

Cite as Det. No. 01-076, 22 WTD 43 (2003)

BEFORE THE APPEALS DIVISION  
DEPARTMENT OF REVENUE  
STATE OF WASHINGTON

In the Matter of the Petition For Correction of	)	<u>D E T E R M I N A T I O N</u>
Assessment and Refund of	)	
	)	No. 01-076
	)	
...	)	Registration No. . . .
	)	FY . . . /Audit No. . . .
	)	Docket No. . . .
	)	

RULE 196; RCW 82.04.4284; ETA 574: B&O TAX – MEASURE – BAD DEBT DEDUCTION – ASSIGNMENT. A creditor who purchases notes from a retailer upon which the debtor defaults, may not take a credit for B&O taxes paid by the retailer. *Puget Sound National Bank v. Department of Rev.*, 123 Wn.2d 284, 868 P.2d 127 (1994) distinguished.

Headnotes are provided as a convenience for the reader and are not in any way a part of the decision or in any way to be used in construing or interpreting this Determination.

NATURE OF ACTION:

A financing company seeks to offset its business and occupation tax with a bad debt credit for business and occupation tax paid by auto dealers on uncollected car loans.<sup>1</sup>

FACTS:

M. Pree, A.L.J. -- . . . (the taxpayer) financed auto loans through Washington car dealerships. It requested a refund of retailing business and occupation (B&O) tax paid by the dealers on loans they assigned to the taxpayer, upon which the car buyers defaulted. The Audit Division reviewed the taxpayers' books and records, and assessed wholesaling B&O tax on sales of repossessed cars in the above referenced assessment. In addition, the Audit Division denied a credit or refund of retailing B&O tax paid by the dealers on vehicle sales financed by loans assigned to the taxpayer upon which the buyers defaulted. The taxpayer appeals only the denial of the retailing B&O tax credit.

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<sup>1</sup> Identifying details regarding the taxpayer and the assessment have been redacted pursuant to RCW 82.32.410.

Auto purchasers entered installment contracts with dealers. The amount financed included the retail sales tax imposed upon the buyers. Dealers paid the retail sales tax and retailing B&O to the state. The dealers assigned the contracts to taxpayer (nonrecourse, usually at face). Buyers defaulted on the contracts at issue. The taxpayer repossessed the cars and sold them at a loss, taking bad debt losses on its federal income tax returns.

The taxpayer requested a refund of retail sales tax on defaulted contracts, which the Department granted [relying on] the decision in *Puget Sound National Bank v. Department of Rev.* 123 Wn.2d 284, 868 P.2d 127 (1994). The Audit Division allowed the taxpayer to take the sales tax credits on its quarterly returns.

The taxpayer also requested a refund of the retailing B&O tax paid by the dealers on contracts where buyers defaulted.<sup>2</sup> The Audit Division denied a B&O tax credit on the defaulted contracts. The Audit Division explained the *Puget Sound National Bank v. Department of Rev.* and Excise Tax Advisory (ETA) 574 issued by the Department following the Supreme Court's decision, only allowed a sales tax credit. Neither *Puget Sound National Bank*, nor ETA 574 addressed B&O tax. The Audit Division explained the B&O tax was an expense of the dealer, and not part of the amount financed, which was due the taxpayer.

Following the hearing we reviewed three "Dealer Agreements" between the taxpayer and the dealers regarding the transactions at issue.<sup>3</sup> The agreements stated in part:

1. Dealer shall from time to time sell, transfer, and assign to [taxpayer] in accordance with this agreement, chattel paper (hereafter called "Contracts") including, but not limited to, purchase money security agreements and/or retail installment sales contracts as company in its sole discretion shall elect to purchase. The Contracts will arise from the credit sale by Dealer of motor vehicles, accessories, service contracts, insurance (including credit life, accident and health insurance) and related items, and other applicable programs.
2. Dealer agrees that all Contracts shall be executed only on forms approved by [taxpayer]. Dealer will provide at a minimum, the following documents before the company will purchase the contract: the original signed contract; the original signed credit application; the lienholder's copy of the application for title properly completed; physical damage insurance form signed by the customer; co-applicant notice, if required; copy of the manufacturer's invoice; copy of Dealer's bill of sale;

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<sup>2</sup> The dispute does not involve a deduction of these losses from its measure of service B&O tax reported on interest accrued (it would be entitled to a deduction of service B&O based upon what the *taxpayer* reported, not the dealer under Rule 196).

<sup>3</sup> During the hearing representative contracts in effect during the audit period were requested from the taxpayer. Two were signed during the audit period, and one 12/26/00 from which the quoted sections were copied. The quoted language was similar in all three contracts.

signed arbitration agreement and signed Addendum to the Contract, if applicable; and other forms as may be required from time to time by the [taxpayer].

3. All contracts purchased by the [taxpayer] shall be without recourse to the Dealer except as otherwise agreed.

4. As to each Contract offered and sold by dealer to the [taxpayer], dealer agrees and does hereby warrant, represent, and covenant that:

a) the Contract is a valid and enforceable deferred payment obligation for the amount set forth in the contract, arising out of the bona fide sale of goods or rendition of services in the ordinary course of business, which has finally been accepted by the buyer(s) named in the Contract (hereafter referred to as the "buyer," whether one or more) and for which buyer is unconditionally liable without right of offset; . . .

. . .

v) Dealer promptly will forward to the proper authorities all federal, state and local fees and taxes due in connection with the sale and financing of the property.

The taxpayer also provided several copies of actual "WASHINGTON RETAIL INSTALLMENT CONTRACT[S]" signed by car buyers and the dealers. These contracts itemized the purchase price of the vehicle reduced by the down payment and if applicable the trade-in allowance before subtotaling the unpaid balance of the cash price. Below that subtotal was added license/registration fees and on a separate line "Sales Tax." These amounts were then totaled resulting in the "Amount Financed (principal balance)." The contracts did not mention business and occupation taxes.

The contracts did state the dealers intended to sell the contracts to the taxpayer. The back-side of these forms listed the terms and conditions including:

Assignment by seller [dealer]. You [dealer] may transfer your rights under this contract to anyone. If you transfer this contract, the person [taxpayer] or entity to which the contract is assigned will have the security interest and the right to insist that I [buyer] perform my agreements under this contract.

Below, under the heading "ASSIGNMENT AND WARRANTY CONDITIONALLY WITHOUT RECOURSE," the form stated in part:

FOR VALUE RECEIVED the agreement herein assigned (on the reverse side) between the buyer and the undersigned, and all right, title, and interest of the undersigned in and to The Property described, together with all moneys due or to become due and payable thereunder are hereby sold, assigned, and transferred by the undersigned [dealer] its

successors and assigns. This assignment is made WITHOUT RECOURSE in consideration of the following warranties: . . .

The contract form did not mention taxes in other sections.

#### ISSUE:

May a finance company taxpayer take a credit for retailing B&O tax paid on vehicle sales by dealers when the buyers later default on the underlying loans assigned to the finance company from the dealers?

#### DISCUSSION:

B&O tax is imposed upon persons engaged in business activities and measured by the application of rates against the gross proceeds of sales or gross income as the case may be. RCW 82.04.220. Auto dealers making retail sales of cars to consumers pay B&O tax on the gross proceeds of sales per RCW 82.04.250 at the retailing rate of 0.0471 percent. Persons engaged in business activities not otherwise specified in Chapter 82.04 RCW pay B&O tax on their gross income at the service and other activities rate of 1.5%.<sup>4</sup> Financing companies such as the taxpayer pay B&O tax on their gross income measured by interest and financing charges, but not on the return of loan principal, at the service and other activities rate of 1.5%.

RCW 82.04.4284 provides a deduction from the measure of tax, stating:

In computing tax there may be deducted from the measure of tax the amount of credit losses actually sustained by taxpayers whose regular books of account are kept upon an accrual basis.

The dealers paid retailing B&O tax on the amount of vehicle sales at the rate of 0.0471%. The taxpayer argues its facts are identical to those in *Puget Sound National Bank*. Puget Sound Bank had claimed a retail sales tax bad debt deduction, based on the sales tax financed with vehicle purchases, which tax the bank was unable to collect from the defaulting buyers. The Department disallowed the deduction, saying it was only available to sellers and the bank was not a seller. The Washington Supreme Court disagreed, finding that the dealers' status as sellers had been assigned to the bank and that, therefore, the bank could claim the bad debt sales tax deductions. Like Puget Sound National Bank, the taxpayer financed sales tax, which in the case of the defaulted loans, the buyers failed to pay. The Audit Division allowed a credit to the taxpayer for sales tax paid by dealers, which was not collected from buyers.

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<sup>4</sup> When the taxpayer repossessed cars and resold them to dealers (not necessarily the dealer that originally sold the car), it incurred 0.0484% wholesaling B&O tax on the sales under RCW 82.04.270, which was assessed and is not in dispute.

Our issue pertains to the business and occupation tax<sup>[5]</sup> paid by the dealers on car sales. We note from the agreements submitted, the taxpayer financed sales tax, but not business and occupation tax. Sales taxes are obligations of the buyers to be paid to the sellers under RCW 82.08.050. In this case, the buyers signed financing agreements agreeing to pay a specified amount, which amount included sales tax but not B&O tax, to the dealer or its assign (the taxpayer).

In contrast to the sales tax, business and occupation taxes are obligations of the persons engaged in the specific business activities. RCW 82.04.250 imposes retailing B&O [tax] upon the dealers' activity of selling the cars. Because the B&O tax is imposed upon the dealer, and not on the buyer, it is not the buyer's obligation, and consequently the dealers' B&O tax was not included in the retail installment contract obligations of the buyers [which the dealers] assigned to the taxpayer.

Under section (1) of the taxpayer's dealer contracts, the dealers agreed to assign their retail installment contracts. Subsection (4)(a) of each dealer contract (referring to the installment contracts) states, "the contract is a valid and enforceable deferred payment obligation for the amount set forth in the contract." While the amount set forth in the installment contracts clearly includes sales tax (the buyer's obligation), it does not include B&O tax imposed upon the dealer. The amount set forth in the installment contracts includes only the purchase price of the vehicle, license/registration fees, and sales tax. The total, after credits, was the amount financed and assigned to the taxpayer. Therefore, while the sales tax obligation was assigned, B&O tax was not.

For instance, if a buyer purchased a car for \$10,000, sales tax of \$800 would be imposed against the buyer. If the entire amount was financed, the buyer would sign a note for \$10,800. The dealer would pay the \$800 retail sales tax to the state. In addition the dealer would pay \$47.10 retailing B&O tax to the state on the transaction (this is the B&O tax for which the taxpayer seeks a credit). The dealer assigns the \$10,800 note to the taxpayer at face (the taxpayer pays the dealer \$10,800).

If the buyer defaults and pays nothing on the note, under *Puget Sound National Bank*, the taxpayer would be entitled to a[n] \$800 retail sales tax credit representing the amount it financed, but did not collect. The taxpayer also requests a refund of the \$47.10 retailing B&O tax. But unlike the \$800 sales tax, the \$47.10 B&O tax was not assigned to the taxpayer as part of the \$10,800 note. The taxpayer did not finance the B&O tax, only the sales tax. The dealer paid the B&O tax upon the full amount it received for selling the car, \$10,000. The \$47.10 B&O tax at issue was never an obligation of the buyer to either the dealer or the taxpayer. Therefore, unlike the sales tax, because the B&O tax was never assigned, the taxpayer was not entitled to a credit.

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<sup>[5]</sup> This discussion is not intended to imply that a taxpayer would be entitled to a credit for B&O tax paid by another entity by merely including language assigning the B&O tax in the contract. As discussed later, the B&O tax must have been imposed upon the entity seeking the credit.]

The taxpayer requests we consider specific language in *Puget Sound National Bank v. Department of Rev.* 123 Wn.2d 284, 868 P.2d 127 (1994). While *Puget Sound National Bank* did not specifically address B&O tax, the Court stated:

Here, the dealers assigned their installment contracts to the Bank. The Bank thereupon stepped into the dealers' shoes and assumed the dealers' status with respect to all the rights and liabilities related to those contracts. Under RCW 82.08.037 the status of the Bank includes the dealers' prior tax attribute of "making sales at retail" . . . .

123 Wn.2d 284 at 293. RCW 82.08.037 provides the sales tax deduction on bad debts.<sup>6</sup>

The taxpayer's contracts, like those in *Puget Sound National Bank*, specifically included sales taxes in the amounts it financed. Therefore, it logically followed the taxpayer assumed the dealers' status with respect to all the rights and liabilities of the sales taxes. The dealers' B&O taxes were not included in those contracts. The B&O taxes were not buyers' obligations, which could be assigned. Rather they were the dealers' direct obligation on the transaction, an expense.<sup>7</sup> The B&O taxes were not assigned with the other buyer obligations. The dealers' retailing B&O tax could not be used to reduce the taxpayer's other B&O taxes.

#### DECISION AND DISPOSITION:

Taxpayer's petition is denied.

Dated this 31<sup>st</sup> day of May 2001.

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<sup>6</sup> For comparative purposes, RCW 82.08.037 states:

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.

<sup>7</sup> An example of another expense specific to a vehicle sales transaction would be a sales commission, which like the B&O tax would have been a dealer liability related to the vehicle sale, not included in the contract amount assigned to the taxpayer.