals in denying Home Depot's refund claim, "a statute that is specific in its requirements must be applied as written." *Home Depot USA, Inc. v. Wilkins*, Case Nos. 2006-M-206, 207 (Ohio Bd. Of Tax Appeals, June 18, 2008). Accordingly, to qualify for a bad debt tax credit, a seller must prove it incurred a bad debt loss: "the fact that bad debts were taken into consideration in deductions on the vendors books does not meet the statutory requirements." *Id.*

Because Home Depot plainly does not qualify for a federal bad debt deduction, this court need not address its contention that it "bore the economic loss" on the defaulted credit card debts owed to GE Capital. However, even if RCW 82.08.037 permitted a seller to present evidence that it somehow incurred the functional equivalent of a deductible bad debt loss, Home Depot could not meet its burden of proof.

**1. RCW 82.08.037 does not authorize a sales tax refund for a seller's voluntary business expenses.**

For federal income tax purposes, any service fees Home Depot paid to GE Capital were ordinary business expenses, not deductible bad debts. Indeed, Home Depot treated the service fees as ordinary business expenses on its federal income tax returns. CP 269-286. A voluntary business expense can never constitute a bad debt for federal income tax purposes. *Spring City Foundry Co.,* 292 U.S. at 189 (bad debt deduction is exclusive of deduction for other business expenses). As the IRS explains, "If someone owes you money that you are not going to be able to collect, you have a bad debt." http://www.irs.gov/publications/p535/ch10.html. In other words, a bad debt is an account receivable that is uncollectible. A bad debt deduction applies only to debts the taxpayer reasonably expected to recover, when incurred, and remains legally entitled to recover. Mertens, § 30:20; *Iowa*

*Southern Utilities Co v. U.S.,* 172 Ct.Cl. 21, 348 F.2d 492, 496, (Ct.Cl. 1965).

Home Depot voluntarily paid service fees on some of the sales transactions financed by GE Capital, presumably because it expected to profit through increased sales volume. Home Depot agreed to pay the service fees in exchange for GE Capital's agreement to assume the costs of the credit card program and to bear the risk of bad debt losses. That the service fee was determined, in part, by GE Capital's anticipated bad debt losses is irrelevant. RCW 82.08.037 allows a seller to recover only amounts it advanced on behalf of the buyer that prove uncollectible. It does not entitle a seller to recover amounts it paid to a third party lender to enable the lender to hedge against the possibility of a buyer's default.

Because the credit card service fees were a business expense that Home Depot voluntarily paid and was not entitled to recover, they cannot be the basis for a bad debt refund.

**2. The service fees were consideration to guarantee Home Depot's collection of the selling price.**

By paying service fees to GE Capital, Home Depot guaranteed its collection of the selling price, an amount it could not have recovered from the State on defaulted credit sales. In exchange for a fixed, negotiated sum, Home Depot protected itself from the risk of loss on the selling price, which constitutes more than 90% of the potential economic loss for each credit sale.

Allowing a sales tax refund predicated on the service fees would amount to a financial windfall for Home Depot by effectively shifting to the State the burden of economic loss, not only as to the sales tax portion of the credit sales, but also as to the selling price. RCW 82.08.037 was not intended to guarantee the risk sellers undertake when they elect to extend credit to their customers, much less to guarantee the investment risk assumed by credit card companies or other lenders that have no sales tax collection obligation to the State.

**3. The service fees Home Depot paid are indistinguishable from the service fees for general-use credit cards.**

Retailers that accept general-use credit cards pay a non-negotiable interchange fee and other merchant discount fees to the national credit card associations and banks that process the transactions. *See* Adam J. Levitin, "*Priceless? The Economic Costs of Credit Card Merchant Restraints*," 55 UCLA L. Rev. 1321 (2008) (discussing increasing transaction costs of general use credit cards). The service fees are consideration for convenience, risk management, and guaranteed payment. *See Household Retail Services, Inc. v. Commissioner of Revenue*, 448 Mass. 226, 859 N.E.2d 837 (2007). Credit card services fees are not deductible from the retail sales tax base. RCW 82.08.010(1); *Central Hardware Co. v. Director of Revenue*, 887 S.W.2d 593, 595 (1994).

The service fees Home Depot paid to GE Capital are indistinguishable from the service fees applicable to general use credit cards. Private label credit card programs are promoted as a strategy to avoid the higher transaction costs associated with general-use credit cards. "*Payment Wars: The Merchant-Bank Struggle for Control of Payment Systems*," 12 Stan. J.L. Bus. & Fin. 425, 449- 50(2007) (discussing retailers' use of private label credit cards as a strategy to avoid non-negotiable fees and conditions imposed by national credit card associations and banks). The service fees for private label credit cards generally are less than the service fees for general-use credit cards.

No merchant can reduce its sales tax liability by the amount of service fees it pays on general-use credit card transactions, even if those fees offset the lender's bad debt, including, in part, sales taxes. *See* RCW 82.080.010(1) (disallowing deduction from sales tax base for seller's costs). Similarly, Home Depot is not entitled to a refund of service fees it paid on private label credit card transactions, which are less than, but otherwise indistinguishable from, service fees it paid on general-use credit cards.

## E. Home Depot Cannot Prove The Correct Amount Of The Sales Tax Refund

Even if Home Depot's legal theory were tenable, and a seller could qualify for a sales tax refund when it "compensates" a third party lender for the lender's bad debt losses, the trial court properly granted summary judgment to the Department because Home Depot cannot prove the correct amount of the sales tax refund. A taxpayer that claims a refund must prove not only that it paid more taxes than it owed, but also "the correct amount of the tax." RCW 82.32.180; *Texaco Refining and Marketing, Inc. v. Dep't of Revenue*, 131 Wn. App. 385, 397-98, 127 P.3d 771, *review denied*, 158 Wn.2d 1012, 145 P.3d 1214 (2006). A taxpayer does not meet this burden when it fails to segregate taxable revenue from non-taxable revenue. *Automobile Club v. Dep't of Revenue*, 27 Wn. App. 781, 786-87, 621 P.2d 760 (1980).

In *Automobile Club*, a non-profit organization sought a refund of business and occupation taxes under an exemption for "bona fide dues," statutorily defined as excluding amounts exchanged for "services rendered." 27 Wn. App. at 783. Some of the annual dues the automobile club collected applied to non-taxable social activities, and some applied to taxable services rendered. The amount of dues collected correlated strongly with the value of the services rendered. Applying the principle that a tax preference applies no more broadly than necessary to fulfill its legislative purpose, this court concluded the taxpayer failed to meet its burden of proof:

> [I]t is quite likely that a portion of dues received by the Auto Club covers expenses incident to providing the privilege of membership and are thus deductible. The Auto Club, however, has made no attempt to segregate these expenses. Absent such a segregation, the Department may presume that the entire amount is taxable.

*Automobile Club*, 27 Wn. App. at 786-87.

As in *Automobile Club*, Home Depot cannot comply with the refund statute because the amount it seeks to recover indisputably encompasses amounts beyond the scope of the tax preference.

Home Depot measures the amount of its refund claim by the bad debt losses GE Capital charged off as worthless on its federal income tax returns. CP 64-65, 264-66. It claims it "compensated" GE Capital for these losses by paying service fees and other valuable consideration. Courts and administrative tribunals around the country have identified a fatal flaw in Home Depot's theory: Home Depot cannot establish the service fees it paid correlate to the uncollectible sales taxes it remitted to the State. *See, Home Depot USA, Inc. v. Director, Division of Taxation*, 24 N.J.Tax 23 (2008); *Home Depot USA, Inc. v. Indiana Dep't of Revenue*, 891 N.E.2d 187 (2008); *In re Home Depot USA, Inc.*, Det. No.

821034, State of New York, Division of Tax Appeals, (May 17, 2007), *affirmed*, N.Y. Tax Appeals Tribunal (November 6, 2008); *Home Depot USA, Inc. v. State of Alabama*, Docket No. S. 06-1079, Dep't of Revenue, Admin. Law Div. (June 6, 2008).

Some of the service fees applied to credit accounts that remained in good standing, and some of the service fees compensated GE Capital for interest income it voluntarily waived on promotional sales. Because Home Depot cannot segregate these amounts, its refund claim must fail.

### 1. The service fees bore no relation to the sales taxes Home Depot remitted on the credit sales.

The service fees Home Depot paid to GE Capital bore no relation to the sales taxes Home Depot collected and remitted on the credit sales. Home Depot paid no service fees on "regular" consumer purchases not exceeding $2,000. CP 254. Thus, Home Depot received 100% of the proceeds (including the sales tax) on such credit sales, without deduction of any kind (except for charge-backs on voided transactions). Home Depot presents no evidence showing what portion of the credit sales GE Capital charged off as worthless related to consumer purchases for which it paid no service fees. Common sense suggests a substantial portion, if not most, of GE Capital's bad debt losses were incurred on such purchases, considering that most of the products Home Depot offers cost less than $2,000. *See* http://www.homedepot.com (last viewed, 11/19/2008). Home Depot has not segregated the bad debt losses for which it paid no service fee. Admitting to this flaw in its evidence, Home Depot simply claims it is entitled to a refund based on the aggregate service fees it paid, "on a portfolio basis." Appellant's Br. at 11.

### 2. Many factors other than GE Capital's anticipated bad debt losses determined the service fees Home Depot paid.

RCW 82.08.037 applies only to the sales tax portion of a retail sale. The service fees Home Depot paid partially compensated GE Capital for a variety of costs associated with financing the credit sales, including the costs of borrowing money, marketing the program, determining a customer's credit-worthiness, processing the sales transactions, billing customers, and collecting payments. CP 32-33, 37, 40, 43, 342. The service fees also varied depending on the amount of interest Home Depot allowed GE Capital to charge Home Depot's customers. CP 37. Home Depot failed to show the service fees it paid correspond to the sales taxes Home Depot remitted to the State on defaulted credit card sales.

### 3. The service fees compensated GE Capital for interest income it voluntarily relinquished on promotional sales.

Home Depot paid the highest fees for what were, in effect, subsidies Home Depot voluntarily offered to its customers: the "after the fact free" transactions for which GE Capital waived its interest charges. CP 38-39, 205, 253. These service fees replaced interest income GE Capital otherwise would have earned. If Home Depot had itself financed the credit sales, it would not have been entitled to a sales tax credit for such promotional costs. Why should it be entitled to a refund for voluntarily compensating a third party lender for foregone interest charges on accounts that were paid in full?

Home Depot benefited from the promotional sales in the form of increased sales volume and customer goodwill. The service fees on these promotional sales were not prepayments of bad debts, and allowing a refund based on such fees goes far beyond the statutory language and intent to reimburse sellers who incur bad debts.

## F. The State Is Not Unjustly Enriched By Retaining Sales Taxes Owed By The Buyer That Home Depot Properly Collected And Remitted

Home Depot argues the State is "unjustly enriched" by retaining the sales taxes because "no sale[s] actually occurred" when its customers failed to pay their credit card debts. Appellant's Br. at 2, 4, 24, 29.

The record does not support Home Depot's characterization of the sales transactions as "unconsummated." *See* Appellant's Brief at 1 ("no sale ultimately occurred"; "busted transaction," "no sale at the end of the day"). A sale occurs when a seller transfers possession of property "for a valuable consideration." RCW 82.04.040; WAC 458-20-103. A buyer's promise to pay is valuable consideration. RESTATEMENT (SECOND) OF CONTRACTS § 79 (1981). A retail sale is "consummated," for sales tax purposes, when a seller transfers property in exchange for the buyer's promise to pay, even though the buyer pays nothing at the time of purchase. *See General Elec. Capital Corp. v. New York State Div. of Tax Appeals,* 2 N.Y. 3d 249, 810 N.E.2d 864, 870, n. 4 (N.Y. 2004) (rejecting financing company's claim a buyer's failure to pay its credit card debt results in an "unconsummated sale" for which it may claim a sales tax refund).

Here, the retail sales were "consummated" when Home Depot accepted a credit card as payment. That some of Home Depot's customers subsequently failed to pay their credit card debt to GE Capital does not convert their purchases into non-taxable transactions. *General Elec*, 810 N.E.2d at 870. A buyer still owes the taxes due on a credit sale that ultimately is charged off as uncollectible. *Olympic Motors*, 15 Wn.2d at 669.

The State is not "unjustly enriched" by retaining the sales taxes on defaulted credit card transactions. Unjust enrichment "is enrichment that lacks an adequate legal basis." *Nelson v. Appleway Chevrolet, Inc.,* 160 Wn.2d 173, 187-88, 157 P.3d 847 (2007) (quoting Restatement (Third) of

Restitution and Unjust Enrichment, s. 1 cmt. B). Unjust enrichment could arise when the State retains taxes that were improperly collected, either because a seller erred in collecting taxes or the State erred in assessing them. *See, e.g., Nelson* 160 Wn.2d at 187-88 (seller unjustly enriched by retaining taxes illegally collected from buyers); *Kitsap-Mason Dairymen's Ass'n v. Washington State Tax Comm.*, 77 Wn.2d 812, 467 P.2d 312 (1970) (seller must either refund or remit improperly collected sales taxes). In this case, the sales taxes were owed at the moment of sale, when Home Depot accepted credit card payment from its customer.

Retaining taxes that were properly collected and remitted does not amount to a "money grab." Appellant's Br. at 4. On the contrary, it is Home Depot that overreaches by claiming a legal right to the sales taxes. RCW 82.08.037 entitles a seller to recover only taxes it paid out-of-pocket on behalf of the buyer, not amounts it received from a third party lender, on behalf of the buyer, and held as the State's trustee. *See* RCW 82.08.050 (sales taxes collected by sellers are held "in trust" for the State). As the State's trustee, Home Depot never had a legal right to the sales tax portion of the proceeds it collected from the buyers on the credit sales.

Home Depot argues that limiting a sales tax refund to sellers that incur a deductible bad debt on a retail sale amounts to an unfair "Catch-22" because neither the third party lender that incurs the bad debt loss, nor the seller would qualify for a tax refund. Appellant's Br. at 23-24. Home Depot's argument incorrectly assumes that someone---either the seller or lender--- must be entitled to recover the sales taxes. The legislature, however, has not authorized a sales tax refund for credit card companies that incur bad debt losses, and any legislation proposing such relief undoubtedly would be hotly contested.

That Home Depot does not fall within RCW 82.08.037 results from its voluntary business choice to rely on a third party lender rather than to finance credit sales itself. As an administrative law judge stated in denying Home Depot's refund petition: "petitioner voluntarily chose to do business in this fashion, albeit in step with industry custom. Since the form of the transaction (third-party financing) was chosen by petitioner with knowledge of the regulation, 20 NYCRR 534.7(b)(3), petitioner is bound by that choice and its ramifications." *In re Matter of Home Depot U.S.A.,* DTA No. 821034 (N.Y. Div. Tax Appeals, May 17, 2008). *See also Impecoven,* 120 Wn.2d at 363-64 (taxpayer bound by the tax consequences ensuing from the manner it structures its business); *Washington Sav-Mor Oil Co. v. Tax Commission*, 58 Wn.2d 518, 520-21, 364 P.2d 440 (1961) (same).

### G. RCW 82.08.037 Reasonably Distinguishes Retailers That Finance Credit Sales Themselves From Those That Use The Services Of A Credit Card Company

Finally, Home Depot contends the denial of its refund claim violates its constitutional rights to equal protection and due process under the federal and state constitutions. Appellant's Br. at 25. Home Depot's constitutional claims lack merit.[7]

It is well-established the legislature has broad discretion in creating tax classifications. *Forbes v. City of Seattle*, 113 Wn.2d 929, 944-45, 785 P.2d 431 (1990). The legislature's power to create tax classifications is even broader than its power to create regulatory classifications. *Forbes,* 113 Wn.2d at 933. "The test is merely whether any state of facts can reasonably be conceived that would sustain the classification." *United Parcel Service Inc. v. Dep't of Revenue*, 102 Wn.2d 355, 369, 687 P.2d 186 (1984).

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[7] Because Home Depot provides no argument or authority suggesting the Washington Constitution provides broader protection than the Fourteenth Amendment to the United States Constitution, its constitutional claims should be decided solely under federal constitutional law. *See Forbes v. City of Seattle*, 113 Wn.2d 929, 934, 785 P.2d 431 (1990). In any event, the Washington Supreme Court has held that tax preferences are not among the "fundamental rights of state citizenship" and therefore will be upheld against an article I, section 12 challenge if "any state of facts can reasonably be conceived that would sustain the classification." *Grant County Fire Protection Dist. No. 5 v. City of Moses Lake,* 145 Wn.2d 702, 731, 42 P.3d 394 (2002), *overruled on other grounds by, Grant County Fire Prot. Dist. No. 5 v. City of Moses Lake*, 150 Wn.2d 791, 813-814, 83 P.3d 419 (2004).

Disparate tax treatment based on reasonable factual distinctions and policy preferences does not violate the equal protection clause.[8] The differences underlying disparate tax treatment need not be great. *Lehnhausen v. Lake Shore Auto Parts*, 410 U.S. 356, 93 S. Ct. 1001 (1973) (distinguishing personal property owned by individuals from that owned by "non-individuals"); *Clerk v. Dwyer*, 56 Wn.2d 425, 435, 353 P.2d 941 (1960) (distinguishing green apples from red ones).

RCW 82.08.037 is a tax preference for retailers that paid sales taxes they cannot actually collect from the buyer. The statute distinguishes sellers that sustain a bad debt loss on a retail sale from those that do not. The disparate tax treatment rests on reasonable considerations of factual differences and tax policy.

A retailer that finances a credit sale itself has paid sales tax to the state but has not received any payment for the sale. In contrast, a retailer that accepts payments from a third-party lender to finance a credit sale receives payment for the customer's purchase, whether or not the purchaser subsequently pays its credit card debt. These retailers do not

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[8] *Oil Heat Institute of Wash. v. Town of Mukilteo*, 81 Wn.2d 7, 11, 498 P.2d 864 (1972); *Armstrong v. State*, 61 Wn.2d 116, 118, 377 P.2d 409 (1962) (citing *Allied Stores of Ohio v. Bowers*, 358 U.S. 522, 526-8, 79 S. Ct. 437, 3 L.Ed. 2d 480 (1958)); *Texas Co. v. Cohn*, 8 Wn.2d 360, 369-70, 112 P.2d 522 (1941) (citing *Bell's Gap R. Co. v. Pennsylvania*, 134 U.S. 232, 10 S. Ct. 533, 33 L.Ed. 892 (1890) ); *State ex rel. Stiner v. Yelle*, 174 Wash. 402, 25 P.2d 91 (1933) (citing *Brown-Forman Co. v. Kentucky*, 217 U.S. 563, 30 S.Ct. 578, 54 L.Ed. 883 (1910)).

"suffer the same economic loss." Appellant's Br. at 27. Nor are the two retailers similarly situated. The legislature reasonably limited the bad debt refund statute to sellers that involuntarily suffer a loss on a credit sale, and excluded sellers that shift the risk of loss to a third-party lender in exchange for a service fee.

Home Depot attempts to minimize the relevant differences by characterizing GE Capital as a company it hired to "administer" its credit programs. Appellant's Br. at 27. This obscures the relevant facts. Home Depot does not extend credit to its customers. GE Capital extends credit to Home Depot's customers, operating under a license to use the Home Depot brand name. CP 99, 161, 227. The credit accounts are created, administered, and wholly owned by GE Capital, not Home Depot. CP 93, 153, 217. These differences are not trivial. The United States Supreme Court and the Washington Supreme Court have sustained tax classifications based on far less consequential differences. *See, e.g., State Bd. Of Tax Comm'rs v. Jackson*, 283 U.S. 527, 536, 51 S. Ct. 540 (1931) (chain stores may be taxed differently than independently owned stores); *Sonitrol Northwest, Inc. v. City of Seattle*, 84 Wn.2d 588, 592, 528 P.2d 474 (1975) (businesses that provide centrally monitored alarm systems may be taxed differently than those that provide on-site security).

Moreover, the State's interest in avoiding an excessive administrative burden is furthered by limiting the bad debt sales tax refund to sellers that sustain a deductible bad debt. *Lehnhausen*, 410 U.S. at 365 (*overruling Quaker City Cab Co. v. Pennsylvania*, 277 U.S. 389, 48 S. Ct. 553, 72 L.Ed. 927(1938)) (avoidance of administrative burden and need to facilitate orderly administration of a tax supply reasonable basis for disparate tax treatment); *United Parcel Service Inc. v. State, Dep't of Revenue*, 102 Wn.2d 355, 368, 687 P.2d 186 (1984) (same). The State has a direct relationship with the seller, which it does not necessarily have with the credit card companies. Processing refunds predicated on the bad debt losses claimed by third party lenders would entail the additional administrative burden of verifying the third party's financial records.

## H. Any Modification Of RCW 82.08.037 Is The Prerogative Of The Legislature

Home Depot contends it is unjust to allow a bad debt refund to retailers that finance credit sales themselves while denying one to those that accept payment from a third-party lender. *See* Appellant's Br. at 1 (denying refund of taxes paid by third party lenders "shocks the conscience", and is "manifestly unjust"). Limiting the sales tax refund to sellers (and their assignees) that paid sales taxes they cannot collect from the buyer is a reasonable tax policy. Most of the other 45 states with a retail sales tax have the same tax policy. *See* Hellerstein, ¶17.11[2] , at 17-52; ¶12.02, Table 12.7 (summarizing bad debt statutes of 45 states). The wisdom of adopting a more generous tax refund policy for retailers that collaborate with financial institutions that issue private label credit cards is a matter for the legislature, not the courts.[9]

## VI. CONCLUSION

The plain, unambiguous language of RCW 82.08.037 authorizes a sales tax credit or refund only for a seller that sustains a deductible bad debt loss on a retail sale. Because Home Depot did not have a deductible bad debt loss on the credit sales at issue, it is not entitled to a sales tax refund under RCW 82.08.037. Therefore, the Superior Court correctly dismissed Home Depot's refund claim on summary judgment, and this Court should affirm the summary judgment order.

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[9] Indeed, while courts and administrative tribunals around the country have declined Home Depot's invitation to expansively interpret bad debt statutes (on the same arguments, and on the same facts, as those presented here), the legislatures of some states have adopted the tax policy Home Depot urges. At the urging of national retailers and financial institutions that provide private label credit cards, the legislatures of some states have recently amended their bad debt statutes to allow refund claims for losses experienced by private label credit card issuers. *See, e.g.,* 2006 N.Y. Law, chapter 664 (allowing vendor to file tax refund for bad debt sustained by third party lender, when vendor or lender file an election with the State);1998 Ga. Laws 747 (amending Ga. Code Ann. S. 48-8-45(c) (1997)); 1999 Tex. Gen. Laws 3211, Section 2.24 (amending Subsection (c) of Section 151.426 (1997) and adding Subsection (e), (f), (g), (h), (i), and (j)). The Washington legislature has not yet considered similar legislation.

RESPECTFULLY SUBMITTED this 19th day of November, 2008.

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# APPENDIX A

*Changes in tax law—Liability: RCW 82.08.064, 82.14.055, and 82.32.430.*

*Community college capital improvements bond redemption fund of 1972—Tax receipts: RCW 28B.56.100.*

*Credit for retail sales or use taxes paid to other jurisdictions with respect to property used: RCW 82.12.035.*

*Direct pay permits: RCW 82.32.087.*

*Excise tax on real estate transfers: Chapters 82.45 and 82.46 RCW.*

*Local sales tax: Chapter 82.14 RCW.*

**82.08.010 Definitions.** For the purposes of this chapter:

(1) "Selling price" means the consideration, whether money, credits, rights, or other property except trade-in property of like kind, expressed in the terms of money paid or delivered by a buyer to a seller without any deduction on account of the cost of tangible property sold, the cost of materials used, labor costs, interest, discount, delivery costs, taxes other than taxes imposed under this chapter if the seller advertises the price as including the tax or that the seller is paying the tax, or any other expenses whatsoever paid or accrued and without any deduction on account of losses; but shall not include the amount of cash discount actually taken by a buyer; and shall be subject to modification to the extent modification is provided for in RCW 82.08.080.

When tangible personal property is rented or leased under circumstances that the consideration paid does not represent a reasonable rental for the use of the articles so rented or leased, the "selling price" shall be determined as nearly as possible according to the value of such use at the places of use of similar products of like quality and character under such rules as the department of revenue may prescribe;

(2) "Seller" means every person, including the state and its departments and institutions, making sales at retail or retail sales to a buyer or consumer, whether as agent, broker, or principal, except "seller" does not mean the state and its departments and institutions when making sales to the state and its departments and institutions;

(3) "Buyer" and "consumer" include, without limiting the scope hereof, every individual, receiver, assignee, trustee in bankruptcy, trust, estate, firm, copartnership, joint venture, club, company, joint stock company, business trust, corporation, association, society, or any group of individuals acting as a unit, whether mutual, cooperative, fraternal, nonprofit, or otherwise, municipal corporation, quasi municipal corporation, and also the state, its departments and institutions and all political subdivisions thereof, irrespective of the nature of the activities engaged in or functions performed, and also the United States or any instrumentality thereof;

(4) The meaning attributed in chapter 82.04 RCW to the terms "tax year," "taxable year," "person," "company," "sale," "sale at retail," "retail sale," "sale at wholesale," "wholesale," "business," "engaging in business," "cash discount," "successor," "consumer," "in this state" and "within this state" shall apply equally to the provisions of this chapter. [1985 c 38 § 3; 1985 c 2 § 2 (Initiative Measure No. 464, approved November 6, 1984); 1983 1st ex.s. c 55 § 1; 1967 ex.s. c 149 § 18; 1963 c 244 § 1; 1961 c 15 § 82.08.010. Prior: (i) 1945 c 249 § 4; 1943 c 156 § 6; 1941 c 78 § 8; 1939 c 225 § 7; 1935 c 180 § 17; Rem. Supp. 1945 § 8370-17. (ii) 1935 c 180 § 20; RRS § 8370-20.]

**Purpose—1985 c 2:** "The purpose of this initiative is to reduce the amount on which sales tax is paid by excluding the trade-in value of certain property from the amount taxable." [1985 c 2 § 1 (Initiative Measure No. 464, approved November 6, 1984).]

**Effective dates—1983 1st ex.s. c 55:** "This act is necessary for the immediate preservation of the public peace, health, and safety, the support of the state government and its existing public institutions, and shall take effect July 1, 1983, except that section 12 of this act shall take effect January 1, 1984, and shall be effective for property taxes levied in 1983, and due in 1984, and thereafter." [1983 1st ex.s. c 55 § 13.]

**82.08.011 Retail car rental—Definition.** For purposes of this chapter, "retail car rental" means renting a rental car, as defined in RCW 46.04.465, to a consumer. [1992 c 194 § 2.]

**Effective dates—1992 c 194:** See note following RCW 46.04.466.

**82.08.020 Tax imposed—Retail sales—Retail car rental.** ***(Effective until April 1, 2003, if Referendum Bill No. 51 is approved at the November 2002 general election.)*** (1) There is levied and there shall be collected a tax on each retail sale in this state equal to six and five-tenths percent of the selling price.

(2) There is levied and there shall be collected an additional tax on each retail car rental, regardless of whether the vehicle is licensed in this state, equal to five and nine-tenths percent of the selling price. The revenue collected under this subsection shall be deposited in the multimodal transportation account created in RCW 47.66.070.

(3) The taxes imposed under this chapter shall apply to successive retail sales of the same property.

(4) The rates provided in this section apply to taxes imposed under chapter 82.12 RCW as provided in RCW 82.12.020. [2000 2nd sp.s. c 4 § 1; 1998 c 321 § 36 (Referendum Bill No. 49, approved November 3, 1998); 1992 c 194 § 9; 1985 c 32 § 1. Prior: 1983 2nd ex.s. c 3 § 62; 1983 2nd ex.s. c 3 § 41; 1983 c 7 § 6; 1982 1st ex.s. c 35 § 1; 1981 2nd ex.s. c 8 § 1; 1977 ex.s. c 324 § 2; 1975-'76 2nd ex.s. c 130 § 1; 1971 ex.s. c 281 § 9; 1969 ex.s. c 262 § 31; 1967 ex.s. c 149 § 19; 1965 ex.s. c 173 § 13; 1961 c 293 § 6; 1961 c 15 § 82.08.020; prior: 1959 ex.s. c 3 § 5; 1955 ex.s. c 10 § 2; 1949 c 228 § 4; 1943 c 156 § 5; 1941 c 76 § 2; 1939 c 225 § 10; 1935 c 180 § 16; Rem. Supp. 1949 § 8370-16.]

**Application—2000 2nd sp.s. c 4 § 1:** "Section 1 of this act applies to taxes collected on and after December 31, 1999." [2000 2nd sp.s. c 4 § 34.]

**Effective date—2000 2nd sp.s. c 4 §§ 1-3, 20:** "Sections 1 through 3 and 20 of this act are necessary for the immediate preservation of the public peace, health, or safety, or support of the state government and its existing public institutions, and take effect immediately [May 2, 2000]." [2000 2nd sp.s. c 4 § 35.]

**Purpose—Severability—1998 c 321:** See notes following RCW 82.14.045.

**Contingent effective dates—1998 c 321 §§ 23-42:** See note following RCW 35.58.410.

**Legislative intent—1992 c 194:** "The legislature intends to exempt rental cars from state and local motor vehicle excise taxes, and to impose additional sales and use taxes in lieu thereof. These additional sales and use taxes are intended to provide as much revenue to the funds currently receiving motor vehicle excise tax revenue, including the transportation funds and the general fund, as each fund would have received if the motor vehicle excise tax exemptions had not been enacted. Revenues from these additional sales and use taxes are intended to be distributed in the same manner as the motor vehicle excise tax revenues they replace." [1992 c 194 § 4.]

**Effective dates—1992 c 194:** See note following RCW 46.04.466.

**Construction—Severability—Effective dates—1983 2nd ex.s. c 3:** See notes following RCW 82.04.255.

**Construction—1983 c 7:** "This act shall not be construed as affecting any existing right acquired, or liability or obligation incurred under the sections amended in this act, nor any rule, regulation, or order adopted, nor any proceeding instituted, under those sections." [1983 c 7 § 34.]

**Severability—1983 c 7:** "If any provision of this act or its application to any person or circumstance is held invalid, the remainder of the act or the application of the provision to other persons or circumstances is not affected." [1983 c 7 § 35.]

**Effective dates—1983 c 7:** "This act is necessary for the immediate preservation of the public peace, health, and safety, the support of the state government and its existing public institutions, and shall take effect March 1, 1983, except as follows:

(1) Sections 9 through 22, and 25 through 31 of this act shall take effect June 30, 1983.

(2) Sections 23 and 24 of this act shall take effect January 1, 1984, for taxes first due in 1984 and thereafter.

The department of revenue and the department of licensing shall immediately take necessary steps to ensure that all sections of this act are properly implemented on their effective dates. The additional taxes and tax rate changes imposed under this act shall take effect on the dates designated in this act notwithstanding the date this act becomes law under Article III, section 12 of the state Constitution." [1983 c 7 § 37.]

**Severability—1982 1st ex.s. c 35:** "If any provision of this act or its application to any person or circumstance is held invalid, the remainder of the act or the application of the provision to other persons or circumstances is not affected." [1982 1st ex.s. c 35 § 47.]

**Effective dates—Expiration date—1982 1st ex.s. c 35:** "This act is necessary for the immediate preservation of the public peace, health, and safety, the support of the state government and its existing public institu-

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

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

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

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

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

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

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

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

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

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

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

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

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

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

**82.08.037 Credits and refunds—Debts deductible as worthless.** A seller is entitled to a credit or refund for sales taxes previously paid on debts which are deductible as worthless for federal income tax purposes. [1982 1st ex.s. c 35 § 35.]

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

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

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

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

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

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

Where a buyer has failed to pay to the seller the tax imposed by this chapter and the seller has not paid the amount of the tax to the department, the department may, in its discretion, proceed directly against the buyer for collection of the tax, in which case a penalty of ten percent may be added to the amount of the tax for failure of the buyer to pay the same to the seller, regardless of when the tax may be collected by the department; and all of the provisions of chapter 82.32 RCW, including those relative to interest and penalties, shall apply in addition; and, for the sole purpose of applying the various provisions of chapter 82.32 RCW, the twenty-fifth day of the month following the tax period in which the purchase was made shall be considered as the due date of the tax. [2001 c 188 § 4; 1993 sp.s. c 25 § 704; 1992 c 206 § 2; 1986 c 36 § 1; 1985 c 38 § 1; 1971 ex.s. c 299 § 7; 1965 ex.s. c 173 § 15; 1961 c 15 § 82.08.050. Prior: 1951 c 44 § 1; 1949 c 228 § 6; 1941 c 71 § 3; 1939 c 225 § 11; 1937 c 227 § 7; 1935 c 180 § 21; Rem. Supp. 1949 § 8370-21.]

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

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

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

**Effective dates—Severability—1971 ex.s. c 299:** See notes following RCW 82.04.050.

*Project on exemption reporting requirements: RCW 82.32.440.*

**82.08.055 Advertisement of price.** A seller may advertise the price as including the tax or that the seller is paying the tax, subject to the following conditions:

(1) Unless the advertised price is one in a listed series, the words "tax included" are stated immediately following the advertised price and in print size at least half as large as the advertised price;

(2) If the advertised prices are listed in a series, the words "tax included in all prices" are placed conspicuously at the head of the list and in the same print size as the advertised prices;

(3) If a price is advertised as "tax included," the price listed on any price tag shall be shown in the same manner; and

(4) All advertised prices and the words "tax included" are stated in the same medium, be it oral or visual, and if oral, in substantially the same inflection and volume. [1985 c 38 § 2.]

**82.08.060 Collection of tax—Methods and schedules.** The department of revenue shall have power to adopt rules and regulations prescribing methods and schedules for the collection of the tax required to be collected by the seller from the buyer under this chapter. The methods and schedules prescribed shall be adopted so as to eliminate the collection of fractions of one cent and so as to provide that the aggregate collections of all taxes by the seller shall, insofar as practicable, equal the amount of tax imposed by this chapter. Such schedules may provide that no tax need be collected from the buyer upon sales below a stated sum and may be amended from time to time to accomplish the purposes set forth herein. [1975 1st ex.s. c 278 § 47; 1961 c 15 § 82.08.060. Prior: 1951 c 44 § 2; 1941 c 76 § 4; 1935 c 180 § 22; Rem. Supp. 1941 § 8370-22.]

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

**82.08.064 Tax rate change.** A sales and use tax rate change under this chapter or chapter 82.12 RCW shall be imposed (1) no sooner than seventy-five days after its enactment into law and (2) only on the first day of January, April, July, or October. [2000 c 104 § 3.]

**Findings—Intent—Effective date—2000 c 104:** See notes following RCW 82.14.055.

**82.08.066 Deemed location for mobile telecommunications services.** ***(Contingent expiration date.)*** For the purposes of this chapter, mobile telecommunications services are deemed to have occurred at the customer's place of primary use, regardless of where the mobile telecommunications services originate, terminate, or pass through, consistent with the mobile telecommunications sourcing act, P.L. 106-252, 4 U.S.C. Secs. 116 through 126. The definitions in RCW 82.04.065 apply to this section. [2002 c 67 § 5.]

**Finding—Continency—Court judgment—Effective date—2002 c 67:** See notes following RCW 82.04.530.

**82.08.080 Vending machine and other sales.** The department of revenue may authorize a seller to pay the tax levied under this chapter upon sales made under conditions of business such as to render impracticable the collection of the tax as a separate item and waive collection of the tax from the customer. Where sales are made by receipt of a coin or coins dropped into a receptacle that results in delivery of the merchandise in single purchases of smaller value than the minimum sale upon which a one cent tax may be collected from the purchaser, according to the schedule provided by the department under authority of RCW 82.08.060, and where the design of the sales device is such that multiple sales of items are not possible or cannot be detected so as practically to assess a tax, in such a case the selling price for the purposes of the tax imposed under RCW 82.08.020 shall be sixty percent of the gross receipts of the vending machine through which such sales are made. No such authority shall be granted except upon application to the department and unless the department, after hearing, finds that the conditions of the applicant's business are such as to render impracticable the collection of the tax in the manner otherwise provided. The department, by regulation, may provide that the applicant, under this section, furnish a proper bond sufficient to secure the payment of the tax. [1986 c 36 § 2; 1975 1st ex.s. c 278 § 48; 1963 c 244 § 2; 1961 c 15 § 82.08.080. Prior: 1937 c 227 § 8; 1935 c 180 § 24; RRS § 8370-24.]

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

**82.08.090 Installment sales and leases.** In the case of installment sales and leases of personal property, the

# APPENDIX B

**Westlaw Delivery Summary Report for FITZPATRICK,ROSA**

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| Date/Time of Request: | Wednesday, November 19, 2008 13:41 Central |
| Client Identifier: | RF/FITZPATRICK/REV/HOME |
| Database: | IN-CS |
| Citation Text: | 891 N.E.2d 187 |
| Lines: | 308 |
| Documents: | 1 |
| Images: | 0 |

Tax Court of Indiana.
HOME DEPOT U.S.A., INC., Petitioner,
v.
INDIANA DEPARTMENT OF STATE REVENUE, Respondent.
**No. 49T10-0703-TA-11.**

July 28, 2008.

**Background:** Corporate taxpayer appealed from a final determination of the Department of State Revenue denying it a refund of state sales tax. The parties filed cross-motions for summary judgment.

**Holding:** The Tax Court, Thomas G. Fisher, J., held that taxpayer was not entitled to refund of state sales tax.

Summary judgment granted to Department.

West Headnotes

**[1] Taxation 371 ⚿3672**

371 Taxation
371IX Sales, Use, Service, and Gross Receipts Taxes
371IX(E) Rate and Amount of Tax
371k3672 k. In General. Most Cited Cases

Corporate taxpayer, a retail chain, was not entitled to refund of state sales tax it had remitted on purchases made by customers who used their private label credit cards to purchase merchandise at taxpayer's stores, but then defaulted on their accounts with finance companies that owned and operated private label credit card program, pursuant to statute allowing retail merchant to adjust for bad debts or uncollectible receivables, as taxpayer failed to write off uncollectible credit card accounts for federal tax purposes under provision of federal internal revenue code governing bad debts. 26 U.S.C.A. § 166; West's A.I.C. 6-2.5-6-9(a).

**[2] Constitutional Law 92 ⚿3576**

92 Constitutional Law
92XXVI Equal Protection
92XXVI(E) Particular Issues and Applications
92XXVI(E)6 Taxation
92k3576 k. Sales and Use Taxes. Most Cited Cases

**Taxation 371 ⚿3672**

371 Taxation
371IX Sales, Use, Service, and Gross Receipts Taxes
371IX(E) Rate and Amount of Tax
371k3672 k. In General. Most Cited Cases

Corporate taxpayer was not similarly situated to finance companies that owned and operated private label credit card program that taxpayer offered to its customers, and, thus taxpayer's equal protection rights were not implicated by Department of State Revenue's denial of its refund claim for state sales tax it had remitted on purchases made by customers who used their private label credit cards to purchase merchandise at taxpayer's stores, but then defaulted on their accounts with finance companies that owned credit card program, as taxpayer did not finance the sales tax on installment contract purchases which were eventually defaulted upon and therefore it could not write those receivables off as uncollectible debt for federal tax purposes. U.S.C.A. Const.Amend. 14; West's A.I.C. 6-2.5-6-9(a).

***187** Jeffrey S. Dible, Michael T. Bindner, Robert L. Hartley, Jennifer L. Vanlandingham, Locke Reynolds LLP, Indianapolis, IN, Attorneys for Petitioner.
Steve Carter, Attorney General of Indiana, Jennifer E. Gauger, Deputy Attorney General, Indianapolis, IN, Attorneys for Respondent.

ORDER ON PARTIES' CROSS-MOTIONS FOR

SUMMARY JUDGMENT

FISHER, J.
Home Depot U.S.A., Inc. (Home Depot) appeals from the final determination of the Indiana Department of State Revenue (Department) denying it a refund of state gross retail tax (sales tax) paid between February 1, 1999 and July 31, 2003 (the period at issue). The matter is currently before the Court on the parties' cross-motions for summary judgment. The issue for the Court to decide is whether Home Depot is entitled to a sales tax ***188** refund pursuant to Indiana Code § 6-2.5-6-9.

**FACTS**

The following facts are undisputed. Home Depot, a national home improvement retail chain, does business in Indiana. During the period at issue, Home Depot offered its customers the option of purchasing merchandise with "private label" credit cards (i.e., credit cards that bore the name and logo of Home Depot and could only be used at Home Depot or its affiliated stores).

Home Depot's private label credit card program was owned and operated by several financial institutions ("finance companies"). Pursuant to the agreements between Home Depot and the finance companies, Home Depot made the credit card application forms available to its customers in its stores and then submitted the completed applications to the finance companies. The finance companies, in turn: 1) screened and processed the applications; 2) issued credit cards to approved customers; and 3) performed all other activities related to the servicing of the credit cards, including billing and collection. The agreements further specified that:

> [The finance companies are] the sole and exclusive owner[s] of all [credit card] Accounts ... and shall be entitled to receive all payments made by Cardholders on Accounts. [Home Depot] acknowledges and agrees that it has no right, title or interest in any of the foregoing and no right to any payments made by Cardholders on Accounts or any proceeds in respect of the Accounts. All collection procedures shall be under the sole control and discretion of [the finance companies.]
>
> * * * * * *
>
> All credit losses on Accounts shall be solely borne at the expense of [the finance companies] and shall not be passed on to [Home Depot].

(*See, e.g.,* Pet'r Designated Evid. Ex. 12 §§ 3.03, 6.02.)

Each day, Home Depot transmitted information to the finance companies relating to the private label credit card charges made that day and the sales tax attributable thereto. Within two business days, the finance companies would remit payment to Home Depot for the specified charges and taxes. Pursuant to the agreements between Home Depot and the finance companies, however, the finance companies were authorized to deduct a service fee from the payments remitted to Home Depot.[FN1]

> FN1. During the period at issue, the service fees ranged from zero to 13.8% of the total amount of the transaction. (*See* Pet'r Designated Evid. Exs. 12, 13, 14 at Schedules 5.03; Pet'r Br. In Supp. of Mot. for Summ. J. (hereinafter, Pet'r Br.) at 7-8.) The variations in the service fees essentially reflected the credit card holder's credit status and time period within which it had to pay on its account. Indeed, as Home Depot's Director of Credit Legal explained in an affidavit:
>
> > When a [finance company] negotiates a private label credit card program agreement with a major retailer such as Home Depot, [it] proposes a combination of terms and conditions, including the interest rate and late fees ... to charge to customers and the service fee ... [it] require[s] the retailer to pay.... Generally,

> the higher the interest rate on the credit card account and the more interest and late fees the [finance company] expects to collect [from the customer], the lower the ... service fee[s] that the [finance company] will propose to the retailer[.]
>
> (Pet'r Designated Evid. Ex.1 ¶ 15.) The service fees were subject to adjustment by the finance companies every six months.

With respect to the Home Depot credit card accounts that had been defaulted upon and were therefore uncollectible, the ***189** finance companies claimed "bad debt" deductions on their federal income tax returns, pursuant to section 166 of the Internal Revenue Code, during the period at issue.FN2 On its federal income tax returns, Home Depot deducted the service fees it paid to the finance companies as a business expense pursuant to section 162 of the Internal Revenue Code.FN3

> FN2. More specifically, the finance companies reported these deductions on line 15 of their federal income tax returns (Forms 1120), entitled "Deductions: Bad debts." (Pet'r Br. at 9-10; Pet'r Designated Evid. Ex. 10.)
>
> FN3. Home Depot reported these deductions on line 26 of its Forms 1120, entitled "Deductions: Other deductions." (Pet'r Br. at 10; Pet'r Designated Evid. Ex. 9.)

On September 19, 2003, Home Depot filed a claim with the Department seeking a refund of the $249,152.42 of Indiana sales tax it had remitted during the period at issue on purchases made by customers who used their Home Depot credit cards but then defaulted on their accounts with the finance companies. On December 4, 2006, the Department issued a final determination denying Home Depot's claim for refund.

Home Depot initiated this original tax appeal on March 2, 2007. On October 2, 2007, both Home Depot and the Department filed motions for summary judgment. The Court conducted a hearing on the parties' motions on February 11, 2008. Additional facts will be supplied as necessary.

## STANDARD OF REVIEW

This Court reviews the Department's denial of claims for refund *de novo.* IND.CODE ANN. § 6-8.1-9-1(d) (West 2008). Accordingly, the Court is not bound by either the evidence presented, or the issues raised, at the administrative level. *See Williams v. Indiana Dep't of State Revenue,* 742 N.E.2d 562, 563 (Ind. Tax Ct.2001). Summary judgment will be granted if there are no genuine issues of material fact and the moving party is entitled to judgment as a matter of law. Ind. Trial Rule 56(C). Cross-motions for summary judgment do not alter this standard. *Williams,* 742 N.E.2d at 563.

## DISCUSSION AND ANALYSIS

[1] Indiana imposes an excise tax, known as the state sales tax, on retail transactions made within the state. IND.CODE ANN. § 6-2.5-2-1(a) (West 2008). "The person who acquires property in a retail transaction is liable for the tax on the transaction and ... shall pay the tax to the retail merchant as a separate added amount to the consideration in the transaction." A.I.C. § 6-2.5-2-1(b). The retail merchant then remits the collected taxes to the Department on a monthly basis. IND.CODE ANN. § 6-2.5-6-1 (West 2008).

To determine how much sales tax it must remit each month, the retail merchant multiplies its gross retail income from taxable transactions made during that month by the applicable sales tax rate. *See*IND.CODE ANN. § 6-2.5-6-7 (West 2008). In so doing, however, Indiana Code § 6-2.5-6-9 allows the retail merchant to adjust for bad debts or uncollectible receivables. During the period at issue, this statute provided:

> In determining the amount of [sales] tax[ ] which he must remit ... a retail merchant shall deduct from his gross retail income from retail transactions made during a particular reporting period, an amount equal to his receivables which:
>
> (1) resulted from retail transactions in which the retail merchant did not collect***190** the [sales] tax from the purchaser;
>
> (2) resulted from retail transactions on which the retail merchant has previously paid the [sales] ... tax liability to the [D]epartment; and
>
> (3) were written off as an uncollectible debt for federal tax purposes during the particular reporting period.

IND.CODE ANN. § 6-2.5-6-9(a) (West 1999). The issue in this case is whether, during the period at issue, Home Depot qualified for this deduction. The parties agree that the first two prongs of the statute are not at issue; thus, the parties' dispute centers on whether the third prong has been met.

Home Depot asserts that, in substance, it-and not the finance companies-has borne the "full economic loss" on the uncollectible credit card accounts. More specifically, Home Depot asserts that in paying the service fees to the finance companies, it fully "reimbursed" them, in advance, for all anticipated losses due to uncollectible credit card accounts.[FN4] In turn, Home Depot explains that Indiana Code § 6-2.5-6-9(a)(3) merely provides "that the bad debt be 'written off as an uncollectible debt for federal tax purposes' [and does not] specify[ ] by whom [or under what] ... section of the Internal Revenue Code ... the income tax deduction [is to] be claimed." [FN5] (Pet'r Br. In Opp'n to Resp't Cross-Mot. for Summ. J. (hereinafter, Pet'r Br. # 2) at 2 (footnote added).) (*See also* Pet'r Br. In Supp. of Mot. for Summ. J. (hereinafter, Pet'r Br.) at 18, 20 (reasoning that under Indiana Code § 6-2.5-6-9(a)(3), neither the identity of the taxpayer that wrote off the bad debt losses nor the section under which the bad debt was written off "is important").) As a result, Home Depot maintains that it is entitled to the deduction because it wrote off the loss it bore on the uncollectible credit card accounts for federal tax purposes by deducting the service fees as a business expense under section 162 of the Internal Revenue Code. (*See* Pet'r Br. at 18-20.) In the alternative, Home Depot argues that it is still entitled to the deduction because the uncollectible credit card accounts were "written off as an uncollectible debt for federal tax purposes," albeit by the finance companies. (*See* Pet'r Br. at 18-20.)

> FN4. The Court notes, however, that Home Depot's designated evidence does not clearly establish this proposition. (*Cf.* Pet'r Designated Evid. Ex. 1 ¶ 22 (affidavit of Home Depot's Director of Credit Legal asserting that in paying the service fees, Home Depot bore the full economic loss on the uncollectible credit card accounts) *with* Pet'r Designated Evid. Exs. 11 ¶¶ 5-6 (affidavit from vice president of one of the finance companies indicating that bad debt loss was only one of several components which made up the overall service fee charge) and 12, 13, 14 (agreements between Home Depot and the finance companies which are silent as to what factors are considered in determining the service fees or what portion of the service fees represent reimbursement for bad debt losses).)
>
> FN5. In other words, Home Depot argues that Indiana Code § 6-2.5-6-9(a)(3) "addresses the proper timing of the deduction." (Pet'r Br. at 17-18 (asserting that (a)(3) merely ensures "that a sales tax deduction is not prematurely claimed before the debt owed by a customer has become truly worthless, with no reasonable prospect of recovery").)

The Department argues, on the other hand, that in order for Home Depot to receive the deduction, *Home Depot* was required to write off the credit card accounts as uncollectible debt for federal tax purposes. Furthermore, it explains that in order for a receivable to be "written off as an uncollectible debt for federal tax purposes," the receivable must be written off *under section 166 of the Internal Revenue Code.*As a result, the Department asserts that Home Depot did not qualify for the ***191** deduction at issue: Home Depot did not write off the credit card accounts as uncollectible debt under section 166 of the Internal Revenue Code. (Resp't Br. In Supp. of Cross[-]Mot. for Summ. J. (hereinafter, Resp't Br.) at 6.) The Department is correct.

Nearly four years ago, the Indiana Supreme Court held that when a retail merchant computes its bad debt deduction under Indiana Code § 6-2.5-6-9, it is limited to deducting that portion of the amount of its receivables equal to the amount actually written off for federal income tax purposes. *Indiana Dep't of Revenue v. 1 Stop Auto Sales, Inc.,* 810 N.E.2d 686, 690 (Ind.2004). More specifically, the Supreme Court explained that when a retail merchant writes off a receivable as uncollectible, it is required to reduce the amount written off by the value of any repossessed collateral when it calculates its bad debt deduction under section 166 of the Internal Revenue Code. *Id.* at 688 (citing, *inter alia,*Treas. Reg. § 1.166-2(a) (as amended in 1993)). The Supreme Court held that this federal rule for calculating the amount of the federal bad debt deduction applies to calculating the sales tax deduction under Indiana Code § 6-2.5-6-9. *See id.* at 689. Indeed, "[i]f the Legislature did not want [the retail merchant] to use Internal Revenue Code Section 166 mathematics [in calculating the amount of the deduction], [ ] it would not have referenced federal tax law at all; it would have simply provided that the receivables were written off as an uncollectible debt." *Id.* at 689. Thus, the Supreme Court implicitly acknowledged that under Indiana Code § 6-2.5-6-9(a)(3), when a retail merchant "writes off a receivable as an uncollectible debt for federal tax purposes," the retail merchant must write off the receivable as uncollectible debt for federal tax purposes under section 166 of the Internal Revenue Code.[FN6]

> FN6. This is supported by the fact that, in 2003, the legislature amended Indiana Code § 6-2.5-6-9(a)(3) to read "were written off as an uncollectible debt for federal tax purposes *under Section 166 of the Internal Revenue Code[.]* "*See*P.L. 257-2003, § 30 (emphasis added) (eff.1-1-2004). Given the ruling in *1 Stop Auto,* this Court finds that the amendment was intended to express more clearly the legislature's intent in enacting the law in the first place. *See United Nat'l Ins. Co. v. DePrizio,* 705 N.E.2d 455, 460 (Ind.1999) (stating that while a statutory amendment generally raises the presumption that the legislature intended to change the statute's meaning, the presumption is rebutted if it appears that the amendment was passed in order to express the original intent more clearly).

## CONCLUSION

[2] Home Depot would be entitled to the deduction under Indiana Code § 6-2.5-6-9 if it wrote off the uncollectible credit card accounts for federal tax purposes under section 166 of the Internal Revenue Code. *See*A.I.C. § 6-2.5-6-9(a); *1 Stop Auto,* 810 N.E.2d at 689-90. Home Depot did not and therefore it is not entitled to the deduction.[FN7] Consequently, ***192** summary judgment is GRANTED in favor of the Department and AGAINST Home Depot. The parties shall bear their own costs.

> FN7. On a final note, Home Depot, while never explicitly labeling it as such, appears to raise an equal protection argument. Indeed, it simply states that it "should be entitled to the same treatment as vendors who extend their own credit and service their own accounts, because Home Depot suf-

fers the exact same economic loss from its bad debts as that suffered by vendors who own their credit accounts. There is no reasonable basis for treating Home Depot differently." (*See* Pet'r Br. at 14, 24-25.)

This Court has explained that an equal protection analysis (under both federal and state Constitutions) is implicated only if an individual has been treated differently from other similarly situated persons. *See UACC Midwest, Inc. v. Indiana Dep't of State Revenue,* 667 N.E.2d 232, 238-239 (Ind. Tax Ct.1996). Home Depot, however, is not similarly situated to vendors who own and service their own credit card programs: it does not finance the sales tax on installment contract purchases which are eventually defaulted upon and therefore it cannot write those receivables off as uncollectible debt for federal tax purposes. Thus, Home Depot's equal protection rights are not implicated in this case.

SO ORDERED.

Ind.Tax,2008.
Home Depot U.S.A., Inc. v. Indiana Dept. of State Revenue
891 N.E.2d 187

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# APPENDIX C

**Westlaw Delivery Summary Report for FITZPATRICK,ROSA**

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| Date/Time of Request: | Wednesday, November 19, 2008 13:43 Central |
| Client Identifier: | RF/FITZPATRICK/REV/HOME |
| Database: | NJTX-CS |
| Citation Text: | 24 N.J.Tax 23 |
| Lines: | 579 |
| Documents: | 1 |
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Tax Court of New Jersey
HOME DEPOT U.S.A., INC., PLAINTIFF, v. DIRECTOR, DIVISION OF TAXATION, DEFENDANT.
March 14, 2008.

SYNOPSIS

**Background:** Taxpayer appealed from denial by the state tax division of request for sales tax refund. State moved for summary judgment dismissing appeal.

**Holdings:** The Tax Court, Kuskin, J.T.C., held that:
(1) regulation that amounts collected be first assigned to sales tax was reasonable and valid interpretation of statute authorizing refund;
(2) taxpayer was not entitled to sales tax refund; and
(3) there was no evidence that service fee paid on each transaction included a measurable amount for finance companies' bad debt loss.

Summary judgment granted.

West Headnotes

**[1] Taxation 371 ⚷3700**

371 Taxation
371IX Sales, Use, Service, and Gross Receipts Taxes
371IX(H) Payment
371k3699 Refunding Taxes Paid
371k3700 k. In General. Most Cited Cases

Tax division's regulation that any recovery on an uncollectible consumer credit debt is assigned to sales tax owed on the transaction first was reasonable and valid interpretation of statute permitting refund of sales tax paid on uncollectible debt, where state, having no ability to participate in credit evaluation of customers, should not bear the credit risk. N.J.S.A. 54:32B-12(c); N.J.A.C. 18:24-23.2(a)(2).

**[2] Taxation 371 ⚷3700**

371 Taxation
371IX Sales, Use, Service, and Gross Receipts Taxes
371IX(H) Payment
371k3699 Refunding Taxes Paid
371k3700 k. In General. Most Cited Cases

Taxpayer was not entitled to sales tax refund for bad debts on credit card sales after receiving at least 86% of the purchase amount including sales tax from the finance companies, even though taxpayer claimed that transaction fees paid to finance companies included portion for bad debts; taxpayer recovered an amount from the finance companies sufficient to pay the sales tax, which rendered it ineligible for refund. N.J.S.A. 54:32B-12(c); N.J.A.C. 18:24-23.2(a)(2).

**[3] Taxation 371 ⚷3700**

371 Taxation
371IX Sales, Use, Service, and Gross Receipts Taxes
371IX(H) Payment
371k3699 Refunding Taxes Paid
371k3700 k. In General. Most Cited Cases

There was no evidence that taxpayer, a retail vendor, suffered any losses on credit card transactions due to bad debts, for purposes of seeking refund of sales tax on those bad debts, where taxpayer failed to identify any measurable portion of the service fee paid to the finance companies for bad debts or any relationship of that amount to the finance companies' actual losses. N.J.S.A. 54:32B-12(c).

***25** *Paul H. Frankel, Irwin M. Slomka* of the New

York bar (admitted pro hac vice), and *Amy F. Nogid* of the New York bar (admitted pro hac vice) for plaintiff (*Morrison Foerster,* attorneys).
*Marlene G. Brown* for defendant (*Anne Milgram, Attorney General of New Jersey,* attorney).

KUSKIN, J.T.C.
Plaintiff, Home Depot U.S.A., Inc., has appealed from the denial by defendant, Director of the New Jersey Division of Taxation ("Director"), of plaintiff's claim for a refund of sales tax in the sum of $1,976,876.95. Plaintiff paid the tax for the period August 1, 1999 through July 31, 2003 ("Refund Period") with respect to purchases made with the use of plaintiff's private label credit card by customers who later failed to pay their credit card indebtedness. Three companies unrelated to plaintiff issued the credit cards and the indebtedness was payable to them. The Director has moved for summary judgment dismissing the appeal. For the reasons set forth below, I grant the Director's motion.

The following facts either were stipulated by the parties or are not in dispute. Plaintiff operates retail home improvement centers in New Jersey and elsewhere in the United States. During the Refund Period, plaintiff offered its customers the option of purchasing merchandise through the use of its private label ("Home Depot") credit card. The cards were issued by Monogram Credit Card Bank of Georgia ("Monogram"), General Electric Capital Corp. ("GE Capital"), and General Electric Capital Financial Inc. ("GE Financial") pursuant to separate agreements with plaintiff each dated as of August 4, 1997 (collectively the "Agreements"). The agreement with Monogram related to purchases by individuals for personal, family, or household use while the GE Capital and GE Financial agreements related to purchases other than for personal, family or household use. The parties ***26** provided no explanation as to why separate agreements were in effect with GE Capital and GE Financial both relating to the same category of customers. I will refer to Monogram, GE Capital, and GE Financial collectively as the "Finance Companies," and will sometimes refer to any one of them as a "Finance Company."

Each of the Agreements contained the following provisions. In order to obtain plaintiff's private label credit card, a customer was required to complete a credit card application at plaintiff's store location, and the store was required to forward the application to the appropriate Finance Company. The Finance Company, "in its sole discretion," then determined the creditworthiness, range of credit limits, and credit criteria to be used in evaluating each application. If a Finance Company rejected an application, plaintiff had no recourse.

Each Finance Company was "the sole and exclusive owner of all documents," credit slips, and documentation relating to the credit card accounts and was entitled to receive all payments from cardholders. Plaintiff "acknowledge[d] and agree[d] that it ha[d] no right, title or interest in any of the foregoing [documents and accounts] and no right to payment by [c]ardholders on [a]ccounts or any proceeds in respect of the [a]ccounts." All procedures for collecting amounts due on the credit card accounts were "under the sole control and discretion" of the Finance Company.

At the end of each business day, plaintiff transmitted electronically to each Finance Company data relating to transactions which occurred during that day using credit cards issued by that Finance Company. Credit card charge slips were to be delivered to the appropriate Finance Company within seven days after the transaction date. With respect to transaction data received before 4:00 p.m. on a business day, the Finance Company was obligated to remit to plaintiff by the next business day the full amount of the charges set forth in the transaction data, including sales tax charged in connection with the transactions. As to transaction data arriving at the Finance Company after 4:00 p.m. on a business day, payment was to be remitted on the second business day thereafter. In remitting the payments, the Finance Company ***27** had the right to deduct any chargebacks against plaintiff (generally relating to breaches of warranty or other defaults by plaintiff and customer disputes as to the amount or existence of the credit card obligation), and a service fee.

The service fee payable to Monogram in connection with "promotional" purchases, that is, purchases in which Monogram agreed to waive the financing charge if the customer made timely payment, ranged from .2% to 13.8% of the aggregate purchase price for purchases of less than $2,000 and from .7% to 11.6% for purchases of $2,000 or more. For "non-promotional" purchases, the service fee varied from zero to .95% of the purchase amount. For GE Capital, the service fee ranged from 3.24% to 3.49% on all purchases, and, for GE Financial, the range was 1.91% to 2.77%. The variations in service fee amounts charged by each Finance Company were functions of the credit standing of the customer and the time period within which payment was due on the credit card debt.

Plaintiff had no credit risk with respect to purchases made using its private label credit cards. The Agreements provided that "all credit losses on [a]ccounts shall be solely borne at the expense of [the Finance Company] and shall not be passed on to [plaintiff]" except for any chargebacks. No issues relating to chargebacks are relevant to plaintiff's contentions in this matter.

Notwithstanding that it bore no direct risk with respect to non-payment of credit card indebtedness, plaintiff seeks a refund of sales tax it was required to pay, and did pay, in connection with sales during the Refund Period made with the use of plaintiff's private label credit card by customers who defaulted on their credit card indebtedness. Plaintiff bases its claim on *N.J.S.A.* 54:32B-12(c), a provision of the New Jersey Sales and Use Tax Act, *N.J.S.A.* 54:32B-1 to -29, and on *N.J.A.C.* 18:24-23.1 and -23.2. In pertinent part, *N.J.S.A.* 54:32B-12(c) authorizes the Director to "provide by regulation for the exclusion from taxable receipts ... of amounts representing sales where the ... charge ... has been ascertained to be uncollectible or, in the case the tax has been paid upon such ... charge ..., for refund or credit of ***28** the tax so paid." The regulations the Director promulgated pursuant to the statute provide as follows:

> A vendor [FN1] of taxable tangible personal property or services must charge and remit the sales tax on all transactions whether for cash or credit.
>
> FN1 A "vendor" is defined in *N.J.S.A.* 54:32B-2(i). The multi-part definition generally includes persons or entities making sales of tangible personal property or services, and does not include entities such as the Finance Companies that are not directly involved in making such sales.
>
> [*N.J.A.C.* 18:24-23.1.]
>
> Where the sales tax in connection with a sale has been remitted to the Division of Taxation and the account receivable has proven to be worthless and uncollectible, an application for a refund may be filed with the Director within four years from the payment thereof.
>
> [*N.J.A.C.* 18:24-23.2(a).]
>
> The latter regulation includes an explanation of its functioning under three circumstances. It permits a total refund where the vendor has collected no money on account of the receivable or sale, and, where a vendor has collected less than the amount payable as tax, it permits a refund based on the difference between the amount remitted to the Division and the amount the vendor collects. *N.J.A.C.* 18:24-23.2(a)(1) and (3). Where the vendor has collected an amount with respect to the receivable "equal to or exceeding the amount of sales tax required to be remitted to the Division, the claim for refund will be denied." *N.J.A.C.* 18:24-23.2(a)(2).

Based on the preceding statutory and regulatory provisions, plaintiff contends that, as a vendor, it is entitled to a refund of sales tax it paid with respect to private label credit card transactions during the Refund Period where the customers defaulted on indebtedness owed to the Finance Companies. Plaintiff acknowledges that it did not directly suffer any loss from the defaults. It asserts, however, that it funded the bad debt losses suffered by the Finance Companies because the service fees it paid to them included an amount constituting reimbursement for projected bad debt losses. In support of this contention, plaintiff submitted the Certification of its Director, Credit/Legal, whose employment with plaintiff commenced six years after the Agreements went into effect. He concluded in his certification that plaintiff "bore the ***29** economic burden for all debts" on the private label credit cards issued by the Finance Companies through the "financial arrangements" between plaintiff and the Finance Companies. He opined that the service fees plaintiff paid pursuant to these financial arrangements "presumably" enabled the Finance Companies to earn profits from issuing plaintiff's private label credit card and "presumably ensured" that the income realized by the Finance Companies from administering the private label credit card program exceeded the Finance Companies' respective expenses, including bad debts. He described the service fee as "the result of negotiations between the parties [that] did not require a delineation of its components in the [A]greements."

The Vice-President of Risk Management for GE Consumer Finance, who described himself as having direct knowledge of the relationship between plaintiff and the Finance Companies and as having administered the private label credit card agreements between plaintiff and GE Capital and GE Finance, submitted a certification that included the following statements:

> It is *my understanding* that the Finance Companies projected the income that they would earn on customer accounts under the credit card agreements, including interest income, late fees, and service fees (also known as merchant discounts, which are percentage discounts charged to Home Depot for certain transactions). The Finance Companies also projected the anticipated costs to issue and service Home Depot's private label credit cards, including anticipated bad debts, billing and collection costs, and administrative costs.
>
> Under the credit card agreements, Home Depot bore the losses of anticipated bad debts by compensating the Finance Companies for those bad debts in advance through the income components of the [private label credit card] program.
>
> [Emphasis supplied.]

A principal of Ernst & Young, LLC, the accounting firm retained by plaintiff to prepare the refund claim at issue in this appeal, certified that he supervised the preparation of the claim and that the refund sought in the sum of $1,976,876.95 represents the actual tax paid with respect to uncollectible accounts for the Refund Period.

Plaintiff has acknowledged that the Agreements do not identify the components of the service fee or allocate the fee to any specific cost, expense, bad debt, or other loss incurred by the Finance Companies. As described in the certification of the Vice-President***30** of Risk Management for GE Consumer Finance, the service fee covered administrative costs and billing and collection costs, as well as anticipated bad debts. Plaintiff also has acknowledged that the component of the service fees representing anticipated bad debt losses by the Finance Companies could total more or less than the actual bad debt losses which are the bases for plaintiff's refund claim.

The Director asserts two grounds for granting her motion for summary judgment. First, she relies on the provisions of *N.J.A.C.* 18:24-23.2(a)(2) that deny any refund of sales tax where a vendor has collected from a customer an amount at least equal to the amount of sales tax payable. The Director argues that, under the express terms of the Agreements, plaintiff collected not less than 86.2% of the face amount of each private label credit card transaction, including applicable sales tax, even if the customer wholly defaulted on the credit card indebtedness. Second, the Director asserts that the service fees paid by plaintiff do not constitute bad debt losses suffered by a vendor under *N.J.S.A.* 54:32B-12(c) or *N.J.A.C.* 18:24-23.2(a), and thus, as a matter of law, cannot provide a basis for a sales tax refund.

In opposing the Director's motion, plaintiff asserts that *N.J.A.C.* 18:24-23.2(a)(2) constitutes an unreasonable and invalid regulatory interpretation of *N.J.S.A.* 54:32B-12(c). Plaintiff claims that the Director's determination, that payments by customers shall be applied first to sales tax, results in an increase in the effective sales tax rate to a rate far in excess of the 6% rate applicable during the Refund Period. Plaintiff also asserts that, under *R.* 4:46-2(a), the motion cannot be granted because genuine issues of material fact exist which require a full hearing for resolution. Specifically, plaintiff contends that it should be permitted to present proofs to explain how the service fees payable to the Finance Companies were calculated and to establish that, as a result of the payment of service fees, plaintiff bore the burden of bad debt losses incurred by the Finance Companies. Plaintiff contends that denying its refund claim would result in a revenue windfall to the Director because, if plaintiff had directly borne the credit risk with respect to its customers, it would be entitled to a ***31** refund of sales tax paid with respect to purchases on which the customers defaulted. Plaintiff argues that it should not be treated any differently simply because it bore the bad debt losses indirectly rather than directly. Finally, plaintiff contends that denying its refund claim would constitute a denial of equal protection, a denial of due process, and a violation of the Commerce Clause of the United States Constitution.

For purposes of deciding the Director's summary judgment motion, I must construe the facts most favorably to plaintiff and accord those facts all reasonably permissible inferences in plaintiff's favor. *Brill v. Guardian Life Ins. Co. of Am.,* 142 *N.J.* 520, 535, 666 *A.*2d 146 (1995). Accordingly, for purposes of deciding the motion, I find the following facts:

(1) the Agreements were in place and in effect during the Refund Period;

(2) the service fees under the Agreements ranged from zero to 13.8%;

(3) the service fees paid by plaintiff pursuant to the Agreements included an element representing projected bad debt losses to be incurred by the Finance Companies, although the portion of each service fee representing that element was not separately identified or quantified in any of the Agreements;

(4) plaintiff paid New Jersey sales tax of $1,976,876.95 with respect to private label credit card sales of merchandise during the Refund Period as to which the credit card payment indebtedness was uncollectible; and

(5) all amounts due on the private label credit card purchases were payable to the Finance Companies, and, therefore, the Finance Companies directly bore all losses resulting from the customer defaults.

I will address first the Director's contentions under *N.J.A.C.* 18:24-23.2(a)(2). As described above, this regulation includes a description of two circumstances involving uncollectible amounts in which sales tax refunds will be paid, *N.J.A.C.* 18:24-23.2(a)(1) and (3), but provides that, when the vendor collects an amount from a ***32** customer at least equal to the tax payable with respect to the transaction, no refund will be paid. *N.J.A.C.* 18:24-23.2(a)(2). In support of its contention that this provision is invalid because it distorts the effective rate of sales tax to a rate substantially higher than 6%, plaintiff cites the decision of the New York Court of Appeals in *In re Abraham & Straus v. Tully,* 47 *N.Y.*2d 207, 417 *N.Y.S.*2d 881, 391 *N.E.*2d 964 (1979). There, Abraham & Straus directly suffered bad debt losses in connection with credit extended to its customers. *Id.* at 881, 391 *N.E.*2d at 965. Although regulations provided for the refund of sales tax paid with respect to uncollectible receivables, the New York Sales Tax Bureau and State Tax Commission took the position that, when the customer paid an amount sufficient to cover the amount of the sales tax, no refund was due. *Id.* at 881, 391 *N.E.*2d at 966. This position was not supported by a regulation similar to *N.J.A.C.* 18:24-23.2(a)(2). The Court concluded as follows:

> The statute and the regulation obviously intend that a vendor shall be relieved of sales tax liability to the extent that the receipt from a sale proves uncollectible, so that the taxes which the vendor is required to remit will most closely reflect the tax due on moneys actually received on sales of personal property. The method employed by the bureau and approved by the commission, by which it is assumed that the first cash received by a vendor on a credit sale is for the entire sales tax due on the sale, would have quite the contrary result and, by reason of the fact that the receipts under consideration are by their nature not fully collectible, would inevitably produce a liability for sales taxes which would deviate from the statutory sales tax rate.
>
> [ *Id.* at 881, 391 *N.E.*2d at 966.]

[1][2] This language reflects a rejection of the concept that the vendor, and not the taxing authority, should bear the entire credit risk with respect to a transaction. The holding of the New York Court of Appeals is not binding on me, and I respectfully disagree with the Court's approach. I conclude that *N.J.A.C.* 18:24-23.2(a)(2) represents a reasonable and valid interpretation of *N.J.S.A.* 54:32B-12(c). *See Metromedia, Inc. v. Director, Div. of Taxation,* 97 *N.J.* 313, 327, 478 *A.*2d 742 (1984) (stating, in a tax context, that the Director's interpretation of a statute "is entitled to prevail, so long as it is not plainly unreasonable" (internal citations omitted)). It is reasonable for the Director to conclude that New Jersey, which has no ability to participate in the credit ***33** evaluation of a particular customer, should not bear any of the credit risk relating to that customer. Thus, if a vendor receives an amount sufficient to pay the sales tax that would be due with respect to a transaction, the State of New Jersey is entitled to receive and retain that tax. If the vendor is unable to collect any additional monies from the customer, the vendor alone should suffer the consequences of its failure to evaluate properly the customer's creditworthiness. Here, in each transaction included in its refund claim, plaintiff received, from one of the Finance Companies, a payment in an amount between 86.8% and 100% of the combined amount of the purchase price and sales tax due. Denying plaintiff's claim for refund under such circumstances is both fair and in accordance with the intent and purpose of the Sales and Use Tax Act. *See N.J.S.A.* 54:32B-12(b) (setting forth a presumption that sales tax is due and payable and placing the burden of establishing the contrary on the person required by the Act to collect taxes.)

Although the preceding analysis and conclusion is dispositive of the Director's motion, I will address plaintiff's second basis for opposing the Director's motion, namely, that a fact issue exists and plaintiff should have the opportunity to present further proofs as to the compensation for bad debt losses included in the service fees it paid to the Finance Companies. *See Busik v. Levine,* 63 *N.J.* 351, 364, 307 *A.*2d 571,*appeal dismissed,* 414 *U.S.* 1106, 94 *S.Ct.* 831, 38 *L.Ed.*2d 733 (1973) (permitting a court to "decide issues which need not be decided when it believes that course is warranted"). Plaintiff's contentions as to the existence of a fact issue are not supported by the certifications plaintiff submitted in opposition to the motion. None of the certifications contains any information identifying or quantifying the component of each service fee attributable to the bad debt losses anticipated by the Finance Companies, or describing how that component was determined, or discussing whether such a component actually was calculated or negotiated separately. The certifications assert conclusions unsupported by facts.

Plaintiff's Director, Credit/Legal certified that the service fees payable by plaintiff compensated the Finance Companies in advance*34 for all credit losses and "presumably ensured" that the Finance companies would realize income greater than the expenses they incurred, including bad debt losses, in administering the private label credit cards for plaintiff. His only comment concerning the negotiations between plaintiff and the Finance Companies was his statement that the negotiations did not require a delineation of the components of the service fees. As noted above, this individual was not employed by plaintiff until six years after the date of the Agreements, and did not indicate in his certification the source of the information reflected in his certification. Consequently, his statements are speculation and hearsay.

The Vice-President of Risk Management for GE Consumer Finance asserted in his certification that he administered the private label credit card agreements between plaintiff and GE Capital and GE Finance, but stated that "it is my understanding" that the Finance Companies projected the income that they would receive under the credit card agreements and projected anticipated costs including bad debts, billing and collection costs, and administration costs. He provided no information as to the bases for his "understanding" and no information as to how the projections of income and costs were made or as to which portion of the service fees paid to GE Capital and GE Finance (ranging from 1.71% to 3.49% of the purchase price) was attributable to projected bad debts and which portion was attributable to billing and collection costs and administrative costs. His conclusions, therefore, are unsupported by facts and are hearsay.

Under *R.* 1:6-6, affidavits or certifications must set forth "only facts which are admissible in evidence." As described above, the certifications submitted by plaintiff do not satisfy the requirements of the Rule because the certifications contain conclusions without factual support that constitute inadmissible hearsay as to the essence of plaintiff's contentions. The certifications, therefore, are insufficient to create a "genuine issue as to any material fact challenged" within the meaning of *R.* 4:46-2(c).

The reasons for the deficiencies in the certifications of plaintiff's Director, Legal/Credit and the Vice-President of Risk Management*35 for GE Consumer Finance are suggested by findings made by the New York Division of Tax Appeals in a matter involving a claim for refund of sales tax under the identical agreements with Monogram and GE Capital that are at issue in this matter. In *In re Home Depot U.S.A., Inc.,* DTA No. 821034 (N.Y. Div. of Tax Appeals May 17, 2007) (appeal pending), the Division made the following findings:

> In consideration of the services provided to petitioner [ (Home Depot U.S.A., Inc.) ], the credit card companies subtracted from all receipts a service charge. The service charge was not specifically defined in either the GECC or Monogram contract except to say that it was calculated in accordance with a formula set forth in an appendix. The parties to this matter stipulated that the service fees were determined by several factors, including the following: the bad debt experience of Home Depot's credit card customers; the interest incurred that Monogram or GECC anticipated they would earn and that Home Depot forwent on the credit card account; the value of Home Depot's credit card data base given to Monogram and GECC; and the administrative costs associated with the managed credit accounts by Monogram and GECC. However it is particularly noteworthy that neither the agreements nor the stipulation apportioned the percentages of the service fee among the various components and that petitioner conceded it could not determine if the actual bad debts written off by Monogram and GECC were equal to, greater than or less than the anticipated bad debt figure used to estimate the bad debt component of the service fee. In sum, petitioner did not demonstrate and acknowledged

that it could not accurately account that it had compensated GECC or Monogram for the accounts which ultimately became uncollectible.

[*In re Home Depot U.S.A., Inc., supra,* DTA No. 821034.]

[3] In this appeal, just as in the New York litigation, plaintiff has failed to identify the portion of the service fees representing compensation to the Finance Companies for their respective anticipated bad debt losses. Although counsel for plaintiff asserted in oral argument that plaintiff could present proofs quantifying that portion, none of the certifications plaintiff submitted in opposition to the Director's summary judgment motion contained any factual or non-hearsay basis for such assertion. Because the New York Division of Tax Appeals cited a similar absence of proof in rejecting plaintiff's sales tax refund claims, plaintiff surely was on notice of the significance of such proofs. From plaintiff's failure to submit certifications identifying or quantifying the bad debt component of the service fees or describing the factors and process by which such component was determined, I infer that, in fact, no such identification or quantification was possible.

***36** Plaintiff has failed to establish, even on a *prima facie* basis, the relationship, if any, between the unmeasured, and apparently unmeasurable, component of the service fees representing the Finance Companies' projected bad debt losses and the actual bad debt losses incurred by the Finance Companies with respect to the private label credit cards issued to plaintiff's customers. As a result, plaintiff has failed to demonstrate that it suffered any losses attributable to bad debts. It received payment in full from the Finance Companies for each transaction in which a customer used plaintiff's private label credit card, subject to deductions from some payments in the amount of the service fees (the service fees under the Monogram Agreement could be zero) and, perhaps, other items not relevant to this appeal. Whether or not the customer eventually defaulted on the credit card obligation, plaintiff received the same payment with respect to the transaction, and paid the same service fee.

Plaintiff has not identified or quantified, by percentage or aggregate dollar amount, the service fees it paid on the $32,947,949.17 in sales transactions that generated (at a tax rate of 6%) the $1,976,875.95 in sales tax which plaintiff seeks to have refunded. In any event, plaintiff does not contend that service fees paid with respect to these sales constituted the only service fees forming the basis for its refund claim. Plaintiff asserts that all service fees contained a bad debt component. As a result, plaintiff seeks a refund apparently based primarily on service fees paid where no bad debt loss occurred and the customer paid in full the credit card debt, including the merchandise charge and applicable sales tax. Neither *N.J.S.A.* 54:32B-12(c) nor *N.J.A.C.* 18:24-23.2(a) contemplates a refund of sales tax where no bad debt loss has occurred. Thus, even if I were to assume (contrary to the actual situation described in plaintiff's certifications) that the service fees, in their entirety, were intended to cover anticipated bad debt losses, plaintiff could not prevail because: (1) no refund would be appropriate based on service fees allocable to private label credit card sales where no customer payment default occurred, and (2) plaintiff has not segregated the service fees paid with respect to private label credit card sales where no default ***37** occurred from the service fees paid with respect to private label credit card sales where a customer payment default did occur.

In short, plaintiff's response to the Director's summary judgment motion is devoid of any factual submissions sufficient, even on a *prima facie* basis under the evidentiary standard applicable under *R.* 4:46-2(c), to demonstrate that its service fee payments constituted bad debt losses for which a sales tax refund is appropriate under *N.J.S.A.* 54:32B-12(c) or *N.J.A.C.* 18:24-23.2. *See Brill v. Guardian Life Ins. Co. of Am., supra,* 142 *N.J.* at 540, 666 *A.*2d 146 (stating that "when the evidence 'is so one-sided that one party must prevail as a

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matter of law' the trial court should not hesitate to grant summary judgment.") (citation omitted). Plaintiff elected to use the services of the Finance Companies in order to enable its customers to make purchases using its private label credit card. Plaintiff is bound by tax consequences of that election. "It is not what might have happened nor what the taxpayer could have done but what actually occurred that determines tax consequences." *General Trading Co., Inc. v. Director, Div. of Taxation,* 83 *N.J.* 122, 138, 416 *A.*2d 37 (1980).

Plaintiff asserts that denying its refund claim would constitute treatment different from the treatment accorded to taxpayers who directly bear bad debt losses under circumstances where plaintiff contends that it, in effect, bore those losses. Plaintiff contends that such treatment would constitute a denial of equal protection of the laws and of substantive due process. Well-established law provides that, in determining whether a tax statute effects a denial of equal protection or due process, a court should apply a rational basis test and determine whether the legislation in question has a rational relationship to a legitimate governmental interest. *See, e.g., Greenberg v. Kimmelman,* 99 *N.J.* 552, 563-64, 494 *A.*2d 294 (1985); *Town of Secaucus v. Hudson County Bd. of Taxation,* 133 *N.J.* 482, 493, 628 *A.*2d 288 (1993) (stating that in the field of taxation, our Supreme Court "has accorded great deference to legislative judgments" and "has recognized that absolute equality in taxation is a practical impossibility" (citations omitted)). Our Supreme Court has recognized that, with respect to tax laws, the Legislature possesses "the greatest freedom in classification." ***38** *Salorio v. Glaser,* 82 *N.J.* 482, 515, 414 *A.*2d 943 (1980) (quoting from *Madden v. Kentucky,* 309 *U.S.* 83, 88, 60 *S.Ct.* 406, 408, 84 *L.Ed.* 590, 593 (1940)).

These principles are applicable in determining whether the Director's interpretation of *N.J.S.A.* 54:32B-12(c), as set forth in *N.J.A.C.* 18:24-23.2(a), constitutes a denial of equal protection or a violation of due process. For the reasons set forth above, I conclude that the statute and the regulation are reasonable and have a rational relationship to a legitimate governmental interest. I further conclude that, insofar as the regulation distinguishes between a taxpayer that directly incurs a bad debt loss and one, such as plaintiff, which asserts that it has funded some portion of the bad debt losses incurred by a third party, the Director has established a rational, reasonable, and valid classification. As a result, denying plaintiff's refund claim does not result in an unlawful revenue windfall to the State of New Jersey. Plaintiff simply is paying sales tax on transactions on which it received at least 86.8%, and sometimes 97% to 100% of the combined amount of the purchase price and applicable sales tax.

Plaintiff also asserts that denying its refund claim would result in a violation of the Commerce Clause, but has failed to set forth any explanation or citation in support of this assertion. The argument is without merit, and I see no need to discuss it further.

For all of the foregoing reasons, I conclude that no genuine issues as to material fact exist in this matter and that the Director is entitled to judgment as a matter of law. Consequently, I grant the Director's summary judgment motion and will enter judgment accordingly.

N.J.Tax,2008.
Home Depot U.S.A., Inc. v. Director, Div. of Taxation
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# APPENDIX D

STATE OF NEW YORK

TAX APPEALS TRIBUNAL

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In the Matter of the Petition

of

**HOME DEPOT U.S.A., INC.**

for Revision of a Determination or for Refund of Sales and Use Taxes under Articles 28 and 29 of the Tax Law for the Period March 1, 1997 through July 31, 2003.

DECISION
DTA NO. 821034

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Petitioner, Home Depot U.S.A., Inc., filed an exception to the determination of the Administrative Law Judge issued on May 17, 2007. Petitioner appeared by Morrison & Foerster, LLP (Irwin M. Slomka, Esq. and Amy F. Nogid, Esq., of counsel). The Division of Taxation appeared by Daniel Smirlock, Esq. (James Della Porta, Esq., of counsel).

Petitioner filed a brief in support of its exception. The Division of Taxation filed a brief in opposition and petitioner filed a brief in reply. Oral argument, at petitioner's request, was heard on May 14, 2008 in Troy, New York.

After reviewing the entire record in this matter, the Tax Appeals Tribunal renders the following decision. Commissioner McDermott concurs for the reasons set forth in a separate opinion.

## *ISSUES*

I. Whether the Division of Taxation properly denied petitioner's claim for refund of sales and use taxes paid on transactions that were financed by third parties and subsequently were ascertained to be uncollectible.

II. Whether the Division of Taxation's regulation at 20 NYCRR 534.7(b)(3) should be determined to be invalid due to an inconsistency with the intent of Tax Law § 1132(e).

III. Whether petitioner is entitled to equitable relief if it is found that the State of New York is being unjustly enriched, contrary to the spirit and intent of Tax Law § 1132(e).

IV. Whether the Division of Taxation has violated petitioner's right to equal protection of the laws and its right to due process under the Federal and New York State constitutions by failing to refund the sales and use taxes remitted by petitioner.

## *FINDINGS OF FACT*

We find the facts as determined by the Administrative Law Judge except for finding of fact "25" which has been modified. The Administrative Law Judge's findings of fact and the modified finding of fact are set forth below.

Home Depot U.S.A., Inc. ("Home Depot") is a Delaware corporation headquartered in Atlanta, Georgia, which operated retail home improvement centers throughout the United States, including New York, during the period March 1, 1997 through July 31, 2003 (the "audit period").

During the audit period, Home Depot provided its customers with the option of purchasing merchandise through a private label credit card.

Home Depot entered into an Amended and Restated Consumer Credit Card Program Agreement with Monogram Credit Card Bank of Georgia ("Monogram"), dated August 4, 1997, to issue and finance Home Depot private label credit cards to consumers. In addition, Home Depot entered into an Amended and Restated Commercial Credit Program Agreement and an Amended and Restated Business Credit Card Program Agreement with General Electric Capital Corporation ("GECC"), both dated August 4, 1997, to issue and finance Home Depot private label credit cards to commercial businesses. Hereinafter, all three agreements are referred to collectively as the "Credit Card Program Agreements." The Credit Card Program Agreements were complete documents reflecting the furnishing of private label credit card programs to Home Depot.

Monogram and GECC applied creditworthiness standards to the applications, issued to qualified customers private label credit cards bearing the "Home Depot" name and entered into credit card agreements with these customers. Monogram and GECC, in their sole discretion, determined the creditworthiness of all individual applicants for credit cards.

During the period in issue, Home Depot did not have an equity interest in either Monogram or GECC.

Home Depot was a vendor of tangible personal property or services as defined in Tax Law § 1131(1), was registered to collect New York State and local sales tax as required by Tax Law § 1134 and remitted sales tax to the Division of Taxation ("Division") on New York sales based on the full purchase price of taxable merchandise, including credit card sales of merchandise.

For each sale made to a customer using the Home Depot private label credit card, Monogram or GECC paid to Home Depot the purchase price and sales tax less a credit card service fee as provided in the Credit Card Program Agreements. The service fee varied depending on the type and amount of the sales transaction financed.

Home Depot recorded an accounts receivable from Monogram or GECC related to each sale subject to a Credit Card Program Agreement, but did not record an account receivable from the customer with respect to such credit card transactions.

Although not specified in the Credit Card Program Agreements, the parties agreed that the credit card service fees were determined by several factors, including the bad debt experience of Home Depot's credit card customers, the interest income that Monogram or GECC anticipated it would earn and that Home Depot forwent on the credit card account, the value of Home Depot's credit card database given to Monogram and GECC, and the administrative costs associated with the managed credit accounts by Monogram and GECC.

Home Depot compensated Monogram and GECC in advance for anticipated bad debts through the credit card service fee. The actual bad debts written off by Monogram and GECC may have been equal to, greater than or less than the anticipated bad debts.

Eugene J. Thorncroft, Jr., Vice President of Risk Management for Monogram, who had knowledge of Monogram's financing of credit sales by Home Depot, attested that the negotiated purchase price of the accounts included an undisclosed bad debt loss component, among other costs and considerations listed above, which represented retention of an economic risk of loss on the accounts receivable by Home Depot.

The agreement between Monogram and petitioner, dated August 4, 1997, specifically listed "service fee" in its definitions, section 1.01, defining it as the meaning given in section 5.03(a), which merely said it was a fee applicable to all charge slips in the charge transaction data as indicated in an attached schedule (Schedule 5.03), which did not mention the components of the service fee.

In addition, the same agreement stated in section 6.02 that all credit losses on accounts were to be borne at the expense of Monogram and not passed on to petitioner except in chargeback situations not present herein.

The terms of the agreement with GECC were substantially similar, reflecting no explanation of the service fee and specifically indicating that losses on the accounts were borne by GECC and not passed on to petitioner.

The parties stipulated that to the extent anything in the stipulation contradicted the terms of the credit card agreements, the terms of the agreements controlled.

Home Depot deducted the credit card service fees for Federal income tax purposes on line "26" ("Other Deductions") of its Federal corporation income tax forms (forms 1120) but did not deduct the bad debts attributable to the Home Depot credit cards issued by Monogram or GECC on line 15 ("Bad Debts") of its Federal income tax returns (forms 1120).

Certain of the receivables related to sales made by Home Depot to its customers using the Home Depot private label credit card became worthless and uncollectible.

On December 13, 2003, petitioner filed three timely refund claims with the Division. One claim, for the period March 1, 1997 through February 28, 2000, requested a refund of $1,553,753.67 ("First Refund Claim"). The second refund claim, for the period March 1, 2000 through November 30, 2001, requested a refund of $1,643,593.81 ("Second Refund Claim"). The last claim, for the period December 1, 2001 through July 31, 2003, requested a refund of $2,573,056.61 ("Third Refund Claim"). The refund claims pertained to sales taxes paid by petitioner with respect to credit card sales, the receivables for which became uncollectible.

On December 28, 2004, the Division denied the First Refund Claim in its entirety.

On March 25, 2005, petitioner timely filed its Request for Conciliation Conference with respect to the December 28, 2004 refund denial.

The Division consolidated for review the Second Refund Claim and the Third Refund Claim, and on May 10, 2005, the Division issued one letter denying both refund claims in their entirety.

On August 3, 2005, petitioner timely filed its Request for Conciliation Conference with respect to the Division's denial of its Second and Third Refund Claims. On December 16, 2005, the Bureau of Conciliation and Mediation Services issued two conciliation orders denying both of petitioner's requests for relief.

In its refund denial letters, the Division did not take issue with the bad debts underlying the refund claims. Instead, the Division based its denial on 20 NYCRR 534.7(b)(3), which prohibited generally a refund of sales tax for transactions that were financed by a third party or for a debt that had been assigned to a third party regardless of whether the third party had recourse to the vendor on the debt.

Home Depot provided substantiation to the Division detailing the actual worthless transactions underlying its refund claims.

Pursuant to the terms of their credit card agreements with Home Depot, Monogram and GECC own the Home Depot credit card accounts, and because of this, they recorded the receivables related to such accounts on their balance sheets.

For Federal income tax purposes, Monogram and GECC wrote off receivables, including those related to their credit card agreements with Home Depot, after they became uncollectible, and claimed a deduction on line "15" ("Bad Debts") on their Federal corporation income tax returns, as permitted by Internal Revenue Code § 166.

If either Monogram or GECC had filed claims for refund of sales taxes related to the sales made by Home Depot to customers using the Home Depot private label credit cards that became worthless and uncollectible, and which are the subject of this case, the Division would have denied those claims as well, consistent with the New York Court of Appeals decision in ***Matter of General Elec. Capital Corp. v. New York State Div. of Tax Appeals*** (2 NY3d 249 [2004]).

We modify finding of fact "25" of the Administrative Law Judge's determination to read as follows:

> The parties agree that if it is determined that petitioner is entitled to a refund of the sales taxes paid with respect to sales subject to the Credit Card Program Agreements, the amounts claimed by it in its First, Second and Third Refund Claims will be refunded.(1)

***THE DETERMINATION OF THE ADMINISTRATIVE LAW JUDGE***

At the outset, the Administrative Law Judge discussed the law governing the outcome in this matter. Tax Law § 1132(e) authorizes the Commissioner of Taxation to promulgate regulations that would exclude from taxable receipts, "amounts representing sales where . . . the receipt . . . has been ascertained to be uncollectible or, in case the tax has been paid upon such receipt, for refund of or credit for the tax so paid."

Consistent with this grant of authority set forth, the Commissioner of Taxation and Finance promulgated 20 NYCRR 534.7(b)(1), which provides that "[w]here a receipt . . . has been ascertained to be uncollectible, either in whole or in part, the vendor of the tangible personal property . . . may apply for a refund or credit of the tax paid on such receipt." The Administrative Law Judge pointed out that the same regulation provides that no refund or credit is available where the transaction is financed by a third party or for a debt that has been assigned to a third party, regardless of whether the third party has recourse to the vendor on the debt (***see***, 20 NYCRR 534.7[b][3]).

The Administrative Law Judge observed that the scenario where the debt has been assigned to a third party was addressed by the Court of Appeals in ***Matter of General Elec. Capital Corp. v. New York State Div. of Tax***

***Appeals (supra)***. The Court upheld the Division's denial of refund claims based upon the finding that Tax Law § 1132(e) granted the commissioner authority to promulgate regulations regarding uncollectible debts and placed no limitations on the commissioner's power to determine the types of parties that could qualify for tax refunds on uncollectible debts. Further, the Administrative Law Judge noted, the Court found that the commissioner's preclusion of refunds for parties that had not paid the taxes and were removed from the taxable transaction was necessary to avoid excessive administrative burdens and facilitate the orderly administration of the sales tax.

Accordingly, the Administrative Law Judge concluded that the Court's rationale is applicable to the instant matter, and determined that the commissioner acted within his authority under Tax Law § 1132(e) in denying petitioner's refund claims herein.

The petitioner in ***General Electric*** conceded that its refund claim fell within the prohibition of 20 NYCRR 534.7(b)(3) but argued that said restriction was not authorized by the statute. Petitioner in this case also claimed that the regulation's prohibition, as applied to it, was unreasonable, arbitrary and restrictive. The Administrative Law Judge rejected this claim, noting the language of the Court in ***General Electric***:

> The cornerstone of administrative law is derived from the principle that the Legislature may declare its will, and after fixing a primary standard, endow administrative agencies with the power to fill in the interstices . . . by prescribing rules and regulations consistent with the enabling legislation . . . . In so doing, an agency can adopt regulations that go beyond the text of that legislation, provided they are not inconsistent with the statutory language or its underlying purposes (Citations omitted).
>
> This regulatory authority is, of course, not unbridled. "As an arm of the executive branch of government, an administrative agency" . . . may adopt only rules and regulations which "are in harmony with the statute's over-all purpose," (citation omitted). That being said, where an agency adopts a regulation that is consistent with its enabling legislation and is not "so lacking in reason for its promulgation that it is essentially arbitrary" (citation omitted) the rule has the force and effect of law (Citation omitted) ***(Matter of General Elec. Capital Corp. v. New York State Div. of Tax Appeals***, ***supra***, at 254).

The Administrative Law Judge observed that the Court in ***General Electric*** found that Tax Law § 1132(e) permitted but did not require the Division to provide refunds for sales taxes paid on uncollectible debts and left to the discretion of the Department of Taxation and Finance, the formulation of regulations that would delineate the situations, if any, where uncollectible debts would be excluded from taxable receipts. The Court found the Division's regulation at 20 NYCRR 534.7(b) to be consistent with this charge, identifying the entities eligible to apply for the refund and under what circumstances a refund would be granted.

The Court of Appeals in ***General Electric*** also found that the Division's regulation that specified which entities would be permitted to seek refunds of the sales tax was necessary to avoid an excessive administrative burden and accomplish an orderly administration of the sales tax. The Court of Appeals considered this in the context of the sales tax statutory scheme and concluded that since retail vendors were in a special trustee relationship with the State, the fact that the Division granted them the benefit of a refund on sales taxes for uncollectible debts was clearly rational given the responsibilities imposed on vendors, and also to foster the trustee relationship with the State, encouraging accurate, timely reporting of taxable sales.

Further, the Administrative Law Judge pointed out that the Court in ***General Electric*** determined that Tax Law § 1132(e) did not limit the commissioner's power to determine the types of entities that qualified for the benefit (i.e., excluding uncollectible debts from taxable receipts). As a result, the Division's refusal to grant a refund to an entity that never paid taxes and was removed from the underlying taxable transaction was deemed both rational and consistent with Tax Law § 1132(e).

The Administrative Law Judge found the same rationale controlling in this matter. Petitioner made taxable sales of tangible personal property or services that customers purchased using Home Depot private label credit cards supplied by either Monogram or GECC. The credit card companies paid petitioner the full amount of the receipt and the sales tax. Petitioner accepted the sales tax as the trustee for the State of New York and paid it over to the Division with its tax returns.

In consideration of the services provided to petitioner, the credit card companies subtracted from all receipts a service charge. The manner of the service charge calcualtion was not specifically defined in either the GECC or Monogram contract. However, the Administrative Law Judge noted that the parties stipulated that the service fees were determined taking several factors into consideration, including: the bad debt experience of Home Depot's credit card customers; the interest income that Monogram or GECC anticipated they would earn and that Home Depot forwent on the credit card account; the value of Home Depot's credit card database given to Monogram and GECC; and the administrative costs associated with the managed credit accounts by Monogram and GECC. However, the Administrative Law Judge found it significant that neither the agreements nor the stipulation apportioned the percentages of the service fee among the various components and that petitioner conceded it could not determine if the actual bad debts written off by Monogram and GECC were equal to, greater than or less than the anticipated bad debt figure used to estimate the bad debt component of the service fee. In sum, the Administrative Law Judge found that petitioner did not demonstrate, and acknowledged that it could not accurately account, that it had compensated GECC or Monogram for the accounts that ultimately became uncollectible.

The Administrative Law Judge also found significant that the credit card companies expressly stated in their agreements with petitioner that all credit losses on accounts were to be borne at the expense of Monogram and GECC and not passed on to petitioner except in chargeback situations not present herein. The credit card companies, not petitioner, reported the bad debts as losses on their Federal corporate income tax returns. The Administrative Law Judge viewed this as an acknowledgment that GECC and Monogram incurred the losses in form as well as in economic substance. The Administrative Law Judge pointed out that it was not the intent of the parties that petitioner would share in the losses that GECC and Monogram represented to the Internal Revenue Service that they had incurred. The Administrative Law Judge found petitioner's argument contrary to the plain meaning of the terms of the agreements with the credit card companies, which specifically provided that all credit losses on accounts were to be borne at their expense and not passed on to petitioner. The Administrative Law Judge observed that this conclusion was further supported by the fact that the parties agreed that the terms of the agreements superseded any facts in the stipulation.

The Administrative Law Judge next addressed what part of the service fee was arguably dedicated to uncollectible accounts. The Administrative Law Judge pointed out that petitioner unequivocally stated that it did not know if the amount corresponded with the amount of bad debts, thus conceding that it was not possible to trace the amounts stated on specific receipts to its refund claims. In addition, as pointed out by the Court of Appeals decision in ***General Electric***, the limitations imposed by the commissioner in 20 NYCRR 534.7(b)(3) were necessary to avoid excessive administrative burden and to facilitate the orderly administration of the sales tax. The Administrative Law Judge found that since petitioner could not trace the source of the refund claims with specificity, a burden the Tax Law lays squarely on petitioners shoulders, the Division could not be expected to do so on audit.

Tax Law § 1132 was amended by chapter 664 of the Laws of 2006 to provide that where accounts are held by a lender, either the vendor or the lender, after filing an election with the Department designating which party is entitled to claim the refund or deduction for bad debt, shall be entitled to a deduction or refund of tax that the vendor has previously reported and paid. (*see*, Tax Law § 1132[e-1][3][i], effective January 1, 2007).

Therefore, the Administrative Law Judge concluded that the rationale of the Court of Appeals in ***General Electric*** and the interpretation of the regulations discussed above are valid as applied to these facts and for the periods at issue herein. Consistent with this conclusion, the Administrative Law Judge also rejected petitioner's contention that the Division's denial of the refund claims was contrary to the spirit of the law and worthy of equitable relief.

The Administrative Law Judge next addressed petitioner's Constitutional claims. The Administrative Law Judge rejected petitioner's claim that it has been denied Equal Protection. The Administrative Law Judge pointed out that the Equal Protection clauses of the State and Federal Constitutions do not forbid classifications, but simply prohibit governmental decision makers from treating differently, persons who are in all relevant respects alike. The Administrative Law Judge noted that petitioner is not in all respects like a vendor who finances a sale. It did not maintain accounts receivable for its customers and did not incur bad debts when customers defaulted on their payments for property and services purchased from petitioner. In fact, petitioner received the purchase price and tax thereon, in full, from the credit card companies, less the credit card service charge. The Administrative Law Judge pointed out that there was a strong policy reason for treating petitioner differently from vendors who financed sales themselves, and as a result, petitioner's equal protection claim was rejected.

Petitioner also argued that the Division's refund denials were so unduly harsh or oppressive that they amounted to a denial of petitioner's due process rights under the Fourteenth Amendment of the US Constitution and article 1, § 6 of the New York Constitution. The Administrative Law Judge also rejected this claim as being without merit. The Administrative Law Judge noted that petitioner voluntarily chose the form of its business transactions and was aware of the regulatory prohibition of refunds thereon. Given the conclusions reached above, the Administrative Law Judge found that the regulations were consistent with the enabling legislation and the refund denials proper.

Accordingly, petitioner's motion for summary determination pursuant to 20 NYCRR 3000.9(b) was denied, and there being no material and triable issue of fact in dispute, summary determination was granted in favor of the Division *sua sponte*.

## *ARGUMENTS ON EXCEPTION*

Petitioner, on exception, argues as it did below, that the Division's regulation at 20 NYCRR 534.7(b)(3) conflicts with the statute pursuant to which it was promulgated, Tax Law § 1132(e), because it prohibits the refund of sales tax paid on purchases by bad debtors merely because the retailer entered into a financing arrangement with a third-party credit card bank. Petitioner asserts that the regulation's prohibition was unreasonable, arbitrary and restrictive.

Petitioner challenges the conclusion of the Administrative Law Judge which finds that the rationale of the Court of Appeals in ***General Electric*** i.e., that the Commissioner acted within his authority is applicable here. Petitioner argues that it is unreasonable to deny sales tax refunds to vendors that have established that sales tax was remitted on transactions that later became uncollectible just because the transactions were financed through third parties. Petitioner states that the court's decision in ***General Electric*** does not support the Administrative Law Judge's determination.

Petitioner maintains that recently-enacted chapter 664 of the Laws of 2006, which explicitly provides that the vendor or the issuer of a private-label credit card may receive refunds on that portion of any such credit card account that is worthless and has been taken as a loss on Federal income taxes, should be given retroactive effect.

Finally, petitioner argues that since the Division's denial of its refund requests resulted in an unjust enrichment of the State, it should prevail herein on the basis of fairness. In addition, petitioner continues to argue that the Division, by treating similarly situated taxpayers differently, has violated petitioner's right to equal protection of the laws, and the denial of its refund requests resulted in a denial of petitioner's due process.

The Division counters that pursuant to ***General Electric***, the permissive language in Tax Law § 1132(e), which states that "the tax commissioner may provide, by regulation," for a refund of sales taxes paid on sales where the receipt has been ascertained to be uncollectible, does not require the Division to grant such refunds to any class of applicants. In other words, the Division believes that it has discretion to determine the scope of the credit it will allow. The Division argues that since the regulation it promulgated pursuant to Tax Law § 1132(e) prohibited a refund or credit in transactions financed by third parties, petitioner was not eligible for the refund it seeks. As such, the Division argues that the regulation was consistent with the statute's intent and within the statutory grant of power to the agency.

The Division also argues that it is impossible to determine which parties assumed the economic burden for the bad debts and to what extent, underscoring the reasonableness of the regulation in issue.

The Division contends that the equities of the tax scheme in issue have no bearing on the legal issue and it cannot be assumed that the Legislature intended the result of its statutory enactment to be a fair and balanced formula.

Finally, the Division urges that enactment of chapter 664 of the Laws of 2006 supports its position herein. It notes that the legislation specifically is not retroactive and also points out that the sponsor's memorandum candidly laments the failure of the prior law to provide such relief.

## ***OPINION***

We affirm the determination of the Administrative Law Judge for the reasons stated therein. The Administrative Law Judge fully and properly addressed each of the issues raised by petitioner. Petitioner has produced no evidence below, nor arguments on exception, that would justify our modifying the determination of the Administrative Law Judge in any respect.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of Home Depot U.S.A., Inc. is denied;

2. The determination of the Administrative Law Judge is affirmed;

3. The petition of Home Depot U.S.A., Inc. is denied; and

4. The denials of petitioner's refund claims, dated December 28, 2004 and May 10, 2005, are sustained.

DATED: Troy, New York
November 6, 2008

/s/ Charles H. Nesbitt
Charles H. Nesbitt
President

/s/ Carroll R. Jenkins
Carroll R. Jenkins
Commissioner

COMMISSIONER ROBERT J. McDERMOTT concurring:

I concur in the outcome of this case for the reasons discussed below.

When a retail customer brings a credit card to a store to pay for purchased goods, the nature of the transaction is much the same as if he instead brought his rich uncle. The customer pays the retailer in cash with funds borrowed by the customer from a third party, avuncular or commercial. If the customer fails to repay the borrowing from the lender, there is no basis for rescinding or otherwise recasting the sale of merchandise, since the customer paid and the merchant received the purchase price in cash. There is no "receipt . . . ascertained to be uncollectible" within the meaning of Tax Law § 1132(e). Imposition of the sales tax does not depend on how the purchaser raised the funds for the sales price.

A sale on the installment plan is quite different. There the merchant agrees with the customer to accept deferred payment of the purchase price. If the customer fails to make all of the promised payments, the merchant will in effect have sold the goods for a lower purchase price. In this situation, the Tax Law authorizes the Division to permit the merchant to claim a credit for sales taxes paid to the Division of Taxation on the portion of the purchase price that was not actually received (Tax Law § 1132[e]). Where, prior to default, the merchant has sold its accounts receivable to an unrelated person who takes on the risk of the customer's credit, the situation is ambiguous since the merchant may be indifferent to the customer's default depending on whether the purchaser of the accounts has any recourse to the merchant for bad debts. Situations in which the merchant has sold its accounts are the subject of the regulations discussed above (20 NYCRR 534.7[b]) and in the determination of the Administrative Law Judge and the ***General Electric Capital Corp.*** case. The present case, however, involves credit card transactions not installment sales. The retail customer makes a credit application to the credit card company providing details of his or her creditworthiness and, if approved, receives an extension of credit from that company, which may be drawn upon at the point of purchase in petitioner's stores. The fact that the retailer pays a fee to the credit card company for the privilege of participating in this arrangement does not make the retailer a lender or a seller on the installment plan. The fact that these "private label" cards can be used only in petitioner's stores is also irrelevant. Accordingly, I would affirm the determination of the Administrative Law Judge for the reasons set forth herein.

DATED: Troy, New York
November 6, 2008

/s/ Robert J. McDermott
Robert J. McDermott
Commissioner

1. We have modified finding of fact "25" to more accurately reflect the record. Also, we note that the second and third refund requests were consolidated and denied in one refund letter dated May 10, 2005.

STATE OF NEW YORK

DIVISION OF TAX APPEALS

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In the Matter of the Petition

of

**HOME DEPOT U.S.A., INC.**

for Revision of a Determination or for Refund of Sales and Use Taxes under Articles 28 and 29 of the Tax Law for the Period March 1, 1997 through July 31, 2003.

DETERMINATION
DTA NO. 821034

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Petitioner, Home Depot U.S.A., Inc., 2455 Paces Ferry Road N.W., Atlanta, Georgia 33039-4024, filed a petition for revision of a determination or for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for the period
March 1, 1997 through July 31, 2003.

Petitioner, by its representative, Morrison & Foerster, LLP (Amy F. Nogid, Esq., of counsel), brought a motion filed December 8, 2006, seeking summary determination in the above- referenced matter pursuant to Tax Law § 2006(6) and
20 NYCRR 3000.9(b). The Division of Taxation appeared in opposition to the motion by its representative, Daniel Smirlock, Esq. (James Della Porta, Esq., of counsel). The parties completed their submission of briefs by February 20, 2007, which date began the 90-day period for issuance of this determination. On April 24, 2007, on notice to the parties, the date for issuance
of this determination was extended from 90 days to six months from February 20, 2007, pursuant to 20 NYCRR 3000.5(d).

After due consideration of the motion and the supporting affidavit of Amy F. Nogid, Esq., sworn to on December 7, 2006,
and the exhibits attached thereto, and all the pleadings and proceedings had herein, Joseph W. Pinto, Jr., Administrative Law Judge, renders the following determination.

## *ISSUES*

I. Whether the Division of Taxation properly denied petitioner's claim for refund of sales and use taxes paid on transactions which were financed by third parties and subsequently were ascertained to be uncollectible.

II. Whether the Division's regulation at 20 NYCRR 534.7(b)(3) should be determined to be invalid due to an inconsistency with the intent of Tax Law § 1132(e).

III. Whether petitioner is entitled to equitable relief if it is found that the State of New York is being unjustly enriched, contrary to the spirit and intent of Tax Law § 1132(e).

IV. Whether the Division of Taxation has violated petitioner's right to equal protection of the laws and its right to due process under the Federal and New York State constitutions by failing to refund the sales and use taxes remitted by petitioner.

## *FINDINGS OF FACT*

The parties entered into a Stipulation of Facts containing 33 numbered findings which have been included in the findings of fact below.

1. Home Depot U.S.A., Inc. ("Home Depot") is a Delaware corporation headquartered in Atlanta, Georgia, which operated retail home improvement centers throughout the United States, including New York, during the period March 1, 1997 through July 31, 2003 (the "audit period").

2. During the audit period, Home Depot provided its customers with the option of purchasing merchandise through a private label credit card.

3. Home Depot entered into an Amended and Restated Consumer Credit Card Program Agreement with Monogram Credit Card Bank of Georgia ("Monogram"), dated August 4, 1997, to issue and finance Home Depot private label credit cards to consumers. In addition, Home Depot entered into an Amended and Restated Commercial Credit Program Agreement and an Amended and Restated Business Credit Card Program Agreement with General Electric Capital Corporation ("GECC"), both dated August 4, 1997, to issue and finance Home Depot private label credit cards to commercial businesses. Hereinafter, all three agreements are referred to collectively as the "Credit Card Program Agreements." The Credit Card Program Agreements were complete documents reflecting the furnishing of private label credit card programs to Home Depot.

4. Monogram and GECC applied creditworthiness standards to the applications, issued to qualified customers private label credit cards bearing the "Home Depot" name and entered into credit card agreements with these customers. Monogram and GECC, in their sole discretion, determined the creditworthiness of all individual applicants for credit cards.

5. During the period in issue, Home Depot did not have an equity interest in either Monogram or GECC.

6. Home Depot was a vendor of tangible personal property or services as defined in Tax Law § 1131(1), was registered to collect New York State and local sales tax as required by Tax Law § 1134 and remitted sales tax to the Division of Taxation ("Division") on New York sales based on the full purchase price of taxable merchandise, including credit card sales of merchandise.

7. For each sale made to a customer using the Home Depot private label credit card, Monogram or GECC paid to Home Depot the purchase price and sales tax less a credit card service fee as provided in the Credit Card Program Agreements. The service fee varied depending on the type and amount of the sales transaction financed.

8. Home Depot recorded an accounts receivable from Monogram or GECC related to each sale subject to a Credit Card Program Agreement, but did not record an account receivable from the customer with respect to such credit card transactions.

9. Although not specified in the Credit Card Program Agreements, the parties agreed that the credit card service fees were determined by several factors, including the bad debt experience of Home Depot's credit card customers, the interest income that Monogram or GECC anticipated it would earn and that Home Depot forwent on the credit card account, the value of Home Depot's credit card database given to Monogram and GECC, and the administrative costs associated with the managed credit accounts by

Monogram and GECC.

10. Home Depot compensated Monogram and GECC in advance for anticipated bad debts through the credit card service fee. The actual bad debts written off by Monogram and GECC may have been equal to, greater than or less than the anticipated bad debts.

11. Eugene J. Thorncroft, Jr., Vice President of Risk Management for Monogram, who had knowledge of Monogram's financing of credit sales by Home Depot, attested that the negotiated purchase price of the accounts included an undisclosed bad debt loss component, among other costs and considerations listed above, which represented retention of an economic risk of loss on the accounts receivable by Home Depot.

12. The agreement between Monogram and petitioner, dated August 4, 1997, specifically listed "service fee" in its definitions, section 1.01, defining it as the meaning given in section 5.03(a), which merely said it was a fee applicable to all charge slips in the charge transaction data as indicated in an attached schedule (Schedule 5.03) which did not mention the components of the service fee.

In addition, the same agreement stated in section 6.02 that all credit losses on accounts were to be borne at the expense of Monogram and not passed on to petitioner except in chargeback situations not present herein.

The terms of the agreement with GECC were substantially similar, reflecting no explanation of the service fee and specifically indicating that losses on the accounts were borne by GECC and not passed on to petitioner.

The parties stipulated that to the extent anything in the stipulation contradicted the terms of the credit card agreements, the terms of the agreements controlled.

13. Home Depot deducted the credit card service fees for Federal income tax purposes on line "26" ("Other Deductions") of its Federal corporation income tax forms (forms 1120) but did not deduct the bad debts attributable to the Home Depot credit cards issued by Monogram or GECC on line 15 ("Bad Debts") of its Federal income tax returns (forms 1120).

14. Certain of the receivables related to sales made by Home Depot to its customers using the Home Depot private label credit card became worthless and uncollectible.

15. On December 13, 2003, petitioner filed three timely refund claims with the Division. One claim, for the period March 1, 1997 through February 28, 2000, requested a refund of $1,553,753.67 ("First Refund Claim"). The second refund claim, for the period March 1, 2000 through November 30, 2001, requested a refund of $1,643,593.81 ("Second Refund Claim"). The last claim, for the period December 1, 2001 through July 31, 2003, requested a refund of $2,573,056.61 ("Third Refund Claim"). The refund claims pertained to sales taxes paid by petitioner with respect to credit card sales, the receivables for which became uncollectible.

16. On December 28, 2004, the Division denied the First Refund Claim in its entirety.

17. On March 25, 2005, petitioner timely filed its Request for Conciliation Conference with respect to the December 28, 2004 refund denial.

18. The Division consolidated for review the Second Refund Claim and the Third Refund Claim, and on

May 10, 2005, the Division issued one letter denying both refund claims in their entirety.

19. On August 3, 2005, petitioner timely filed its Request for Conciliation Conference with respect to the Division's denial of
its Second and Third Refund Claims. On December 16, 2005, the Bureau of Conciliation and Mediation Services issued two conciliation orders denying both of petitioner's requests for relief.

20. In its refund denial letters, the Division did not take issue with the bad debts underlying the refund claims. Instead, the Division based its denial on 20 NYCRR 534.7(b)(3) which prohibited generally a refund of sales tax for transactions which were financed by a third party or for a debt which had been assigned to a third party regardless of whether the third party had recourse to the vendor on the debt.

21. Home Depot provided substantiation to the Division detailing the actual worthless transactions underlying its refund claims.

22. Pursuant to the terms of their credit card agreements with Home Depot, Monogram and GECC own the Home Depot credit card accounts, and because of this, they recorded the receivables related to such accounts on their balance sheets.

23. For Federal income tax purposes, Monogram and GECC wrote off receivables, including those related to their credit card agreements with Home Depot, after they became uncollectible, and claimed a deduction on line "15" ("Bad Debts") on their Federal corporation income tax returns, as permitted by Internal Revenue Code § 166.

24. If either Monogram or GECC had filed claims for refund of sales taxes related to the sales made by Home Depot to customers using the Home Depot private label credit cards which became worthless and uncollectible, and which are the subject of this case, the Division would have denied those claims as well, consistent with the New York Court of Appeals decision in ***Matter of General Electric Capital Corp. v. New York State Division of Tax Appeals*** (2 NY3d 249,
778 NYS2d 412).

25. The parties stipulated that, if it is determined that petitioner is entitled to a refund of the sales taxes paid with respect to sales subject to the Credit Card Program Agreements, the amounts claimed by it in its First and Second Refund Claims will
be refunded.

## *SUMMARY OF THE PARTIES' POSITIONS*

26. Petitioner argues that the Division's regulation at 20 NYCRR 534.7(b)(3), which was the basis for the Division's denial
of petitioner's refund claims, conflicts with the statute pursuant to which it was promulgated, Tax Law § 1132(e), because it prohibits the refund of sales tax paid on purchases by bad debtors merely because the retailer entered into a financing arrangement with a third-party credit card bank. Petitioner believes the regulation's prohibition was unreasonable, arbitrary
and restrictive. The result of the Division's interpretation of Tax Law § 1132(e), which provided an exclusion from taxable receipts for receipts that proved uncollectible, was that the Division received a windfall which was not intended by the statute.

27. Petitioner contends that the Division's interpretation of Tax Law § 1132(e) increased the effective tax rate and, therefore, must be found invalid. Further, by depriving petitioner of a refund of the sales tax

paid on uncollectible sales, petitioner argues that the regulation shifted the financial burden for the tax from the purchaser to the vendor in contravention of the statute.

28. Petitioner maintains that recently enacted legislation, which explicitly provides that the vendor or the issuer of its private-label credit card may receive refunds on that portion of any such credit card account that is worthless and has been taken as a loss on Federal income taxes, should be considered when determining the intent of the earlier legislation.

29. Finally, petitioner believes that since the Division's denial of its refund requests resulted in an unjust enrichment of the State it should prevail herein on the basis of fairness, i.e., equity. In addition, by treating similarly situated taxpayers differently, the Division has violated petitioner's right to equal protection of the laws, and the denial of its refund requests resulted in a denial of petitioner's due process.

30. The Division contends that pursuant to the decision in ***Matter of General Electric Capital Corp., (supra)***, the permissive language in Tax Law § 1132(e) which states that "the tax commission may provide, by regulation," for a refund of sales taxes paid on sales where the receipt has been ascertained to be uncollectible, does not require the Division to grant such refunds to any class of applicants. In other words, the Division believes it has discretion to determine the scope of the credit it will allow. Since the regulation it promulgated pursuant to Tax Law § 1132(e) prohibited a refund or credit in transactions financed by third parties, petitioner was not eligible for the refund it seeks. As such, the regulation was consistent with the statute's intent and within the statutory grant of power to the agency.

31. The Division also argues that it is an impossibility to determine which parties assumed the full economic burden for the bad debts and to what extent, underscoring the reasonableness of the regulation in issue.

32. The Division contends that the equities of the tax scheme in issue have no bearing on the legal issue and it cannot be assumed that the Legislature intended the result of its statutory enactment to be a fair and balanced formula.

33. The Division believes that the enactment of chapter 664 of the Laws of 2006, which provided for a sales tax bad debt credit when a sale is financed by a third party supports its position herein. It notes that the legislation specifically is not retroactive and also points out that the sponsor's memorandum candidly laments the failure of the prior law to provide such relief.

## *CONCLUSIONS OF LAW*

A. Tax Law § 1132(e) states, in pertinent part, as follows:

> The Tax Commission may provide, by regulation, for the exclusion from taxable receipts . .
> . of
> amounts representing sales where . . . the receipt . . . has been ascertained to be
> uncollectible or,
> in case the tax has been paid upon such receipt, for refund of or credit for the tax so paid.

B. In fact, consistent with the explicit grant of authority set forth in Tax Law §1132(e), the Commissioner of Taxation
and Finance promulgated 20 NYCRR 534.7(b)(1), which states that "[w]here a receipt . . . has been ascertained to be uncollectible, either in whole or in part, the vendor of the tangible personal property . .

. may apply for a refund or credit of
the tax paid on such receipt." The same regulation, however, provides that a refund or credit is not available for a transaction which is financed by a third party or for a debt which has been assigned to a third party, regardless of whether the third party has recourse to the vendor on the debt. (20 NYCRR 534.7[b][3].)

C. The scenario where the debt has been assigned to a third party was specifically addressed by the Court of Appeals in ***Matter of General Electric Capital Corp. v. New York State Division of Tax Appeals*** (***supra***), wherein the Court upheld the Division's denial of refund claims based upon its finding that Tax Law § 1132(e) granted the commissioner the authority to promulgate regulations regarding uncollectible debts and placed no limitations on the commissioner's power to determine the types of parties that could qualify for tax refunds on uncollectible debts. In addition, the Court found that the commissioner's preclusion of refunds for parties that had not paid the taxes and were removed from the taxable transaction
was necessary to avoid excessive administrative burdens and facilitate the orderly administration of the sales tax.

It is concluded that the Court's rationale is applicable to the instant matter, and it is determined that the commissioner acted within the power and authority granted to him by Tax Law § 1132(e) in denying petitioner's refund claims herein. Just as the petitioner in ***General Electric*** conceded its refund claim fell within the prohibition of 20 NYCRR 534.7(b)(3) but argued that said restriction was not authorized by the statute, so too does Home Depot claim that the regulation's prohibition as applicable to this matter was unreasonable, arbitrary and restrictive. It is determined that was not the case.

C. The Court in ***General Electric*** noted:

> The cornerstone of administrative law is derived from the principle that the legislature may declare its will,
> and after fixing a primary standard, endow administrative agencies with the power to fill in the interstices
> in the legislative product by prescribing rules and regulations consistent with the enabling legislation . . . .
> In so doing, an agency can adopt regulations that go beyond the text of that legislation, provided they are
> not inconsistent with the statutory language or its underlying purposes. [Citations omitted.]
>
> This regulatory authority is, of course, not unbridled. 'As an arm of the executive branch of government,
> an administrative agency may not, in the exercise of rule-making authority, engage in broad-based public
> policy determinations' [citation omitted] and may adopt only rules and regulations which 'are in harmony
> with the statute's over-all purpose.' [Citation omitted.] That being said, where an agency adopts a regulation
> that is consistent with its enabling legislation and is not "so lacking in reason for its promulgation that it is
> essentially arbitrary" [citation omitted] the rule has the force and effect of law. [Citation omitted.] ***(Matter***
> ***of General Electric Capital Corp. v. New York State Division of Tax Appeals***, ***supra***, at 254, 778 NYS2d at 415.).

The Court in ***General Electric*** determined that Tax Law § 1132(e) permitted but did not require the Division to provide refunds for sales taxes paid on uncollectible debts and left to the discretion of the Department of Taxation and Finance the formulation of regulations which would delineate the situations, if any, where uncollectible debts would be excluded from taxable receipts. The Division's regulation at 20 NYCRR 534.7(b) was found to be consistent with this charge, identifying the entities eligible to apply for the refund and under what circumstances a refund would be granted.

The Division's regulation which specified which entities would be permitted to seek refunds of the sales tax was necessary to avoid an excessive administrative burden and accomplish an orderly administration of the sales tax. The Court of Appeals in ***General Electric*** considered this in the context of the sales tax statutory scheme and came to the conclusion that, since retail vendors were in a special trustee relationship with the State and were subject to specific registration and record-keeping requirements, the fact that the Division granted them the benefit of a refund on sales taxes for uncollectible debts was clearly rational given the responsibilities imposed on vendors and to foster the trustee relationship with the State, encouraging accurate reporting of taxable sales and payment of taxes in a timely manner.

Finally, it was determined in ***General Electric*** that Tax Law § 1132(e) did not limit the commissioner's power to determine the types of entities that qualified for the benefit (i.e., excluding uncollectible debts from taxable receipts). As a result, the Division's refusal to grant a refund to an entity that never paid taxes and was removed from the underlying taxable transaction was deemed both rational and consistent with Tax Law § 1132(e).

D. The same rationale is controlling in this matter. Petitioner made taxable sales of tangible personal property or services which customers purchased using Home Depot private label credit cards supplied by either Monogram or GECC. The credit card companies paid petitioner the full amount of the receipt and the sales tax. Petitioner accepted the sales tax as the trustee for the State of New York and paid it over to the Division with its returns.

In consideration of the services provided to petitioner, the credit card companies subtracted from all receipts a service charge. The service charge was not specifically defined in either the GECC or Monogram contract, except to say that it was calculated in accordance with a formula set forth in an appendix. The parties to this matter stipulated that the service fees were determined by several factors, including the following: the bad debt experience of Home Depot's credit card customers; the interest income that Monogram or GECC anticipated they would earn and that Home Depot forwent on the credit card account; the value of Home Depot's credit card database given to Monogram and GECC; and the administrative costs associated with the managed credit accounts by Monogram and GECC. However, it is particularly noteworthy that neither the agreements nor the stipulation apportioned the percentages of the service fee among the various components and that petitioner conceded it could not determine if the actual bad debts written off by Monogram and GECC were equal to, greater than or less than the anticipated bad debt figure used to estimate the bad debt component of the service fee. In sum, petitioner did not demonstrate and acknowledged that it could not accurately account that it had compensated GECC or Monogram for the accounts which ultimately became uncollectible.

It is also pertinent that the credit card companies emphatically stated in their agreements with petitioner that all credit losses on accounts were to be borne at the expense of Monogram and GECC and not passed on to petitioner except in chargeback situations not present herein. In turn, the credit card companies, not petitioner, then reported the bad debts as losses on their Federal corporate income tax returns, an acknowledgment that GECC and Monogram incurred the losses in form as well as in economic substance. It was not the intent of the parties that petitioner would share in the losses which GECC and Monogram represented to the Internal Revenue Service they had incurred. Indeed, if petitioner's characterization of the circumstances were adopted, the losses reported by the credit card companies on their Federal income tax returns would have been in bad faith since, according to petitioner, the bad debts had been reimbursed. Further, petitioner's argument creates the untenable circumstance where deductions for bad debts and service fees are taken by both parties with no corresponding income reported. This argument is contrary to the plain meaning of the terms of the agreements with the credit card companies, which specifically provided that all credit losses on accounts were to be borne at their expense and not passed on to petitioner. That the parties agreed that the terms of the agreements superseded any facts in the stipulation is further support for this conclusion.

E. Assuming arguendo that part of the service fee was dedicated to uncollectible accounts, petitioner has unequivocally stated that it did not know if the amount corresponded with the amount of bad debts, thus conceding it was not possible to trace the amounts stated on specific receipts to its refund claims. In addition, as pointed out by the Court of Appeals in the ***General Electric*** decision, the limitations imposed by the commissioner in 20 NYCRR 534.7(b)(3) were "necessary to avoid excessive administrative burden and facilitate the orderly administration of the sales tax." Since petitioner conceded it could not trace the source of the refund claims with specificity, a burden the Tax Law lays squarely on its shoulders, certainly the Division could not be expected to do so on audit.

F. Both parties have pointed out that Tax Law § 1132 was amended by chapter 664 of the Laws of 2006 to provide that where accounts are held by a lender, either the vendor or the lender, after filing an election with the Department designating which party is entitled to claim the refund or deduction for bad debt, shall be entitled to a deduction or refund of tax that the vendor has previously reported and paid. (Tax Law § 1132[e-1][3][i], effective January 1, 2007.)

The Division contends that the statutory change was not retroactive and was enacted to address a change in industry custom with respect to the use of third-party finance companies. Petitioner argues that the change was a clear invalidation of the Division's regulation at 20 NYCRR 534.7(b)(3) and overruled the ***General Electric*** decision. In essence, petitioner believes the amendment, effective in January 2007, demonstrated that the Legislature believed the Division's interpretation was improper and unreasonable *ab initio* and supports its interpretation of Tax Law § 1132(e) vis-a-vis its entitlement to the refunds herein.

There is a general presumption that statutes operate prospectively. (McKinney's Cons Laws of NY, Book 1, Statutes
§ 51[c].) This is equally true for amendatory statutes unless their language clearly indicates a contrary interpretation. (McKinney's Cons Laws of NY, Book 1, Statutes § 52.) The amendment to Tax Law § 1132 contains no such language
and the Introducer's Memorandum in Support of S.6541, containing the amendments, provides no support for such an interpretation. In fact, the Memorandum cites the same rationale as petitioner, i.e., that industry customs have changed and
that the amendment was necessary to reflect the business environment as it now exists, with retailers turning to third-party financing partners. The tone of the Memorandum and the consistent rationale for the amendment was clearly prospective in its curative objectives. Even petitioner seems to endorse this conclusion when it opined in its reply brief that "[t]he new legislation merely confirms that there can be no reasonable **continuing** policy justification for 20 NYCRR 534.7(b)(3)," intimating that there had been a valid policy justification prior to the enactment of the amendment.

Therefore, the rationale of the ***General Electric*** decision and the interpretation of the regulations discussed above remain valid as applied to the facts and circumstances in the periods at issue herein. Consistent with this analysis and conclusion, petitioner's contention that the Division's denial of the refund claims was contrary to the spirit of the law and worthy of equitable relief is determined to be without merit.

G. The Fourteenth Amendment to the United States Constitution provides that no state shall "deny to any person within its jurisdiction the equal protection of the laws." Similarly, New York's Constitution provides that "no person shall be denied the equal protection of the laws of this state or any subdivision thereof" (NY Const, art I, § 11).

The Equal Protection clauses of the State Constitution and Federal Constitution do not forbid classifications, but simply prohibit governmental decision makers from treating differently persons *who are in all relevant respects alike.* Petitioner is not in all respects like a vendor who finances a sale. It did not maintain accounts receivable for its customers and did not incur bad debts when customers defaulted on their payments for property and services purchased from petitioner. In fact, petitioner received the purchase price and tax thereon, in full, from the credit card companies, less the service charge. There was a very strong policy reason for treating petitioner differently from vendors who financed sales themselves, and as a result, petitioner's equal protection claim must fail.

Further, although not argued by the parties, petitioner voluntarily chose to do business in this fashion, albeit in step with industry custom. Since the form of the transaction (third-party financing) was chosen by petitioner with knowledge of the regulation, 20 NYCRR 534.7(b)(3), petitioner is bound by that choice and its ramifications. "The choice of form did not rest with the tax authorities but with the taxpayer. If he unfortunately chose a form which was taxable instead of an equally available form which was non-taxable, he must bear the consequences" (***Matter of Sverdlow v. Bates,*** 283 App Div 487, 129 NYS2d 88, 91-92; ***see also***, ***Matter of North Shore Cadillac v. Tax Appeals Tribunal***, 13 AD3d 994, 787 NYS2d 463, ***lv denied*** 5 NY3d 704, 801 NYS2d 1).

H. Likewise, petitioner's argument that the Division's refund denials were so unduly harsh or oppressive that they amounted to a denial of petitioner's due process rights under the Fourteenth Amendment of the US Constitution and article 1 (§ 6) of the New York Constitution is without merit. Petitioner voluntarily chose the form of its business transactions and was aware of the regulatory prohibition of refunds thereon. Given the conclusions reached above, the regulations were consistent with the enabling legislation and the refund denials proper.

I. For the reasons stated, petitioner's motion for summary determination pursuant to 20 NYCRR 3000.9 (b) is denied. However, it is further determined that given the facts, analysis and conclusions reached above, and there being no material
and triable issue of fact, summary determination in the Division of Taxation's favor is warranted as a matter of law, without the necessity of a cross-motion. (20 NYCRR 3000.9[b][1].)

J. The petition of Home Depot U.S.A., Inc., is denied, the Division of Taxation's denials of petitioner's refund claims, dated December 28, 2004 and May 10, 2005, are sustained, and summary determination is granted in the Division of Taxation's favor.

DATED: Troy, New York
May 17, 2007

/s/ Joseph W. Pinto, Jr.
ADMINISTRATIVE LAW JUDGE

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# APPENDIX E

# OHIO BOARD OF TAX APPEALS

| | | |
|---|---|---|
| Home Depot USA, Inc., | ) | CASE NOS. 2006-M-206, 207 |
| | ) | |
| Appellant, | ) | (SALES TAX) |
| | ) | |
| vs. | ) | DECISION AND ORDER |
| | ) | |
| William W. Wilkins, | ) | |
| Tax Commissioner of Ohio, | ) | Appeal Filed June 18, 2008 |
| | ) | |
| Appellee. | ) | Ohio Supreme Court |

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Entered May 20, 2008

Ms. Margulies, Mr. Eberhart, and Mr. Dunlap concur

This cause and matter comes to be considered by the Board of Tax Appeals upon notices of appeal filed on February 6, 2006. Appellant challenges two final determinations of the Tax Commissioner, appellee, wherein the commissioner denied refund claims for the periods January 1, 1998 through December 31, 2000 and January 1, 2001 through July 31, 2003.

The two notices of appeal are identical except for the tax periods involved, and seek refunds of sales taxes originally paid by Home Depot USA, Inc. ("Home Depot") on sales of consumer goods within the state of Ohio. Home Depot specifies the following as error:

> "A. The Tax Commissioner erred in denying the Appellant's bad debt deduction as provided pursuant to Ohio Revised Code ('R.C.') 5739.121.
>
> "B. The Tax Commissioner erred in concluding that the Appellant did not satisfy the requirements for claiming a bad debt deduction as set forth in R.C. 5739.121 and Ohio Administrative Code Rule 5703-9-44.
>
> "C. The Tax Commissioner erred in concluding that the appellant did not satisfy the requirement for claiming a bad debt deduction where the record shows that the appellant remitted sales tax to the Department on credit sales, the underlying debt became worthless or uncollectible and the appellant properly deducted the expense on its Federal income tax return.
>
> "D. The Tax Commissioner erred in denying the Appellant's bad debt deduction where the Appellant, alone, bears the economic risk for the bad debt loss deducted for sales tax purposes.
>
> "E. The Tax Commissioner erred in denying the Appellant's bad debt deduction resulting in the appellant remitting more Ohio sales tax than it actually collects which discriminates against the Appellant in favor of other vendors in the state.
>
> "F. The Tax Commissioner erred by denying the Petitioner the right to due process of law and equal protection under the Fifth and Fourteenth Amendments of the Constitution of the United States of America, and Article I, Section 2 of the Ohio Constitution, and denying Petitioner the right to due course of law under Article I, §16 of the Constitution of the State of Ohio, by, among other things, improperly denying the Appellant's bad debt deduction based on the appellant's method of financing and accounting for credit sales.

> "G. The Appellant hereby renews its arguments previously presented to the Tax Commissioner before the Tax Appeals Division to the extent not accepted by the Tax Commissioner in the Final Determination."

The matter is considered by the Board of Tax Appeals upon the notices of appeal, the statutory transcripts certified to this board by the Tax Commissioner, and the testimony and other evidence adduced at the hearing. The parties have also provided written argument by way of brief.

As a preliminary matter, we consider the admission of appellant's exhibits 7 and 8. The presiding attorney examiner reserved ruling at hearing. Counsel for the Tax Commissioner objected to the exhibits on the ground that the exhibits were in summary form without supporting documentation. Counsel claimed that they had not received the underlying information. However, a review of the statutory transcript indicates that the underlying information was presented to the Tax Commissioner's agent during the refund review process. S.T. at 20. Therefore, the Tax Commissioner's objection is overruled and Appellant's Exhibits 7 and 8 are received into the evidence to be considered in this matter.

At issue in this appeal are sales made by Home Depot and financed by General Electric Capital Corporation ("General Electric Capital") and its subsidiaries through use of a "private-label credit card." A private-label credit card is a card identified as a particular retail store's credit card and used in a limited number of stores, usually those under a corporate umbrella. In this instance, Home Depot's private-label credit card can be used at its retail locations and the locations of its sister company, EXPO Design Center. H.R. at 19.

Testimony at hearing indicated that the private-label credit card business grew out of the difficulty of companies with national presences to comply with state-by-state consumer credit regulations. Federal regulations have also tightened, making the administration of credit-lending programs outside the core competency of retailers like Home Depot. H.R. at 28. However, studies have shown that credit cards identified with a single retailer bring about customer loyalty. A private-label credit card can also be cheaper for the identified retail establishment than general credit cards, such as VISA or MasterCard. H.R. at 20.

Because of the benefits, Home Depot entered into private-label credit card agreements with General Electric Capital. The two corporations actually had three programs operating during the refund periods, the consumer revolving program, the commercial PROX agreement, and the business revolving agreement. H.R. at 23-24, appellant's Exs. 1-3. Each program had a different target customer. However, as is relevant to our determination herein, the programs would operate in similar manners. In return for General Electric Capital presenting credit customers with a credit card with Home Depot's name on it, Home Depot would advertise the program in its stores, solicit customers either through the mail or in-store, and obtain credit applications using General Electric Capital forms. H.R. at 26.

The decision whether or not to provide credit was General Electric Capital's alone. Upon receipt of a credit application (usually transmitted electronically at the store), General Electric Capital would determine creditworthiness of a particular customer and set a credit limit. H.R. at 26. If the customer then purchased the item with credit established by General Electric Capital, Home Depot would accept the cardholder's number, close the transaction, and then transmit the information to General Electric Capital, which would then transfer funds to Home Depot. The funds transferred on a daily basis, but would be less than the full transaction price, as a "merchant discount" would be deducted. H.R. at 29.

A merchant discount is not unique to private-label credit cards, but is charged by all credit card providers. As Michael J. Mitchell, director of credit-legal for Home Depot explained during his testimony before the board, the merchant discounts of a private-label credit card issuer were usually less than those of a general-purpose credit card issuer. H.R. at 21. Home Depot brought forth testimony at hearing indicating that, with private-label credit card issuers, the merchant discount can be targeted to the customer base. Mr. Mitchell testified that both General Electric Capital and Home Depot do studies to determine the type of customer that will seek credit for Home Depot purchases. That customer profile is taken into account when setting merchant discount fees, as, with sophisticated modeling, the companies are able to predict with some accuracy the cost of running of the programs. H.R. at 36-37.

Mr. Mitchell testified that, in setting merchant fees, bad debts are taken into account:

> "Bad debt is part of the cost that GE incurs. And that we – And our position, of course, is that we prepay all that. GE is

> in the business to make money. They did make money during the period that this operated. We're sure of that. And all their costs had to be covered and were covered. And bad debt, expected loss and actual loss was one of their costs." H.R. at 38.

This statement is the crux of the claim made by Home Depot. It is Home Depot's position that General Electric Capital's bad debts were paid by Home Depot through its merchant fees. Home Depot further argues that, as anticipated, General Electric Capital did have accounts that remained unpaid after attempts to collect. Home Depot provides evidence of defaulted accounts for the refund periods. Appellant's Ex. 7, 8. Home Depot claims that it remitted sales tax upon each sale made. The state provides a retailer with a method for reimbursement of sales taxes when certain sales are consummated, but the consumer does not meet financing obligations. Home Depot argues that as the state provides a vendor with a method of reimbursement for sales tax paid on bad debts, and as it prepaid actual bad debts, Home Depot asserts that its refund claims should not have been rejected.

In any appeal from a decision of the Tax Commissioner, the standard by which review takes place begins with the acknowledgement that the Tax Commissioner's findings are entitled to a presumption of correctness and it is incumbent upon a taxpayer challenging a finding of the Tax Commissioner to rebut the presumption and establish a right to the relief requested. *Alcan Aluminum Corp. v. Limbach* (1989), 42 Ohio St.3d 121; *Belgrade Gardens v. Kosydar* (1974), 38 Ohio St.2d 135; *Midwest Transfer Co. v. Porterfield* (1968), 13 Ohio St.2d 138. Moreover, the taxpayer is assigned the burden of showing in what manner and to what extent the Tax Commissioner's determination is in error. *Federated Dept. Stores, Inc. v. Lindley* (1983), 5 Ohio St.3d 213.

As a general rule, statutory provisions for the refund of taxes illegally or erroneously paid or paid on an illegal or erroneous assessment should be liberally construed in favor of the taxpayer. *Columbus Southern Lumber Co. v.. Peck* (1953), 159 Ohio St. 564; *Phoenix Amusement Co. v. Glander* (1947), 148 Ohio St. 592. However, in *Chrysler Financial Co., L.L.C. v. Wilkins*, 102 Ohio St.3d 443, 2004-Ohio-3922, the court considered the Tax Commissioner's denial of a refund under R.C. 5739.121 and concluded that when, as here, the refund does not stem from an illegal or erroneous payment, the refund is more analogous to an exemption or exception from tax and should be strictly construed.

R.C. 5739.121,[1] entitled "Bad debt deduction," provided in pertinent part the following during the major portion of the refund period:

> "As used in this section, 'bad debt' means any debt that has become worthless or uncollectible in the time period between a vendor's preceding return and the present return, has been uncollected for at least six months, and that may be claimed as a deduction pursuant to the 'Internal Revenue Code of 1954' 68A Stat. 50, 26 U.S.C. 166, as amended, and regulations adopted pursuant thereto, or that could be claimed as such a deduction if the vendor kept accounts on an accrual basis. 'Bad debt' does not include any interest or sales tax on the purchase price, uncollectible amounts on property that remains in the possession of the vendor until the full purchase price is paid, expenses incurred in attempting to collect any account receivable or for any portion of the debt recovered,

[1] The statute was amended twice during the refund period. The first amendment merely redirected remittances from the treasurer to the Tax Commissioner. Am. Sub. H.B. 94, Eff. Jan. 1, 2002. The second amendment divided the statute into subsections and established a refund procedure when the amount of bad debts to be deducted was greater than the amount of tax due during a reporting period. The substance of the statute remained unchanged. H.B. 95, Eff. Sep. 26, 2003.

> any accounts receivable that have been sold to a third party for collection, and repossessed property.
>
> "In computing taxable receipts for purposes of this chapter, a vendor may deduct the amount of bad debts as defined in this section. The amount deducted must be charged off as uncollectible on the books of the vendor. A deduction may be claimed only with respect to bad debts on which the taxes pursuant to sections 5739.10 and 5739.12 of the Revised Code were paid in a preceding tax period. If the vendor's business consists of taxable and nontaxable transactions, the deduction shall equal the full amount of the debt if the debt is documented as a taxable transaction in the vendor's records. If no such documentation is available, the maximum deduction on any bad debt shall equal the amount of the bad debt multiplied by the quotient obtained by dividing the sales taxed pursuant to this chapter during the preceding calendar years by all sales during the preceding calendar year, whether taxed or not. If a consumer or other person pays all or part of a bad debt with respect to which a vendor claimed a deduction under this section, the vendor shall be liable for the amount of taxes deducted in connection with that portion of the debt for which payment is received and shall remit such taxes in his next payment to the treasurer of state.

Each party to this appeal accuses the other of seeking (or keeping) sales taxes not rightfully due that entity. Home Depot argues that the Tax Commissioner has received sales tax upon items for which the General Assembly has granted the vendor reimbursement. The Tax Commissioner claims that Home Depot does not fall within the class of persons which may avail themselves of R.C. 5739.121. The Tax Commissioner focuses on the language in the second paragraph[2] of R.C. 5739.121 – that a bad debt must be "charged off as uncollectible on the books of the vendor." The Tax Commissioner points out that Home Depot is the vendor, but any bad debt is

[2] In the current version of R.C. 5739.121, the paragraph is now subsection (B).

charged off General Electric Capital's books. That statement is supported by testimony at hearing. At hearing, Mr. Andrew Donnelly, the tax director for GE Money-Americas, presented tax returns for 1998 through 2003 exhibiting a bad debt deduction taken. H.R. at 93-96, Appellant's Ex. 4. Thus, the Tax Commissioner argues, the vendor, Home Depot, does not charge off the bad debt, as required by statute, but deducts a merchant discount (identified on its tax return as a"credit card discount") as an expense of doing business from gross income.

In *Chrysler Financial Co., L.L.C. v. Wilkins*, 102 Ohio St.3d 443, 2004-Ohio-3922, the Ohio Supreme Court considered a refund claim for sales taxes paid the state on automobiles after the loans securing those automobiles were reduced to bad debts. The refund claims were filed by the lending institution, as the bad debt deductions had been taken by it. The court, however, strictly construed R.C. 5739.121 and concluded that the lending institution was not the vendor of the sale, and, therefore, could not avail itself of the bad debt deduction.

We now have before us facts similar to those found in *Chrysler Financial* – a refund claim for sales taxes paid the state on consumer goods after the loans securing those consumer goods were reduced to bad debts – but a different claimant. The applicant is not the lending institution holding the debt, but the vendor originally making the sale. However, a strict construction of R.C. 5739.121 leads to the same result. Whereas Chrysler Financial was not the vendor in the earlier matter, in the present appeal, Home Depot is not the entity reporting the bad debts on its books.

Home Depot argues that it is responsible for the bad debt deduction and does take that deduction on its books each time it deducts a merchant fee, as the fee itself includes a bad debt component. Home Depot brought forth evidence that a consideration of potential losses for non-payment is made in setting merchant fees for private-label credit cards. H.R. at 38. However, a statute that is specific in its requirements must be applied as written. *Columbia Gas Transmission Corp. v. Levin*, 117 Ohio St.3d 122, 2008-Ohio-511. R.C. 5739.121 requires that bad debts *must* be charged off as uncollectible on the vendor's books. The fact that bad debts were *taken into consideration* in deductions on the vendor's books does not meet statutory requirements.

Home Depot argues that the Tax Commissioner's position in this appeal defies the legislative purpose and intent behind R.C. 5739.121 and allows the state to retain taxes that were never collected from the ultimate consumer. The board would agree that the statute as written has limited application under current business practices. When originally passed in Am. Sub. S.B. 16, eff. Oct. 29, 1979, retailers were more likely to provide credit directly to customers. Therefore, the entity making the sale was likely to be the same entity extending the credit. R.C. 5739.121 reflects the unity between retailer and lender, as the statute is written to allow a vendor to remit taxes due after deducting for bad debts. See Ohio Adm. Code 5703-9-44 (which provides "In reporting gross sales and net taxable sales a vendor may exclude an amount equal to the sum of the vendor's bad debts arising from sales occurring on or after July 1, 1980 and charged off as uncollectible on his books during the sales tax reporting period.").

In the present appeal, Home Depot is paid the full purchase price (less merchant discount), plus sales tax, which tax it then remits to the state of Ohio. General Electric Capital purchases the right to collect payment from the ultimate consumer. *Chrysler Financial* instructs that the "bad debt" was never Home Depot's, as when the transaction occurred, the vendor was paid in full. Thus, even if a consumer ultimately defaults, the default occurs after the transaction leaves Home Depot. Thus, the board cannot find that the statute permits reimbursement to Home Depot.

The Tax Commissioner[3] argues in the alternative that Home Depot's proof of claim was not sufficient. However, as this board has concluded Home Depot is not entitled to a refund, we find no reason to consider this claim.

Through its notice of appeal, Home Depot makes a number of constitutional claims, and argues its position through its briefs. The Board of Tax Appeals is without authority to rule on claims of a constitutional nature. Instead, such determination is properly reserved for courts created by Section 1, Article IV, of the Ohio Constitution. *Dublin City School Dist. Bd. of Edn. v. Tracy* (Feb. 14, 1996), BTA No. 1995-K-692, unreported, affirmed on other grounds (1998), 126 Ohio

[3] Home Depot argues that the Tax Commissioner cannot claim it did not present sufficient evidence to support its refund claim, as it did not raise that as an issue in his final determination and cites this board's holding in *Key Services Corp. v. Tracy* (Oct. 15, 1999), BTA No. 1998-K-553, unreported. However, the Supreme Court reversed the board's holding in *Key Servs. Corp. v. Zaino*, (2002) 95 Ohio St.3d. 11, where the court held that in a proceeding before the Board of Tax Appeals, there is no statutory limit on what the Tax Commissioner may contest.

App.3d 603. See, also, *NACCO Industries v. Tracy* (June 7, 1996), BTA No. 1995-K-1210, unreported, affirmed on other grounds (1997), 79 Ohio St.3d 314. In *MCI Telecommunications Corp. v. Limbach* (1994), 68 Ohio St.3d 195, the court explained this board's role as being limited to a "receiver of evidence" when constitutional issues are raised at this level. Home Depot has availed itself of the hearing process; the board has fulfilled its duty.

Considering the record, the statutes and case law, this board concludes that Home Depot has failed to prove error on the part of the commissioner. Therefore, the Tax Commissioner's final determinations must be, and hereby are, affirmed.

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# APPENDIX F

| | | |
|---|---|---|
| HOME DEPOT USA, INC.<br>2455 PACES FERRY ROAD, NW<br>ATLANTA, GA 30339-4024, | § | STATE OF ALABAMA<br>DEPARTMENT OF REVENUE<br>ADMINISTRATIVE LAW DIVISION |
| | § | |
| Taxpayer, | | DOCKET NO. S. 06-1079 |
| | § | |
| v. | | |
| | § | |
| STATE OF ALABAMA<br>DEPARTMENT OF REVENUE. | § | |

## FINAL ORDER

Home Depot USA, Inc. ("Home Depot") petitioned the Revenue Department for a refund of sales tax for September 2000 through July 2003. The Department denied the refund. Ernst & Young, LLP appealed to the Administrative Law Division on behalf of Home Depot pursuant to Code of Ala. 1975, §40-2A-7(c)(5)a.[1] A hearing was conducted on November 20, 2007. Bruce Ely and Jimmy Long represented Home Depot at the hearing. Assistant Counsel Wade Hope represented the Department.

## ISSUE

Alabama residents purchased goods at Home Depot stores during the period in issue using Home Depot private label credit cards ("Home Depot cards").[2] The cards had been issued by third party finance companies. The finance companies immediately paid Home Depot for the goods, including the applicable State and local sales tax. If the sale

[1]The Department moved to have the appeal dismissed as untimely. The Administrative Law Division initially granted the motion and dismissed the appeal. Home Depot applied for a rehearing. The Administrative Law Division granted the application and accordingly reinstated the appeal on the Division docket.

[2] Home Depot also accepted most major credit cards, i.e., Visa, Master Card, etc., during the subject period.

4

occurred at a Home Depot store in Alabama, Home Depot reported and remitted the State and Department-administered local Alabama sales tax to the Department.

Some of the Alabama-based Home Depot cardholders failed to pay the finance companies the full amounts charged on the cards. The companies subsequently deducted those amounts as bad debts on their federal income tax returns. The issue in this case is whether Home Depot is entitled to a refund of State and local Alabama sales tax based on the bad debt amounts that the Alabama-based cardholders failed to pay to the finance companies.

**FACTS**

Home Depot sells home improvement products and related items at retail stores in Alabama and throughout the United States. It had credit card agreements during the period in issue with three finance companies affiliated with General Electric (the "GE affiliates"), Monogram Credit Card Bank of Georgia, General Electric Capital Financial, Inc., and General Electric Capital Corporation. The agreements authorized the GE affiliates to issue Home Depot credit cards to qualified Home Depot customers, and thereby extend various types of credit to those customers. The agreements also required the affiliates to immediately pay Home Depot the amounts charged on the cards, including sales tax, less a negotiated service fee. The agreements stated the percentage amount of the service fees, but did not identify or specify how the percentages were determined.

The Home Depot cards could only be used at Home Depot stores. A Home Depot customer applied for a Home Depot card by submitting a written credit application to the GE affiliate. The affiliate evaluated the credit-worthiness of the customer and decided whether to approve or reject the application. If the application was accepted, the affiliate issued the customer a card in due course.

The GE affiliates at all times owned and serviced the Home Depot card accounts. Home Depot was not liable to an affiliate if a customer failed to pay the amount owed. The affiliates retained all rights to charge interest and late fees in accordance with the card agreements entered into with their cardholders.

The parties used the following example to illustrate a typical Home Depot card transaction. A customer purchases a $100 lawnmower at a Home Depot store in Alabama at which the combined State/local sales tax rate is 10 percent. The customer presents his Home Depot card at the checkout counter and, if the sale is approved, the card is charged $110 for the cost of the lawnmower and sales tax. Home Depot reports and remits the full $10 in sales tax to the Department with its next monthly sales tax return.[3]

Home Depot electronically submits the card sale information to the GE affiliate. The affiliate immediately pays Home Depot the $100 for the lawnmower, plus the $10 in sales tax, less the agreed upon fee. For example, if the fee was 3 percent, the affiliate would pay Home Depot $106.70 ($110 less 3 percent, or $3.30, equals $106.70). Home Depot deducts the service fee paid to the affiliate as an ordinary and necessary business expense on its federal income tax return. As discussed, the customer is thereafter solely liable to the affiliate for the amount charged, plus any applicable interest, late fees, etc.

[3] This assumes, of course, that the Department administers the applicable county and municipal sales tax due on the transaction. If a local jurisdiction's taxes are self-administered, Home Depot would separately report and remit the applicable local tax due to the self-administered jurisdiction.

Some Alabama-based customers that purchased goods using a Home Depot card failed to pay the GE affiliates any or all of the amounts owed. The affiliates made various attempts to collect, but if an amount due was not paid in full within 180 days of the due date, the affiliates generally deducted the unpaid amount as a bad debt on their federal income tax returns.

Home Depot timely petitioned the Department in October 2003 for a sales tax refund for the period in issue. The refund was based on the uncollected amounts owed by Alabama-based cardholders that the GE affiliates had deducted as bad debts during the subject period. Home Depot computed the refund amount using bad debt information obtained from the GE affiliates.

In computing the refund, Home Depot netted out all amounts collected by the affiliates during the refund period on delinquent accounts that the affiliates had previously written off, and also those amounts collected up until the affiliates submitted the bad debt information to Home Depot. Any payments received by the affiliates after that time have not been considered or factored into the refund amount. Home Depot also estimated its sales to tax-exempt entities and sales of exempt products during the subject period, and removed those amounts from the calculation.

Home Depot's original petition claimed a refund of $610,449.84, but did not indicate that the amount included both State and local sales tax. The claim also included some local jurisdictions in Alabama that were not administered by the Department. Finally, the original claim was computed on the 4 percent State rate and a blended 3.8 percent local rate, for a combined rate of 7.8 percent.

Home Depot amended its refund claim at (or immediately before) the November 20, 2007 hearing. Home Depot now claims a refund of State and Department-administered local sales tax of $383,341.29. The amended claim is based on the 4 percent State rate and a reduced .76 percent blended local rate.

Other relevant facts are stated as necessary in the below analysis of the issues.

## ARGUMENTS

Home Depot argues that it is entitled to a refund because the requirements of the Department's "bad debt" regulation, Reg. 810-6-4-.01, have been satisfied. It contends in the alternative that it is entitled to the refund because it fully compensated the GE affiliates for the bad debts when it paid the service fees, and consequently, it suffered the economic loss for the bad debts. It asserts that the State would be unjustly enriched if allowed to keep the sales tax on the unpaid accounts.

The Department counters that the bad debt regulation does not apply. It also contends that the agreements between Home Depot and the three GE affiliates do not specify that the service fees paid by Home Depot included a bad debt component, and consequently, there is no proof that Home Depot compensated the affiliates for the anticipated bad debts.

## ANALYSIS

Retailers in Alabama are required to file monthly sales tax returns and remit the tax due on (1) cash sales in the month, and (2) payments received in the month on prior credit sales. But "in no event shall the gross proceeds of credit sales be included in the measure of the tax to be paid until collections of such credit sales have been made." Code of Ala. 1975, §40-23-8.

The Department, recognizing that some retailers may nonetheless report and remit sales tax on credit sales before the amounts are collected, promulgated the bad debt regulation in issue in this case, Reg. 810-6-4-.01. The regulation reads in pertinent part:

> (1) The term "bad debt or uncollectible account" as used in this rule shall mean any portion of the sales price of a taxable item which the retailer cannot collect. Bad debts include, but are not limited to, worthless checks, worthless credit card payments, and uncollectible credit accounts. Bad debts, for sales and use tax purposes, do not include finance charges, interest, or any other nontaxable charges associated with the original sales contract, or expenses incurred in attempting to collect any debt, debts sold or assigned to third parties for collection, or repossessed property.
>
> (3) The term "credit sale" shall include all sales in which the terms of the sale provide for deferred payments of the purchase price. Credit sales include installment sales, conditional sales contracts, and revolving credit accounts.
>
> (5) In the event a retailer reports and pays the sales or use tax on credit accounts which are later determined to be uncollectible, the retailer may take a credit on a subsequent tax report or obtain a refund for any tax paid with respect to the taxable amount of the unpaid balance due on the uncollectible credit accounts within three years following the date on which the accounts were charged off as uncollectible for federal income tax purposes.
>
> (6) If a retailer recovers in whole, or in part, amounts previously claimed as bad debt credits or refunds, the amount collected shall be included in the first tax report filed after the collection occurred. (Sections 40-23-8 and 40-23-68(e))

Home Depot claims it is entitled to a refund because the regulation's four requirements have been satisfied – "(1) the customer purchased an item on credit; (2) the retailer reported and remitted the applicable sales tax; (3) some portion of the credit account balance was subsequently determined to be worthless and uncollectible; and (4) the refund or credit is claimed within three years from the date the account is written off for federal income tax purposes." Home Depot's Post-Hearing Brief at 12.

I disagree that the bad debt regulation was satisfied, or even applies, in this case. Rather, §40-23-8 and related Reg. 810-6-4-.01 only apply where the retailer makes a credit sale by extending credit to the purchaser. The statute and regulation do not apply to credit card sales where credit is extended to the customer by a third party finance company, as in this case.

Section 40-23-8 applies to "[a]ny person taxable under this division (an Alabama retailer), having cash and credit sales, . . ." For the statute to apply, a retailer must make the credit sale. A sale by a retailer to a customer that uses a credit card issued by a third party finance company is not a credit sale by the retailer because the retailer is promptly paid in full, including all applicable sales tax, less a negotiated service fee. A purchaser that uses a credit card may be buying on credit (extended by the card issuer), but the retailer is not selling on credit, i.e., making credit sales, as required for §40-23-8 and Reg. 810-6-4-.01 to apply. Consequently, Home Depot's claim that the regulation applies anytime a customer purchases an item on credit (requirement (1) above) is incorrect. Rather, it applies only when the retailer sells on credit.

The above holding is supported by the Alabama Court of Civil Appeals' opinion in *Marks-Fitzgerald Furniture Company, Inc. v. State, Dept. of Revenue*, 678 So.2d 121 (Ala. Civ. App. 1995). The primary issue in *Marks-Fitzgerald* involved the taxpayer's sales tax liablity on credit accounts initially owned by the taxpayer but later discounted to a third party finance company. A discussion of that issue is not required because Home Depot never owned the credit accounts in issue, as did the taxpayer in *Marks-Fitzgerald*.

*Marks-Fitzgerald* also involved the taxpayer's sales tax liability on credit card sales. The specific issue was whether the taxpayer owed sales tax on the full sales price, or only on the amount it received from the credit card company, i.e., the sales price less the service fee. The Administrative Law Division held that the entire sales price was taxable, and that the service fee could not be deducted from taxable gross proceeds. It also concluded that credit card sales were not credit sales within the purview of §40-23-8. The Final Order issued by the Administrative Law Division reads in pertinent part:

> The Taxpayer argues that §40-23-8 applies to both the credit card sales and the discounted account receivables, and that tax is owed only on the net amount received from the credit card or finance companies.
>
> First, in my opinion credit card sales are not credit sales governed by §40-23-8. Rather, on credit card sales the retailer receives payment immediately or almost immediately and in return pays the credit card company a fee for its services.
>
> 'Gross proceeds of sale' is defined at Code of Ala. 1975, §40-23-1(6) as the value proceeding or accruing from the sale of tangible personal property, without deduction for any expenses whatsoever. The credit card fee paid by a retailer to a credit card company is a non-deductible expense or cost of doing business. The fact that the credit card company deducts the fee before paying the retailer does not change the nature of the fee. The credit card fees paid by the Taxpayer in this case must be included in gross receipts subject to sales tax.

*Marks-Fitzgerald*, S. 91-203 at 3.

The Court of Civil Appeals affirmed that the fee was not deductible. Importantly, the Court also confirmed that credit card sales are not credit sales governed by §40-23-8 (or Reg. 810-6-4-.01).

> Furthermore, credit card sales are not credit sales governed by §40-23-8. Rather, on credit card sales the retailer receives payment immediately and, in return, pays the credit card company a fee for its service.

*Marks-Fitzgerald*, 678 So.2d at 124.

The bad debt regulation also indicates that the retailer must be the party extending credit to the purchaser. The entire regulation is prefaced by the first sentence in paragraph

(1) – "The term 'bad debt or uncollectible account' as used in this rule shall mean any portion of the sales price of a taxable item which the *retailer* cannot collect." That statement confirms that the retailer must extend the credit to the customer and be owed the amount due, and that only if "the retailer cannot collect" the amount does the bad debt regulation apply. The retailer in this case, Home Depot, collected the sales proceeds, albeit from the GE affiliates and not directly from the customers, but the sales proceeds plus the applicable sales tax was collected, and the sales tax was properly remitted to the Department.

Paragraph (3) of the regulation defines "credit sale" to include "all sales in which the terms of the sale provide for deferred payments of the purchase price." Home Depot cites that definition in support of its position because the credit card agreements between the cardholders and the GE affiliates allowed the cardholders to make deferred payments to the affiliates. Home Depot's Post-Hearing Brief at 12, 13. But the agreements between the affiliates and Home Depot required the affiliates to immediately pay Home Depot the sales proceeds and tax. Consequently, because the terms of the Home Depot card sales did not provide for deferred payment of the purchase price to the retailer, Home Depot, the transactions did not constitute credit sales by the retailer as defined by the regulation. Paragraph (3) also identifies credit sales to "include installment sales, conditional sales contracts, and revolving credit accounts." The regulation does not include credit card sales as a type of credit sale, which further confirms the Court's holding in *Marks-Fitzgerald* that credit card sales are not credit sales within the intended scope of §40-23-8.

Paragraph (5) specifies that if a retailer pays sales tax on credit accounts which are later determined to be uncollectible, the retailer may obtain a refund within three years from when "the accounts were charged off as uncollectible for federal income tax purposes." Home Depot argues that the regulation does not specify that the retailer must be the party that deducts the bad debt for federal tax purposes, and consequently, that the regulation was satisfied because the GE affiliates deducted the bad debts.

I agree that paragraph (5) does not directly state that the retailer must be the party that writes off the bad debt, but that requirement is implicit in the regulation. As discussed, paragraph (1) identifies a bad debt as any amount "the retailer cannot collect." Also, paragraph (6) of the regulation, which is discussed below, specifies that "[i]f a retailer recovers" a previously written off amount on which it had received a bad debt sales tax refund, the retailer must report and pay sales tax on the amount. When read together and in context, the various paragraphs in the regulation clearly envision that the retailer must extend credit to the customer and own the account, and that if the account is not paid, the retailer must be the party that deducts the debt as uncollectible.[4]

Finally, as discussed, paragraph (6) provides in substance that "[i]f a retailer" subsequently collects on a previously written off debt concerning which it had received a sales tax refund, the retailer must report and pay sales tax on the amount collected. The reference to "retailer" in paragraph (6) is consistent with the fact that for purposes of §40-23-8 and Reg. 810-6-4-.01, a bad debt must be a debt owed to and subsequently written off by the retailer that made the sale.

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[4] Home Depot notes in its Post-Hearing Brief at 17, that several other states have enacted statutes or issued regulations which require that the retailer must be the party that writes off the account as a bad debt. As discussed, that is consistent with how Reg. 810-6-4-.01 should be construed.

In this case, the GE affiliates subsequently recovered some of the delinquent accounts that they wrote off during the period in issue. Home Depot contends that it netted out all amounts that the affiliates collected on the previously written off accounts during the subject period, and also those amounts collected up until the affiliates submitted the bad debt information to Home Depot in mid-2003. A Home Depot witness testified, however, that the affiliates continue trying to collect on previously written-off accounts, and are sometimes paid two years or more after the amount is written off. (T. 109) Consequently, Home Depot's refund claim may be based on bad debt amounts that were collected after the affiliates provided the bad debt information to Home Depot. The affiliates have not and are not required to report and remit sales tax on those collections because they are not licensed Alabama retailers. Home Depot also has not removed those payments from its refund petition because the affiliates have not provided the information to Home Depot.

Home Depot's refund claim also presents various other problems. To begin, Home Depot's calculations are based on bad debts relating to Home Depot cardholders with Alabama billing addresses. The calculations are thus based on the assumption that the cardholders purchased the goods and paid the State and applicable local Alabama sales tax at a Home Depot store in Alabama. But some of the Alabama cardholders may have in many cases used their cards at a Home Depot location outside of Alabama. For example, an Alabama cardholder that lives in Phenix City, Alabama on the Georgia line may have used his Home Depot card to purchase goods at a Home Depot store in Columbus, Georgia because it was the closest store to his house; or a Birmingham cardholder may have visited his daughter in Tennessee and purchased lumber at a Home Depot location there to build his daughter a new deck. Obviously, State and local Alabama sales tax would not have been paid on those transactions, yet Home Depot is seeking a refund of State and local Alabama tax on those out-of-state transactions.[5]

A related problem involves the local tax refund claimed by Home Depot. Home Depot has claimed a lump-sum local refund based on a .76 percent blended local tax rate, which is the average of the county and municipal rates in the Department-administered local jurisdictions in Alabama in which Home Depot stores were located during the refund period. But again, there is no way of determining if or how much the "bad debt" customers purchased in each local jurisdiction, and thus no way of knowing how much local sales tax Home Depot remitted to each local jurisdiction relating to the written off accounts.

Alabama law requires that if tax is refunded, the county or municipality that received the overpayment is required to pay the refund. Code of Ala. 1975, §40-2A-7(c)(4). In this case, even if a refund was due, the Department (and Home Depot) cannot determine how much local sales tax Home Depot "erroneously" paid to each local jurisdiction, and thus how much local tax the jurisdiction, through the Department, should be required to refund to Home Depot. In short, claiming a lump-sum local jurisdiction refund is not sufficient. Home Depot must establish the amount of sales tax it claims was overpaid to each local

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[5] The Administrative Law Division raised this issue at the hearing in the case. Home Depot's attorney responded – "Your Honor, as best we can tell, that kind of situation (an Alabama cardholder buying at a Home Depot store outside of Alabama) would be de minimis." (T. 131) But as best I can tell, Home Depot has no way of knowing where the cardholders used their cards, or at least where they made the purchases that were defaulted on, and thus no way of knowing the dollar amount or number of out-of-state credit card sales, de minimis or not, that are included in its refund calculation. It could be argued that the out-of-state purchases by the Alabama cardholders were offset by the fact that some out-of-state cardholders also used their cards to purchase items at Home Depot stores in Alabama, but again, there is no way of knowing.

jurisdiction. It has failed to do so, and presumably cannot do so.

Finally, Home Depot also estimated its sales to tax-exempt entities and its sales of exempt products in computing its refund claim. Home Depot concedes that the amounts are estimated, but that reasonable estimates can be used to compute a taxpayer's sales tax liability. Home Depot's Post-Hearing Brief at 9, n. 5.

Alabama's courts have in certain limited circumstances allowed taxpayers to compute their sales tax liability based on projections and reasonable estimates. See generally, *State v. Ludlum*, 384 So.2d 1089 (Ala. Civ. App.), cert. denied, 384 So.2d 1094 (Ala. 1980). In this case, however, Home Depot has piled assumptions upon estimates in computing its refund claim. First, it assumes that if a Home Depot cardholder with an Alabama address defaulted on his or her debt to a GE affiliate, the underlying sale or sales were at a Home Depot location in Alabama, and that the 4 percent Alabama tax and the applicable local Alabama tax was paid on the sale or sales. As discussed, however, some Alabama cardholders that failed to pay may have, and surely did, purchase some items outside of Alabama. The amount, de minimis or not, cannot be determined. Home Depot also can only estimate the percentage of local tax that might have been paid on the worthless accounts by taking a blended average of the various local rates. And Home Depot has not, and presumably cannot, identify the amount of local sales tax that was paid on the bad debt amounts to each of the various local jurisdictions. Finally, the exempt and otherwise non-taxable sales also can only be estimated. "In a refund suit the taxpayer bears the burden of proving the amount he is entitled to recover." *United States v. Janis*, 96 S.Ct. 3021 (1976). Home Depot has failed to carry that burden in this case.

In *State Dept. of Revenue v. Moss Furniture, Inc.*, S. 90-152 (Admin. Law Div. 6/14/1991), a furniture company made credit sales and transferred the accounts receivable to a subsidiary corporation for collection. The Administrative Law Division held that the furniture retailer was obligated to keep or have access to records of the amounts subsequently paid by its credit customers, and was liable to report and pay sales tax on those amounts.[6] The Administrative Law Division also stated in *Moss* that "[i]n no event should the Department receive less tax than is paid by the customer." *Moss* at 3. Home Depot argues that "[c]onversely, in no event should the Department retain more tax than was paid by the customer." (underline in original) Home Depot's Post-Hearing Brief at 11.

The above-quoted statement by the Administrative Law Division in *Moss* was correct under the circumstances because in *Moss*, the customers were making the payments. A retailer is, however, required to report and remit sales tax when it receives the sale proceeds and tax due, whether the amount is paid by the customer directly, as in *Moss*, or by a third party finance company on behalf of the customer, as in this case. On a credit card sale, the customer is in substance borrowing the sale proceeds and sales tax from the card issuer, which in turn pays that amount to the retailer on behalf of the customer. From the retailer's perspective, the sale is a cash sale because the retailer is paid immediately. That is, the terms of the sale do not provide for deferred payments of the purchase price to the retailer, as required to be a credit sale pursuant to Reg. 810-6-4-.01. The Court of Civil Appeals recognized the above fact in *Marks-Fitzgerald*, when it held that "credit card sales

[6] The Alabama Court of Civil Appeals affirmed the Administrative Law Division's rationale in *Moss* in *Marks-Fitzgerald*, 678 So.2d at 123.

are not credit sales governed by §40-23-8. Rather, on credit card sales the retailer receives payment immediately. . . ." *Marks-Fitzgerald*, 678 So.2d at 124.

Home Depot argues that it is being penalized for using the GE affiliates instead of issuing its own private label cards, "resulting in discriminatory treatment of similarly-situated retailers and unjust enrichment to the Department." Home Depot's Post-Hearing Brief at 27. I disagree because if Home Depot had issued its own cards, the situation would not be similar, i.e., there would not be "similarly-situated retailers." If Home Depot had issued its own cards, it would have made credit sales within the purview of Reg. 810-6-4-.01 because it would have extended the credit to the cardholders, it would have owned the accounts receivable, and it would have been the party that could write off the bad accounts for federal tax purposes. Instead, however, it freely contracted for the GE affiliates to issue and service the cards, own the accounts receivable, and also bear the risk of loss. It is bound by the tax consequences of that decision. *Leavitt v. Commissioner of Internal Revenue*, 875 F.2d 420 (4th Cir. 1989) (Taxpayers "are bound by the 'form' of their transaction and may not argue that the 'substance' of their transaction triggers different tax consequences." *Leavitt,* 875 F.2d at 423.)

To summarize, Home Depot made the retail sales, it was paid the sales proceeds plus sales tax by the GE affiliates, on behalf of the customers, and it correctly remitted the sales tax due to the Department. Home Depot was thereafter not responsible or required to reimburse an affiliate if an account became uncollectible. Consequently, the sales tax was not "erroneously paid," as required for a refund to be due. Code of Ala. 1975, §40-2A-7(c)(1). And even if the tax had been erroneously paid, Home Depot has failed to carry its burden of proving the amount of State sales tax that was erroneously paid on the underlying sales because it cannot show that the Alabama-based cardholders that failed to pay had purchased the goods and paid the sales tax in Alabama. Home Depot also cannot identify the amount of local tax that may have been paid on the bad debt accounts to the various local taxing jurisdictions in Alabama. The Department thus correctly denied Home Depot's refund petition.

Home Depot argues in the alternative that it is entitled to a refund because a bad debt component was included in the fees it paid to the GE affiliates, and consequently, it suffered the economic loss for the bad debts. Home Depot claims that it "fully compensated GE for worthless (Home Depot card) accounts through the service fee and other consideration." Home Depot's Post-Hearing Brief at 21. I disagree.

The agreements between Home Depot and the GE affiliates included only the fee percentages, and did not specify how the percentages were determined. Several witnesses testified, however, that the parties estimated and considered the expected bad debt amounts when negotiating the fee amounts. But there is no evidence showing the amount or what part of the fees constituted a bad debt component. Consequently, there is no proof that the fees included a bad debt component that fully compensated the affiliates for the actual bad debts.

The GE affiliates competitively bid against other finance companies for the right to issue the Home Depot private label cards. Gene Thorncroftt, the vice president of risk management for a GE division, explained how the GE affiliates determine the service fees they charge:

> A. Yeah. When – when we negotiate a deal, we make a series of assumptions. We take a look at what our through-the-door populations are going to look like, or what the customers look like when they come through.

> We make a determination of how they're going to spend. How many are going to revolve and pay interest so we can determine a cash flow. We'll know what our interest rates are. We'll know how many will go delinquent so we can know what our late fee stream will be. Any other sundry income stream would be incorporated into that. We also then take a look at what our costs are going to be. Money costs, operating expense, bad debts, et cetera. From that, we determine what our threshold of profitability should be. And based on that, we would assess fees to – we would set the service fee so we assess that fee to the retailer.

(T. 92, 93)

The above testimony shows that the affiliates considered several factors in determining the fee amounts it would charge Home Depot, including the anticipated bad debts and the substantial administrative costs associated with issuing and servicing the cards. Against those costs, however, the affiliates weighed the expected profits they would receive from the interest and late fees to be paid by the card holders. They then determined the level of acceptable profit, and set the fee accordingly. The affiliates may have, for example, estimated that its costs would approximate 8 percent (4 percent for bad debts and 4 percent for administrative costs). It may also have expected to receive 15 percent in profits from interest and late fees. Knowing that other finance companies were bidding for Home Depot's business, the affiliates could have decided to offer a fee of only 4 percent. The affiliates would thus have absorbed some of the bad debt and administrative costs, but still realized a substantial 11 percent profit on the deal. Consequently, while the affiliates may have considered the anticipated bad debts in computing the fee amounts, there is no way to determine the amount of the bad debt component actually included in the fees. As testified to by another GE witness, the agreements were the result of an "arms length negotiation . . . You sign up for the deal you sign up for. The service fee is (the percentage amount) it is . . . Why those fees are the way they are, I think in most contract analysis would be surplusage . . . What all the various factors are that went into (the fees) would have been surplusage." (T. 68, 69)

Even if it is assumed that the fees included a bad debt component equal to the estimated bad debt amounts, which, as discussed, cannot be established, the bad debts actually incurred by the affiliates may have been (or could be in the future) much greater than anticipated. For example, assume that the affiliates estimated that during a given period x amount of the accounts would become uncollectible. Assume further that it included that x amount as a bad debt component in the fees. Due to an unexpected economic downturn, however, the actual bad debt amount was xxx. Applying Home Depot's rationale, it would be entitled to a sales tax refund based on xxx amount, even though it had paid the affiliates a bad debt component in the fee, i.e., had suffered an economic loss, of only x amount. Clearly, that cannot be allowed.

Home Depot asserts that the fees fully compensated the affiliates for the bad debts because the affiliates "covered all its costs and earned a profit during the period in issue." Home Depot's Post-Hearing Brief at 21. As discussed, however, the fees received from Home Depot were only one source of income for the affiliates. They also received substantial interest income and late fees from their cardholders.[7] Consequently, the fact that the affiliates made a profit during the subject period does not establish, or even suggest, that Home Depot fully compensated the affiliates for the expected bad debts. In short, there is nothing proving the amount of the bad debt component included in the fees,

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[7] A Home Depot witness testified that a private label card issuer also benefits because "[t]here is dollar value that is assigned to (the issuer) having access to the names and addressed of all the cardholders for marketing purposes." (T. 67)

and nothing tying that undeterminable amount to the actual bad debts incurred by the affiliates.

Home Depot argues that other states have granted it sales tax refunds based on the bad debts incurred by the affiliates. But at least two states have also denied Home Depot's refund claim under identical facts. In *Home Depot U.S.A., Inc. v. Director, Division of Taxation*, Docket No. 006005-2005 (March 14, 2008), the New Jersey Tax Court, citing The New York Division of Tax Appeals opinion in *In re Home Depot U.S.A., Inc.*, DTA No. 821034 (NY Div. of Tax Appeals May 17, 2007) (appeal pending), stated as follows:

> In consideration of the services provided to petitioner [(Home Depot U.S.A., Inc.)], the credit card companies subtracted from all receipts a service charge. The service charge was not specifically defined in either the GECC or Monogram contract except to say that it was calculated in accordance with a formula set forth in an appendix. The parties to this matter stipulated that the service fees were determined by several factors, including the following: the bad debt experience of Home Depot's credit card customers; the interest incurred that Monogram or GECC anticipated they would earn and that Home Depot forwent on the credit card account; the value of Home Depot's credit card data base given to Monogram and GECC; and the administrative costs associated with the managed credit accounts by Monogram and GECC. However, it is particularly noteworthy that neither the agreements nor the stipulation apportioned the percentages of the service fee among the various components and that petitioner conceded it could not determine if the actual bad debts written off by Monogram and GECC were equal to, greater than or less than the anticipated bad debt figure used to estimate the bad debt component of the service fee. In sum, petitioner did not demonstrate and acknowledged that it could not accurately account that it had compensated GECC or Monogram for the accounts which ultimately became uncollectible.
>
> In this appeal, just as in the New York litigation, plaintiff has failed to identify the portion of the service fees representing compensation to the Finance Companies for their respective anticipated bad debt losses. Although counsel for plaintiff asserted on oral argument that plaintiff could present proofs quantifying that portion, none of the certifications plaintiff submitted in opposition to the Director's summary judgment motion contained any factual or non-hearsay basis for such assertion. Because the New York Division of Tax Appeals cited a similar absence of proof in rejecting plaintiff's sales tax refund claims, plaintiff surely was on notice of the significance of such proofs.

> From plaintiff's failure to submit certifications identifying or quantifying the bad debt component of the service fees or describing the factors and process by which such component was determined, I infer that, in fact, no such identification or quantification was possible.
>
> Plaintiff has failed to establish, even on a prima facie basis, the relationship, if any, between the unmeasured, and apparently unmeasureable, component of the service fees representing the Finance Companies' projected bad debt losses and the actual bad debt losses incurred by the Finance Companies with respect to the private label credit cards issued to plaintiff's customers. As a result, plaintiff has failed to demonstrate that it suffered any losses attributable to bad debts. It received payment in full from the Finance Companies for each transaction in which a customer used plaintiff's private label credit card, subject to deductions from some payments in the amount of the service fees (the service fees under the Monogram Agreement could be zero) and, perhaps, other items not relevant to this appeal. Whether or not the customer eventually defaulted on the credit card obligation, plaintiff received the same payment with respect to the transaction, and paid the same service fee.

The New Jersey Tax Court's rationale also applies in this case. Home Depot has failed to establish the amount of the bad debt component, if any, included in the fees. Even if it could show what it had predicted or estimated that the bad debt amounts would be, those amounts may or may not have remained in the final negotiated fee amounts agreed to by the parties. The fees contained a number of cost and income components, and the bad debt component initially included or considered by the affiliates may have been reduced or eliminated altogether during negotiations with Home Depot. And because the bad debt components cannot be determined, it cannot be argued that Home Depot fully (or even partially) compensated the affiliates for the bad debts.

I also disagree that the State has been unjustly enriched. The GE affiliates paid the sales tax to Home Depot on behalf of their cardholders, and Home Depot correctly remitted the tax to the Department.[8] There is nothing unjust with the State and the various local jurisdictions retaining those amounts.

Home Depot also will not be unjustly harmed because the refund is denied. While the parties may have considered many factors in negotiating the fee amounts, there is no evidence that Home Depot assumed or considered that it would receive a sales tax refund based on the subsequent bad debt amounts. That is, the parties did not consider and include a sales tax refund component in the fee amounts. Consequently, Home Depot cannot argue that it had anticipated or expected a refund.

If Home Depot had contracted to reimburse the GE affiliates for all subsequent uncollectible accounts, then Home Depot would have a better argument that it is entitled to a refund of the sales tax paid on the bad debts because it could identify the bad debt amounts that it repaid to the affiliates. But even in that case, Home Depot still could not prove the amount of Alabama sales tax paid on the bad debts because it cannot prove that the underlying sales occurred in Alabama. And for the same reason it also cannot establish the amount of local tax that was paid on the bad accounts to the various Department-administered local jurisdictions in Alabama. In any case, the parties agreed that the affiliates, not Home Depot, would be liable for any uncollectible accounts. As

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[8] Home Depot claims that it "remits the applicable sales tax to the Department out of its own pocket. . ." Home Depot's Post-Hearing Brief at 6. I disagree because the GE affiliates remitted the sales proceeds and the applicable sales tax to Home Depot no later than a day or two after each card sale. Home Depot was not required to remit the sales tax to the Department until the 20th of the subsequent month. Consequently, Home Depot in all cases received the sales tax from the affiliates, on behalf of the customers, before it was required to remit the tax to the Department. It thus did not pay the sales tax on the card sales out of its own pocket.

stated by the New Jersey Tax Court – "Home Depot elected to use the services of the Finance companies in order to enable its customers to make purchases using its private label credit card. Home Depot is bound by the tax consequences of that election. 'It is not what might have happened nor what the taxpayer could have done but what actually occurred that determines tax consequences.'" *Home Depot U.S.A., Inc. v. Director, Division of Taxation, supra*, citing *General Trading Co., Inc. v. Director, Div. of Taxation*, 83 N.J. 122, 138 (1980).

The Department's denial of Home Depot's refund petition is affirmed.

This Final Order may be appealed to circuit court within 30 days pursuant to Code of Ala. 1975, §40-2A-9(g).

Entered June 6, 2008.

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BILL THOMPSON
Chief Administrative Law Judge

bt:dr
cc: J. Wade Hope, Esq.
Bruce P. Ely, Esq.
Joe Cowen
John Rhodes

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DIVISION II

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NO. 37854-0-II

**COURT OF APPEALS, DIVISION II**
**OF THE STATE OF WASHINGTON**

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| HOME DEPOT, USA, INC.,<br><br>Appellant,<br><br>v.<br><br>WASHINGTON DEPARTMENT OF REVENUE,<br><br>Respondent. | CERTIFICATE OF SERVICE |

I certify that I served a true and correct copy of the Brief of Respondent and this Certificate of Service, via U.S. Mail, postage prepaid, through Consolidated Mail Services, on the following:

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I certify under penalty of perjury under the laws of the State of Washington that the foregoing is true and correct.

DATED this 19th day of November, 2008, at Tumwater, WA.

KRISTIN D. JENSEN, Legal Assistant