

New York State Department of Taxation and Finance
Taxpayer Services Division
Technical Services Bureau

TSB-A-96 (61)S
Sales Tax
October 1, 1996

STATE OF NEW YORK

COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION

PETITION NO.S950925B

On September 25, 1995, the Department of Taxation and Finance received a Petition for Advisory Opinion from Price Waterhouse LLP, Attn: Alan Floria, 400 South Hope Street, Los Angeles, CA 90071.

The issue raised by Petitioner, Price Waterhouse LLP, is whether Company B may claim a credit or file a claim for refund for the sales tax paid on debts written off by Company A for Federal income tax purposes, and, if not, whether Company A is entitled to file a claim for refund for such amount.

Petitioner submits the following facts as the basis for this Advisory Opinion.

Company A has entered into a contract with Company B, a retailer of consumer products, to issue lines of credit to Company B's customers. Petitioner indicates that the contract provides as follows:

Company A will issue a credit card utilizing Company B's name to qualified Company B customers. Company A will remit payment to Company B for the amounts associated with the credit card sales based upon a predetermined discount rate.

In determining the price to be paid to Company B, Company A has calculated the discount rate so that it achieves its targeted profit margin. As a result, program revenue (cardholder finance charges, other income, etc.) and expenses (funding costs, operating expenses, bad debts, etc.) are estimated to compute the discount rate. Although the base discount rate will be negotiated annually as part of the budgeting process, the rate is adjusted throughout the year for anticipated changes in program revenues and expenses. Consequently, Company A's targeted profit margin will remain relatively constant throughout the term of its contract with Company B.

Company B's sales are generally subject to sales tax. Company B will charge sales tax on its taxable sales of merchandise and remit the tax to the New York State Department of Taxation and Finance. On a daily basis, Company A will settle with Company B for the amount of the credit card sales on a discounted basis. Such payments made by Company A to Company B include the full amount of sales tax due on the credit card sales.

Under the terms of the credit card agreement, the credit cardholders will be responsible for remitting all payments directly to Company A. Any amounts subsequently determined to be uncollectible will be written off by Company A for Federal income tax purposes.

The allowance for bad debts is a material consideration in calculating the discount rate. If all other factors (program revenues and expenses other than bad debts) were to remain constant and the actual bad debt experience for the credit card sales exceeds the amount forecasted by Company A, the discount rate will increase. Alternatively, if the other factors are constant and the bad debt experience is less than the forecasted amount, the discount rate will decrease. Company B's bad debt experience is directly related to the discount rate on an ongoing basis. Company B, therefore, bears the risk of economic loss associated with those accounts ultimately found to be uncollectible by Company A.

Applicable Law and Regulations

Section 1132(a) of the Tax Law provides:

(a) Every person required to collect the tax shall collect the tax from the customer when collecting the price, amusement charge or rent to which it applies. If the customer is given any sales slip, invoice, receipt or other statement or memorandum of the price, amusement charge or rent paid or payable, the tax shall be stated, charged and shown separately on the first of such documents given to him. The tax shall be paid to the person required to collect it as trustee for and on account of the state.

Section 1132(e) of the Tax Law provides, in part:

(e) The tax commission may provide, by regulation, for the exclusion from taxable receipts, amusement charges or rents of amounts representing sales where the contract of sale has been cancelled, the property returned or the receipt, charge or rent has been ascertained to be uncollectible or, in case the tax has been paid upon such receipt, charge or rent, for refund of or credit for the tax so paid.

Section 1133(a) of the Tax Law provides:

(a) Except as otherwise provided in section eleven hundred thirty-seven, every person required to collect any tax imposed by this article shall be personally liable for the tax imposed, collected or required under this article. Any such person shall have the same right in respect to collecting the tax from his customers or in respect to nonpayment of the tax by customers as if the tax were a part of the purchase price of the property or service, amusement charge or rent, as the case may be, and payable at the same time; provided, however, that the tax commission shall be joined as a party in any action or proceeding brought to collect the tax.

Section 534.7 of the New York State Sales and Use Tax Regulations provides, in pertinent part, as follows:

Refunds and credits attributable to bad debts.--(Tax Law, Secs. 1132(e), 1139(e)).(a) Definitions. The following definitions apply for the purpose of determining entitlement and computation of the refunds and credits authorized in this section only--(1) The term "uncollectible" means worthless, as used for federal income tax purposes. Legal action to enforce payment when it would probably not result in satisfaction of a judgment upon a showing of the underlying facts is not a necessary prerequisite in determining worthlessness.

(2) The term "retail-vendor" means a vendor of tangible personal property or services, payment for which is made, in whole or in part, by the extension of credit to the purchaser by such vendor who is responsible for remitting applicable sales tax to the department and includes a lessor-vendor which meets the conditions of paragraph (b)(2) of this section.

(3) The term "account-obligor" means the purchaser of tangible personal property or services, the receipts of which are paid, in whole or in part, by the extension of credit by the retail-vendor.

(4) The term "receivables of a retail-vendor" means indebtedness to the retail-vendor incurred by an account-obligor upon his purchases whether or not subject to the sales and use taxes.

(5) The term "captive finance company" means a company that meets all of the following conditions:

(i) it is wholly owned by the retail-vendor or is wholly owned by a company which is related to such retail-vendor through an unbroken chain of wholly owned companies;

(ii) it does not finance receivables of any vendor other than its retail-vendor or any company related to such retail-vendor by an unbroken chain of wholly owned related companies;

(iii) it does not extend credit to anyone other than in the form of the purchase of receivables created as a result of extension of credit by the retail-vendor, except that the requirement of this subparagraph shall not be violated by the investment of excess cash funds in the short or long-term financial markets or by advancing funds to its retail-vendor or a company which is related to such retail-vendor through an unbroken chain of wholly owned companies;

(iv) it does not sell receivables to a third party other than a transfer of a receivable to its retail-vendor; and

(v) it does not receive payments on the receivable directly from the account-obligors. Instead, the foregoing payments, including interest, on the receivable must be made by the account-obligors directly to the retail-vendor, and

must be reported as income by the retail-vendor for income and franchise tax purposes.

(6) The term "recourse" means that all bad debts are transferred back to the retail-vendor or such bad debts are charged against the retail-vendor's reserve account established for that purpose.

(b) Allowance of refund or credit. (1) Where a receipt, amusement charge, or hotel rent has been ascertained to be uncollectible, either in whole or in part, the vendor of the tangible personal property or services, the recipient of the amusement charges, or the operator of the hotel (as such terms are defined in section 1101 of the Tax Law) may apply for a refund or credit of the tax paid on such receipt, amusement charge, or hotel rent within three years from the date the tax was payable by such person to the Tax Department. However, no refund or credit shall be allowed based upon the fact that receipts are not actually paid on transactions described in section 527.15(e) of this Title.

(2) A vendor will be considered the vendor of the tangible personal property or services giving rise to the bad debt even though the property or services are sold by a leased department or concession (as described in section 526.10(f) of this Title), provided all the following conditions are met:

(i) the leased department or concession accounts for and pays over all of its receipts to the lessor-vendor;

(ii) the lessor-vendor reports and remits to the Department of Taxation and Finance the tax on all of the leased department or concession's receipts; and

(iii) the transfer of all receivables from the leased department or concession to the lessor-vendor is made without any discount for any credit transactions which involve the lessor-vendor's receivables and without recourse to the leased department or concession.

(3) A refund or credit is not available for a transaction which is financed by a third party or for a debt which has been assigned to a third party, whether or not such third party has recourse to the vendor on that debt.

(4) Receivables transferred to a captive finance company by its retail-vendor (as such terms are defined in subdivision (a) of this section) will not be treated as debts assigned to a third party provided the following conditions are met:

(i) such captive finance company has recourse (as defined in paragraph (a)(6) of this section) on all bad debts to the transferor retail-vendor; and

(ii) annually (for a period determined from June 1st to May 31st of each year) not more than 10 percent of the receivables of the retail-vendor are incurred by account obligors upon purchases from any vendor other than the retail-vendor or a leased department or concession of the retail-vendor which meets the conditions of paragraph (2) of this subdivision.

Though a retail-vendor is not denied eligibility for the refund or credit with respect to debts determined to be uncollectible with respect to its receivables financed by a captive finance company if no more than 10 percent of its receivables (whether or not financed by the captive finance company) are derived from sales of any vendor other than the retail-vendor or a leased department or concession of such retail-vendor which meets the conditions of paragraph (2) of this subdivision, there is no refund or credit allowable to such retail-vendor with respect to any receivables derived from sales of such other vendors. (emphasis added)

Opinion

In this case, Company A has entered into a contract with Company B to issue lines of credit to Company B's customers. In doing so, Company A will issue a credit card utilizing Company B's name to qualified Company B customers. Under the terms of the credit card agreement between Company A and the customers of Company B, Company B's customers will be responsible for remitting all payments directly to Company A. Company A will remit payment to Company B for the amounts associated with the credit card sales based upon a predetermined discount rate. Company B, as the vendor of tangible personal property, is responsible under New York law for collecting sales tax due on its taxable sales and remitting the tax required to be collected to the New York State Department of Taxation and Finance. The tax required to be collected must be paid to the person required to collect it, in this case, Company B, as trustee for and on account of the State. See Sections 1132(a) and 1133(a) of the Tax Law.

Company B does not itself extend credit to its customers; rather Company A extends the credit. Company A is not the vendor under Section 1101(b)(8) of the Tax Law of the goods which Company B sells to Company B's customers, since Company B sold the goods. Company B's retail sales customers use Company A's credit card to make purchases from Company B. Thus, Company A forwards the customers' payments to Company B and establishes a debt from the customers to Company A. Since Company A extends the credit to Company B's customers and receives reimbursement of the debt created from the customers, Company A is not a captive finance company of Company B for purposes of the Sales and Use Tax Regulations. See Section 534.7(a)(5)(iii) and (v) of the Sales and Use Tax Regulations.

Company B is required to collect tax due from its customers and is personally liable for the tax imposed, collected or required to be collected. It is Company B that has the same right under Section 1133(a) of the Tax Law to collect the tax from its customer or in respect to the customer's nonpayment of tax as if the tax were part of the purchase price. (See Sections 1132(a) and

TSB-A-96 (61)S
Sales Tax
October 1, 1996

1133(a) of the Tax Law). These statutory rights and obligations of Company B cannot be modified by contract. Any amounts of tax collected by Company A from Company B's customers cannot be discounted; the full amount of tax required to be paid by Company B's customers must be turned over to Company B.

Pursuant to Section 1132(e) of the Tax Law, the Commissioner may provide, by regulation, for the refund of or credit for tax paid on sales receipts that have been ascertained to be uncollectible. Pursuant to Section 534.7 of the Sales and Use Tax Regulations, where a receipt has been ascertained, either in whole or in part, to be uncollectible, the vendor of the tangible personal property or services who has extended credit to the purchaser of the tangible personal property or services may apply for a refund or credit for the tax paid on such receipt. However, a refund or credit is not available for a transaction which is financed by a third party whether or not such third party has recourse to the vendor on such debt, unless the third party is a captive finance company. See Section 534.7(b)(3),(4) of the Sales and Use Tax Regulations. Accordingly, since Company A is not the vendor with respect to Company B's sales to its customers (rather Company A is only extending credit to Company B's customers), and since Company A is not a captive finance company, pursuant to Section 1132(e) of the Tax Law and Section 534.7 of the Sales and Use Tax Regulations, Company A may not claim a credit or file a claim for refund for the sales tax paid on debts which are deemed uncollectible by Company A. Nor may Company B claim such a credit or refund, since Company A paid to Company B the full amount of the sale, less the discount rate, and the sales tax due on the entire sales price (without regard to any discount) on behalf of the purchaser.

DATED: October 1, 1996

/s/
John W. Bartlett
Deputy Director
Technical Services Bureau

NOTE: The opinions expressed in Advisory Opinions
are limited to the facts set forth therein.