

FILED
SUPREME COURT
STATE OF WASHINGTON
4/1/2019 2:39 PM
BY SUSAN L. CARLSON
CLERK

NO. 96383-5
IN THE SUPREME COURT
OF THE STATE OF WASHINGTON

LOWE'S HOME CENTERS, LLC

Petitioner

v.

DEPARTMENT OF REVENUE, STATE OF WASHINGTON

Respondent

FROM THE COURT OF APPEALS, DIVISION II
NO. 50080-9-II

**SUPPLEMENTAL BRIEF OF PETITIONER
LOWE'S HOME CENTERS, LLC**

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I. INTRODUCTION

Respondent the Washington Department of Revenue (“DOR”) insists that this case is indistinguishable from and thus governed by the Court of Appeals’ decision in *Home Depot USA, Inc. v. Department of Revenue*¹ and similar decisions issued by other courts.² In each decision cited by DOR, the subject private label credit card (“PLCC”) agreement followed the *Home Depot* template, the seller: (1) contracted away its right to take the loss on defaulted PLCC accounts; (2) was fully paid for the purchase prices and corresponding tax; (3) had no further obligation to the lender; (4) bore absolutely no risk of loss; and (5) was therefore ineligible to take PLCC bad debt deductions on its federal corporate income tax returns.³ Citing these cases as applicable authorities, DOR maintains the extreme position that sellers who participate in PLCC arrangements with third party lenders can *never*, under *any* circumstances, qualify for Washington bad debt credits or deductions. *See Answer to Pet. at 15-16.*

In a published decision filed by Division II of the Court of Appeals

¹ 151 Wn. App. 909, 215 P.3d 222 (2009), *review denied*, 168 Wn.2d 1008, 226 P.3d 781 (2010) (“*Home Depot*”).

² *See Answer to Pet. at 16* (citing *Citibank (South Dakota), N.A. v. Dep’t of Taxes*, 202 Vt. 296, 149 A.3d 149 (2016); *Sears, Roebuck & Co. v. Roberts*, No. M2014-02567-COA-R3-CV, 2016 WL 2866141 (Tenn. Ct. App. May 11, 2016)).

³ For instance, in *Citibank*, the bank “pa[id the] retailer the amount charged; that is, the sale amount plus any applicable sales tax,” and the bank “could not collect the unpaid amounts, including the sales tax amounts, from retailer.” 202 Vt. at 298, 149 A.3d at 151. Further, the bank took bad debt deductions on its federal returns pursuant to Internal Revenue Code (“IRC”) § 166. *Id.* at 298-99, 149 A.3d at 151-152.

on September 5, 2018 (the “Decision”), a majority agreed with the DOR. The Chief Justice, however, dissented. Petitioner Lowe’s Home Centers, LLC (“Lowe’s”) filed a Petition for Review of the Decision, which this Court granted by Order dated February 7, 2019.

As set out below, the Decision is contrary to Washington law and should be reversed. The PLCC arrangement here (the “PLCC Agreement”) does not follow the *Home Depot* template. Unlike the contracts addressed in the cited cases, the arrangement between Lowe’s and third party lenders (the “Bank”) provided that Lowe’s (1) remained liable to the Bank for bad debts arising from PLCC accounts; (2) directly bore the economic loss for such bad debts; (3) paid sales taxes it could not collect from buyers; (4) wrote off the PLCC bad debt losses in its books and records; and (5) deducted the losses as bad debts on its federal tax returns pursuant to IRC § 166. Further, when proceeds were recovered on written-off PLCC accounts, they went to Lowe’s, not the Bank (which had already been reimbursed for the loss).⁴ This is because when Lowe’s made guaranty payments to the Bank on these accounts, it stepped into the Bank’s shoes and therefore held the debts when the recoveries were made.

The controlling Bad Debt Statutes⁵ are unambiguous: “A seller is

⁴ CP 454-55 (Aultman Decl. ¶¶13-14).

⁵ RCW 82.08.037 and 82.04.4284.

entitled to a credit or refund for sales taxes previously paid on debts, as that term is used in [IRC §] 166.”⁶ The controlling regulation confirms that credits, refunds, and deductions for bad debts are based exclusively “*on federal standards for worthlessness under section 166 of the Internal Revenue Code.*”⁷ There are no other requirements or preconditions.

No court decision issued in Washington has addressed this specific arrangement and none has held that such a seller is barred from claiming the corresponding credit or deduction for taxes previously remitted on defaulted PLCC accounts.⁸ Consequently, decisions based on agreements consistent with the *Home Depot* template are inapplicable here. This is, in fact, a case of first impression involving unambiguous statutes and undisputed facts.

Nothing in the Bad Debt Statutes, the Regulation, or even in *Home Depot* supports banning sellers from claiming tax credits and deductions for bad debt losses they actually suffer on PLCC accounts. Rather, the lesson derived from *Home Depot* is that a seller who (1) actually bears losses on

⁶ RCW 82.08.037(1) (as amended effective July 1, 2004) (App. 50). See also RCW 82.04.4284(1) (as amended effective July 1, 2004) (providing a similar deduction for B&O tax: “In computing tax there may be deducted from the measure of tax bad debts, as that term is used in 26 U.S.C. Sec. 166 . . . on which tax was previously paid.”) (App. 52).

⁷ WAC 458-20-196(1)(d) & (2) (emphasis added) (the “Regulation”) (App. 56).

⁸ In fact, the Arizona Court of Appeals suggested that where, as here, a seller “experiences the loss,” it is entitled to the deduction. CP 1366 (Smith Decl., Ex. L (*Home Depot USA, Inc. v. Arizona Dep’t of Revenue*, 287 P.3d 97, 102 (Ariz. Ct. App. 2012))). See also CP 1404 (Smith Decl., Ex. P (*Home Depot USA, Inc. v. Levin*, 905 N.E.2d 630, 633 (2009) (indicating Home Depot did not qualify for a bad-debt deduction because it “specifically rejected a recourse arrangement” with its bank and therefore bore no risk of loss))).

PLCC accounts, (2) deducts the losses as bad debts on line 15 of its federal returns, and (3) is thereafter entitled to recoveries made on those accounts, is eligible to take corresponding credits and deductions in Washington.⁹

Indeed, the dissent in the Decision observed that “the majority unnecessarily complicates what should be a straightforward analysis of the applicable Washington statutes, federal statute, and federal regulations.”¹⁰ Likewise, DOR continues to try to complicate the “straightforward analysis” by focusing, not on the applicable laws and regulations, but instead on various subsidiary contentions. For example, DOR claims that, because Lowe’s did not initiate and own the PLCC accounts when they went into default, “it had nothing to write off as uncollectible when a cardholder defaulted.” Answer to Pet. at 9. DOR also refers to a 2010 amendment of RCW 82.08.037 and the Legislature’s decision not to further amend the statute in 2017. *Id.* at 17-18. These subsidiary contentions are meritless.

II. ASSIGNMENTS OF ERROR

1. The majority erred in ruling a retailer who guarantees worthless customer debts and bears the risk of loss for all PLCC bad debts is ineligible to take a Washington sales tax credit or B&O tax deduction on bad debts.

2. The majority erred in purporting to rely on *Home Depot* to hold

⁹ *Home Depot*, 151 Wn. App. at 919-20, 215 P.3d at 227-228.

¹⁰ *Lowe’s Home Ctrs., LLC v. Dep’t of Revenue*, 5 Wn. App. 2d 211, 243, ¶81, 425 P.3d 959, 974. (2018) (“*Lowe’s P*”) (Maxa, C.J., dissenting).

that Lowe's can never claim a sales tax credit or B&O tax deduction on bad debts arising from PLCC accounts it did not initiate and own.

3. The majority erred in concluding that the Regulation imposes a condition that a retailer must write off as uncollectible the specific bad debt accounts in its books and records, and that Lowe's did not do so.

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

III. STATEMENT OF THE CASE

Lowe's incorporates the Statement of the Case in its Petition. The following is an abridged version:

A. PROCEDURAL HISTORY

DOR assessed Washington sales and B&O taxes, interest, and penalties against Lowe's in the principal sum of \$2,218,507.63 (the "Refund Amount") for the tax period April 1, 2001 to December 31, 2009 (the "Assessment Period").¹¹ Lowe's paid the Refund Amount under protest and then filed suit to recover it, plus interest.¹²

The trial court conducted a hearing on the parties' cross motions for summary judgment and concluded that there was no genuine issue of material fact. It denied Lowe's motion and granted DOR summary

¹¹ CP 450, 464-87 (Aultman Decl. ¶3 & Exs. A & B).

¹² CP 450-51 (Aultman Decl. ¶4).

judgment.¹³ Lowe's appealed the ruling to the Court of Appeals. As noted, the majority affirmed the trial court, but the Chief Judge dissented.¹⁴ This Court subsequently granted Lowe's Petition for Review.

B. FACTUAL BACKGROUND

Prior to the Assessment Period, Lowe's executed the PLCC Agreement, which provided that the Bank would, in certain circumstances, extend credit to customers. Lowe's entered the Agreement in the ordinary course of its business and for reasonable consideration.¹⁵ A customer could submit an application at any Lowe's store and, if the Bank approved the application, the customer would be granted a line of credit to use in making purchases at Lowe's stores. Shortly after a PLCC customer makes a purchase, the Bank forwards to Lowe's payment for the purchase price plus all corresponding taxes. Lowe's, as the retailer, would remit Washington sales and B&O tax on PLCC purchases occurring within the state.¹⁶

After Lowe's remitted tax on the purchases, some cardholders defaulted ("PLCC Bad Debts"). Though the Bank initiated and managed these accounts, the PLCC Agreement required Lowe's to assume responsibility for all PLCC Bad Debts up to a specified cap ("Cap"). Thus,

¹³ CP 1154-55 (Notice of Hearing); Verbatim Report of Proceedings at 3:15-5:1; 29:20-25; CP 2800-02 (Order).

¹⁴ See generally, *Lowe's I*, 5 Wn. App. 2d. 211, 425 P.3d 959.

¹⁵ CP 451-52, 488-844 (Aultman Decl. ¶¶7-9 & Exs. C-F).

¹⁶ CP 453 (Aultman Decl. ¶10).

Lowe's reimbursed the Bank for all payments due on defaulted PLCC accounts, up to the Cap ("Bad Debt Guarantee").¹⁷ When it makes reimbursements, Lowe's "steps into the creditor's shoes" with respect to these accounts.¹⁸ If and when proceeds are recovered on these written-off accounts, they go to Lowe's,¹⁹ who reports and remits taxes on the proceeds.

In honoring the Bad Debt Guarantee, Lowe's paid back to the Bank the full unpaid balances due on the written-off PLCC accounts, including any related sales taxes Lowe's had previously remitted to DOR. Thus, for the PLCC Bad Debts, Lowe's had remitted taxes it could not recover from either its customers or the Bank, and was the *only* party out of pocket as to taxes paid on the transactions.²⁰ Lowe's books and records reflected all PLCC Bad Debt losses it had incurred.²¹ Lowe's therefore had the exclusive right to take corresponding credits and deductions for the resulting losses.²²

Throughout the Assessment Period, Lowe's filed consolidated federal corporate income tax returns. Pursuant to IRC § 166, it deducted the PLCC Bad Debts, along with its other worthless debts, as "Bad Debts" on Line 15 of the returns.²³ The Internal Revenue Service regularly audited

¹⁷ CP 453 (Aultman Decl. ¶¶10, 11). Lowe's did not claim credits or deductions for any amounts exceeding the Cap.

¹⁸ *Putnam v. Comm'r*, 352 U.S. 82, 85, 77 S. Ct. 175, 1 L. Ed. 2d 144 (1956).

¹⁹ CP 454-55 (Aultman Decl. ¶¶ 13-14).

²⁰ CP 2668 (Aultman Decl. ¶2).

²¹ CP 455 (Aultman Decl. ¶16).

²² CP 454, 523, 613, 696, 782 (Decl. ¶13 & Exs. C-F); 1137-38 (Aultman Decl. ¶12).

²³ CP 455-57, 845-98 (Aultman Decl. ¶¶17-18 & Exs. G-1 to G-9).

these federal returns and proposed no adjustments to the PLCC Bad Debts claimed by Lowe's.²⁴ Separately, Lowe's timely claimed corresponding Washington sales tax credits and B&O tax deductions on the principal amounts of the written-off PLCC Bad Debts attributable to the state.²⁵

IV. ARGUMENT

Where, as here, the only issues to be resolved are questions of law, this Court reviews legal conclusions in a tax refund action *de novo*.²⁶

A. **DOR'S CONTENTION THAT LOWE'S CANNOT CLAIM BAD DEBT CREDITS OR DEDUCTIONS ON PLCC ACCOUNTS IS UNSUPPORTED BY LAW**

DOR contends that no seller can ever claim a refund of sales or B&O taxes it remitted on worthless PLCC accounts if the transactions were initially financed by a third party bank. But, under the law, the mere fact that a bank owned and managed the PLCC accounts prior to their being written off does not affect whether Lowe's, as guarantor, is entitled to claim a credit or deduction for taxes it remitted on the defaulted accounts.

1. **THE BAD DEBT STATUTES AND REGULATION DO NOT REQUIRE SELLERS TO ORIGINATE AND OWN THE DEFAULTED PLCC ACCOUNTS.**

DOR acknowledges that this Court interpreted RCW 82.08.037 for

²⁴ CP 457-59 (Aultman Decl. ¶¶19-25).

²⁵ CP 459 (Aultman Decl. ¶¶26-27).

²⁶ See *Wash. Imaging Servs., LLC v. Dep't of Revenue*, 171 Wn.2d 548, 555, 252 P.3d 885, 888 (2011). See also CP 2801 (Order (“[T]here is no genuine issue of material fact”).).

the first and only time in *Puget Sound National Bank v. Department of Revenue*²⁷ and this decision controlled throughout the Assessment Period. Answer to Pet. at 10. In *Puget Sound*, this Court identified only *three* requirements a seller had to satisfy to claim a bad debt credit or deduction: “(1) the seller must be a person, (2) making sales at retail, and (3) entitled to a refund for sales taxes previously paid on debts which are deductible as worthless for federal income tax purposes.”²⁸ Here, Lowe’s met all three.

DOR concedes that neither the Bad Debt Statutes nor the Regulation provides that, in order to obtain a refund of sales and/or B&O taxes remitted on bad debts, a seller must have extended credit directly to its customers and owned the accounts when they defaulted.²⁹ Instead, DOR suggests that the law, although silent on this issue, somehow *implies* such an “ownership” requirement. It insists that the “write-off is the ‘essence of the bad debt deduction’” and, since Lowe’s did not own the PLCC accounts, it could not write them off in its books and records when they defaulted. Answer to Pet. at 9. As purported authority, DOR cites the Regulation’s language describing *when* a taxpayer may claim the credit: during “the tax reporting

²⁷ 123 Wn.2d 284, 868 P.2d 127 (1994) (*en banc*) (“*Puget Sound*”).

²⁸ 123 Wn.2d at 287, 868 P.2d at 129.

²⁹ See CP 1259 (Smith Decl., Ex. B (Barrett Dep., pp. 75:22-76:9, 76:16-19)). The sworn testimony of DOR’s designated representative regarding DOR’s understanding and implementation of the law is a binding admission about a material fact. See *Raborn v. Hayton*, 34 Wn.2d 105, 108, 208 P.2d 133,135 (1949) (“[U]ndenied admissions of a party-opponent have substantial weight.”).

period in which the bad debt is written off as uncollectible in the taxpayer's books and records and would be eligible for a bad debt deduction for federal income tax purposes."³⁰ DOR speculates that the Regulation's inclusion of the words "written off" necessarily implies that sellers must own the unpaid accounts and, since Lowe's did not own the PLCC accounts, it had nothing to "write off" when the accounts became worthless. Answer to Pet. at 9.

But the cited language is merely descriptive, *not* prescriptive. It describes *when* the credit or deduction may be taken; it does not create or imply any additional, extra-statutory requirements a seller must satisfy.³¹ Furthermore, Lowe's in fact reflected in its books and records the losses it suffered related to the PLCC Bad Debts.³² Ronald W. Blasi, an expert in federal corporate income tax law, testified that there is no specific manner in which the bad debt losses must be recorded:

There should be some type of accounting entry that indicates Lowe's is fulfilling its obligation as a guarantor. It doesn't have to follow any fixed pattern. There's nothing in the law or in the regulations that requires any fixed pattern to be followed. It just has to be demonstrated that it has had a debt, in this case, a debt that arises as a result of the guarantee, and that debt is bad. And if you could just demonstrate that is some reasonable way, it's going to be accepted for federal

³⁰ WAC 458-20-196(2)(a).

³¹ Neither IRC § 166 nor the corresponding regulations require a write off for a taxpayer to be eligible for a bad debt deduction for wholly worthless debts. *In re Hoffman*, 16 F. Supp. 391 (E.D. Penn. 1936), is of no use to the DOR because it did not concern the Bad Debt Statutes. Further, the Pennsylvania court disallowed the taxpayer's bad debt deduction because he deliberately waited to charge off the debts until the year after they were deemed worthless – confirming that the write off is a timing requirement. *Id.* at 393.

³² See CP 455 (Aultman Decl. ¶16).

income tax purposes.³³

2. LOWE'S GUARANTY PAYMENTS REPRESENT TAXES IT REMITTED BUT COULD NOT RECOVER FROM ITS CUSTOMERS.

This Court's "paramount concern" is to ensure that statutes are "interpreted consistently with the[ir] underlying policy."³⁴ Although DOR agrees that the policy underlying the Bad Debt Statutes is to provide a remedy for sellers that paid sales taxes they could not collect from buyers,³⁵ it nevertheless asserts that Lowe's is barred from this remedy because it "received cash payment of the entire sale proceeds, including the sales taxes Lowe's remitted to the State." Answer to Pet. at 2. This assertion is false.

When the Bank approved a PLCC credit application, it granted the customer a line of credit to use to buy items at Lowe's stores. When the customer made a purchase, the Bank forwarded payment to Lowe's, along with all corresponding taxes. Lowe's, the seller, remitted Washington sales and B&O taxes on the PLCC transactions taking place in the state.³⁶ But Lowe's remained subject to recourse (on a dollar-for-dollar basis) on PLCC accounts that defaulted during the Assessment Period. In honoring the Bad Debt Guarantee, Lowe's paid back to the Bank the unpaid balances due on

³³ Blasi Dep. 31:14-32:9 (App. 37-47) (also at CP 2714-24). DOR made no attempt to challenge Mr. Blasi's expert testimony.

³⁴ *Safeco Ins. Cos. v. Meyering*, 102 Wn.2d 385, 392, 687 P.2d 195, 200 (1984).

³⁵ *Home Depot*, 151 Wn. App. at 917, 215 P.3d at 226.

³⁶ CP 453 (Aultman Decl. ¶10).

written-off PLCC accounts, including any sales taxes Lowe’s previously received from the Bank. On these accounts, Lowe’s – and not the Bank – was the “seller that paid sales taxes [it] could not collect from the buyer.”³⁷

3. THE FEDERAL STANDARDS AUTHORIZE BAD DEBT DEDUCTIONS FOR GUARANTORS WHO NEITHER ORIGINATE NOR OWN THE BAD DEBT ACCOUNT.

Under IRC § 166 and the corresponding Treasury Regulation, a guarantor of a worthless debt is entitled to claim a bad debt deduction once he makes good on his guaranty obligation.³⁸ During the Assessment Period, Lowe’s made guaranty payments to the Bank for the PLCC Bad Debts up to the Cap,³⁹ a fact DOR does not dispute.

Instead, DOR declares – citing no supporting authority – that “under *Puget Sound*, the requisite basis for a sales tax refund is an unpaid debt obligation *originated by a seller*.” Answer to Pet. at 11. Not so. As this Court confirmed, the controlling requirement is that the seller be entitled to a federal deduction of “bad debts, as that term is used [for federal income tax purposes] in [IRC] Sec. 166.”⁴⁰ DOR asks this Court to *alter* the Bad Debt Statutes by declaring that no seller can qualify for a sales tax refund

³⁷ CP 2668 (Second Aultman Decl. ¶2).

³⁸ See CP 1235 (Smith Decl., Ex. A (Jones Dep., p 86:1-25) (acknowledging that the federal standards “make[] very clear that a guarantor of an account that goes bad, if he has to pay on his guarantee, has the right to claim a bad debt deduction.”)).

³⁹ See CP 451-55 (Aultman Decl. ¶¶6-14); 1137-38 (Blasi Decl. ¶12).

⁴⁰ 123 Wn.2d at 287; RCW 82.08.037(1) & 82.04.4284(1).

by contractually agreeing to indemnify a third party lender for its bad debt losses. *See* Answer to Pet. at 6-7. To make this declaration, the Court would have to ignore Treasury Regulation § 1.166-9 and the controlling U.S. Supreme Court and other federal court decisions that interpret it, along with the acknowledged legislative policy underlying the Bad Debt Statutes.

IRC § 166(a)(1) “allow[s] as a deduction any debt which becomes worthless within the taxable year.” Treasury Regulation § 1.166-9(a) explains that “a payment of principal or interest made . . . by the taxpayer in discharge of part or all of the taxpayer’s obligation *as a guarantor, endorser, or indemnitor is treated as a business debt becoming worthless in the taxable year in which the payment is made.*” (Emphasis added). These are the governing “federal standards” and they specifically allow a bad debt deduction for guarantors of defaulted credit accounts initiated and owned by third party lenders. By definition, guarantors do not extend the credit and do not own or manage the accounts, but they still bear the loss when the accounts default.

The U.S. Supreme Court explained the reasoning as follows:

Instantly upon the payment by the guarantor of the debt, *the debtor’s obligation to the creditor becomes an obligation to the guarantor, not a new debt, but, by subrogation, the result of the shift of the original debt from the creditor to the guarantor who steps into the creditor’s shoes.* Thus, the loss sustained by the guarantor unable to recover from the debtor is by its very nature a loss from the worthlessness of

a debt. *This has been consistently recognized in the administrative and the judicial construction of the Internal Revenue laws, which . . . have always treated guarantors' losses as bad debt losses.*⁴¹

Moreover, "no independent debt between principal debtor and the third party [guarantors], created by subrogation, is necessary."⁴²

It is undisputed that Lowe's met the federal standards for qualifying as a guarantor: (1) it entered the PLCC Agreement in the ordinary course of its business; (2) it had an enforceable legal duty to make the guaranty payments; (3) the parties entered into the PLCC Agreement before the accounts became worthless; and (4) Lowe's received reasonable consideration for entering into the Agreement.⁴³

Of note, DOR failed to address these controlling authorities in its Answer to the Petition.

4. HOME DEPOT DOES NOT REQUIRE A SELLER TO INITIATE AND OWN THE PLCC ACCOUNTS.

In claiming that there must be a direct connection between the purported bad debts and the retail sales transactions for which a seller seeks a refund, DOR relies on neither the Bad Debt Statutes nor the Regulation. Instead, like the majority in the Court of Appeals' decision, it cites only

⁴¹ CP 1284 (Smith Decl., Ex. F (*Putnam v. Comm'r*, 352 U.S. 82, 85-86, 77 S. Ct. 175, 1 L. Ed. 2d 144 (1956)) (emphasis added).

⁴² *Horne v. Comm'r*, 523 F.2d 1363, 1365 (9th Cir. 1975).

⁴³ TREAS. REG. § 1.166-9(d)&(e). CP 1131-37 (Blasi Decl. ¶¶2, 4-7 & 11).

Home Depot. Answer to Pet. at 13-14 (insisting that, like Home Depot, Lowe’s did not incur a bad debt loss “‘**directly attributable to**’ its retail sales”) (emphasis added). DOR claims that “[t]he *Home Depot* court correctly held that RCW 82.08.037 **impliedly requires** the person claiming a sales tax refund to be ‘the one **holding** the bad debt as well as the one to whom repayment on such a debt would be made.’”⁴⁴

There is, however, a fundamental difference between **holding** a debt and **owning** the underlying account, a distinction DOR ignores. When a PLCC cardholder purchased merchandise from Lowe’s, the initial debtor-creditor relationship was between the cardholder and the Bank. But once Lowe’s fulfilled its obligation under the Bad Debt Guarantee, it stepped into the Bank’s shoes as the creditor and, by operation of law, Lowe’s became “the one holding the debt” and the “one to whom repayment on such debt would be made.”⁴⁵ In fact, Lowe’s subsequently received recoveries on some of the defaulted PLCC accounts, and it remitted sales tax on these amounts. These are the determinative distinctions between this case and all the cases addressing the *Home Depot* template.

The Bad Debt Statutes tie eligibility to claim a sales tax credit or B&O tax deduction **exclusively** to whether the bad debts were deductible as

⁴⁴ Answer to Pet. at 14 (quoting *Home Depot*, 151 Wn. App. at 922) (emphasis added).

⁴⁵ See CP 454-44 (Aultman Decl. ¶¶13-14).

worthless under “federal standards” (IRC § 166 and the corresponding regulations).⁴⁶ Treasury Regulation § 1.166-9 identifies guarantors as appropriate parties to take bad debt deductions if the accounts they guarantee become worthless. Therefore, under a “straightforward analysis of the applicable Washington statutes, federal statute and federal regulations,”⁴⁷ Lowe’s qualified for the deductions as a matter of law.

5. SECTION 320.C OF THE STREAMLINED SALES AND USE TAX AGREEMENT DOES NOT SUPPORT THE DENIAL OF LOWE’S CLAIM.

Washington is a member state of the Streamlined Sales and Use Tax Agreement (“SSUTA”), the purposes of which include simplifying and promoting uniformity in state and local tax laws.⁴⁸ The bad debt provision contained in SSUTA § 320 provides that each member state shall:

- A. Allow a deduction for taxable sales for bad debts. Any deduction taken that is attributed to bad debts shall not include interest.
- B. Utilize the federal definition of “bad debt” in [IRC § 166] as the basis for calculating bad debt recovery. . . .
- C. Allow bad debts to be deducted on the return for the period during which the bad debt is written off as uncollectable in the claimant’s books and records and is eligible to be deducted for federal income tax purposes.

⁴⁶ RCW 82.08.037, 82.04.4284; WAC 458-20-196(1)(d).

⁴⁷ *Lowe’s I*, 5 Wn. App. 2d at 243, ¶81, 425 P.3d at 974.

⁴⁸ See The Streamed Sales Tax Governing Board, Inc., About Us (last visited March 22, 2019), <http://www.streamlinedsalestax.org/index.php?page=About-Us>.

Under this section, a seller must meet only two requirements to claim a deduction for bad debts: (1) the deduction must meet the criteria of a bad debt pursuant to IRC § 166; and (2) the seller must claim it in the period during which it wrote off the debt in its books and records (SSUTA § 320(C)). Nothing in § 320 requires the seller to initiate and own the PLCC account or to write off the specific account in its books and records.

Lowe's plainly met the SSUTA § 320 requirements for claiming a bad-debt deduction, because it (1) properly claimed the debt as an IRC § 166 bad debt deduction on its federal return; and (2) was liable, as a contractual guarantor, for that debt up to the Cap, which it wrote off as uncollectable in its books and records.

6. THE 2010 AMENDMENT TO THE BAD DEBT STATUTE DOES NOT SUGGEST A LEGISLATIVE INTENT TO ADOPT A BLANKET PROHIBITION.

DOR also relies on a 2010 amendment of RCW 82.08.037(7) to suggest that the Legislature always intended to preclude sellers from obtaining Washington tax credits and deductions on accounts originated by third party banks. Answer to Pet. at 17. This suggestion is without merit. The 2010 amendment – enacted after the end of the Assessment Period – does not suggest any legislative intent to impose a blanket prohibition.

Following the 2010 amendment, the Bad Debt Statute now provides:

If the original seller in the transaction that generated the bad

debt has sold or assigned the debt instrument to a third party with recourse, the original seller may claim a credit or refund under this section only after the debt instrument is reassigned by the third party to the original seller.⁴⁹

This amendment represented a substantive change in the law, effective July 1, 2010, that is not applicable to the Assessment Period.⁵⁰ Nonetheless, the amendment supersedes only that portion of *Puget Sound* that allowed a bank, as assignee, to fall within the definition of the term “seller” for purposes of claiming sales tax credits for bad debts. The statute now limits such credits to the original seller (which Lowe’s is). But the amendment does not indicate, as DOR argues, that the Legislature also intended to bar sellers on credit accounts originated by banks from claiming bad debt credits or deductions as a guarantor.

Consistent with the 2010 statutory amendment, the Department added a new section (6) to the Bad Debt Regulation:

If a business contracts with a financial company to provide a private label credit card program, and ***the financial company becomes the exclusive owner of the credit card accounts and solely bears the risk of all credit losses***, the business that contracted with the financial company is not entitled to any bad debt deduction if a customer fails to pay his or her credit card invoice.⁵¹

⁴⁹ RCW § 82.08.037(7) (2010).

⁵⁰ See, e.g., *In re Cascade Fixture Co.*, 8 Wn.2d 263, 273, 111 P.2d 991, 995 (1941) (“In view of the statutory rule of construction enunciated, the language of the 1939 amendment cannot be regarded as creating a retroactive paramount lien in favor of the department, since there is nothing in that language which either expressly, or by necessary implication, shows that such an effect was intended.”).

⁵¹ WAC § 458-20-196(6) (2010) (emphasis added).

Again, this new rule became effective after the Assessment Period and is inapplicable here. But in any event, the rule contains *two* separate requirements for precluding a bad debt deduction: the financial company (i) must be “the exclusive owner of the credit card accounts” *and* (ii) must “solely bear[] the risk of all credit card losses.”⁵²

Even under this new rule, a third party’s ownership of the debt, by itself, does not bar the seller from claiming the credit. Under federal standards, ownership of the account is irrelevant.⁵³ While Lowe’s did not own the PLCC accounts, it (unlike Home Depot) ultimately bore the losses when the accounts defaulted, reflected the losses as bad debts in its books and records, and was entitled to take the federal bad debt deduction on such losses. Therefore, even under the new rule, Lowe’s is still entitled to claim the corresponding Washington tax credits and deductions.

7. THE FAILED 2017 AMENDMENT IS IRRELEVANT.

DOR further claims the Legislature deliberately declined to act on a bill in 2017 that would have allowed a bad debt sales tax refund for retailers who contract with third-party financial institutions. Answer to Pet. at 18 (citing S.B. 5910). Its reliance on S.B. 5910 is misplaced.

First of all, “failed amendments tell [the court] ‘little’ about what a

⁵² *Id.*

⁵³ *See supra* pp. 12-14.

statute means.”⁵⁴ More importantly, S.B. 5910 is irrelevant because the bill was intended to amend RCW 82.08.037 to allow retailers to receive bad debt credits where the debts are sold or assigned to third parties and *the third party is without recourse against the seller*. In other words, the bill was intended to provide relief to retailers who are parties to PLCC Agreements following the *Home Depot* template; not like in this case where Lowe’s bears the risk of loss.⁵⁵ The bill is therefore irrelevant to this matter.

B. EQUAL PROTECTION

Lowe’s incorporates the argument set forth in its Petition.

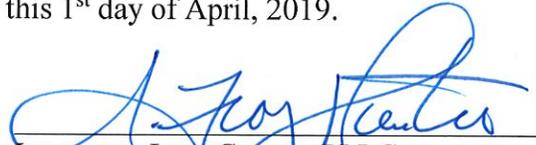
CONCLUSION

As guarantor of the PLCC Bad Debts, Lowe’s properly received a bad debt deduction on its federal returns under IRC § 166 and Regulation § 1.166-9. As a matter of law, it was entitled to claim the corresponding credits and deductions on its Washington sales and B&O tax returns. There is no legal requirement that, to claim the credit or deduction, Lowe’s must have initiated and owned the PLCC accounts at the time of default. The Court of Appeals’ ruling is erroneous and should be overturned.

⁵⁴ *Texas Dep’t of Housing & Cmty. Affairs v. Inclusive Cmty. Project, Inc.*, 135 S. Ct. 2507, 2539, 192 L. Ed. 2d 514 (2015).

⁵⁵ The fact that the Legislature specifically limited its proposed remedy in S.B. 5910 to PLCC Agreements that follow the *Home Depot* template demonstrates the Legislature’s understanding that PLCC Agreements like the ones at issue here did not require a statutory change in order to preserve the seller’s right to claim bad debt credits and deductions.

Respectfully submitted this 1st day of April, 2019.

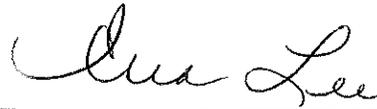


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CERTIFICATE OF SERVICE

THIS IS TO CERTIFY that on the 1st day of April, 2019, I caused to be served a true and correct copy of the foregoing via Legal Messenger and addressed to the following:

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April 01, 2019 - 2:39 PM

Transmittal Information

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

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