

ST 09-1

Tax Type: Sales Tax

Issue: Bad Debt Write-Off

**STATE OF ILLINOIS  
DEPARTMENT OF REVENUE  
OFFICE OF ADMINISTRATIVE HEARINGS  
CHICAGO, ILLINOIS**

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ABC, INC.,	)	Docket No.	07-ST-0000
Taxpayer	)	Claim Periods	1/04 — 11/06
v.	)		
THE DEPARTMENT OF REVENUE	)	John E. White,	
OF THE STATE OF ILLINOIS,	)	Administrative Law Judge	

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**RECOMMENDATION FOR DISPOSITION**

**Appearances:**

Peter Larsen, Akerman Senterfitt, appeared, *pro hac vice*, for Taxpayers, appeared for ABC, Inc.; John Alshuler, Special Assistant Attorney General, appeared for the Illinois Department of Revenue.

**Synopsis:**

The matter involves the Illinois Department of Revenue's (Department) denial of amended returns that ABC, Inc. (ABC) filed to claim a refund of taxes paid regarding transactions undertaken during the months of January 2004 through December 2006.

In lieu of hearing, the parties submitted a Joint Stipulation of Facts (Stip.), which included exhibits. The issue is whether ABC is entitled to a refund of tax that is equal to the amount of the pro rata portion of retailers' occupation tax remitted on the unpaid balance of accounts of ABC's credit card customers who made retail purchases of tangible personal property using credit cards issued by ABC, and which accounts were written off by ABC as bad debts. I am including in this recommendation findings of fact and conclusions of law. I recommend the denial be finalized as issued.

**Findings of Fact:**

1. ABC is not registered as a retailer pursuant to either the Illinois Use Tax Act (UTA) or the Illinois Retailers' Occupation Tax Act (ROTA). Stip. ¶ 1.
2. ABC provides financing to customers who purchase tangible personal property (property) at retail, for use or consumption in Illinois, which purchases are subject to tax under the ROTA and/or UTA. Stip. ¶ 1.
3. In order to make financing available to their customers, certain retail merchants doing business in Illinois (hereinafter, the Retailers) entered into agreements with ABC to finance the sale of property to the Retailers' customers. Stip. ¶ 2.
4. The agreement between ABC and each Retailer called for ABC to issue private label credit cards to Retailers' customers. Stip. ¶ 3. Private label credit cards are credit cards bearing the name of a particular Retailer, and which may be used only at the named Retailer's retail locations. Stip. ¶ 3.
5. Each of the Retailers offered its customers the opportunity to obtain a private label credit card, and ABC issued a credit card bearing the name of the particular Retailer to each Retailer's approved customers. Stip. ¶ 4.
6. The Retailers made sales of tangible personal property to the Retailers' customers, which sales were subject to tax under the ROTA and UTA. Stip. ¶ 2.
7. Customers financed their purchases of property from the Retailers, including the amount of tax charged and collected for each sale. Stip. ¶ 5.
8. At the time of each private label credit card sale, ABC paid the applicable Retailer an amount equal to the purchase price of the property plus applicable tax, and the Retailer's customer agreed to pay ABC the purchase price of the property plus the tax due on that sale. Stip. ¶ 5. In the Stipulation, the parties refer to the outstanding debt that a Retailer's customer owed to ABC as an Account. Stip. ¶ 5.
9. At or about the time of each private label credit card sale, the Retailer remitted the full amount of tax due on the transaction to the State of Illinois. Stip. ¶ 6; 35 **ILCS**

120/3 (return due on 20<sup>th</sup> day of month following month in which receipts from retail sales were realized).

10. After some private label credit card sales, some customers failed to pay ABC the full amount due regarding the customer's Account. Stip. ¶ 7. ABC subsequently determined that some Accounts were uncollectible. Stip. ¶ 7.
11. ABC determined that some uncollectible Accounts were bad debts pursuant to Section 166 of the Internal Revenue Code (IRC). Stip. ¶ 8. ABC wrote off such bad debts on its books, and claimed such bad debts as a deduction on its federal income tax returns. Stip. ¶¶ 9-10.
12. All of the Accounts have an unpaid balance remaining that includes the proportional share of the sales (that is, retailers' occupation) taxes paid by the Retailers. Stip. ¶ 11.
13. On March 2, 2007, ABC filed amended returns (Claims) to claim a refund of retailers' occupation tax (ROT) for the period from January 2004 through December 2006. Stip. ¶ 12; Stip. Ex. 2.
14. ABC filed separate Claims for each month from January 2004 through December 2006. Stip. Ex. 2 (copies of ABC's completed Claim forms). Each separate form requested a refund in the identical amount of \$540,477. *Id.* On each form, and within the section designed to let the claimant notify the Department of the reason for the change to a prior return, ABC stated, "The requested refund is for the portion of sales tax paid on accounts determined to be worthless and charged off for federal income tax purposes." *Id.* (Part 2, line 9 of each Claim form).
15. The Department denied ABC's Claim on April 20, 2007 (Stip. ¶ 13; Stip. Ex. 3), following which ABC protested that denial, and asked for an administrative hearing. Stip. ¶ 14; Stip. Ex. 4.
16. In its protest, counsel for ABC stated, in part, "[A]ll of the Accounts [written off as bad debts] have an unpaid balance remaining that includes the proportional share of the sales taxes paid by ABC. ABC seeks a credit or refund of these amounts, based

on the ratio that the total sales tax bears to the unpaid balances on the accounts, excluding non-taxable charges.” Stip. Ex. 4, p. 2.

**Conclusions of Law:**

Section 6b of the ROTA provides that the Department’s denial of a taxpayer’s claim for credit constitutes prima facie proof that the taxpayer is not entitled to a credit. 35 ILCS 120/6b. The Department’s prima facie case is a rebuttable presumption. The presumption is overcome, and the burden shifts back to the Department to prove its case, only after a taxpayer presents evidence that is consistent, probable and identified with its books and records, to show that the Department’s determinations are wrong. Copilevitz v. Department of Revenue, 41 Ill. 2d 154, 156-57, 242 N.E.2d 205, 206-07 (1968); A.R. Barnes & Co. v. Department of Revenue, 173 Ill. App. 3d 826, 832, 527 N.E.2d 1048, 1052 (1<sup>st</sup> Dist. 1988).

The Department has express authority to make, promulgate and enforce reasonable rules and regulations relating to the administration and enforcement of the ROTA and UTA. 35 ILCS 120/12; 35 ILCS 105/12. Here, ABC relies on retailers’ occupation tax regulation (ROTR) § 130.1960(d) as the authority for its claim for refund. 86 Ill. Admin. Code § 130.1960(d). Within their respective briefs, both parties refer to that regulation as the bad debt regulation. Taxpayer’s Brief, p. 1; Department’s Response Brief, pp. 4-5.

The applicable ROTR provides, in pertinent part:

Section 130.1960 Finance Companies and Other Lending Agencies --  
Installment Contracts -- Bad Debts

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d) Bad Debts

1) In case a retailer repossesses any tangible personal property and subsequently resells such property to a purchaser for use or consumption, his gross receipts from such sale of the repossessed

tangible personal property are subject to Retailers' Occupation Tax. He is entitled to a bad debt credit with respect to the original sale in which the default has occurred to the extent to which he has paid Retailers' Occupation Tax on a portion of the price which he does not collect, or which he is not permitted to retain because of being required to make a repayment thereof to a lending agency under a "with recourse" agreement. Retailers of tangible personal property other than motor vehicles, watercraft, trailers and aircraft that must be registered with an agency of this State may obtain this bad debt credit by taking a deduction on the returns they file with the Department for the month in which the federal income tax return or amended return on which the receivable is written off is filed, or by filing a claim for credit as provided in subsection (d)(3) of this Section. Because retailers of motor vehicles, watercraft, trailers and aircraft do not pay Retailers' Occupation Tax to the Department on retail sales of motor vehicles, watercraft, trailers, and aircraft with monthly returns, but remit the tax to the Department on a transaction by transaction basis, they are unable to take a deduction on the returns that they file with the Department, but may file a claim for credit with the Department, as provided in subsection (d)(3), on any transaction with respect to which they desire to receive the benefit of the repossession credit.

2) Retailers who incur bad debt on any tangible personal property that is not repossessed may also obtain bad debt credit as provided in subsections (d)(1) and (3).

3) In the case of tax paid on an account receivable that becomes a bad debt, the tax paid becomes a tax paid in error, for which a claim for credit may be filed in accordance with Section 6 of the Retailers' Occupation Tax Act, on the date that the Federal income tax return or amended return on which the receivable is written off is filed.

86 Ill. Admin. Code § 130.1960 (2000); 24 Ill. Reg. 18376 (eff. December 1, 2000).

ABC argues that the bad debt regulation allows a retailer to claim a refund or deduction where (1) retailers' occupation tax (ROT) was remitted on the sale and (2) the account is written off as uncollectible for federal tax purposes. Taxpayer's Brief, p. 5. ABC claims that it meets each requirement because it is undisputed that ROT was remitted to the State of Illinois on each of the sales that relate to the Accounts, and it is also undisputed that ABC wrote off its bad debt Accounts on its federal income tax returns and on its books and records. Taxpayer's Brief, p. 5; Stip. ¶¶ 6, 9-10. The Department responds that ABC is not entitled to a credit under ROTR § 130.1960(d)

because it is not a retailer, and because none of the Retailers with whom ABC entered into agreements would have had a claim for a bad debt deduction under the express text of ROTR ¶ 130.1960(d). Department's Response Brief, pp. 5-8.

I agree with the Department that ABC is not entitled to the refunds requested. That conclusion is based on the plain text of the statutory scheme the Illinois General Assembly created to provide a remedy for retailers who, through a mistake of fact or law, paid tax to the Department that was not due. Section 6 of the ROTA provides, in pertinent part:

§ 6. Credit memorandum or refund. If it appears, after claim therefor filed with the Department, that an amount of tax or penalty or interest has been paid which was not due under this Act, whether as the result of a mistake of fact or an error of law, except as hereinafter provided, then the Department shall issue a credit memorandum or refund to the person who made the erroneous payment or, if that person died or became a person under legal disability, to his or her legal representative, as such. ... Claims submitted by the retailer are subject to the same restrictions and procedures provided for in this Act. ... However, as to any claim for credit or refund filed with the Department on and after each January 1 and July 1 no amount of tax or penalty or interest erroneously paid (either in total or partial liquidation of a tax or penalty or amount of interest under this Act) more than 3 years prior to such January 1 and July 1, respectively, shall be credited or refunded, except that if both the Department and the taxpayer have agreed to an extension of time to issue a notice of tax liability as provided in Section 4 of this Act, such claim may be filed at any time prior to the expiration of the period agreed upon.

\*\*\* No credit may be allowed or refund made for any amount paid by or collected from any claimant unless it appears (a) that the claimant bore the burden of such amount and has not been relieved thereof nor reimbursed therefor and has not shifted such burden directly or indirectly through inclusion of such amount in the price of the tangible personal property sold by him or her or in any manner whatsoever; and that no understanding or agreement, written or oral, exists whereby he or she or his or her legal representative may be relieved of the burden of such amount, be reimbursed therefor or may shift the burden thereof; or (b) that he or she or his or her legal representative has repaid unconditionally such amount to his or her vendee (1) who bore the burden thereof and has not shifted such burden directly or indirectly, in any manner whatsoever; (2) who, if he or she has shifted such burden, has repaid unconditionally such

amount to his own vendee; and (3) who is not entitled to receive any reimbursement therefor from any other source than from his or her vendor, nor to be relieved of such burden in any manner whatsoever. No credit may be allowed or refund made for any amount paid by or collected from any claimant unless it appears that the claimant has unconditionally repaid, to the purchaser, any amount collected from the purchaser and retained by the claimant with respect to the same transaction under the Use Tax Act.

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35 ILCS 120/6.

Section 6 of the ROTA “is a special remedial statute. Its general purpose is limited to those who have paid a tax pursuant to the act which, by reason of some mistake of law or fact, they should not have paid.” Peoples Store of Roseland v. McKibben, 379 Ill. 148, 152, 39 N.E.2d 995, 998 (1942). Here, however, ABC has never borne the burden of the tax that is imposed by the ROTA. Retailers’ occupation tax is imposed upon persons engaged in the occupation of selling tangible personal property, at retail, to purchasers for use or consumption in Illinois. *E.g.*, Farrand Coal Co. v. Halpin, 10 Ill. 2d 507, 510, 140 N.E.2d 698, 700 (1957). ABC has stipulated that it is not registered with Illinois as a retailer, and that it did not make sales of property at retail to customers for use in Illinois. Stip. ¶ 1. Rather than engaging in the occupation that is taxed by the ROTA, ABC engaged in the occupation of extending credit to persons who then purchased property at retail for use in Illinois, using the credit that ABC agreed to extend to each such purchaser. Stip. ¶¶ 1, 5. Since the ROTA does not apply to ABC, ABC is not within the class of persons to whom the legislature intended to provide the special remedy authorized by ROTA § 6. 35 ILCS 120/6; Peoples Store of Roseland, 379 Ill. at 152, 39 N.E.2d at 998.

Further, and as a natural result of ABC not being engaged in the occupation that is taxed pursuant to the ROTA, ABC has never paid any amounts of tax that is imposed by

the ROTA to the Department. *See* Stip. ¶ 6; Stip. Ex. 2 (on its Claim forms, ABC entered “0” on all lines in Column A, which is where the claimant is asked to report the amounts reported on its most recent return for the period). As the stipulations in this matter reflect, the actual Retailers from whom ABC’s cardholders purchased property are the persons that collected use tax, plus its selling price for such property, from the purchasers, and then each Retailer paid *its* respective, and corresponding, amount of ROT liability to the Department. Stip. ¶ 6. Since ABC never paid any ROT to the Department, it cannot have paid any such tax in error. ABC, therefore, is not entitled to any refund expressly authorized by ROTA § 6. 35 **ILCS** 120/6; Peoples Store of Roseland, 379 Ill. at 152, 39 N.E.2d at 998.

Nor is ABC entitled to a refund under the plain text of ROTR § 130.1960(d). Notwithstanding ABC’s argument that it satisfies all the requirements of the regulation, it is undisputed that ABC fails to meet the most important requirement — that the person claiming the refund be the retailer who paid ROT regarding a sale in the first place. 86 Ill. Admin. Code § 130.1960(d)(2). Specifically, ROTR § 130.1960(d)(2) expressly provides that “Retailers who incur bad debt on any tangible personal property that is not repossessed may also obtain bad debt credit as provided in subsections (d)(1) and (3).” While the parties stipulate that ABC incurred bad debts because some credit card holders did not pay all they owed to ABC regarding their respective Accounts (Stip. ¶¶ 8-11), it is also clear that ABC is not a retailer. Stip. ¶ 1. Because ABC is not a retailer, it is not entitled to a credit “as provided in subsections (d)(1) and (3)” of ROTR § 130.1960(d). 86 Ill. Admin. Code § 130.1960(d)(2).

Related to this point, ABC asserts that under the agreements it made with its Retailers, it “acquired any and all rights of the Retailers with respect to the Accounts, including all contractual and statutory rights of the Retailers.” Taxpayer’s Brief, p. 6. ABC argues that it “stepped into the shoes of the Retailers for purposes of financing the sale of tangible personal property and acquired the rights of the Retailers.” Taxpayer’s Brief, p. 8. ABC, however, identifies no express contractual provision pursuant to which a Retailer consented to have ABC act, on the Retailer’s behalf, to request a refund of tax that the Retailer paid regarding a sale for which ABC extended credit to a purchaser. And even if it had, ABC’s contracts with others cannot supersede the express provisions of the statutory scheme the Illinois General Assembly created to provide a special and limited remedy to retailers that actually paid ROT in error. *See United Airlines, Inc. v. Johnson*, 84 Ill. 2d 446, 454, 419 N.E.2d 899, 903 (1981) (“The mere fact that United contracted to pay Shell's gross income tax liability does not entitle United to an exemption from the Illinois use tax any more than if United would have contracted to pay any other of Shell's direct tax obligations or overhead charges.”).

Further, while ABC relies on *People ex rel. Stone v. Nudelman*, 376 Ill. 535, 34 N.E.2d 851 (1941), a case in which the Illinois Supreme Court allowed a credit memorandum to be assigned at a time when no such express authorization was included with the ROTA (Taxpayer’s Brief, pp. 6-7), the Illinois legislature long ago amended the ROTA to include its own express authorization for such assignments, under limited circumstances. Specifically, ROTA § 6 now includes the following provision in its first full paragraph:

\*\*\* If it is determined that the Department should issue a credit memorandum or refund, the Department may first apply the amount

thereof against any tax or penalty or interest due or to become due under this Act or under the Use Tax Act, the Service Occupation Tax Act, the Service Use Tax Act, any local occupation or use tax administered by the Department, Section 4 of the Water Commission Act of 1985, subsections (b), (c) and (d) of Section 5.01 of the Local Mass Transit District Act, or subsections (e), (f) and (g) of Section 4.03 of the Regional Transportation Authority Act, from the person who made the erroneous payment. If no tax or penalty or interest is due and no proceeding is pending to determine whether such person is indebted to the Department for tax or penalty or interest, the credit memorandum or refund shall be issued to the claimant; or (in the case of a credit memorandum) the credit memorandum may be assigned and set over by the lawful holder thereof, subject to reasonable rules of the Department, to any other person who is subject to this Act, the Use Tax Act, the Service Occupation Tax Act, the Service Use Tax Act, any local occupation or use tax administered by the Department, Section 4 of the Water Commission Act of 1985, subsections (b), (c) and (d) of Section 5.01 of the Local Mass Transit District Act, or subsections (e), (f) and (g) of Section 4.03 of the Regional Transportation Authority Act, and the amount thereof applied by the Department against any tax or penalty or interest due or to become due under this Act or under the Use Tax Act, the Service Occupation Tax Act, the Service Use Tax Act, any local occupation or use tax administered by the Department, Section 4 of the Water Commission Act of 1985, subsections (b), (c) and (d) of Section 5.01 of the Local Mass Transit District Act, or subsections (e), (f) and (g) of Section 4.03 of the Regional Transportation Authority Act, from such assignee.

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### 35 ILCS 120/6.

This statutory assignment provision does not help ABC here. As the plain text of ROTA § 6 provides, before there may an assignment of a credit memorandum, the Department must first determine that a credit memorandum or refund is properly due to a particular retailer. 35 ILCS 120/6. Yet there is nothing within the Stipulation that clearly establishes that any of the Retailers paid tax in error on any particular transaction for which ABC extended credit to a purchaser. 35 ILCS 120/6. Specifically, there is nothing to suggest that: (1) some sales made by a Retailer to a customer who purchased property using a credit card issued by ABC were not subject to ROT or UT; or that (2) some specific Retailer — as opposed to ABC — incurred some bad debt as a result of the sales

for which ABC extended credit to purchasers. In this respect, ABC's argument is not so much that ABC stands in the shoes of the Retailers, as it is that ABC's bad debts should be treated like the bad debts of a Retailer. But again, ABC is not a retailer, it sold no property at retail, and it had not filed any original returns or paid any ROT to the Department regarding any of the months at issue. Moreover, nothing within the Stipulation shows that some Retailer incurred bad debt — in any amount — as a result of ABC's bad debts. No section within the ROTA, and nothing within ROTR § 130.1960(d), authorizes a credit to be given to a non-retailer under the circumstances described within the parties' Stipulation.

**Conclusion:**

ABC never bore the burden of the tax that is imposed by the ROTA, and it never paid any ROT to the Department. Stip. ¶¶ 1, 5-6. Thus, it never paid any ROT in error, and it is not entitled to a credit under either ROTA § 6 or ROTR § 130.1960(d). I recommend, therefore, that the Director finalize the Department's denial as issued.

January 21, 2009  
Date

John E. White, Administrative Law Judge