

**BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO**

In the Matter of the Protest of )  
[Redacted], ) DOCKET NO. 24529  
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 )  
Petitioner. ) DECISION  
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\_\_\_\_\_ )

On August 19, 2011, the staff of the Sales, Use, and Miscellaneous Tax Audit Bureau (Bureau) of the Idaho State Tax Commission (Commission) issued a Notice of Deficiency Determination (Notice) to [Redacted] (taxpayer), proposing sales tax and interest for the period July 1, 2008, through June 30, 2011, in the total amount of \$41,831. For the reasons that follow, the Commission upholds the audit findings.

Background

The taxpayer is a [Redacted] retailer with one Idaho location. At issue in this decision are unsecured in-house credit transactions and the method by which the taxpayer accounted for sales tax charged to customers on retail sales when those customers' accounts were later deemed worthless.

As a retailer, the taxpayer filed periodic sales tax returns with the Commission which reported sales activity and included remittances for taxable sales. On 36 monthly returns, the taxpayer took a tax credit for sales tax related to bad debt, a practice allowed under the Idaho Sales and Use Tax Act. In general, the amount of sales tax credit available is based on the unpaid principal amount that exists at the time of default.

For reasons not relevant to this decision, the monthly adjustments were allowed and processed, but the Bureau subsequently conducted an audit and determined that much of the credit should not have been allowed. The auditor disagreed with the taxpayer's method of first

applying periodic payments to late fees and punitive interest accrual and only thereafter reducing the principal amount with any payment amount remaining.

In the auditor's opinion, the taxpayer's allocation method impermissibly resulted in an overstated principal amount at the time of default, thus allowing the taxpayer a sales tax refund greater than calculated by the auditor's method, which is detailed later in this decision. The Bureau issued a Notice to recover the amount it deemed in excess of what was refundable, and the taxpayer timely protested in a letter dated October 18, 2011. At the taxpayer's request, the Commission held an informal hearing on April 4, 2012.

#### Relevant Tax Code

In Idaho, the sale, purchase, and use of tangible personal property is subject to tax unless an exemption applies. (Idaho Code § 63-3612.) Retailers must collect the tax from their customers, and the tax must be computed on the sales price at the time of the sale for all credit, installment, or similar conditional sales (Idaho Code § 63-3619).

In general, sales tax is due and payable to the Commission monthly for all sales on or before the twentieth day of the sales' succeeding month (Idaho Code § 63-3623). The taxpayer, in this case, was a monthly filer.

For credit sales made with in-house credit cards, tax is often due to the Commission prior to its collection by the retailer from its customers because the retailer finances the sales price as well as the tax:

- (a) The tax shall apply to, be computed on, and collected for all credit, installment, conditional or similar sales at the time of the sale or, in the case of rentals, at the time the rental is charged.
- (b) The tax hereby imposed shall be collected by the retailer from the consumer (Idaho Code § 63-3619).

This is confirmed in an administrative rule which states that tax is owed to the state at the time of sale regardless of when the payment is made by the customer (IDAPA 35.01.02.063.01).

However, the tax code has a provision for a retailer to recover taxes it paid on credit sales accounts later found to be worthless. The retailer may take a credit against subsequent payments of sales tax (i.e., future sales tax returns) to the Commission (Idaho Code § 63-3613(d)):

Taxes previously paid on amounts represented by accounts found to be worthless may be credited upon a subsequent payment of the tax provided in this chapter....

The details of calculating a refund of sales tax for worthless accounts is described in Sales Tax Administrative Rule 063, excerpted in pertinent part:

...02. Rules for Unsecured Credit Sales. The following rules apply to unsecured credit sales:

- a. When a seller cannot collect accounts receivable arising from an unsecured credit sale of tangible personal property subject to sales tax, he may make an adjustment on his sales tax return or apply for a refund of taxes according to this rule.
- b. The adjustment or refund may be claimed on the sales tax return for the month in which the bad debt adjustment is made on the books and records of the taxpayer. The tax for which the credit or refund is sought must be included in the amount which is financed and which is charged off as a bad debt for income tax purposes.
- c. A written claim for the refund may also be filed with the State Tax Commission within three (3) years from the time the tax was paid to the State Tax Commission. The State Tax Commission will review all such refund claims. See Rule 117 of these rules, Refund Claims.

...

05. Amount of Credit Allowed. The amount of credit that can be claimed is the amount of sales tax that is uncollectible. If both nontaxable and taxable items are financed, credit may be taken only for that portion of the bad debt which represents unpaid sales tax..... (IDAPA 35.01.02.063...)

However, sales tax refunds are subject to a statute of limitations:

Refunds, limitations, interest. (a) Subject to the provisions of subsection (b) of this section, if any amount due under this chapter has been overpaid, the excess amount may be credited on any amount then due to the state tax commission from the person by whom the excess was paid and any balance refunded to that person.

(b) (1) No such credit or refund shall be allowed after three (3) years from the time the payment was made to the state tax commission, unless before the expiration of such period a written claim therefor is filed with the state tax commission by the claimant or the claimant's representative, but only if the claimant has authorized in writing the representative to file a claim (Idaho Code § 63-3626, excerpted in pertinent part).

#### Additional Information and Analysis

Based on its understanding of the administrative rule cited previously, the Commission believes that for the purpose of computing bad debt for sales tax purposes, payments by customers against their credit accounts should be applied to both the principal and interest referred to in the sales contract. The principal contains the sales tax, and the interest does not. Thus, each payment made by the customer must be allocated between principal and interest. Once allocated, a percentage of the sales tax the retailer remitted to the state is considered satisfied, and the outstanding principal contains the remainder. As time progresses and payments are made, additional sales tax is considered to have been paid by the consumer, culminating at 100 percent when the principal balance reaches zero. Should the consumer default, however, the remaining unpaid sales tax as represented in the unpaid principal is available as a refund to the retailer, within the confines of the statute of limitations for refunds.

Under the provisions of the contracts with its customers, the taxpayer imposed penalties on late payments and increased the interest rate on the remaining balance. Under its method of accounting for sales tax credit attributable to bad debt, the taxpayer applied payments to penalties and increased interest first, reducing the amount available to lower the principal. As less of the payments were applied to principal and more to the increased interest and penalties, more of a sales tax credit was available to the taxpayer when customers with late payment histories defaulted.

The Commission does not quarrel with the taxpayer's method for internal accounting for debt in the general sense. Rather, it objects to such an accounting for a bad debt sales tax credit for the following reasons. For its in-house credit card transactions, the taxpayer and its customers agree to finance a principal amount, which includes the sales tax, as well as an interest component. Future events that are conditional on customer behavior, including larger interest rates and penalties, are not certainties, nor do they directly relate to the sales transactions that gave rise to the sales tax charged. The Commission does not believe that conditional events should negatively impact its rights to sales tax collections and reward the retailer with a greater sales tax credit.

In sum, this opinion is consistent with the practice of the Bureau in calculating sales tax bad debt refunds: for the purpose of computing the sales tax bad debt refund, all payments must be applied to the principal (in the instant case, this is the sum of the sales taxable amount and the tax) and an agreed-upon interest component, regardless of the retailer's imposition of late fees and higher interest based on conditional events. No conditional events following the sale should result in payment allocations to Idaho's detriment by inflating the remaining principal for bad debt sales tax credit purposes. The tax code and administrative rule do not support the taxpayer's approach, and the Commission believes the Bureau's method to be appropriate in the absence of code and administrative guidance to the contrary.

At the time of the informal hearing, the taxpayer provided additional customer payment information that, had it been accepted, would have increased its claim to additional sales tax credits. As the Bureau disagrees with the taxpayer's methodology for calculating the bad debt sales tax recovery, it was unable to apply this information to the taxpayer's advantage.

Another point of contention is the taxpayer's interpretation of the statute of limitations with respect to sales tax refunds. Both the Commission and the taxpayer agree with the aforementioned statute that limits the taxpayer's refund period to three years, but the parties disagree on when that three-year period begins.

The Commission believes that a retailer's remittance of tax as a consequence of making a sale starts the three-year period. The taxpayer argues that the date of its declaration of bad debt begins the three-year period. In the taxpayer's words, "a new tax event has been established" (Protest letter, October 18, 2011, page 1). The taxpayer argues that there are unsecured credit transactions that can enter into default too late for the retailer to make a sales tax refund claim within the three-year time period beginning with the sale. It contends that the auditor's application of the refund statute has barred it from a sales tax refund on some of its claims. The auditor states that this disagreement is responsible for a minor part of the disallowed refund claimed by the taxpayer, but nevertheless disagrees with the taxpayer's opinion.

The Commission recognizes the inherent risk a retailer faces in extending unsecured credit beyond three years but sees no remedy within the tax code or the administrative rules. The refund statute states that, "No such credit or refund shall be allowed after three (3) years from the time the payment was made to the state" (Idaho Code § 63-3626(b)(1)). Payment was made shortly after the sale and is in no way tied to a debt default date in the indeterminate future. The Commission sees no code language that establishes a debt default date as a sales tax transaction subject to new limitations. Sales tax is imposed on a transaction wherein tangible personal property and consideration are exchanged (Idaho Code §§ 63-3612 and 63-3619). This is a reference to the sale date, not the debt default date.

In defense of its own methodology, the taxpayer notes that amounts later collected from consumers on worthless accounts after debt default and a subsequent refund of sales tax by the retailer must be paid back to the Commission. The Commission agrees:

Taxes previously paid on amounts represented by accounts found to be worthless may be credited upon a subsequent payment of the tax provided in this chapter or, if no such tax is due, refunded. If such accounts are thereafter collected, a tax shall be paid upon the amount so collected (Idaho Code § 63-3613(d)).

Bad Debt Collected at a Later Date. If a bad debt account is collected later, the retailer must pay tax on the amount collected (IDAPA 35.01.02. 063.06).

The taxpayer believes that following the Commission's logic with respect to the statute of limitations, amounts collected on accounts deemed worthless could result in a sales tax liability to the retailer even if it did not previously obtain a bad debt sales tax refund. The Commission is not persuaded by this argument because it believes the bad debt collection language cited previously in the administrative rule (Rule 063.06) is in the context of an act subsequent to a bad debt sales tax refund. Nothing in the text suggests that it is a new tax on a transaction, and the Commission, as well as the Bureau, have never viewed it as such.

The Commission finds the deficiency prepared by the Bureau to be an accurate representation of the taxpayer's sales and use tax liability for the period July 1, 2008, through June 30, 2011.

The Bureau added interest to the sales tax deficiency. The Commission found it appropriate per Idaho Code sections 63-3045 and has updated interest accordingly. Interest is calculated through October 15, 2012, and will continue to accrue at the rate set forth in Idaho Code § 63-3045(6) until paid.

THEREFORE, the Notice of Deficiency Determination dated August 19, 2011, is hereby APPROVED, in accordance with the provisions of this decision, and is AFFIRMED and MADE FINAL.

IT IS ORDERED and THIS DOES ORDER that the taxpayer pay the following tax and interest:

<u>TAX</u>	<u>INTEREST</u>	<u>TOTAL</u>
\$38,678	\$4,676	\$43,354

DEMAND for immediate payment of the foregoing amount is hereby made and given.

An explanation of the taxpayer's right to appeal this decision is enclosed.

DATED this \_\_\_\_\_ day of \_\_\_\_\_ 2012.

IDAHO STATE TAX COMMISSION

\_\_\_\_\_  
COMMISSIONER

**CERTIFICATE OF SERVICE**

I hereby certify that on this \_\_\_\_\_ day of \_\_\_\_\_ 2012, a copy of the within and foregoing DECISION was served by sending the same by United States mail, postage prepaid, in an envelope addressed to:

[Redacted]

Receipt No.  
  
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