

BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO

In the Matter of the Protest of)	
)	DOCKET NO. 39277
[Redacted] ,)	
)	
Petitioner.)	DECISION
_____)	

On September 25, 2014, the staff of the Sales, Use and Miscellaneous Tax Audit Bureau (Bureau) of the Idaho State Tax Commission (Commission) issued a Notice of Taxpayer Initiated Refund Determination (Notice) to **[Redacted]** (Petitioner), allowing a reduced refund of sales tax and interest for the period January 1, 2012, through April 30, 2012, in the total amount of \$244.

On November 7, 2014, the Petitioner filed a timely appeal and petition for redetermination of the Notice.

The Commission sent a letter advising the Petitioner of its hearing rights on April 14, 2015. The Petitioner responded to the request, indicating that it did not wish to participate in an informal hearing, but did provide additional documentation supporting its argument for review. The Commission, having reviewed the additional documentation, the audit file and considered the information provided in the months following, hereby modifies the Notice for the reasons detailed below.

BACKGROUND

The Petitioner contracts with a related entity, an automobile dealership, to provide vehicle loan financing for its customers. In the event that the customer defaults on the loan, the Petitioner repossesses the vehicle and sells it back to the dealership for a reduced price who then resells the vehicle.

On May 23, 2013, the Petitioner requested a refund in the amount of \$566 for sales tax remitted under its vehicle loan financing program for customers who later defaulted on their loans resulting in vehicle repossessions. The Bureau reviewed the documentation provided by the Petitioner and found issues related to late fees, allocation of payments to interest, and the subsequent sale of the repossessed vehicles. As a result, the Bureau revised the refund requested to reflect only the amount of sales tax that is uncollectible. On September 25, 2014, the Bureau issued a refund of tax and interest in the amount of \$244.

The Petitioner protested the Bureau's revision, requesting that the Commission review its calculations and refund the balance.

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 on a monthly basis by the twentieth day of the sales' succeeding month (Idaho Code § 63-3623.) During the audit period, the Petitioner was a quarterly filer which required it to file a return by the twentieth day of the month following each quarter end along with any sales tax collected during the quarter.

For credit sales, tax is due to the Commission prior to full collection by the retailer from its customers even though the amount financed includes sales 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 practice 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 sale tax it paid on credit sales accounts which are 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.

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.... (Idaho Code § 63-3613(d)).

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

03. Rules for Secured Credit Sales. The following rules apply to secured credit sales:

a. If the collateral is not repossessed, the seller may treat a bad debt the same as an unsecured credit sale.

b. If the collateral is repossessed and not seasonably resold at a public or private sale, its retention is considered to satisfy the debt and no bad debt adjustment is allowed.

c. If the collateral is repossessed and seasonably resold at public or private sale, then the seller is entitled to a bad debt adjustment. However, before calculating the amount of tax that may be credited or refunded, the taxpayer must reduce the amount claimed as worthless by the amount realized from the sale of the collateral...

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).

ANALYSIS

In this case, both the Bureau and the Petitioner agree that the Petitioner has a right to a refund of sales tax for the amount of bad debt that represents unpaid sales tax. Where the Bureau and the Petitioner disagree is the amount that represents the unpaid portion of the tax collected. IDAPA 35.01.02.063.05 states that “[t]he 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.”

The Commission conducted a review of the calculations done by the Bureau and compared those to calculations done by the Petitioner in order to determine where the differences were so that they can be addressed individually.

Penalty Charges/Late Fees

One of the areas identified in this comparison dealt with penalty charges/late fees. The Petitioner was in the practice of applying payments first to late fees and then distributing the balance to principal/interest. The Bureau advised the Petitioner that these amounts should not be excluded in the calculation of bad debt and added these amounts as subsequent charges.

The Commission agrees with the Bureau that practice of applying payments first to late fees and then to principal/interest is inappropriate because those fees were never part of the sales price subject to the tax that the Petitioner wishes to recover. This applies to all fees, penalties, increased interest, etc., which occur because a customer didn't comply with the original sales contract.

This is consistent with previous decisions of the Commission. The decision for docket 22762 states that “no payment required by the seller/financier (i.e. the taxpayer) at the time of

sale or after it, that was not subject to sales tax, can be of consequence to the refund of the tax to the taxpayer” (meaning fees, penalties, increased interest, etc.)

Principal/Interest Allocation

Another area identified in this comparison dealt with the allocation of payments between interest and penalty. 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 customer, culminating to one-hundred percent when the principal balance reaches zero. Should the customer 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.

The Bureau determined that the Petitioners method of allocation between principal and interest resulted in an increased amount of the payments being applied to interest rather than principal which results in a greater refund of the sales tax in the event of default. The Bureau held that the Petitioner should apply all payments on a basis that is unrelated to the customer’s future behavior in paying off the loan and to that end recalculated the distribution of the payments.

The Petitioner disagreed with the change in arguing that the principal calculation completed to determine the amount of interest and principal in each payment does not involve the principal balance at all. The Petitioner asserts that the interest paid is directly related to the

outstanding balance. The Petitioner provided a copy of its amortization schedule for each of the defaulted loans and questions what right the Commission has to recalculate interest in this case.

The Commission supports the Bureau's position that all payments should be applied to principal and interest on a basis that is unrelated to the customer's future behavior in paying off the loan when calculating the amount of credit for the portion of sales tax that is uncollectible, but used an alternate method to calculate this. The Commission used the original contracted amounts in order to come up with the total ratio of principal to interest at the end of the loan period, and then applied those ratios to the total payments received by the Petitioner. This alternate allocation results in a fair allocation for the purpose of calculating the portion of the sales tax that was uncollectable.

Subsequent Sale

The last area identified in this comparison dealt with the sale of the repossessed vehicles by the dealership. IDAPA 35.01.02.063.03.c requires that "[i]f the collateral is repossessed and seasonably resold at public or private sale, then the seller is entitled to a bad debt adjustment. However, before calculating the amount of tax that may be credited or refunded, the taxpayer must reduce the amount claimed as worthless by the amount realized from the sale of the collateral."

In this case, when the customer defaults on the loan the Petitioner repossesses the vehicle and sells it back to the dealership, a related entity, for a reduced price satisfying the requirement of the subsequent sale. In both cases it would appear that the sale between the Petitioner and the dealership was significantly lower than the sales price to its customer.

The Bureau disregarded the sale between the Petitioner and the dealership, asserting that a sale to a related entity for a price less than what it will sell the vehicle in a public or private sale

does not satisfy the requirement for the purposes of the bad debt calculation. The Bureau was able to retrieve the information on the subsequent sale for both of the vehicles in this request and calculated the amount realized as a result of the sale, reducing the amount claimed as worthless by the amount realized from the sale of the collateral.

Subsequent Sale	Bad Debt 1	Bad Debt 2
Related Entity	771	1,000
Subsequent Sale	2,099	3,495

The Petitioner protested the Bureau's refusal to acknowledge the sale between itself and the dealership as a subsequent sale. The Commission reviewed the information provided by the Petitioner and agrees with the Bureau that the amount realized in the subsequent sale of the vehicles does not qualify. In this case, this is not a sale of an asset between related parties, rather it is a "fictitious sale" made with the purpose of increasing its sales tax refund claim to the detriment of the state. In reality, the vehicle continues to be held awaiting its ultimate sale to an actual customer. Under the Petitioner's logic, one could sell the vehicle for a dollar to its related entity and maximize the bad debt refund. This approach is entirely unreasonable and no support is found for it in the code or rules. Only when the vehicle has been seasonably resold at public or private sale, is the seller entitled to a bad debt adjustment. Once the asset is sold to a customer, the amount realized as a result of the sale can be calculated.

CONCLUSION

The Commission determined that the portion of the bad debt that represents unpaid sales tax for the transactions in question is \$228. The Petitioner has already received a refund in the amount of \$244, resulting in an overpayment of \$16. Interest has not been added to the overpayment that was made. Interest has not been added to the overpayment but will begin to accrue as of January 1, 2017 at the rate set forth in Idaho Code § 63-3045(6) until paid.

THEREFORE, the Notice of Taxpayer Initiated Refund Determination dated September 25, 2014, is hereby MODIFIED, in accordance with the provisions of this decision, and is AFFIRMED as modified and MADE FINAL

TAX	PENALTY	INTEREST	TOTAL
\$16	\$0	\$0	\$16

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

An explanation of the Petitioner's right to appeal this decision is included with this decision.

DATED this _____ day of _____ 2016.

IDAHO STATE TAX COMMISSION

COMMISSIONER

CERTIFICATE OF SERVICE

I hereby certify that on this _____ day of _____ 2016, 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.

CERTIFICATE OF SERVICE

I hereby certify that on this _____ day of _____ 2016, 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.
