DRAFT

STATE BOARD OF EQUALIZATION
STAFF LEGISLATIVE BILL ANALYSIS

Date Introduced:	**01/29/08**	Bill No:	**AB 1839**
Tax:	**Sales and Use**	Author:	**Calderon**
Related Bills:			

BILL SUMMARY

This bill would delete the provisions that allow an affiliate of a retailer, or lender, under specified conditions, to claim a bad debt deduction or refund for sales or use tax reported and paid by a retailer on transactions on accounts held by a lender that are determined to be uncollectible.

ANALYSIS

CURRENT LAW

Sections 6055 and 6203.5 of the Sales and Use Tax Law relieve a retailer from the liability for sales or use tax on transactions that were reported on a retailer's sales and use tax return but which were subsequently found to be worthless and written off for income tax purposes. If a retailer is not required to file income tax returns, the law allows a bad debt deduction or refund if the amount is charged off in accordance with generally accepted accounting principles. The law specifies that if a retailer subsequently collects any amounts for which a bad debt deduction or refund is claimed, the amount so collected is required to be reported and paid to the Board on the first return subsequently filed with the Board.

In addition, with respect to credit sales where retailers sell their accounts receivables without recourse to lenders, or who use financing companies that extend credit to the retailer's customers, Sections 6055 and 6203.5 also do the following:

- Allow entities affiliated with a retailer to claim a bad debt deduction or refund on accounts found worthless that the retailer originally reported as taxable sales on the retailer's sales and use tax returns.
- Allow a lender, as described, or a retailer, to make an election, as specified, to claim a bad debt deduction or refund for accounts reported as taxable by the retailer but subsequently found to be worthless.
- Specify that the contract between the retailer and the lender contain an irrevocable relinquishment of all rights to the account from the retailer to the lender.
- Require the party making the election to claim the deduction or refund to file a claim in a manner prescribed by the Board.
- Specify that if the retailer claimed the bad debt deduction or refund, and collects in whole or in part any account, the retailer shall report that amount on its next sales and use tax return.
- Specify that if the lender claimed a refund or deduction, and collects in whole or in part any account, the lender shall pay the tax in accordance with Section 6451.

This staff analysis is provided to address various administrative, cost, revenue and policy issues; it is not to be construed to reflect or suggest the Board's formal position.

PROPOSED LAW

This bill would amend Sections 6055 and 6203.5 of the Sales and Use Tax Law to delete the provisions that allow an affiliate of a retailer or lender to claim a bad debt deduction for sales or use tax reported and paid by a retailer.

The bill would become operative January 1, 2009.

IN GENERAL

Businesses involved with credit sales often sell their receivables or use "private label credit cards." Accounts receivables are sold with recourse or without recourse. "With recourse" means the purchaser of the debt may give the debt back to, or has recourse against, the retailer if the debt may not be collected. Generally, sellers selling accounts with recourse receive a better price for these accounts receivable than accounts sold without recourse because there is less risk to the purchaser. Accounts receivable sold with recourse and later returned to a retailer are allowable as a bad debt deduction or refund only to the retailer for any portion of the loss on the sale that represents a previously reported taxable sale under the specified conditions.

Accounts sold "without recourse" are debts in which the purchaser of the accounts receivable (assignee) accepts all the risks for collecting the debt and cannot return the debt to the seller. The Sales and Use Tax Law allows either the assignee, lender, or the retailer in such cases to file an election, as specified, with the Board designating which of them may claim the deduction or refund.

BACKGROUND

The provisions that allow an affiliate of a retailer and lender to claim a deduction or refund for sales or use tax paid by the retailer on accounts found to be worthless were added in law by AB 599 (Lowenthal, Stats. 2000, Ch. 600). The sponsors of that measure were GE Capitol and the California Taxpayers' Association

A similar measure was considered in the 1997-98 Legislative Session. That measure, AB 1229 (Migden) was held in the Senate Appropriations Committee.

COMMENTS

1. **Sponsor and purpose.** The author is sponsoring this bill in order to eliminate the ability of affiliates of retailers and lenders to claim a deduction or refund for sales tax on worthless accounts, thereby increasing revenues to reduce California's fiscal imbalance.
2. **Who would this bill affect?** Since enactment of the provision that allowed deductions or refunds to retailers' affiliates and lenders, the Board has received numerous claims for refund for sales or use tax remitted by retailers on accounts found to be worthless by such lenders as credit unions (primarily due to delinquent auto loans) and other automobile financing companies, thrift and loan associations, banks, and various financial services companies. Enactment of this measure would essentially end the refunds to these entities. As a result, these entities may pay less to retailers for "without recourse" accounts, since they could no longer claim refunds for the sales or use tax portion of those accounts.

3. **Rationale of enabling lenders and assignees of debts to claim a refund or deduction.** The bill that allowed lenders to claim a refund or a deduction for worthless accounts (AB 599, Stats. 2000, Ch. 600) was intended to correct an inequity in the law for assignees who essentially assume the role of a retailer when they purchase outstanding receivables without any further recourse against the retailer. Since the retailer is paid on the transaction, it is the assignee that suffers the loss of uncollected debts if the customer does not make all their required payments. Unlike the retailer, however, the assignee was not entitled under the law at that time to claim a bad debt loss even though the assignee virtually steps into the retailer's role on that transaction. AB 599 was and was supported by the Board and enacted by the Legislature as a fair method of correcting the perceived double standard in the law where the state was able to retain sales and use tax dollars that would otherwise be refunded to a retailer had it not sold the debt to a lender or an assignee.
4. **Enactment of this bill would eliminate the considerable staff time devoted to verifying the accuracy of the bad debts claimed.** There is currently considerable audit workload associated with verifying the claims for refund submitted by retailers' affiliates and lenders under current law. This bill would essentially eliminate this workload and enable the Board's field auditors to focus their efforts on other revenue generating activities.
5. **Suggested amendment.** The Board's Regulation 1642, *Bad Debts*, interprets and makes specific the law applicable to claiming deductions or refunds for bad debts. The regulation (both before enactment of AB 599 as well as after) allows a successor to a business that paid full consideration for receivables acquired from the predecessor to claim a bad debt deduction or refund to the same extent that the predecessor is entitled to had the predecessor continued its business. Since this bill is intended to no longer allow lenders to claim a deduction or refund for bad debts incurred by a retailer, the following language is recommended to be added on page 2, line 12, and page 3, line 29:

   > "For purposes of this section, "retailer" shall include a successor who pays full consideration for receivables acquired from the retailer. A "successor" for purposes of the preceding sentence is a purchaser of a business or stock of goods for which liability of the predecessor could be imposed under Chapter 7, Article 7 (commencing with Section 6811)."

COST ESTIMATE

Some administrative costs would be incurred in notifying lenders and affected retailers, amending the Board's regulation, and answering inquiries from taxpayers. These costs would be offset by the savings attributable to the audit time that would no longer be required in verifying the accuracy of claimed bad debt losses.

REVENUE ESTIMATE

Since enactment of AB 599 in 2000, the Board has initiated refunds to qualifying lenders that average $41.6 million annually. Therefore, enactment of this bill would provide an average annual revenue gain as follows:

	Revenue Gain
State (5.00%)	$26,100,000
Fiscal Recover Fund (0.25%)	1,300,000
Local (2.00%)	10,500,000
Special District (0.70%)	3,700,000
Total	$41,600,000

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