

Amend Revenue and Taxation Code Sections 6055 and 6203.5 of the Sales and Use Tax Law to remove the requirement that retailers and lenders file an election form with the Board of Equalization (BOE) *prior* to claiming a bad debt in the case of accounts held by a lender that have been found worthless and written off by the lender.

Source: Board Member George Runner

Current Law

Under existing law, Sections 6055 and 6203.5 of the Sales and Use Tax Law allow a retailer to be relieved of the liability for the sale or use tax when the measure of tax is represented by amounts that have been found to be worthless and charged off for income tax purposes. These sections also allow retailers who sell their accounts receivables or lenders who purchase them to claim a refund or claim a deduction on sales and use tax returns for the portion of the accounts receivable which is written off as worthless. In such circumstances, existing law requires the retailer and the lender to file an election form with the BOE signed by both parties designating which party is entitled to claim the bad debt loss *prior to claiming a deduction or refund*.

This Proposal

This proposal would amend BOE-sponsored [Proposal 3-3](#), adopted by the Members of the BOE upon unanimous consent at its January 27, 2011 Legislative Committee meeting. Proposal 3-3 amends Sections 6055 and 6203.5 to remove the requirement that the election form be filed with the BOE. Instead, it requires that the election form simply be retained by both the retailer and the lender (this proposal, among other BOE proposals, is contained in this session's [AB 242](#), currently set for hearing on August 15, 2011 in the Senate Appropriations Committee).

This proposal would delete the requirement that the election form be prepared and retained by the lender and the retailer *prior* to claiming a deduction or refund. Instead, this proposal would specify that a proper election for purposes of these provisions shall be established when the retailer who reported the tax and lender prepare and retain the election form, signed by both parties, designating which party is entitled to claim the deduction or refund.

The purpose of this proposal is to address an unintended consequence that has resulted in situations where the lenders have failed to file properly completed election forms when claiming the deduction or refund. In such cases, the claim for deduction or refund is not considered valid. Currently, staff allows the claimant to obtain the election form *after* the claim for deduction or refund is filed, but will not consider the claim valid until such time the election form is obtained (see Regulation 1642 (i)(F)(5), which interprets and explains these provisions). Consequently, if an election form is not obtained by the lender and retailer within the general limitations period for which a claim for refund or credit may be accepted as timely under the law, the BOE is barred from accepting the claim for

deduction or refund for those periods that fall outside the statute of limitations for filing refund claims pursuant to Section 6902. Consequently, the staff has been disallowing otherwise valid claims for deductions or refunds by lenders for periods beyond the limitations period in situations where the retailer and lender obtain the election form after the limitations period.

Therefore, this proposal would specify that, instead of requiring the election form be prepared and retained *prior* to claiming a deduction or refund, a proper election shall be established when the signed election form is obtained and retained by both the lender and retailer who reported the tax.

Sections 6055 of the Revenue and Taxation Code is amended to read:

6055. (a) A retailer is relieved from liability for sales 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 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 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, For purposes of this section, a "proper election" shall be established when the retailer who reported the tax and the lender shall file~~ *prepare and retain* an election ~~form 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 is filed with the board~~ *prepared and retained by the retailer and the lender*.

(Shaded areas are the previously BOE-adopted changes in Proposal 3-3. Proposal 3-3 is now part of this session's AB 242 (Assembly Revenue and Taxation Committee) currently set for hearing in the Senate Appropriations Committee for August 15, 2011)

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, For purposes of this section, a "proper election" shall be established when the retailer who reported the tax and the lender shall file~~ *prepare and retain* an election ~~form~~ *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 is filed with the board~~ *prepared and retained by the retailer and the lender.*

(Shaded areas are the previously BOE-adopted changes in Proposal 3-3. Proposal 3-3 is now part of this session's AB 242 (Assembly Revenue and Taxation Committee) currently set for hearing in the Senate Appropriations Committee for August 15, 2011)