

**M e m o r a n d u m**

**To** : Ms. Cynthia Bridges  
Executive Director, MIC: 73

**Date:** July 25, 2013

  
**From** : Randy Ferris, Chief Counsel  
Legal Department, MIC: 83

**Subject** : **Board Meeting, August 13, 2013**  
**Item J - Chief Counsel's Rulemaking Calendar**  
**Regulation 1642, *Bad Debts***

We request your approval to place proposed changes to Sales and Use Tax Regulation 1642, *Bad Debts*, on the Chief Counsel's Rulemaking Calendar for the August 13, 2013, Board meeting. The proposed changes incorporate and make the regulation consistent with amendments to Revenue and Taxation Code (RTC) sections 6055 and 6203.5 made by Assembly Bill No. (AB) 242 (Stats. 2011, ch. 727) and AB 2688 (Stats. 2012, ch. 362).

RTC sections 6055 and 6203.5 allow a retailer to be relieved of liability for the sales or use tax when the measure of tax is represented by accounts receivable that are held by the retailer, which have been found to be worthless and charged off for income tax purposes or, if the retailer is not required to file income tax returns, charged off in accordance with generally accepted accounting principles. These sections also allow a retailer or lender to claim a deduction or refund for tax the retailer has previously reported or paid on the portion of accounts receivable, held by the lender, which is written off as worthless. However, before the enactment of AB 242, a retailer or lender could only claim a deduction or refund for accounts receivable held by the lender if, prior to making such claim, the retailer and the lender filed an election form with the Board, signed by both parties, designating which party was entitled to claim the deduction or refund for the portion of the accounts receivable which is written off as worthless.

AB 242 amended RTC sections 6055 and 6203.5 to remove the requirement that the election form be filed with the Board, and instead required that the lender and retailer prepare, sign, and retain the election form prior to claiming the deduction or refund.

AB 2688 amended RTC sections 6055 and 6203.5 to remove the requirement that an election form be prepared, signed, and retained by the lender and the retailer *prior* to claiming a deduction or refund.

We will request the Board's authorization to make the changes to Sales and Use Tax Regulation 1642 to incorporate and make the regulation consistent with the amendments to RTC sections 6055 and 6203.5 made by AB 242 and AB 2688 and make minor grammatical

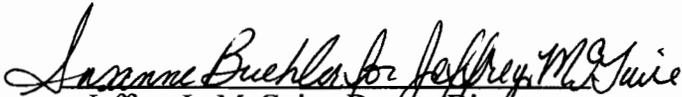
edits under California Code of Regulations, title 1, section (Rule) 100, without the normal notice and public hearing process. The changes are appropriate for processing under Rule 100 because they make the regulation consistent with the statutory changes made by AB 242 and AB 2688, make other minor grammatical edits, and do not materially alter any requirement, right, responsibility, condition, prescription or other regulatory element of any California Code of Regulations provision.

Attached is a strikeout and underlined version of the regulation illustrating the proposed changes.

If you have any questions regarding this request, please let me know or contact Mr. Bradley Heller at 916-323-3091.

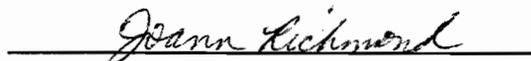
Approved:

Approved:

  
Jeffrey L. McGuire, Deputy Director  
Sales and Use Tax Department

  
Cynthia Bridges, Executive Director

BOARD APPROVED  
At the 8/13/13 Board Meeting

  
Joann Richmond, Chief  
Board Proceedings Division

Attachments

- cc: Mr. Jeffrey L. McGuire MIC: 43
- Ms. Joann Richmond MIC: 80
- Mr. Robert Tucker MIC: 82
- Ms. Susanne Buehler MIC: 92
- Mr. Bradley M. Heller MIC: 82
- Ms. Kirsten Stark MIC: 50
- Mr. Clifford Oakes MIC: 50
- Ms. Kim Rios MIC: 50

Text of Proposed Changes to  
California Code of Regulations, Title 18, Section 1642

**Regulation 1642. BAD DEBTS**

*Reference:* Sections 6055 and 6203.5, Revenue and Taxation Code.

**(a) IN GENERAL.** A retailer is relieved from liability for sales tax (section 6055 of the Revenue and Taxation Code) or from liability to collect use tax (section 6203.5 of the Revenue and Taxation Code) insofar as the measure of the tax is represented by accounts found worthless and charged off for income tax purposes (which include circumstances where the retailer's income is reported on a related person's income tax return and the bad debt is charged off on that return) or, if the retailer is not required to file income tax returns and the retailer's income is not reported on another person's return, charged off in accordance with generally accepted accounting principles. A retailer may claim a bad debt deduction provided that the sales tax, or amount of use tax, was actually paid to the state.

This deduction should be taken on the return filed for the period in which the amount was found worthless and charged off for income tax purposes or, if the retailer is not required to file income tax returns, charged off in accordance with generally accepted accounting principles.

Failure to take the deduction on the proper return will not in itself prevent the allowance of a refund measured by an amount for which a retailer could have taken a timely deduction provided a claim for refund is filed with the Board within the limitation periods specified in section 6902 of the Revenue and Taxation Code.

**(b) AMOUNT SUBJECT TO DEDUCTION.**

(1) **TAXABLE RECEIPTS.** If the amount of an account found to be worthless and charged off is comprised in part of nontaxable receipts such as interest, insurance, repair, or installation labor and in part of taxable receipts upon which tax has been paid, a bad debt deduction may be claimed only with respect to the unpaid amount upon which tax has been paid. In determining that amount, all payments and credits to the account may be applied ratably against the various elements comprising the amount the purchaser contracted to pay (pro rata method), may be applied as provided in the contract of sale (contract method), or may be applied by another method which reasonably determines the amount of the taxable receipts (alternative method). When claiming a bad debt deduction or refund using an alternative method, the retailer must include a clear explanation of that method along with the claiming of the deduction or refund. After having applied payments and credits using one method and claiming a deduction or refund based on such method, a retailer shall not thereafter reapply the payments or credits using another method with respect to such losses previously claimed.

(2) **EXPENSES OF COLLECTION.** No deduction is allowable for expenses incurred by the retailer in attempting to enforce collection of any account receivable, or for that portion of a debt recovered that is retained by or paid to a third party as compensation for services rendered in collecting the account.

**(c) REPORTING.** All retailers must report sales tax liability on an accrual basis. Bad debt deductions will not be disallowed solely for the reason that a retailer is on a cash reporting basis for income tax purposes.

**(d) WORTHLESS ACCOUNT SUBSEQUENTLY COLLECTED.** If any account found worthless and charged off is thereafter collected by the retailer, in whole or in part, the taxable percentage of the amount so collected shall be included in the first return filed after such collection and tax shall be paid on such amount with the return. The same percentage of the account which the retailer claimed as an allowable bad debt deduction or refund shall be used to determine the taxable percentage of the recovery. The taxable percentage of any amounts received from a third party for the sale of an account after the retailer has found them to be worthless and has claimed a bad debt deduction or refund are regarded as amounts subsequently collected for purposes of this provision, and the retailer must include such amounts in the first return filed after receipt of such amounts and pay tax thereon.

**(e) RECORDS.** In support of deductions or claims for refund for bad debts, retailers must maintain adequate and complete records showing:

- (1) Date of original sale.
- (2) Name and address of purchaser.
- (3) Amount purchaser contracted to pay.
- (4) Amount on which retailer paid tax.
- (5) The jurisdiction(s) where the local taxes and, when applicable, district taxes were allocated.
- (6) All payments or other credits applied to account of purchaser.
- (7) Evidence that the uncollectible portion of gross receipts on which tax was paid actually has been legally charged off as a bad debt for income tax purposes (whether or not the income tax return has yet been filed) or, if the retailer is not required to file income tax returns and the retailer's income is not reported on another person's return, charged off in accordance with generally accepted accounting principles.

(8) The taxable percentage of the amount charged off as a bad debt properly allocable to the amount on which the retailer reported and paid tax. (See Appendix 1.)

**(f) ALLOWABLE METHODS OF COMPUTING LOSS.**

(1) **IN GENERAL.** When there is a repossession, a bad debt deduction is allowable only to the extent that the retailer sustains a net loss of gross receipts upon which tax has been paid. This will be when the amount of all payments and credits allocated to the purchase price of the merchandise, including the wholesale value of the repossessed article, is less than that price. If the pro rata method is used to apply payments, a retailer incurs an allowable bad debt deduction if the wholesale value of the repossessed merchandise is less than the net contract balance (after excluding unearned insurance and finance charges) at the date of repossession. If the contract method is used to apply payments, a retailer incurs an allowable bad debt deduction if the wholesale value of the repossessed merchandise is less than the net contract balance at the date of repossession. An alternative method of computing a bad debt loss may be used subject to approval by the Board.

(2) **METHOD OF COMPUTING LOSS - PRO RATA METHOD.**

**(A) LOSS PER RECORDS.** The loss per records is the bad debt loss the retailer writes off for income tax purposes. An estimate of bad debt losses based in part upon the history of the business or industry averages, may not be used to claim bad debt deductions or refunds for sales and use tax purposes.

**(B) TAXABLE PORTION OF LOSS PER RECORDS.** Only that portion of a bad debt loss attributable to the amount on which the retailer paid tax may be used to claim a bad debt deduction or refund for sales and use tax purposes. Even an account with all sales subject to tax may include some amounts on which tax was not paid, such as the tax or tax reimbursement charged to the consumer which is included in the account balance. The percentage of loss on which tax was paid for an account which is secured by the merchandise purchased, or which represents a single purchase of a significant amount, should be calculated on an actual basis. The percentage of loss on which tax was paid for accounts involving a large volume of small transactions may be calculated based on an analysis of the composition of the accounts receivable. All accounts of the retailer for which this calculation is made should use the same method of applying payments for the calculation (e.g., use FIFO for all accounts or use LIFO for all accounts). Examples using the pro rata method are attached as Appendices 1 and 2.

(3) **METHOD OF COMPUTING LOSS CONTRACT METHOD.** The allowable bad debt deduction is calculated by subtracting all payments and credits from the purchase price of the merchandise pursuant to the method of applying payments set forth in the applicable contract(s) with the customer and, to the extent the contract is silent on the method of applying payments, the loan accounting systems used by the retailer in the ordinary course of business, and from that amount subtracting the proceeds of the sale of any repossessed merchandise in accordance with (4) below.

(4) **DETERMINING THE WHOLESALE VALUE OF REPOSSESSED MERCHANDISE.** The wholesale value of repossessed merchandise must be determined in order to calculate the allowable bad debt deduction, if any, for the account. When the retailer sells the repossessed merchandise to a reseller in an arm's length transaction, the amount the retailer receives for the sale, less the direct cost of reconditioning the property prior to that sale and direct auction expenses paid to a third party, is the wholesale value. Otherwise, other sources must be used to determine the wholesale value. In the case of automobiles, industry-recognized price guides are generally the best source of such information. Adjustments should be made to the published wholesale prices in those instances where the automobile is in other than average condition.

Establishing the wholesale value of other types of repossessed merchandise, such as jewelry, furniture, appliances, etc., presents a more difficult problem if the retailer does not sell the merchandise to a reseller in an arm's length transaction. Each case must be considered on its own merits. Generally, if the retailer places the repossessed property into resale inventory, the retailer should use the amount at which the merchandise is recorded in resale inventory as its wholesale value. This amount should not, however, include any costs of repossessing, reconditioning, or other expense to put the merchandise in saleable condition.

(5) **CONSOLIDATION OF NUMEROUS REPOSSESSED ITEMS.** Retailers who have several repossessions each reporting period will find it convenient and time saving to consolidate the pertinent data. When this is done, only one calculation for each set of transactions need be made to compute the allowable deduction. The consolidations may be made by using 15-column working paper with one column for each of the elements required to compute the deduction (see Appendix 2).

Only those repossessions on which a loss is incurred should be scheduled. The retailer may quickly determine whether a particular transaction should be scheduled by comparing the net payoff with the wholesale value of the merchandise. If the net payoff is greater, a loss has been suffered and the transaction should be scheduled.

**(g) BAD DEBT LOSSES OTHER THAN REPOSSESSIONS.** Allowable bad debt deductions or refunds also may arise from sales made on an open account or on an unsecured installment basis. The deduction or refund should be computed in substantially the same manner as those involving repossessions (i.e., by prorating all

payments or credits between the sales price of the merchandise on which the retailer paid tax and the nontaxable charges or by applying all payments and credits as provided in the contract of sale and, if the contract is silent, the loan accounting systems used by the retailer in the ordinary course of business). No deduction or claim for refund will be allowed in any period subsequent to the period in which a bad debt deduction is taken based on a method of calculating the bad debt deduction different from that originally used in calculating the bad debt deduction.

**(h) SPECIAL SITUATIONS.**

**(1) BAD DEBT DEDUCTIONS FOR PERSONS OTHER THAN THE RETAILER OR LENDER.**

**(A)** A successor who pays full consideration for receivables acquired from the predecessor is entitled to a bad debt deduction to the same extent that the predecessor would have been entitled had the predecessor continued the business. A "successor" for purposes of this provision is one who is required by Revenue and Taxation Code section 6811 to withhold sufficient of the purchase price of the subject business to cover amounts due from the seller of the business under the Sales and Use Tax Law. A predecessor may not claim a bad debt deduction for any transaction or account for which a successor is entitled to a bad debt deduction under this provision.

**(B)** Except as provided in subdivision (h)(1)(A) and subdivision (i), a purchaser of receivables cannot claim a bad debt deduction or refund for accounts which are not collected.

**(C)** A retailer who sells receivables with recourse so that the retailer will bear any bad debt loss on them is entitled to a bad debt deduction to the same extent as if the receivables had not been sold. The fact that a retailer sells receivables at a discount, however, with or without recourse, does not in itself entitle the retailer to a bad debt deduction to the extent of the discount.

**(2) BAD DEBTS OF CONSTRUCTION CONTRACTORS.**

A construction contractor who is a consumer of materials or fixtures, or both, under Sales and Use Tax Regulation 1521 cannot claim a bad debt deduction or refund with respect to such materials or fixtures. A United States construction contractor as defined in subdivision (a)(3) of Regulation 1521 is always the consumer of both materials and fixtures, and thus can never claim a bad debt deduction or refund with respect to such materials or fixtures. A construction contractor, other than a United States construction contractor, is generally the consumer of materials, and thus may claim a bad debt deduction with respect to materials only when the contractor is regarded as selling those materials under subdivision (b)(2)(A)2. of Regulation 1521. A construction contractor, other than a United States construction contractor, is the retailer of fixtures and thus may claim a bad debt deduction or refund with respect to its retail sales of such fixtures. A construction contractor incurring a bad debt loss for which it is entitled to a bad debt deduction or refund as just explained must claim the deduction or refund in the same manner as those resulting from other types of taxable retail sales of tangible personal property.

**(3) ENTITY AFFILIATED WITH RETAILER.** The provisions of this subdivision (h)(3) apply only with respect to bad debt losses incurred on accounts created as a result of retail sales of tangible personal property for which the retailer remitted California sales or use tax on or after January 1, 2000.

**(A)** If a retailer wishes to assign to a person who is its affiliated entity under section 1504 of Title 26 of the United States Code the right to claim a deduction or refund for the amount of bad debts for which the retailer is otherwise entitled to a deduction or refund, the retailer and the affiliated entity must file an election with the Board prior to the affiliated entity's claiming of any deduction or refund. This election filed with the Board must include all the following elements:

1. The name, address, and seller's permit number of the retailer who reported or will report the tax; and the name, address, and seller's permit number of the affiliated entity of the retailer to whom the assignment is made.

2. A statement clearly specifying that the affiliated entity is entitled to any (and all) deductions or refunds as a result of any bad debt losses charged off on the account(s) covered by the election and the effective date of that election, and a statement that the retailer relinquishes all claims to such deductions or refunds.

3. A list of accounts to which the election pertains.

4. The agreement of the retailer to furnish any and all documentation required by the Board to support the claiming of deductions or refunds by the affiliated entity.

5. The acknowledgement by both the retailer and its affiliated entity that the Board may disclose relevant confidential information to all parties involved in order to support and confirm any deductions or refunds claimed.

6. A statement that the election may not be amended or revoked unless a new election signed by both the retailer and its affiliated entity is filed with the Board.

7. The acknowledgement by the affiliated entity that it cannot further assign the right to claim a deduction or refund for bad debts charged off on the account.

8. The dated signatures of the retailer and its affiliated entity, or their authorized representatives. If a copy of the signed election is filed with the Board rather than the original, the affiliated entity must retain the election with the original signatures.

(B) The term "retailer" as used in this regulation (except as used in subdivisions (h) and (i)) includes an entity affiliated with a retailer under section 1504 of Title 26 of the United States Code with respect to those accounts for which the affiliated entity is the person entitled to the bad debt deduction or claim pursuant to an election filed under this subdivision (h)(3).

**(i) BAD DEBTS INCURRED IN CONNECTION WITH ACCOUNTS HELD BY LENDERS.** The provisions of this subdivision (i) apply only with respect to bad debt losses incurred on accounts created as a result of retail sales of tangible personal property for which the retailer remitted California sales or use tax on or after January 1, 2000.

(1) **LENDER DEFINED.** A "lender" for purposes of this regulation is defined as any of the following:

(A) A person who holds an account which that person purchased without recourse directly from a retailer who reported California sales or use tax with respect to the sales of tangible personal property for which credit was extended under the retail account.

(B) A person who holds an account without recourse pursuant to that person's contract directly with a retailer who reported California sales or use tax with respect to the sales of tangible personal property for which credit was extended under the retail account.

(C) A person who is either an affiliated corporation (or affiliated entity electing to be taxed as a corporation) under section 1504 of Title 26 of the United States Code or an assignee of a person described in subdivision (i)(1)(A) or (i)(1)(B). A person is a "lender" under this subdivision (i)(1)(C) only if an election is filed prepared and retained under subdivision (i)(4).

(2) **CONDITIONS TO CLAIMING DEDUCTION OR REFUND.** With respect to an account held by a lender without recourse, a deduction or refund may be claimed for bad debt losses on the account only if all of the following conditions are met:

(A) ~~No~~ deduction or refund was not previously claimed or allowed on any portion of the account.

(B) The account has been found worthless and charged off by the lender for income tax purposes (which include circumstances where the lender's income is reported on a related person's income tax return and the bad debt is charged off on that return) or, if the lender is not required to file income tax returns and the lender's income is not reported on another person's return, charged off in accordance with generally accepted accounting principles.

(C) The contract between the retailer and the lender under which the lender has the right to the account contains an irrevocable relinquishment of all rights to the account from the retailer to the lender.

(D) The account is for sales for which the retailer remitted California sales or use tax on or after January 1, 2000.

(E) The retailer and the lender file prepare and retain an election ~~with the Board, signed by both parties,~~ which contains the elements specified in subdivision (i)(3) and ~~which designates either the retailer or the lender as the person which party is~~ entitled to claim any deduction or refund under this regulation for tax previously paid by the retailer measured by the amount of the account found to be worthless and charged off. ~~No deduction or refund can be claimed until this election is filed with the Board.~~

(3) **ELECTION BETWEEN RETAILER AND LENDER.**

(A) In order for the retailer or the lender to claim a deduction or refund for bad debt losses from an account held by the lender without recourse, the retailer and the lender must file prepare and retain an election ~~with the Board~~ designating which of them may claim such deduction or refund. The election may be in any form, including an existing contract between the retailer and the lender, so as long as the election contains the following elements:

1. The name, address, and seller's permit number of the retailer who reported or will report the tax and the name, address, and seller's permit number, if any, of the lender to whom the account(s) is assigned.

2. An agreement that the retailer relinquishes all rights to the account to the lender.

3. A statement clearly specifying whether the retailer or the lender is entitled to claim any (and all) deductions or refunds as a result of any bad debt losses charged off by the lender for the account(s) covered by the election.

the effective date of that election, and a statement that the other party relinquishes all rights to claiming such deductions or refunds.

4. A list of accounts to which the election pertains. If the election is a blanket election for all accounts assigned without recourse by the retailer to the lender or all accounts held by the lender without recourse pursuant to the lender's contract directly with the retailer, the election must so state.

5. The agreement of both the retailer and the lender to furnish any and all documentation requested by the Board to support the deductions or refunds claimed.

6. The acknowledgement by both the retailer and the lender that the Board may disclose relevant confidential information to all parties involved in order to support and confirm any deductions or refunds claimed.

7. If the lender is the person entitled to claim any deduction or refund for bad debts on the account, the Certificate of Registration – Lender account number of the lender. If the lender does not yet hold such a registration, the agreement of the lender that it will apply for the Certificate of Registration – Lender no later than on the date the lender first claims a deduction or refund for bad debts charged off on the account.

8. A statement that the election may not be amended or revoked unless a new election, signed by both parties, is prepared and retained by the retailer and the lender is filed with the Board.

9. The date of the election and the signatures of the retailer and the lender, or their authorized representatives. If a copy of the signed election is filed with the Board rather than the original, the person with the right under the election to claim the bad debt deduction or refund must retain the election with the original signatures. An election may be signed in counterparts, and its filing would be regarded as perfected as of the filing of the second signed counterpart, provided each counterpart is identical except for the signature and date of the signature. If copies of the signed counterparts are filed with the Board, the person with the right under the election to the bad debt deduction or refund must retain all counterparts with the original signatures not filed with the Board.

(B) The term "retailer" as used in this regulation (except as used in subdivisions (h) and (i)) includes a lender with respect to those accounts for which the lender is the person entitled to the bad debt deduction or claim pursuant to an election filed under this subdivision (i)(3).

#### (4) ELECTION BETWEEN LENDER AND AFFILIATED ENTITY OR OTHER ASSIGNEE.

(A) If a person who is a lender under subdivision (i)(1)(A) or (i)(1)(B) and who has the right to claim any deduction or refund for bad debts the lender charges off on the account wishes to assign to a person who is its affiliated entity under section 1504 of Title 26 of the United States Code or to some other assignee the right to claim any deduction or refund for the amount of bad debts charged off on the account, the lender and the affiliated entity or other assignee must file prepare and retain an election signed by both parties with the Board prior to the affiliated entity's or other assignee's claiming of any deduction or refund. The election filed with the Board may be in any form, but must include all the following elements:

1. The name, address, and seller's permit number of the retailer who reported or will report the tax; the name, address, seller's permit number, if any, and Certificate of Registration – Lender account number, if any, of the lender under subdivision (i)(1)(A) or (i)(1)(B) making the assignment; and the name, address, seller's permit number, if any, and Certificate of Registration – Lender account number, if any, of the person to whom the assignment is made under subdivision (i)(1)(C).

2. A copy of the election between the retailer and the lender under which the lender has the right to any (and all) deductions or refunds as a result of any bad debt losses charged off by the lender on the account(s). If that election has not yet been prepared filed with the Board, then that election must be filed prepared along with the election between the lender and its affiliated entity or other assignee. If the elections with the original signatures was retained by the lender rather than filing it with the Board, that election must either be filed with the Board or must be retained by the affiliated entity or other assignee.

3. A statement clearly specifying that the affiliated entity or other assignee is entitled to any (and all) deductions or refunds as a result of any bad debt losses charged off on the account(s) covered by the election and the effective date of that election, and a statement that the lender under subdivision (i)(1)(A) or (i)(1)(B) relinquishes all claims to such deductions or refunds.

4. A list of accounts to which the election pertains. If the election is a blanket election for all accounts held by the lender, the election must so state.

5. The agreement of the lender to furnish any and all documentation required by the Board to support the claiming of deductions or refunds by the affiliated entity or other assignee.

6. The acknowledgement by both the lender and its affiliated entity or other assignee that the Board may disclose relevant confidential information to all parties involved in order to support and confirm any deductions or refunds claimed.

7. If the affiliated entity or other assignee does not yet hold a Certificate of Registration - Lender, the agreement that it will apply for that certificate no later than on the date it first claims a deduction or refund for bad debts charged off on the account.

8. The acknowledgement by the affiliated entity or other assignee that it cannot further assign the right to claim a deduction or refund for bad debts charged off on the account.

9. A statement that the election may not be amended or revoked unless a new election, signed by both parties, is prepared and retained by both the lender and the affiliated entity or assignee is filed with the Board.

10. The date of the election and the signatures of the lender and the affiliated entity or other assignee, or their authorized representatives. ~~If a copy of the signed election is filed with the Board rather than the original, the person with the right under the election to claim the bad debt deduction or refund must retain the election with the original signatures. An election may be signed in counterparts, and its filing would be regarded as perfected as of the filing of the second signed counterpart, provided each counterpart is identical except for the signature and date of the signature. If copies of the signed counterparts are filed with the Board, the person with the right under the election to the bad debt deduction or refund must retain all counterparts with the original signatures not filed with the Board.~~

(B) The term "retailer" as used in this regulation (except as used in subdivisions (h) and (i)) includes an entity affiliated with a lender under section 1504 of Title 26 of the United States Code, or other assignee, with respect to those accounts for which the affiliated entity or other assignee is the person entitled to the bad debt deduction or claim pursuant to an election filed under this subdivision (i)(4).

#### (5) REGISTRATION, RETURNS, CLAIMS FOR DEDUCTION AND REFUNDS, AND PAYMENT OF TAX.

(A) A retailer who has the right to claim deductions or refunds for bad debts charged off by a lender on an account held by that lender pursuant to an election filed under subdivision (i)(3) shall claim those deductions or refunds under the provisions of this regulation in the same manner as if the retailer held the account itself.

(B) Without regard to whether a lender holds a seller's permit for its own sales of tangible personal property, a lender who has the right to claim deductions or refunds for bad debts charged off on accounts pursuant to an election filed under subdivision (i)(3) and, if applicable, subdivision (i)(4), shall register with the Board for a Certificate of Registration - Lender no later than the date on which it first claims such a deduction or refund.

(C) A lender who has the right to claim deductions or refunds for bad debts charged off pursuant to an election filed under subdivision (i)(3) and, if applicable, subdivision (i)(4), is entitled to the same amount of deduction or refund, calculated in the same manner under the provisions of this regulation, as if the lender were the retailer who had sold the tangible personal property for which the retailer had reported and paid tax. If the lender has provided the name, address, and seller's permit number of the retailer responsible for paying the tax, in determining whether to grant the lender's claim for deduction or refund, the Board shall regard the retailer as having paid the applicable tax due unless the Board establishes otherwise. (Regardless of the Board's action on the lender's claim for deduction or refund, a retailer who failed to pay the applicable tax due remains liable for that tax.)

(D) A lender who claims a deduction or refund for bad debts charged off shall be liable for tax on the taxable percentage of worthless accounts subsequently collected under subdivision (d), including amounts received for the sale of accounts for which the lender has claimed a bad debt deduction or refund.

(E) A lender who has a seller's permit for its own sales of tangible personal property may not commingle the claiming of its deductions pursuant to an election under subdivision (i)(3) and, if applicable, subdivision (i)(4), with any bad debt deductions related to its own sales of tangible personal property but must instead report such deductions on a separate return or schedule in the form specified by the Board. If the lender files a schedule attached to its sales and use tax return, it may apply the amount of its deduction calculated on that separate schedule against its liability for sales and use tax. To the extent that the deduction is not fully exhausted when applied to the lender's own sales and use tax liability, the lender may file a claim for refund.

(F) The filing by a lender of a claim for deduction or refund for bad debts on accounts covered by this subdivision (i) is not valid if an election pursuant to subdivision (i)(3) and, if applicable, subdivision (i)(4), has not been is not prepared and retained that is signed by both parties filed with the Board. ~~If a lender files a claim for deduction or refund and the applicable election(s) is filed thereafter, the claim for deduction or refund will be regarded as having been filed on the date of the filing of the election(s).~~

(G) A lender holding a Certificate of Registration - Lender shall file a return in a form specified by the Board to report the taxable percentage of recoveries and claim losses on accounts covered by an election pursuant to

subdivision (i)(3) and, if applicable, an election pursuant to subdivision (i)(4). This return shall be filed on a quarterly basis unless otherwise specified by the Board. The return shall include the taxable percentage of the amount of any recoveries for which the lender is liable for tax under subdivision (i)(5)(D). The lender may offset the amount of tax for which it would otherwise be entitled to a bad debt refund for the reporting period against the amount of tax for which it is liable for the taxable percentage of recoveries received during that same reporting period. The lender must file a return without regard to whether the lender received any net recoveries of previously claimed bad debts in the filing period. If the lender files a return under a seller's permit it holds for its own sales of tangible personal property, the lender must file a separate schedule to report the taxable percentage of its bad debt recoveries and losses on accounts covered by an election pursuant to subdivision (i)(3) and, if applicable, an election pursuant to subdivision (i)(4), in a form specified by the Board, as an attachment to the lender's sales and use tax return rather than filing a separate return for such recoveries and losses.

(H) A lender claiming a deduction or refund for bad debts, or reporting tax on recoveries for accounts for which it previously claimed a bad debt deduction or refund, must properly allocate the local and district taxes. If the transactions were approved by the lender on a transaction-by-transaction basis or the lender has the necessary information to do so, local and district taxes should be allocated on an actual basis. The lender may allocate local and district taxes related to all other accounts on an appropriate basis subject to approval by the Board.

# Appendix 1

## EXAMPLE OF COMPUTING ALLOWABLE BAD DEBT DEDUCTION FOR A REPOSSESSED VEHICLE USING PRO RATA METHOD

### I. Step One. Compute the Repossession Loss Per Records

a.	Retail sales price		\$12,000	
b.			<u>230</u>	
	<i>Taxable fees (i.e., doc/smog)</i>			
c.	Total amount subject to tax		12,230	(a+b)
d.	Sales tax (6%)	734		(c*.06)
e.	License fees	240		
f.		<u>0</u>		
	<i>Other non-taxables</i>			
g.	Total non-taxable charges		974	(d+e+f)
h.	<i>Total sales price</i>		13,204	(c+g)
i.	Down payment		<u>2,000</u>	
j.	Balance on contract		11,204	(h-i)
k.	Finance charges/accrued interest		<u>3,000</u>	
l.	Total contract value		14,204	(j+k)
m.	Payments received on contract		<u>2,100</u>	
n.	Balance on date of repossession		12,104	(l-m)
o.	Unearned finance charges		<u>2,750</u>	
p.	Net contract balance		9,354	(n-o)
q.	Value of repossession		<u>6,000</u>	
r.	<i>Repossession loss per records</i>		<u><b>\$ 3,354</b></u>	

### II. Step Two. Compute the Taxable Percentage of Loss.

This is done by dividing the total amount subject to tax (line c) by the total sales price (line h).

$$12,230 / 13,204 = 92.62\%$$

### III. Step Three. Compute the Allowable Deduction.

This is done by multiplying the taxable percentage of loss (step Two) by the repossession loss per records (step One).

$$92.62\% * 3,354 = \underline{\$3,106.47}$$

## Appendix 2

### CONSOLIDATION OF ALLOWABLE BAD DEBT DEDUCTION FOR MULTIPLE REPOSSESSED VEHICLES USING PRO RATA METHOD

(A)	(B)	(C)	(D)	(E)	(F)	(G)	(H)	(I)	(J)	(K)	(L)	(M)	(N)
Date Repos- session	of Car #	Sales Price Mdse <sup>A</sup>	Sales Tax (6%)	License Fee	Insurance (Net) <sup>B</sup>	Total Sales Price	Down Payment	Balance to Finance	Finance Charges (Net) <sup>C</sup>	Net Contract Balance	Payment s	Value of Repos- - sessio n	Repos- session Loss Per Records
			[C*.06]			[C...F]		[G-H]		[I+J]			[K-L-M]
09-30-00	507	\$ 9,000	\$ 540	\$160	\$200	\$ 9,900	\$2,000	\$ 7,900	\$ 400	\$ 8,300	\$1,900	\$ 5,000	\$1,400
10-27-00	521	8,000	480	140	160	8,780	1,700	7,080	350	7,430	1,650	4,400	1,380
11-04-00	540	6,000	360	110	120	6,590	1,300	5,290	260	5,550	1,250	3,300	1,000
12-09-00	575	5,000	300	90	100	5,490	1,100	4,390	200	4,590	1,000	2,700	890
<b>Totals</b>		<u>\$28,000</u>	<u>\$1,680</u>	<u>\$500</u>	<u>\$580</u>	<u>\$30,760</u>	<u>\$6,100</u>	<u>\$24,660</u>	<u>\$1,210</u>	<u>\$25,870</u>	<u>\$5,800</u>	<u>\$15,400</u>	<u>\$4,670</u>
		(1)				(2)							(3)

Computation of the Taxable Percentage of Loss:

$$\frac{\$28,000^{(1)}}{\$30,760^{(2)}} = 91.03\%$$

$$\frac{\$28,000}{\$30,760}$$

Computation of Allowable Deduction:

$$91.03\% \times \$4,670^{(3)} = \$4,251$$

<sup>A</sup> Includes taxable amounts, such as doc and smog fees.

<sup>B</sup> Original insurance charge less rebate of unearned premium.

<sup>C</sup> Total finance charges per contract less unearned charges.

