

New York State Department of Taxation and Finance
Office of Tax Policy Analysis
Technical Services Division

TSB-A-05(45)S
Sales Tax
December 27, 2005

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION

PETITION NO. S050815A

On August 15, 2005, the Department of Taxation and Finance received a Petition for Advisory Opinion from Grana & Teibel, CPAs, P.C., 300 Corporate Parkway, Suite 116N, Amherst, NY 14226. Petitioner, Grana & Teibel, CPAs, P.C., provided additional information pertaining to the Petition on August 25, 2005.

The issue raised by Petitioner is whether a finance company may claim a credit or refund of the amount of the sales tax included in bad debts from accounts purchased by the finance company at a discount from its affiliated retail vendor when such accounts become uncollectible.

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

Company B (a New York subchapter S corporation for federal and New York State tax purposes) sells items subject to sales tax on a retail basis and, in some instances, provides financing to customers on their purchases. If a customer is a credit risk, the account receivable for the amount financed will be transferred without recourse at a discounted amount to Company A, also a federal and New York subchapter S corporation owned by the same shareholder as Company B. Frequently the retail customers of Company B fail to fulfill their contracts.

Company A only buys Company B's receivables. Company A does not sell its receivables to a third party. The payments by customers on accounts that are purchased by Company A are made to Company A.

Applicable law and regulations

Section 1101(b) of the Tax Law provides, in part:

When used in this article for the purposes of the taxes imposed by subdivisions (a), (b), (c), and (d) of section eleven hundred five and by section eleven hundred ten, the following terms shall mean:

* * *

(8) Vendor. (i) The term "vendor" includes:

(A) A person making sales of tangible personal property or services, the receipt from which are taxed by this article;

Section 1131 of the Tax Law provides, in part:

Definitions- When used in this part IV,

(1) "Persons required to collect tax" or "person required to collect any tax imposed by this article" shall include: every vendor of tangible personal property or services; . . .

Section 1132 of the Tax Law provides, in part:

(a)(1) 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. . . . The tax shall be paid to the person required to collect it as trustee for and on account of the state.

* * *

(d) The tax commission may provide by regulation that the tax upon receipts from sales on the installment plan may be paid on the amount of each installment and upon the date when such installment is due.

(e) The tax commission may provide, by regulation, for the exclusion from taxable receipts . . . of amounts representing sales where . . . 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. . . . (Emphasis added)

Section 1133(a) of the Tax Law provides:

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 to be collected under this article. Any such person shall have the same right in respect to collecting the tax from his customer or in respect to nonpayment of the tax by the customer 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 Sales and Use Tax Regulations provides, in part:

(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 . . . may apply for a refund or credit of the tax paid on such receipt . . . within three years from the date the tax was payable by such person to the Tax Department. . . .

* * *

(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.

(c) Computation of refund or credit. (1) Only the amount attributable to the sales tax imposed and remitted to the Department of Taxation and Finance by the vendor

remaining unpaid by the customer to the vendor is allowable as a refund or credit in respect of a debt determined to be uncollectible.

* * *

(d) Procedures. (1) No credit or refund may be sought until an account has been found to be uncollectible and has been actually charged off for federal income tax purposes.

Opinion

Petitioner presents a scenario in which Company B, a retail vendor, makes retail sales to customers and in some instances provides financing to the customers. When a customer is a credit risk, Company B transfers the account receivable to Company A. Some of the customers whose accounts are sold to Company A fail to fulfill their purchase contracts.

Under section 1101(b)(8) of the Tax Law, Company A is not the vendor of the items that Company B sells to Company B's customers. Since Company B sells the items, Company B is the vendor as defined by section 1101(b)(8) and Company B is responsible for the collection and remittance of the sales tax imposed on its sales. See sections 1131, 1132, and 1133 of the Tax Law. Only the vendor or person required to collect tax is eligible for a refund of, or credit for, the sales tax remitted by it to the State on sales where all or a portion of the receipt for the sale has been ascertained to be uncollectible. See *Matter of General Electric Capital Corp. v NYS Division of Tax Appeals, Tax Appeals Trib.*, 2NY3d 249 [2004]; *Price Waterhouse LLP*, Adv Op Comm T&F, October 1, 1996, TSB-A-96(61)S. Thus, Company A is not entitled to a refund of, or credit for, the sales tax collected and remitted by Company B.

Company B is eligible for a refund or credit for sales tax paid for those accounts receivable sales that it has on its own books and which are determined to be uncollectible. Generally, a vendor is not eligible for a refund or credit for bad debts from receivables assigned to a third party regardless of whether the third party has recourse to the vendor on that debt. (See section 534.7(b) of the Sales and Use Tax Regulations.)

However, section 534.7(b)(4) of the Sales and Use Tax Regulations provides that receivables transferred to a captive finance company by its retail-vendor will not be treated as debts assigned to a third party if the conditions of section 534.7(b)(4)(i) and (ii) are met. In order for an entity to qualify as a captive finance company all of the conditions of section 534.7(a)(5) of the Sales and Use Tax Regulations must be met. If these conditions are satisfied, the vendor will be eligible to claim a refund or credit for the sales tax remitted by it to the State on sales where all or a portion of the receipt for the sale has been ascertained to be uncollectible.

Based on the scenario provided by Petitioner, Company A fails to meet the requirements of section 534.7(a)(5) of the Sales and Use Tax Regulations and, therefore, is not a captive

finance company for purposes of section 534.7. Specifically, the customers' payments on the accounts transferred to Company A are made to Company A and not to Company B. (See section 534.7(a)(5)(v) of the Sales and Use Tax Regulations.) It should be noted that if Company A occasionally extended credit directly to Company B's customers this activity would also disqualify Company A from being a captive finance company. (See section 534.7(a)(5)(iii) of the Sales and Use Tax Regulations.)

Company A does not have recourse to Company B on the debts purchased. Therefore, it does not appear that Company B would be entitled to a refund of, or credit for, tax for bad debts on accounts transferred to Company A even if Company A qualified as an affiliated captive finance company for purposes of section 534.7. (See section 534.7(a)(6) and section 534.7(b)(4)(i) of the Sales and Use Tax Regulations.)

It is noted that the captive finance provisions operate to ensure that the vendor who makes the sale is the same entity that incurs the bad debt and then applies for the refund or credit authorized under section 1132(e) of the Tax Law. Were the relationship between Company A and Company B that of a captive finance company and its related retail vendor and the requirements of section 534.7(b)(4) of the Sales and Use Tax Regulations satisfied, it would be Company B that would be incurring both the bad debt and the entitlement to the sales tax refund or credit.

In the present case, however, any bad debts incurred by Company A arise from sales for which Company B, not Company A, was the retail vendor required to collect and remit sales tax. Company A is not a captive finance company as defined in section 534.7 of the Sales and Use Tax Regulations. Therefore, neither Company A nor Company B is entitled under section 1132(e) of the Tax Law or section 534.7 of the Sales and Use Tax Regulations to claim a refund or credit for the New York State and local sales taxes paid on receipts determined to be uncollectible.

DATED: December 27, 2005

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