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SUPREME COURT OF THE STATE OF WASHINGTON

LOWE'S HOME CENTERS, LLC,

Petitioner,

v.

DEPARTMENT OF REVENUE, STATE OF WASHINGTON,

Respondent.

DEPARTMENT OF REVENUE'S SUPPLEMENTAL BRIEF

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I. INTRODUCTION

Sellers can recover sales taxes they paid to the State on a buyer's behalf if the buyer fails to repay the seller. To qualify for such a sales tax refund the seller must be the person that actually extended credit to the buyer on the retail sale. Similarly, the corresponding business and occupation (B&O) tax deduction for bad debts applies only to sellers that paid retailing B&O taxes on their own uncollectible sales receipts.

Here, Lowe's did not extend credit to buyers and did not have any uncollectible sales receipts. Instead, the bank operating Lowe's' private label credit card program is the entity that extended credit to the buyer and incurred credit losses. Lowe's received the entire amount it was entitled to collect from the buyer, including sales taxes it remitted to the State and the sale proceeds on which it paid B&O taxes. Thus, under the plain meaning of the bad debt tax statutes, Lowe's does not qualify for a refund.

It is of no consequence whether Lowe's properly deducted its contractual payments to the bank as bad debts on its federal tax returns. The amounts Lowe's deducted do not qualify as "bad debts" within the meaning of the sales tax credit or B&O tax deduction because they were not for uncollectible sales receipts. Lowe's' contract with the bank did not, and could not, convert the bank's bad debt losses into refundable sales taxes or retailing B&O taxes. This Court should affirm.

II. STATEMENT OF THE CASE

A. Lowe's' Private Label Credit Card Program

During the relevant period, Lowe's entered into agreements with banking subsidiaries of the General Electric Capital Corporation (the Bank) to establish a private label credit card program. CP 47, 451. Private label credit cards are bank-issued cards bearing the retailer's logo and may be used to purchase goods from that retailer. CP 68. Under these agreements, the Bank extended credit to Lowe's' customers meeting the Bank's creditworthiness standards and established credit card accounts for those customers, allowing them to finance their purchases at Lowe's. CP 30, 453. The Bank had exclusive ownership and control over the terms and conditions of those credit card accounts. CP 41, 136.

When a customer purchased goods with a private label credit card, Lowe's received payment of the full purchase price, including the sales taxes, within a day or two, the same as with any other bank-issued credit card transaction. CP 144 (Section 5.01 Daily Settlement Procedures). Lowe's properly remitted the sales taxes to the State and paid retailing B&O taxes on its taxable sale proceeds. CP 453.

Lowe's did not extend any credit to its customers with respect to these retail sales and credit accounts. CP 49. Lowe's did not at any time own the accounts or debts, and it did not at any time hold or maintain

these accounts or debts on its own books and records. The exclusive right to receive payments by the cardholders was "vested in the Bank." CP 136 (Section 3.02 Ownership of Accounts). The Bank was entitled to all the revenues and bore all the costs relating to the credit accounts. *Id.* Accordingly, when a customer defaulted on its credit card debt, the Bank, not Lowe's, wrote off the uncollectible debt on its books. CP 85, 128.

Lowe's' contract with the Bank included a profit-sharing provision. CP 140, 454. Under this provision, Lowe's was entitled to any additional profits generated by the credit accounts once the Bank reached its annual "target rate" of return on a portfolio-wide basis. CP 44, 141. The Bank routinely enters into such profit-sharing agreements with retailers as an incentive to promote usage of private label credit cards. CP 66. The Bank's bad debt write-offs on defaulted private label credit card accounts were one of the "program expenses" that reduced Lowe's' "monthly profit-sharing distributions" from the Bank. CP 455, 950.

On its federal income tax returns, Lowe's deducted the bad debts that reduced its profit-share amount as bad debts arising from a contractual guaranty. CP 455. For federal income tax purposes, contractual payments in reimbursement of third party bad debts are deductible as bad debts if the promise to pay was supported by "reasonable consideration." 26 C.F.R. § 1.166-9(e). The consideration Lowe's received in exchange for absorbing

a share of the Bank's bad debts included "reduced tender costs" (because Lowe's avoided interchange fees and other payment processing expenses on the credit card transactions financed by the Bank) and "increased sales" (because the Bank made credit available to its customers), in addition to its share of the Bank's profits. CP 44, 454.

The Bank gave Lowe's a monthly report of the Bank's bad debt write-offs on the credit accounts. CP 454. The monthly reports separately stated the amounts attributable to the sales taxes and the selling price. *Id.* Lowe's used the information to claim bad debt sales tax credits and retailing B&O tax deductions on its state tax returns. CP 460.

B. Procedural History

The Department audited Lowe's for 2001 through 2009 and assessed Lowe's for the amount of sales tax credits and B&O tax deductions Lowe's took on the defaulted private label credit accounts. CP 441. Lowe's paid the taxes and filed a refund action, claiming it was entitled to a tax refund based on its federally-qualified bad debt deductions. CP 13. The trial court granted summary judgment to the Department. CP 2800. The Court of Appeals affirmed, holding that Lowe's' federally-deductible bad debts are not "bad debts" within the meaning of the State's excise tax statutes. *Lowe's Home Centers, LLC v. Dep't of Revenue*, 5 Wn. App. 2d 211, 425 P.3d 959 (2018).

III. QUESTIONS PRESENTED

1. RCW 82.08.037 allows a seller to recover the sales taxes it paid on the buyer's behalf if the seller incurs a bad debt loss on a retail sale. Does Lowe's qualify for a sales tax refund on amounts it paid in reimbursement of a third-party lender's bad debts when (a) Lowe's collected the full purchase price from the buyer, including the sales taxes it remitted to the State; and (b) Lowe's' guaranty payments were in exchange for a right to a share of the Bank's financing income and other valuable consideration?

2. Does RCW 82.04.4284 allow sellers to deduct amounts paid in reimbursement of bad debts incurred by third-party lenders from the measure of the retailing B&O tax?

3. Does providing a tax benefit to sellers extending credit to buyers and incurring bad debts, while denying a tax benefit to sellers contractually absorbing third-party bad debts, comport with the equal protection clause?

IV. ARGUMENT

Sellers are required to remit sales taxes to the State and to pay retailing B&O taxes regardless of whether they collect anything from the buyer at the time of sale. Washington's bad debt tax statutes allow sellers to recover the excise taxes they paid to the State if the buyer fails to pay

the sale proceeds to the seller. Here, the buyers paid for their purchases with borrowed funds, and Lowe's actually received payment of both the sales taxes it remitted to the State and the sales price on which it paid retailing B&O taxes. The fact that Lowe's' customers ultimately defaulted on their repayment obligation to a third-party lender has no bearing on Lowe's' sales tax obligations or B&O tax liabilities.

A. Lowe's Does Not Qualify for a Sales Tax Refund Because It Did Not Incur Bad Debts on Its Retail Sales

The principal legal issue in this case is whether Lowe's is entitled to a sales tax refund under RCW 82.08.037 for its contractual payments reimbursing the Bank's bad debt write-offs. The goal of statutory interpretation is to determine and give effect to the Legislature's intent. *TracFone Wireless, Inc. v. Dep't of Revenue*, 170 Wn.2d 273, 296-97, 242 P.3d 810 (2010). To discern the legislative intent of the bad debt sales tax statute, the Court should read the statute in the context of closely related statutes governing the seller's sales tax obligations. *See Dep't of Ecology v. Campbell & Gwinn, LLC,* 146 Wn.2d 1, 10-11, 43 P.3d 4 (2002). To the extent the tax credit is ambiguous, it must be narrowly construed to avoid unanticipated revenue losses. *See TracFone*, 170 Wn.2d at 296-97.

1. To qualify for a refund, the "seller" must be the person that extended credit to the buyer and "paid" the tax

Retail sales tax, levied under RCW 82.08.020, "must be paid by

the buyer to the seller," and "[t]he amount of the tax, until paid by the buyer to the seller or to the department, constitutes a debt from the buyer to the seller." RCW 82.08.050(1), (8). For a seller that paid sales tax on the buyer's behalf but was unable to collect the debt from the buyer, RCW 82.08.037(1) provides a remedy:

> A seller is entitled to a credit or refund for sales taxes previously paid on bad debts, as that term is used in 26 U.S.C. Sec. 166, as amended or renumbered as of January 1, 2003.

A "bad debt" for purposes of the federal tax code is an uncollectible debt obligation "owed to the taxpayer." 26 C.F.R. § 1.166(a).

"Bad debts," within the meaning of the sales tax credit, plainly refers to unpaid debts *owed by the buyer to the seller* on a retail sale. Sales tax is "paid on" the "selling price," which is the amount the buyer owes to the seller in exchange for the goods sold. RCW 82.08.010(1). In addition, the buyer has a statutory "debt" obligation to pay sales taxes to the seller. RCW 82.08.050(8). The plain meaning of RCW 82.08.037 allows a seller to recover the sales taxes it paid on the buyer's behalf, if the buyer fails to repay the seller. To qualify for a sales tax refund, the "seller," itself, must be the person that "paid" the sales taxes for the buyer and incurred a bad debt. *See* WAC 458-20-196(2)(a) (debts must be "owed to the taxpayer" and "written off as uncollectible in the taxpayer's books and records").

Lowe's argues that this Court's decision in *Puget Sound National Bank v. Department of Revenue*, 123 Wn.2d 284, 868 P.2d 127 (1994), establishes a simple three-factor test that it meets. Pet. at 2. But Lowe's ignores *Puget Sound*'s primary holding: only a "seller" that extended credit to the buyer can qualify for a sales tax refund under RCW 82.08.037. 123 Wn. 2d at 288. The Court addressed a prior version of the statute with the same operative language: "A seller is entitled to a credit or refund for sales taxes previously paid on bad debts which are deductible as worthless for federal income tax purposes." RCW 82.08.037 (1994).

Puget Sound involved an automobile dealership that financed its customers' vehicle purchases. 123 Wn.2d at 285. The seller assigned its customers' unpaid debt obligations to a bank. The issue addressed by the Court was whether the bank was entitled to a sales tax refund on bad debts arising from the assigned accounts. The complicating factor, in the Court's view, was that a sales tax refund is only available to a "seller" that paid the sales taxes on the buyer's behalf. *Puget Sound*, 123 Wn. 2d at 287-88.

The Court reasoned that the bank acquired the "tax attribute" of being the retail seller that made the credit sale through the contract of assignment. *Id.* at 288. The Court held the bank was thus entitled to recover the sales taxes the seller could have claimed had it not assigned ownership of its customer's unpaid debt obligations. *Id.* at 290.

Implicit in the Court's reasoning was that RCW 82.08.037 applies only to bad debts owed by the buyer to the seller on a retail sale. The bank qualified only because it had "stepped into the [seller's] shoes" by virtue of the contract of assignment. *Puget Sound,* 123 Wn.2d at 292-93.

In 2009, the Court of Appeals correctly followed *Puget Sound* in holding a retailer did not qualify for a sales tax refund on defaulted private label credit card transactions financed by a third-party lender. *Home Depot USA, Inc. v. Dep't of Revenue*, 151 Wn. App. 909, 920, 215 P.3d 222 (2009). The issues in *Home Depot* were (1) whether RCW 82.08.037 requires the seller to be the person incurring a federally-qualified "bad debt," and (2) if so, whether the seller qualified by showing it "actually bore the loss" by paying "service fees" covering the third-party lender's bad debts. The Court held that RCW 82.08.037 impliedly requires that the seller, itself, incurred a bad debt loss on a retail sale. *Id.* at 922. Further, a seller cannot qualify by showing a third party lender recouped its bad debt losses through the transaction fees paid by the seller. *Id.* at 924.

The *Home Depot* court correctly interpreted RCW 82.08.037 in the context of closely related statutes, concluding that the statute provides a limited remedy for sellers that paid sales taxes they could not collect from the buyer. 151 Wn. App. at 921. To qualify, the seller must have a bad debt "directly attributable" to the buyer's unpaid sales tax debt obligation

to the seller. *Id.* at 922. Home Depot did not qualify because it collected the entire amount owed by the buyer on a retail sale. The Court reasoned that allowing sales tax refunds on a seller's contractual payments to third party lenders would contravene related statutes defining the measure of the tax and the seller's obligation to collect and remit the tax. *Id.* at 923-24.

Here, the Court of Appeals properly followed *Puget Sound* and *Home Depot* in concluding Lowe's does not qualify for a sales tax refund. Just as in *Home Depot*, Lowe's did not incur bad debts on its retail sales; the buyer's debt to Lowe's on a retail sale was discharged in full when Lowe's received the settlement funds from the Bank, the same as with any other credit card transaction. Lowe's' contractual "guarantee" of the Bank's profit margins did not alter the tax consequences of its retail sales.

2. Lowe's does not qualify because it is not the person that extended credit to the buyer

The Court of Appeals correctly held that Lowe's does not qualify for a sales tax refund under RCW 82.08.037 because it is not the person that extended credit to the buyer. *Lowe's*, 5 Wn. App. 2d at ¶ 46. The credit card loan transaction was between the cardholder and the Bank. Lowe's received cash payment of the entire amount it was entitled to collect from the buyer, including sales taxes it remitted on the buyer's behalf to the State. Under RCW 82.08.050(8), no "debt from the buyer to

the seller" existed. In the absence of a debt, there can be no bad debt.

In its petition for review, Lowe's misleadingly states: "Lowe's wrote off in its books and records the losses it bore in paying the Bank on the defaulted PLCC accounts." Pet. at 8 n.13. Whatever entries Lowe's made in its books were not for uncollectible sales receipts.[1] Any amounts Lowe's wrote off were for amounts Lowe's owed to the Bank, not amounts the buyer owed to Lowe's. CP 41, 945.

Lowe's received cash payment of the sales taxes it remitted to the State on the buyer's behalf. The only actual transfer of funds Lowe's made back to the Bank as a result of its contractual guarantee was to make up any shortfall in the Bank's desired profit margins on a portfolio-wide basis. CP 44. In rejecting a very similar bad debt refund claim, an appellate court in Tennessee stated: "The risk that the private label credit card program will be less profitable than anticipated does not qualify as bad debt." *Sears, Roebuck & Co. v. Comm'r of Revenue*, No. M201402567COAR3CV, 2016 WL 2866141 (Tenn. Ct. App. May 11, 2106), *application for permission to appeal denied* (Tenn. Sept. 23, 2016). This Court should also hold that whatever amounts Lowe's "paid" in

[1] Unlike in the case of a bad check or a credit card chargeback, Lowe's was not required to return any amount to the Bank; nor did Lowe's have recourse against the defaulting cardholder. *Cf.* Resp't Br. at 15 n.6 (describing Lowe's' accounting treatment supporting its bad debt credits for NSF checks and credit card chargebacks). CP 926, 945.

discharge of its guarantee of the Bank's profit margins do not qualify as "bad debt" under RCW 82.08.037.

3. Lowe's could not qualify by "stepping into the shoes" of the Bank

Relying principally on this Court's decision in *Puget Sound*, Lowe's argues it "stepped into the shoes" of the Bank as the buyer's creditor, via its contractual reimbursement of the Bank's bad debt losses, thereby acceding to the status of the person incurring the credit loss. Pet. at 13. Lowe's' reliance on *Puget Sound* is unsound.

First, the Bank did not assign any credit accounts to Lowe's. So Lowe's did not, in fact, step into the Bank's shoes as the buyer's creditor. Ownership of the credit accounts was "vested in the Bank." CP 136. More importantly, unlike the credit accounts at issue in *Puget Sound*, the right to a sales tax refund for bad debts never attached to the credit accounts established by the Bank. To qualify for a sales tax refund for bad debts, a "seller" must be the person that extended credit to the buyer. *Puget Sound*, 123 Wn.2d at 288. RCW 82.08.037 carves out a limited exception to a seller's otherwise strict liability for ensuring the buyer's duty to pay sales taxes is fulfilled.[2] Banks have never been entitled to recover the sales

[2] *See* RCW 82.08.050(3) (making seller personally liable for uncollected sales taxes); RCW 82.08.050(4) (imposing recordkeeping requirements); RCW 82.08.050(9) (imposing criminal liability for intentionally diverting sales taxes); RCW 82.08.050(10) (authorizing collection action against sellers).

taxes they loaned to a consumer. Since the Bank had no right to a sales tax refund on its uncollectible loans, Lowe's could not have acquired any such right by stepping into the Bank's shoes.

Finally, Lowe's' reverse logic is fundamentally at odds with the fiduciary nature of a seller's sales tax obligations to the State. The sales taxes the Bank financed on the borrower's behalf were amounts Lowe's collected and held as the State's trustee until they were remitted to the State. *See* RCW 82.08.050(2) (sales taxes are "deemed to be held in trust by the seller until paid to the department"). Sellers are strictly prohibited from diverting collected sales taxes for their own purposes or for any use other than to satisfy the buyer's sales tax debt obligation to the State. RCW 82.08.050(3). Thus, the Court of Appeals correctly held that Lowe's' contract with the Bank could not "negate" the buyer's satisfaction of its sales tax obligation to the State. *Lowe's*, 5 Wn. App. 2d at ¶ 59. *Cf. Washington Imaging Servs. LLC v. Dep't of Revenue*, 171 Wn.2d 548, 556, 252 P.3d 885 (2011) (terms of private contractual agreement cannot alter the tax code). Lowe's was not free to use the State's trust funds as leverage to increase its share of the Bank's financing income.

The Court should reject Lowe's effort to convert the bad debt sales tax credit from a limited remedy for sellers that paid sales taxes they could not collect from the buyer into a tax subsidy for third-party lenders.

4. Lowe's' "guaranty payments" are not refundable "bad debts"

It is immaterial that Lowe's deducted the bad debts it contractually absorbed as bad debts rather than ordinary expenses on its federal tax returns. As the Court of Appeals correctly recognized, the existence of a federally-qualified bad debt is a necessary but not sufficient condition for a sales tax refund under RCW 82.08.037. *Lowe's*, 5 Wn. App. 2d at ¶ 55. To qualify, the seller must have a bad debt loss on a retail sale. Lowe's did not incur any bad debts on its retail sales. It simply shared in the bad debt losses *and profits* of the Bank's credit card business. The bad debts from the Bank-issued loans do not qualify as "bad debts" on which sales taxes were previously paid within the meaning of RCW 82.08.037.

The Court of Appeals correctly concluded Lowe's' guaranty payments were no different, in substance, from the "service fees" paid by Home Depot. *Lowe's*, 5 Wn. App. 2d at ¶ 47. Like the service fees, the guaranty payments were in exchange for valuable services Lowe's received from the Bank and, thus, not equivalent to the losses of a seller that paid sales taxes on its uncollectible sales receipts.[3]

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[3] Notably, Lowe's used to deduct its contractual payments to the Bank as ordinary business expenses on its federal tax returns. It filed amended tax returns with the IRS to recharacterize them as bad debts. CP 939. When an IRS examiner questioned the treatment, Lowe's candidly explained it made the change for "state presentation purposes" to support its recovery of sales taxes from the states. *Id.*

Lowe's relies heavily on the fact that the IRS "accepted" its federal bad debt deductions.[4] Pet. at 10. But the IRS had no reason to disallow them because deducting the contractual payments on line 15 rather than on line 26 had no impact on Lowe's' federal income tax liability. CP 2723.

Virtually any contractual payment, measured in whole or in part, by third-party bad debts, could be recharacterized as a bad debt rather than an ordinary expense by a corporate taxpayer. This is because, as Lowe's' expert testified, the scope of the federal bad debt deduction for "guaranty losses" is extremely broad. CP 2715-16. It applies to virtually any contractual payment indemnifying a third party for its bad debt losses. *See* Resp. Br., at 38, n. 14. Allowing sales tax refunds on guaranty payments would go far beyond the legislative intent of the bad debt sales tax statute and open the door wide to sales tax refunds on bank-issued credit card loans.

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[4] Lowe's has relied heavily on an Oklahoma Tax Commission ruling that Lowe's' federally-qualified bad debt deductions were deductible under the "plain meaning" of Oklahoma's bad debt sales tax statute. The Tax Commission ultimately concluded, however, that Lowe's failed to meet its burden of proving the "correct" amount of its sales tax liability because an unquantifiable amount of Lowe's' guaranty payments actually replaced the Bank's unrealized financing income. Lowe's' pyrrhic victory in Oklahoma demonstrates that its interpretation of RCW 82.08.037 cannot be correct. If "bad debts" meant "guaranty payments," the statute would be unadministrable.

On March 4, 2019, the Oklahoma Court of Appeals affirmed the Tax Commission's denial of Lowe's' sales tax refund claim. *Sales Tax and Use Tax Protest of Lowe's Home Centers, LLC v. Oklahoma Tax Comm'n*, 117119, *available at* http://www.oscn.net/dockets/GetCaseInformation.aspx?db=appellate&number=TC-117119&cmid=124235. On March 21, 2019, Lowe's filed a petition for certiorari in the Oklahoma Supreme Court, which is pending.

Amicus curiae COST and Kohl's would applaud this result because they believe a sales tax refund should be available on all bank-financed retail sales in the event of a buyer's default. COST Br. at 10 (advocating neutral tax treatment of "seller-issued credit cards" and "bank-issued credit cards"); Kohl's Br. at 4 (denying refunds unfairly results in a "financial windfall" for the State). The legislative purpose of RCW 82.08.037 is to provide a limited remedy for sellers that paid sales taxes with their own funds on sale proceeds they never actually received. The availability of a sales tax refund is a "statutory courtesy" for sellers required to serve as the State's tax collector. *Cf. Household Retail Servs. Inc. v. Comm'r of Revenue*, 448 Mass. 226, 229, 859 N.E.2d 837 (2007). Essentially, the State guarantees the retailer will recover the sales taxes it financed for the buyer. But there is no reason to believe the Legislature intended to underwrite the credit risk assumed by third-party lenders.

5. Case law from other states supports the Court of Appeals' interpretation

Lowe's argues the Department has taken a radical position in denying sales tax refunds for a seller's contractual indemnity payments to third-party lenders. COST, similarly, asserts that affirming the Court of Appeals would make Washington an outlier among its fellow member states that have pledged to conform with the uniform bad debt rules of the

Streamlined Sales and Use Tax Agreement (SSUTA). The truth is that the decision below reflects the consensus view of SSUTA member states. State courts nationwide have been remarkably consistent in rejecting retailer claims for sales tax refunds on bad debts arising from private label credit card accounts.[5]

Contrary to Lowe's protestations, the facts of this case are not materially different from those in *Home Depot* or the many other state-court decisions that have rejected similar refund claims based on variations in a retailer's contractual agreement with a third party lender. The dispositive facts are the same: Lowe's did not extend credit to the buyer. The sales taxes Lowe's collected and remitted were trust funds. Lowe's' bargain with the Bank could not nullify the buyer's satisfaction of its sales tax obligation to the State.

This Court should reject Lowe's reliance' on *Puget Sound* and instead follow the well-reasoned decisions of other SSUTA-member states that have strictly construed similarly-worded bad debt statutes. *Puget Sound* is factually distinguishable for the reasons previously discussed.

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[5] *See Citibank (South Dakota), N.A. v. Dep't of Taxes*, 149 A.3d 149 (Vt. 2016) ("the overwhelming majority of courts" addressing the issue have held that "third-party bad debt does not entitle the retailer or creditor to reclaim sales tax"); *Circuit City Stores, Inc. v. Director of Revenue*, 438 S.W.3d 397 (Mo. 2014) ("the rules regarding who must pay the tax and who is entitled to a refund cannot vary depending on what extra-statutory contractual arrangements a particular retailer chooses to make with a bank"); James Amdur, *Recovery of Sales Taxes Paid on Bad Debts*, 38 A.L.R. 6th 255 (2019).

Moreover, it no longer is good law.[6] See Laws of 2010, 1st Spec. Sess., ch. 23, §§ 1501-03 (superseding *Puget Sound* by disallowing sales tax refunds to anyone other than the "original seller" that "generated the bad debt").

Affirming the Court of Appeals will fulfill the legislative intent that RCW 82.08.037 be interpreted and applied consistent with the uniform bad debt rules of the SSUTA. *See* RCW 82.02.210(3). Those rules prohibit sales tax refunds on bad debts attributable to anything other than a seller's uncollectible sales receipts. *See* SSUTA, § 320.B.

B. Lowe's Does Not Qualify for a B&O Tax Refund Because It Paid Retailing B&O Taxes on Sale Proceeds It Actually Received, Not on Bad Debts

Lowe's is not entitled to a retailing B&O tax refund because it did not incur bad debts on its retail sales. Instead, Lowe's absorbed bad debts incurred by the Bank in exchange for a share of the Bank's profits.

The B&O tax deduction for bad debts provides: "In computing tax there may be deducted from the measure of the tax bad debts, as that term is used in 26 U.S.C. Sec. 166...on which tax was previously paid." RCW 82.04.4284. Like the sales tax, the B&O tax is an excise tax applied to

[6] When the Legislature enacted legislation conforming Washington's sales tax laws with the SSUTA, it allowed the *Puget Sound* decision to die a slow death. *See* Laws of 2004, ch. 153, § 301 (clarifying that the Legislature did not intend to "affect the holding" in *Puget Sound*). For a six-year period, financial institutions were entitled to rely on *Puget Sound* in claiming sales taxes refunds as the assignee of a seller's credit accounts. But both before and after the 2010 amendment, sales tax refunds were available only on seller-financed credit sales.

business transactions. The principal difference between the B&O tax deduction and the sales tax credit for bad debts is that the B&O tax obligation on a retail sale is Lowe's' alone: it pays the tax on its own gross income, not as a tax collector acting on behalf of the State.

Also, the B&O tax applies at different rates to different categories of taxable business activity. That difference is relevant here because Lowe's' federally-qualified bad debts arose from its profit-sharing agreement, which is a separate and distinct business transaction from its retail sales. Each activity is taxable at a different rate and subject to different statutory tax exemptions and deductions. *See* RCW 82.04.250 (retailing); RCW 82.04.290 (service and other activities); *Dep't of Revenue v. J.C. Penney Co., Inc.*, 96 Wn.2d 38, 44-45, 633 P.2d 870 (1981) (analyzing the business activities creating taxing jurisdiction over a seller's financing income separately from those relating to its retail sales).

Lowe's paid retailing B&O taxes on sale proceeds it actually received, not on bad debts. Lowe's' contractual agreement to indemnify the Bank merely reduced the amount of *additional* financing income it received from the Bank. Lowe's was free to share in the profits and losses of the Bank's credit card operations, but it was not free to boost its profit margins from the profit-sharing agreement by taking bad debt deductions on retail sales for which it was paid in full.

C. The Bad Debt Tax Statutes Do Not Violate Lowe's Right to Equal Protection

The Court of Appeals correctly held that the denial of Lowe's' refund claim does not violate its right to equal protection. *Lowe's*, 5 Wn. App. 2d at 240-41. Lowe's is not in the same class as retailers the Legislature intended to benefit. The bad debt tax statutes provide a remedy for retailers that paid excise taxes on sale proceeds they never received. Lowe's actually received the sales taxes it remitted to the State and the sale proceeds on which it paid retailing B&O taxes. Its contractual agreement to reimburse bad debt losses incurred by third-party lenders does not put Lowe's in the same class as retailers that extended credit to customers and were never repaid.

V. CONCLUSION

For the foregoing reasons, the Department asks this Court to affirm the trial court and Court of Appeals.

RESPECTFULLY SUBMITTED this 1st day of April, 2019.

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PROOF OF SERVICE

I certify that on April 1, 2019, I electronically filed this document with the Clerk of the Court using the Washington State Appellate Courts' e-file portal, which will send notification of such filing to all counsel of record at 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.

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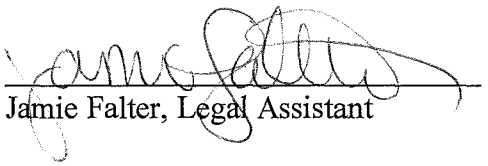

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