

INITIAL DISCUSSION FOR ISSUE PAPER

Proposed Regulatory Changes to Clarify Bad Debt Deductions

Regulation 1642, Bad Debts

Issue

Should Regulation 1642, *Bad Debts*, be amended to incorporate the statutory changes in Assembly Bill 599 (“AB 599”)?

Background

Revenue and Taxation Code (“RTC”) section 6051 imposes sales tax on retailers for the privilege of selling tangible personal property at retail within the state. RTC section 6201 imposes use tax for the storage, use, or other consumption in this state of tangible personal property purchased from any retailer in a transaction that was not subject to the sales tax. The sales tax is imposed on the retailer but is generally passed through to the consumer as sales tax reimbursement. (Civ. Code § 1656.1, Reg. 1700(a)(1).) The use tax is imposed on the consumer; however, any retailer engaged in business in this state is required to collect the use tax and remit it to the state. (RTC §§ 6202, 6203)

Since 1957, the Sales and Use Tax Law has provided tax relief for retailers that hold accounts receivable that had been included in the measure of tax, and become worthless prior to full payment of the account. Added to the RTC by Stats. 1957, p. 1938, RTC sections 6055 and 6203.5 permit retailers to claim a deduction or refund with respect to that portion of the sales price of tangible personal property on which tax (sales or use) had been paid but is not collected from the consumer. The ability to claim the deduction or refund arises when the retailer writes off the debt for income tax purposes. In 1970, each section was amended to relieve a retailer from tax liability in cases where, although not required to file income tax returns, the retailer charged off worthless accounts in accordance with generally accepted accounting principles. (Stats. 1970, p. 1056.)

Regulation 1642, *Bad Debts*, was adopted by the Board in 1965 to provide guidance for these provisions. Regulation 1642 has been amended several times to provide further clarification and to incorporate the statutory changes made after 1970. Regulation 1642 was last amended in 1995 to clarify that if a deduction is not taken in the period during which the debt was charged off, a claim for refund must be filed with the Board within the limitations period set forth in Revenue and Taxation Code Section 6902. A copy of Regulation 1642 is attached as Exhibit 1.

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In general, retailers selling tangible personal property on terms other than cash have several options with respect to the accounts receivable arising in the course of business. A retailer may retain an account receivable or may sell or otherwise dispose of it before it is fully collected. The sale of a debt (account receivable) is a financial arrangement between a retailer and another person (“lender”) separate from the original transaction creating the debt (i.e., the sale from the retailer to the customer). Accounts receivable can be sold with recourse or without recourse. “With recourse” means the seller of the debt (the retailer) will suffer any loss resulting from the inability to collect all amounts due. In essence, the retailer guarantees that the debt will be paid to the lender. “Without recourse” means that the lender will suffer any loss resulting from an uncollectible account. In essence, the lender accepts all the risks for collecting a debt acquired without recourse. Generally, retailers selling accounts with recourse receive a better price than selling accounts without recourse because there is less risk to the lender.

The RTC worthless debt provisions created a disparity in treatment between the accounts retailers retained through collection and the accounts retailers sold or otherwise disposed of prior to collection. Retailers could claim a bad debt deduction on their Sales and Use Tax Return for any portion of an uncollected account representing a previously reported taxable sale if the account receivable had been retained or sold with recourse. Prior to the AB 599 amendment, the RTC did not permit any accounts sold without recourse and thereafter written off by the lender to qualify for deduction as “bad debts” of the retailer. Further, a lender was not entitled to a bad debt deduction for amounts uncollected because the lender was not the person paying sales or use tax with respect to the retail transaction.

Similarly, there was no bad debt deduction allowed when a retailer used a “private label credit card.” Private label credit cards are credit cards through which a financing company extends credit to the customers of a retailer with the name of the retailer shown on the face of the card. The financing company generally mails statements, collects payments, owns the receivables, and suffers any loss in the collection process. Prior to the amendments in AB 599, neither the retailer nor the financing company was entitled to claim a bad debt deduction for a worthless debt created through a private label credit card.

Discussion of Statutory Changes

AB 599 amends the RTC to allow a holder of a worthless accounts to claim a deduction or refund for worthless accounts that represent amounts previously included in the measure of tax. AB 599 sets the statutory framework to permit a retailer to claim a bad debt deduction or refund when accounts receivable that had been sold later become worthless, even when such accounts are sold without recourse. Also, AB 599 allows lenders to file a claim for refund for bad debts realized from accounts receivable purchased from a retailer, whether or not the receivables were purchased with recourse.

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AB 599 defines the term “lender” to include affiliates of the retailer, persons that purchase accounts directly from a retailer, and persons who hold a retail account pursuant to a contract directly with a retailer. Lenders are not necessarily engaged in the business of selling tangible personal property and, if not, would not be registered with the Board as retailers.

AB 599 amends RTC sections 6055 and 6203.5 to:

- Allow entities affiliated with a retailer to claim a bad debt deduction on worthless accounts when the retailer originally included the account in the measure of tax on a sales and use tax return and has paid the tax reported.
- Allow a bad debt deduction for worthless accounts that had been sold or transferred without recourse, provided that certain conditions are met.
- Allow a lender and a retailer to determine between themselves who may claim a bad debt deduction or refund for accounts reported as taxable by the retailer and subsequently becoming worthless.
- Require the party making the election to claim the deduction or refund to file a claim in a manner prescribed by the Board.
- Require a retailer claiming the bad debt deduction whom later collects any account, in whole or in part, to report that amount on its next sales and use tax return.
- Require a lender claiming a refund or deduction whom later collects any account, in whole or in part, to pay tax on the amount collected in accordance with Section 6451.

The provisions of AB 599 are effective January 1, 2001, and apply to any tax remitted on or after January 1, 2000. A copy of Assembly Bill 599 is attached as Exhibit 2.

Discussion of Proposed Regulatory Changes

Staff received a submission from Mr. Scott G. Roberti, representing General Electric Company. In his letter dated November 17, 2000, Mr. Roberti provides suggested language to amend subsection (h) of Regulation 1642 (see attached Exhibit 3).

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Staff agrees that subsection (h) should be amended to incorporate the amendments to RTC sections 6055 and 6203 from AB 599. However, staff does not believe that the language provided in the current subsection (h)(1)(A) should be removed as proposed by Mr. Roberti, since this subsection was not impacted by the provisions of AB 599. In addition, staff has concerns regarding the implementation of the unprecedented policy of granting claims for refund to persons other than retailers and shares Mr. Roberti's concerns regarding several key issues that he acknowledged, but did not address, in his proposed language. Staff is of the opinion that amendments to subsection (h) of Regulation 1642 must include, but not be limited to, addressing the following issues:

- The requirements for filing of the election with the Board by the retailer and the lender regarding which person has the right to take the bad debt deduction.
- The documentation requirements for claiming a deduction or refund under the provisions of AB 599. For example, when a lender files a claim for refund under AB 599, records will be needed to properly allocate the refund to the appropriate local taxing jurisdictions.
- The registration requirements for lenders who file elections under which they will file claims for refunds related to bad debts from their purchased accounts. The regulation should also explain the requirements and procedures for such registered lenders to file returns related to subsequently collected accounts.

Summary

In consultation with interested parties, staff will draft the necessary amendments to subdivision (h) of Regulation 1642 to incorporate the provisions of AB 599 that allow retailers and lenders to claim refunds for bad debts from accounts receivable representing amounts that were included in the measure of tax, and that require payment of tax or subsequently collected accounts.

Prepared by the Program Planning Division, Sales and Use Tax Department

Current as of 12/14/2000

Regulation 1642. Bad Debts

(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 or, if the retailer is not required to file income tax returns, 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) **Nontaxable 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 other charges exempt from sales or use tax 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), or may be applied as provided in the contract of sale (contract method). After having applied payments and credits by either the pro rata method or the contract method, and having filed returns based on such application of payments and credits, a retailer shall not thereafter reapply the payments or credits by the other method so as to claim additional bad debts by way of deduction, credit or refund.

(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 retailers solely for the reason that they are on a cash reporting basis for income tax purposes.

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(d) **Worthless Accounts Subsequently Collected.** If any accounts found worthless and charged off are thereafter in whole or in part collected by the retailer, the amount so collected shall be included in the first return filed after such collection and the amount of the tax thereon paid with the return.

(e) **Records.** In support of deductions or claims for credit 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) All payments or other credits applied to account of purchaser.
- (6) 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 or, if the retailer is not required to file income tax returns, charged off in accordance with generally accepted accounting principles.

(f) **Repossessions.**

(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. Depending on whether the pro rata method or the contract method is used to apply payments, a retailer incurs an allowable bad debt deduction (1) 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 or (2) if the wholesale value of the repossessed merchandise is less than the net merchandise balance at the date of repossession.

(2) **Computing Loss On repossession - Information Required.**

The amount of net loss will be computed by deducting from the original sales price upon which tax has been paid, the amount of all payments, trade-in allowances or other credits applicable to such sales price, under the pro rata method or contract method, plus the amount for which a retailer, at the time of repossession, could acquire a similar article from a wholesaler.

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In order to compute an allowable deduction for repossessed merchandise, the following information is necessary:

- (A) Date of sale.
- (B) Cash sales price of the merchandise sold.
- (C) Amount of charges for intangibles included in the cash sales price:
 - 1. Sales tax reimbursement.
 - 2. License fees, if a vehicle.
 - 3. Installation labor, etc., for a fixture, furniture or heavy appliance.
 - 4. Insurance.
 - 5. Any other nontaxable charges except finance charges.
- (D) Total cash sales price.
- (E) Amount of down payment.
- (F) Amount of cash sales balance.
- (G) Finance charges.
- (H) Contract balance.
- (I) Payments on contract.
- (J) Contract balance at date of repossession.
- (K) Date of repossession.
- (L) Date of payoff.
- (M) Unearned finance charges.
- (N) Amount of insurance rebate.
- (O) Wholesale value of repossessed merchandise.
- (P) Repossession loss per records.

(3) Method Of Computing Loss - Pro Rata Method.

(A) Loss Per Records. This is the net payoff less the wholesale value of the repossessed merchandise. The net payoff is the contract balance at the date of repossession less unearned finance charges and insurance rebates.

(B) Taxable Portion of Loss Per Records. This is computed in two steps:

1. Allocation of down payment to merchandise. Sales price of merchandise divided by total cash selling price (includes all intangibles other than finance charges) less the insurance rebate multiplied by the down payment.

2. Taxable portion of loss per records. The unpaid balance of merchandise cost (sales price less down payment allocation per (1) above) divided by the contract balance less unearned finance charges and insurance rebates.

The repossession loss per records as computed in (A) above, multiplied by the taxable portion of the loss, as computed in (B)2. above, results in the allowable bad debt deduction. (See Appendix 1 at end of regulation for example.)

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(4) Method Of Computing Loss - Contract Method. The allowable bad debt deduction is the net merchandise balance after payments and credits have been applied as provided by the contract, less the wholesale value of the repossessed merchandise.

(5) Determining The Wholesale Value Of Repossessed Merchandise. One of the prerequisites in computing the loss on repossessed merchandise is determining the wholesale value thereof. In the case of automobiles, information contained in industry-recognized wholesale and retail price guides will be acceptable. Adjustments may be made to the published wholesale prices in those instances where the automobile is in other than average condition.

Establishing the wholesale value on other types of repossessed merchandise such as jewelry, furniture, appliances, etc., presents a more difficult problem. Each case must be considered on its own merits. Generally, the retailer will be able to use the amount at which the merchandise is brought back into resale inventory. This amount should not, however, include any costs of repossessing, reconditioning or other expense to put the merchandise in saleable condition.

(6) 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 taxpayer 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.

(7) Net Merchandise Balance. The term "net merchandise balance" as used herein means the amount remaining after all payments and credits have been deducted from the purchase price of the merchandise.

(g) Bad Debt Losses Other Than Repossessions. Allowable bad debt deductions also may arise from sales made on open account or on unsecured installment bases. These should be computed in substantially the same manner as those involving repossessions, i.e., by prorating all payments or credits between the cash sales price of the merchandise and the intangible charges or by applying all payments and credits as provided in the contract of sale. No claim for refund or credit 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.

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(h) Special Situations.

(1) Bad Debt Deductions To Persons Other Than The Retailer.

(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.

(B) A purchaser of receivables, other than a successor, cannot obtain a bad debt deduction on 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. Subparagraph (b)(2)(A)2. of Section 1521 of Title 18 recognizes two instances when a contractor (other than a United States construction contractor as defined in section (b)(1)(A) of Section 1521 of Title 18) is considered to be selling materials prior to installation. In those two instances only, when the contractor reports and pays tax on the sales price of the materials and the receivable is thereafter found to be worthless and is charged off for income tax purposes, a bad debt deduction may be taken by the contractor.

Since a contractor (other than a United States construction contractor as defined in section (b)(1)(A) of Section 1521 of Title 18) is the retailer of fixtures, bad debt losses incurred in connection with the furnishing and installing of such fixtures are to be treated in the same manner as those resulting from other types of retail sales.

History: Amended August 2, 1965, effective on and after August 1, 1965.
Adopted January 6, 1970, as a restatement of a portion of former Ruling 61 (Cal. Admin. Code 2041), effective February 7, 1970.
Amended November 5, 1970, effective December 10, 1970.
Amended February 4, 1976, effective April 1, 1976. In (h)(2) added new category where contractor is a retailer of materials prior to installation.
Amended August 17, 1976, effective September 19, 1976. In (h)(2) noted U.S. construction contractors are not retailers and corrected an erroneous reference.
Amended April 9, 1980, effective June 19, 1980. Appendices 1 and 2, reflecting a 6% tax rate, replace the former 5% appendices. Change without regulatory effect, effective July 9, 1986.
Amended November 30, 1988, effective February 16, 1989. Amended subdivision (f) to include the "contract method" as a means of treating bad debt deductions by retailers.
Amended June 28, 1995, effective October 12, 1995. Amended subdivision (a) to clarify that if a deduction is not taken in the period in which the debt is found to be

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worthless and charged off, a claim for refund must be filed with the Board within the limitations period set forth in Revenue and Taxation Code Section 6902.

Appendix 1

EXAMPLE OF COMPUTING ALLOWABLE LOSS USING PRO RATA METHOD

I. Repossession Loss Per Records:

a. Rate.....		6%
b. Sales price of car(*).....	\$9,000 (1)	
c. (1) Sales tax.....	540	
(2) License fees.....	160	
(3) Insurance.....	<u>300</u>	
d. Total cash selling price	\$10,000	
e. Down payment.....	<u>2,000</u> (2)	
f. Cash sales balance.....	\$8,000	
g. Finance charges.....	<u>1,600</u>	
h. Contract balance.....	\$9,600	
I. Payments on contract.....	<u>1,900</u>	
j. Contract balance at date of repossession.....	\$7,700	
m. Unearned finance charges.....	\$1,200	
n. Insurance rebate.....	<u>100</u>	<u>1,300</u>
"Net Payoff"		\$6,400
o. Value of repossession.....	<u>\$5,000</u>	
p. Repossession loss per records.....	<u>\$1,400</u>	

II. Deductible Percentage of Loss:

a. Allocation of Down Payment:		
Sales price of car.....	<u>\$9,000</u>	
Total cash selling price.....	\$10,000	
Less insurance rebate.....	<u>100</u>	
Net Cash Price.....	<u>\$9,900</u> (3)	
<u>\$9,000 (1) x \$2,000 (2) =</u>	<u>\$1,818</u>	
\$9,900 (3)		
b. Unpaid Balance of Car:		
Sales price of car	\$9,000	
Less down payment.....	<u>1,818</u>	
Unpaid balance of car.....	<u>\$7,182</u> (4)	
Contract balance.....	\$9,600	
Less: Unearned finance.....	\$1,200	
Insurance rebate.....	<u>100</u>	<u>1,300</u>
Balance.....	<u>\$8,300</u> (5)	
c. Deductible Percentage of Loss:		
<u>\$7,182</u> (4) = 86.53% (taxable portion of loss)		
\$8,300 (5)		

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III. Allowable Deduction:

$$\$1,400 \times 86.53\% = \$1,211 \text{ (allowable deduction)}$$

NOTE: The letters 'k' and 'l' have been omitted from the example of computation of loss since they refer to information not used in this example.

(*Includes miscellaneous charges such as "undersealing," "documentary fees," and "smog control certification."

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Appendix 2

CONSOLIDATION OF ALLOWABLE BAD DEBT DEDUCTION FOR REPOSSESSED
MERCHANDISE USING PRO RATA METHOD
(6% Sales)

Date of Repos- Session	Car #	(1)	Sales Tax (6%)	License Fee	Insurance (Net) (A)	(2)	(3)	Balance to Finance	Finance Charges (Net) (B)	(4)	Less		(5)
		Sales Price of Mdse.				Net Cash Sales Price	Down Payment			Net Contract Balance	Payments	Value of Repos- session	Repos- session Loss Per Records
9-30-78	507	\$9,000	\$540	\$160	\$200	\$9,900	\$2,000	\$7,900	\$400	\$8,300	\$1,900	\$5,000	\$1,400
10-27-78	521	8,000	480	140	160	8,780	1,700	7,080	350	7,430	1,650	4,400	1,380
11-4-78	540	6,000	360	110	120	6,590	1,300	5,290	260	5,550	1,250	3,300	1,000
12-9-78	575	<u>5,000</u>	<u>300</u>	<u>90</u>	<u>100</u>	<u>5,490</u>	<u>1,100</u>	<u>4,390</u>	<u>200</u>	<u>4,590</u>	<u>1,000</u>	<u>2,700</u>	<u>890</u>
Totals		<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>

Computation of allocation of down payment to merchandise.

$$\frac{\$28,000^{(1)}}{\$30,760^{(2)}} \times \$6,100^{(3)} = \$5,553$$

Computation of allowable bad debt deduction.

$$\frac{\$28,000^{(1)} - \$5,553}{\$25,870^{(4)}} \times \$4,670^{(5)} = \$4,052$$

^(A)Original insurance charge less rebate of unearned premium.

^(B)Total finance charges per contract less unearned charges.

thereafter in whole or in part collected by the retailer, the amount collected shall be included in the first return filed after the collection and the tax shall be paid with the return. For purposes of this subdivision, the term "retailer" shall include any entity affiliated with the retailer under Section 1504 of Title 26 of the United States Code.

(b) (1) In the case of accounts held by a lender, a retailer or lender who makes a proper election under paragraph (4) shall be entitled to a deduction or refund of the tax that the retailer has previously reported and paid if all of the following conditions are met:

(A) No deduction was previously claimed or allowed on any portion of the accounts.

(B) The accounts have been found worthless and written off by the lender in accordance with the requirements of subdivision (a).

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

(D) The retailer remitted the tax on or after January 1, 2000.

(E) The party electing to claim the deduction or refund under paragraph (4) files a claim in a manner prescribed by the board.

(2) If the retailer or the lender thereafter collects in whole or in part any accounts, one of the following shall apply:

(A) If the retailer is entitled to the deduction or refund under the election specified in paragraph (4), the retailer shall include the amount collected in its first return filed after the collection and pay tax on that amount with the return.

(B) If the lender is entitled to the deduction or refund under the election specified in paragraph (4), the lender shall pay the tax to the board in accordance with Section 6451.

(3) For purposes of this subdivision, the term "lender" means any of the following:

(A) Any person who holds a retail account which that person purchased directly from a retailer who reported the tax.

(B) Any person who holds a retail account pursuant to that person's contract directly with the retailer who reported the tax.

(C) Any person who is either an affiliated entity, under Section 1504 of Title 26 of the United States Code, of a person described in subparagraph (A) or (B), or an assignee of a person described in subparagraph (A) or (B).

(4) Prior to claiming any deduction or refund under this subdivision, the retailer who reported the tax and the lender shall file an election with the board, signed by both parties, designating which party is entitled to claim the deduction or refund. This election may not be amended or revoked unless a new election, signed by both parties, is filed with the board.

SEC. 2. Section 6203.5 of the Revenue and Taxation Code is amended to read:

6203.5. (a) A retailer is relieved from liability to collect use tax that became due and payable, insofar as the measure of the tax is represented by accounts that have been found to be worthless and charged off for income tax purposes by the retailer or, if the retailer is not required to file income tax returns, charged off in

accordance with generally accepted accounting principles. A retailer that has previously paid the amount of the tax may, under rules and regulations prescribed by the board, take as a deduction the amount found worthless and charged off by the retailer. If these accounts are thereafter in whole or in part collected by the retailer, the amount collected shall be included in the first return filed after the collection and the amount of the tax shall be paid with the return. For purposes of this subdivision, the term "retailer" shall include any entity affiliated with the retailer under Section 1504 of Title 26 of the United States Code.

(b) (1) In the case of accounts held by a lender, a retailer or lender who makes a proper election under paragraph (4) shall be entitled to a deduction or refund of the tax that the retailer has previously reported and paid if all of the following conditions are met:

(A) No deduction was previously claimed or allowed on any portion of the accounts.

(B) The accounts have been found worthless and written off by the lender in accordance with the requirements of subdivision (a).

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

(D) The retailer remitted the tax on or after January 1, 2000.

(E) The party electing to claim the deduction or refund under paragraph (4) files a claim in a manner prescribed by the board.

(2) If the retailer or the lender thereafter collects in whole or in part any accounts, one of the following shall apply:

(A) If the retailer is entitled to the deduction or refund under the election specified in paragraph (4), the retailer shall include the amount collected in its first return filed after the collection and pay tax on that amount with the return.

(B) If the lender is entitled to the deduction or refund under the election specified in paragraph (4), the lender shall pay the tax to the board in accordance with Section 6451.

(3) For purposes of this subdivision, the term "lender" means any of the following:

(A) Any person who holds a retail account which that person purchased directly from a retailer who reported the tax.

(B) Any person who holds a retail account pursuant to that person's contract directly with the retailer who reported the tax.

(C) Any person who is either an affiliated entity, under Section 1504 of Title 26 of the United States Code, of a person described in subparagraph (A) or (B), or an assignee of a person described in subparagraph (A) or (B).

(4) Prior to claiming any deduction or refund under this subdivision, the retailer who reported the tax and the lender shall file an election with the board, signed by both parties, designating which party is entitled to claim the deduction or refund. This election may not be amended or revoked unless a new election, signed by both parties, is filed with the board.

Scott G. Roberti
Director, State Tax Policy

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November 17, 2000

HAND DELIVERED

Mr. James C. Kuhl
State of California
State Board of Equalization
Program Policy Specialist
Business Taxes Committee Team

Re: Proposed Regulation Project - Assembly Bill No. 599
Recovery of Sales and Use Tax on Worthless Accounts

Dear Mr. Kuhl:

The following suggestions are being submitted on behalf of General Electric Company and affiliates concerning the SBE's regulation project for AB 599 which allows for the recovery of sales and use tax on worthless accounts by retailers and lenders.

It is our understanding that the SBE will be making regulatory changes required by AB 599 to current Sales and Use Tax Regulation 1642. Therefore, we have outlined below the points we believe need to be addressed in drafting these regulatory changes under Sections 6055 and 6203.5 of the Revenue and Taxation Code:

- Election procedure between the retailer and a lender under Section 6055(b)(1)(E) should address the following:
 - (i) election to be filed prior to claiming first deduction or filing first refund;
 - (ii) election effective until new joint election filed by retailer and lender.
- Type of documentation to be maintained by the retailer and lender should be consistent with existing Regulation 1642;
- The ability to equitably apportion local sales and use taxes on worthless accounts;
- Ability to allocate taxable and nontaxable charges;

November 17, 2000

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- See attached for suggested language changes to Regulation 1642.

Members of the GE Corporate Tax organization are available to meet with the SBE to assist in promulgating regulations concerning the recovery of sales and use tax on bad debts. If you have any questions or would like to discuss this further, please contact Bill McConnell at (941) 418 - 5186 or me at (203) 373 – 3413.

Sincerely,

Scott G. Roberti

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California Regulation 1642 (h) *Special Situations*.

ADD / [DELETE]

(1) Bad Debt Deductions to Persons Other Than the Retailer. ~~[(A) A successor who pays full consideration for receivables acquired from his 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) A lender who holds a retail account can obtain a bad debt deduction or refund on accounts, which are not collected. The term "lender" means any of the following:

- (i) Any person who holds a retail account which that person purchased directly from a retailer who reported the tax.**
- (ii) Any person who holds a retail account pursuant to that person's contract directly with the retailer who reported the tax.**
- (iii) Any person who is either an affiliated entity, under Section 1504 of Title 26 of the United State Code, of a person described in subparagraph (i) or (ii), or an assignee of a person described in subparagraph (i) or (ii).**

~~[(B) A purchaser of receivables, other than a successor, cannot obtain a bad debt deduction on accounts, which are not collected.]~~

~~[(C)](B) 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.~~