DEPARTMENT OF STATE REVENUE

04-20160448R.ODR

Final Order Denying Refund: 04-20160448R
Sales Tax
For Tax Year 2012

NOTICE: IC § 4-22-7-7 permits the publication of this document in the Indiana Register. The publication of this document provides the general public with information about the Indiana Department of Revenue's official position concerning a specific set of facts and issues. The "Holding" section of this document is provided for the convenience of the reader and is not part of the analysis contained in this Final Order Denying Refund.

HOLDING

Business did not establish that its refund claim qualified for the stated reasons. Therefore, the Department's initial denial of refund was correct.

ISSUE

I. Sales Tax–Refund.

Authority: IC § 6-2.5-6-9; *Dept. of State Revenue v. Caterpillar, Inc.*, 15 N.E.3d 579 (Ind. 2014); *SAC Finance, Inc. v. Indiana Dept. of State Revenue*, 24 N.E.3d 541 (Ind. Tax 2014); I.R.C. § 166.

Taxpayer protests the denial of a claim for refund.

STATEMENT OF FACTS

Taxpayer is an Indiana business. In December of 2015, Taxpayer filed a claim for refund of sales tax based on its claim that the sales tax in question arose from consumer loans in which the sales tax had been financed and a portion of the loans, including a portion of the sales tax which had been financed, was listed as a loss on Taxpayer's federal income tax return for the tax year 2012. After review of the claim, the Indiana Department of Revenue ("Department") denied the claim based on the grounds that Taxpayer had not provided sufficient documentation to establish that the circumstances listed in its claim for refund were factually accurate. Taxpayer protested the denial and an administrative hearing was held. This Final Order Denying Refund results. Further facts will be supplied as required.

I. Sales Tax–Refund.

DISCUSSION

Taxpayer protests the Department's denial of a claim for refund of sales tax for the tax year 2012. Taxpayer based its refund claim on the basis that it believed that it was entitled to receive a refund of sales tax which was included in consumer loans which it purchased from a related entity and a portion of which Taxpayer listed as repossession losses on its federal income tax return. The Department's initial determination denying the claim for refund was based on the lack of documentation establishing Taxpayer's position. At hearing, Taxpayer reiterated its position that it was entitled to receive a refund of sales tax which had been listed as repossession losses.

The Department notes that, "[W]hen [courts] examine a statute that an agency is 'charged with enforcing. . .[courts] defer to the agency's reasonable interpretation of [the] statute even over an equally reasonable interpretation by another party.'" *Dept. of State Revenue v. Caterpillar, Inc*., 15 N.E.3d 579, 583 (Ind. 2014). Thus, all interpretations of Indiana tax law contained within this decision shall be entitled to deference.

While it was amended in 2015, for the 2012 tax year IC § 6-2.5-6-9 provided:

> (a) In determining the amount of state gross retail and use taxes which a retail merchant must remit under section 7 of this chapter, the retail merchant shall, subject to subsections (c) and (d), deduct from the retail merchant's gross retail income from retail transactions made during a particular reporting period, an amount equal to the retail merchant's receivables which:
> (1) resulted from retail transactions in which the retail merchant did not collect the state gross retail or use tax from the purchaser;
> (2) resulted from retail transactions on which the retail merchant has previously paid the state gross retail

or use tax liability to the department; and

(3) were written off as an uncollectible debt for federal tax purposes under Section 166 of the Internal Revenue Code during the particular reporting period.

(b) If a retail merchant deducts a receivable under subsection (a) and subsequently collects all or part of that receivable, then the retail merchant shall, subject to subsection (d)(6), include the amount collected as part of the retail merchant's gross retail income from retail transactions for the particular reporting period in which the retail merchant makes the collection.

(c) This subsection applies only to retail transactions occurring after June 30, 2007. As used in this subsection, "affiliated group" means any combination of the following:

(1) An affiliated group within the meaning provided in Section 1504 of the Internal Revenue Code (except that the ownership percentage in Section 1504(a)(2) of the Internal Revenue Code shall be determined using fifty percent (50[percent]) instead of eighty percent (80[percent])) or a relationship described in Section 267(b)(11) of the Internal Revenue Code.

(2) Two (2) or more partnerships (as defined in IC 6-3-1-19), including limited liability companies and limited liability partnerships, that have the same degree of mutual ownership as an affiliated group described in subdivision (1), as determined under the rules adopted by the department. The right to a deduction under this section is not assignable to an individual or entity that is not part of the same affiliated group as the assignor.

(d) The following provisions apply to a deduction for a receivable treated as uncollectible debt under subsection (a):

(1) The deduction does not include interest.

(2) The amount of the deduction shall be determined in the manner provided by Section 166 of the Internal Revenue Code for bad debts but shall be adjusted to exclude:

(A) financing charges or interest;

(B) sales or use taxes charged on the purchase price;

(C) uncollectible amounts on property that remain in the possession of the seller until the full purchase price is paid;

(D) expenses incurred in attempting to collect any debt; and

(E) repossessed property.

(3) The deduction shall be claimed on the return for the period during which the receivable is written off as uncollectible in the claimant's books and records and is eligible to be deducted for federal income tax purposes. For purposes of this subdivision, a claimant who is not required to file federal income tax returns may deduct an uncollectible receivable on a return filed for the period in which the receivable is written off as uncollectible in the claimant's books and records and would be eligible for a bad debt deduction for federal income tax purposes if the claimant were required to file a federal income tax return.

(4) If the amount of uncollectible receivables claimed as a deduction by a retail merchant for a particular reporting period exceeds the amount of the retail merchant's taxable sales for that reporting period, the retail merchant may file a refund claim under IC 6-8.1-9. However, the deadline for the refund claim shall be measured from the due date of the return for the reporting period on which the deduction for the uncollectible receivables could first be claimed.

(5) If a retail merchant's filing responsibilities have been assumed by a certified service provider (as defined in IC 6-2.5-11-2), the certified service provider may claim, on behalf of the retail merchant, any deduction or refund for uncollectible receivables provided by this section. The certified service provider must credit or refund the full amount of any deduction or refund received to the retail merchant.

(6) For purposes of reporting a payment received on a previously claimed uncollectible receivable, any payments made on a debt or account shall be applied first proportionally to the taxable price of the property and the state gross retail tax or use tax thereon, and secondly to interest, service charges, and any other charges.

(7) A retail merchant claiming a deduction for an uncollectible receivable may allocate that receivable among the states that are members of the streamlined sales and use tax agreement if the books and records of the retail merchant support that allocation.

I.R.C. § 166 states:

(a) General rule

(1) Wholly worthless debts

There shall be allowed as a deduction any debt which becomes worthless within the taxable year.

(2) Partially worthless debts

When satisfied that a debt is recoverable only in part, the Secretary may allow such debt, in an amount not in excess of the part charged off within the taxable year, as a deduction.

(b) Amount of deduction

For purposes of subsection (a), the basis for determining the amount of the deduction for any bad debt shall be the adjusted basis provided in section 1011 for determining the loss from the sale or other disposition of property.
[(c) Repealed. Pub. L. 99-514, title VIII, § 805(a), Oct. 22, 1986, 100 Stat. 2361]
(d) Nonbusiness debts
(1) General rule
In the case of a taxpayer other than a corporation–
(A) subsection (a) shall not apply to any nonbusiness debt; and
(B) where any nonbusiness debt becomes worthless within the taxable year, the loss resulting therefrom shall be considered a loss from the sale or exchange, during the taxable year, of a capital asset held for not more than 1 year.
(2) Nonbusiness debt defined
For purposes of paragraph (1), the term "nonbusiness debt" means a debt other than–
(A) a debt created or acquired (as the case may be) in connection with a trade or business of the taxpayer; or
(B) a debt the loss from the worthlessness of which is incurred in the taxpayer's trade or business.
(e) Worthless securities
This section shall not apply to a debt which is evidenced by a security as defined in section 165(g)(2)(C).
(f) Cross references
(1) For disallowance of deduction for worthlessness of debts owed by political parties and similar organizations, see section 271.
(2) For special rule for banks with respect to worthless securities, see section 582.

The Indiana Tax Court addressed Indiana's bad debt statute in *SAC Finance, Inc. v. Indiana Dept. of State Revenue*, 24 N.E.3d 541 (Ind. Tax 2014), in which the court provided:

Having decided that SAC's use of the Market Discount Rules to calculate its federal bad debt deduction under IRC § 166 was proper, the Court turns to whether the Indiana Bad Debt Statute excludes SAC's market discount income from the Indiana bad debt calculation. The Indiana Bad Debt Statute, in relevant part, states:

(a) In determining the amount of [sales] and use taxes to which a retail merchant must remit under [Indiana Code § 6-2.5-6-7], the retail merchant shall, subject to subsections (c)8 and (d), deduct from the retail merchant's gross income from retail transactions made during a particular reporting period, an amount equal to the retail merchant's receivables which ... were written off as uncollectible debt for federal tax purposes under [IRC § 166] during the particular reporting period.
. . . .
(d) The following provisions apply to a deduction for a receivable treated as uncollectible debt under subsection (a):
(1) The deduction does not include interest.
(2) The amount of the deduction shall be determined in the manner provided by [IRC § 166] for bad debts but shall be adjusted to exclude:
(A) financing charges or interest;
(B) sales or use taxes charged on the purchase price;
(C) uncollectible amounts on property that remain in the possession of the seller until the full purchase price is paid;
(D) expenses incurred in attempting to collect any debt; and
(E) repossessed property.
I.C. § 6-2.5-6-9(a)(3), (d)(1)-(2) (footnote added).
The Indiana Bad Debt Statute first requires a retail merchant (or its assignee) to deduct the amount written off as uncollectible debt for federal tax purposes under IRC § 166 from its gross retail income. See I.C. § 6-2.5-6-9(a)(3). Accordingly, the amount written off under IRC § 166 is incorporated into the Indiana calculation solely as the computational starting point in determining Indiana's bad debt deduction.

Indiana Code § 6-2.5-6-9(d) (hereinafter "Subsection (d)") lists the types of revenue that must be excluded from this starting point in calculating the amount of the Indiana bad debt deduction. I.C. § 6-2.5-6-9(d)(1)-(2). Specifically, Subsection (d) requires a taxpayer to exclude amounts that reduce the original sales tax base (*i.e.*, the value of repossessed property or property still in the seller's possession) and that were not part of the original retail sales tax base (i.e., interest, financing charges, sales or use tax, and debt collection expenses) from the difference between gross retail income and the amount of the federal bad debt. (**Emphasis added**).

Taxpayer's federal return did not list any amount on line ten (10) of its 1120S federal income tax return, which is the line for bad debts. Rather, the amount Taxpayer refers to in its claim for refund of sales tax is found on line nineteen (19) of its 1120S, which is the line for other deductions. The amount listed on line nineteen is explained on statement 3 and includes "repossession losses."

After review of the documentation supplied in the course of the protest process, the Department is unable to agree with Taxpayer that the amounts it is claiming qualify for the bad debt deduction provided under IC § 6-2.5-6-9. As provided by the Court in *SAC Finance*, the amount written off as uncollectible debt for federal tax purposes under I.R.C. § 166 from its gross retail income is the starting point. Since repossession losses are not one of the listed categories found under I.R.C. § 166 and since Taxpayer did not list the amounts at issue as bad debt on its federal income tax return for the year at issue, IC § 6-2.5-6-9 does not allow for the deduction of those amounts from the amount of sales tax required to be remitted. Thus, Taxpayer cannot claim the sales tax as a refund as bad debt under IC § 6-2.5-6-9 and the Department's initial denial of the claim for refund of 2012 sales tax was correct. Finally, the Department notes that during the protest process, Taxpayer also included refund materials and arguments for 2013 and 2014 for the same tax for the same reasons. Since the refund claim at issue only listed a refund claim for sales tax paid in 2012, the Department may not address refund claims for 2013 and 2014 in this document.

FINDING

Taxpayer's protest is denied.

Posted: 11/29/2017 by Legislative Services Agency
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