

**COMMONWEALTH OF KENTUCKY
KENTUCKY BOARD OF TAX APPEALS
FILE NO. K10-R-25**

HOME DEPOT USA, INC.

APPELLANT

v.

ORDER NO. K-22609

**FINANCE AND ADMINISTRATION CABINET
DEPARTMENT OF REVENUE**

APPELLEE

The parties having filed a joint stipulation of facts; the case having been briefed by the parties on the Appellant's Motion for Partial Summary Judgment on the Issue of Liability; and, the parties having had an oral argument on August 21, 2012, the Board enters the following Conclusions of Law.

BACKGROUND

The taxpayer Home Depot contracted with a third party credit card issuer (a financing company) to handle its private label credit card program ("PLCC"). Home Depot paid the financing company a service fee for administering the program. When a customer makes a purchase with a Home Depot credit card, the financing company advances the money (purchase price and tax) to Home Depot minus the service fee and the customer receives the merchandise. Home Depot remits the sales tax to the Department of Revenue. If the financing company later determines the debt has become uncollectible, the financing company writes off the debt on its federal income tax returns. Home Depot does not have the right to collect the debt from the customer, nor does it write the bad debt off on its income tax returns. Home Depot

writes off the service fee as an expense.

Home Depot seeks a refund of the sales tax that it paid on the bad debts which the financing company incurred for the periods covering 1999-2007, totaling approximately \$900,000 plus applicable interest. The Department of Revenue takes the position that under the plain meaning of KRS 139.350, a retailer may deduct bad debts from its total sales, only if the retailer has charged the bad debt off of its books and on its income tax returns. KRS

139.350 provides as follows:

A retailer may deduct as bad debt the amount found to be worthless and charged off for income tax purposes provided the retailer is reporting and remitting the tax on the accrual basis. The retailer may take the deduction on the return for the period during which the bad debt is written off as uncollectible in the retailer's books and records and is eligible to be charged off for income tax purposes. (emphasis added)

Home Depot argues that the statute does not require that it has to be the one who writes off the uncollectible amounts as bad debts on its own federal income tax returns. Alternatively, Home Depot argues that even if the statute did require it to be the entity to write off the bad debt, it operated as a "unit" with the finance company and together they have satisfied the statute. Home Depot also argues that it effectively wrote off the bad debt when it charged off the service fees that it paid to the finance companies as a business expense and that it bears the risk of loss on the bad debts, because it has fully compensated the finance companies with fee schedules that would cover all of the finance company's bad debt write offs.

Finally, Home Depot argues that if this Board allows the Department of Revenue to deny this refund and retain the money from these defaulted transactions, the state will be unjustly enriched and its Equal Protection and Due Process rights will be violated.

CONCLUSIONS OF LAW

The plain meaning of the statutory language is presumed to be what the legislature intended. Revenue Cabinet v. O'Daniel, 153 S.W.3d 815, 819 (Ky. 2005). This Board must

ascertain the intention of the legislature from the words it used in enacting the statutes. This Board concludes that by the plain meaning of the controlling statute, KRS 139.350, it is clearly the retailer who must have charged off the bad debt on its income tax returns and no one else. The latter portion of the statute, which is underlined above, was added to the provision in 2004. The Board concludes that the statute was clear on its face before the amendment in 2004; however, the amendment in 2004 further clarifies, that it is the retailer who must charge off the bad debt in its books and records, and on its income tax returns.

The Board is not alone in its determination that Home Depot cannot recover a refund when its finance company charges off the bad debts arising from a customer's use of the PLCC. Home Depot has lost this issue in almost every state where there has been litigation on it. See e.g., In Re Sales Tax Claim for Refund of Home Depot, 198 P.3d 902 (Okla. Civ. App. 2008); Home Depot USA, Inc. v. State Dept. of Revenue, 215 P.3d 222 (Washington 2009); Home Depot USA, Inc v. Levin, 905 N.E.2d 630 (Ohio 2009); Home Depot USA, Inc. v. Indiana Dept. of Revenue, 891 N.E.2d 187 (Ind. Tax Court 2008); Home Depot USA v. Tax Appeals Tribunal of New York, 68 A.D. 3d 1571 (New York 2009). There are also several unpublished decisions, wherein Home Depot has lost this issue.

While this Board is not bound by these out-of-state cases, this abundance of caselaw is quite instructive, particularly where the state statutes are similar to Kentucky's provision and where precisely the same arguments are being made by the taxpayer in each of those state cases. For example, in Washington, the state statute at issue in that case provided only that, "a seller is entitled to a credit or refund for sales taxes previously paid on debts which are deductible as worthless for federal income tax purposes." The Court in denying the refund claim held that: Here Home Depot sold all of its interest in the Home Depot card accounts to GECC. ... Home Depot surrendered both its right to deduct these losses as bad debt and its ability to claim a refund for this defaulted debt. ... As a result, Home Depot no longer has the authority to deduct the defaults as bad debts or to seek a sales tax refund. ... Although the tax refund statute at issue does not explicitly contain a requirement that bad debts be deductible by the refund claimant,

analysis of related federal and state tax laws demonstrates that the party seeking the deduction must be the one holding the bad debt. Home Depot v. Washington Department of Revenue , 215 P.3d at 227-228.

The Washington Court also addressed and dismissed the "unit" argument, stating that "GECC and Home Depot did not act as one another's agents nor did they act with any singularity of purpose; rather, they are two separate companies bound by only a negotiated contract." The Court further dismissed the constitutional arguments stating, "Home Depot does not show that it is in the same class as those retailers that finance their own retail sales, GECC is." Id. at 230-231.

This Board holds that Home Depot's "unit," constitutional, and unjust enrichment arguments fail in Kentucky as well. There was no stipulation of fact entered into which described a relationship between the financing company and Home Depot as a unit or as interchangeable entities for taxation purposes. As for the constitutional argument, vendors who extend credit themselves are not, with respect to bad debt, similarly situated to vendors like Home Depot, who hire financial institutions to extend credit. Vendors that extend credit themselves assume the risk of loss along with the burdens of lending and collecting. Home Depot avoided such burdens when it hired the finance company. The differing treatment of a vendor that extends credit itself and a vendor that hires a finance company to extend credit meets the requirements of the Constitution.

Finally, as for the unjust enrichment argument, the sale tax is levied with respect to a consummated sale, and the subsequent default by a consumer on a debt does not undo that original sale that triggered the tax obligation. The statutory bad debt deduction is merely an authorization by the legislature to grant a deduction to certain taxpayers in certain circumstances and the plain meaning of the statutory requirements must be followed in order for the deduction to be applicable.

While Counsel for Home Depot claims that it "felt" these losses, as if it had written off

the bad debts, in actuality, Home Depot neither wrote these bad debts off as losses on its books nor on its income tax returns, and it has not, therefore, met the statutory requirements for the bad debt deduction as they presently exist. The decision as to whether a retailer should also be allowed a bad debt deduction for losses written off by the third-party finance company, is one for the legislature to make.

The Department of Revenue's Final Ruling No. 2010-46 is, therefore, upheld and the refund claims are denied.

This is a final and appealable order. All final orders of this agency shall be subject to judicial review in accordance with the provisions of KRS Chapter 13B. A party shall institute an appeal by filing a petition in the Circuit Court of venue, as provided in the agency's enabling statutes, within thirty (30) days after the final order of the agency is mailed or delivered by personal service. The Board's statute, KRS 131.370(1), provides that the Circuit Court of venue for any party aggrieved by any final order of the Kentucky Board of Tax Appeals, except on appeals from a county board of assessment appeals, is the Franklin Circuit Court or the Circuit Court of the county in which the party aggrieved resides or conducts his place of business. Copies of the petition shall be served by the petitioner upon the agency and all parties of record. The petition shall include the names and addresses of all parties to the proceeding and the agency involved, and a statement of the grounds on which the review is requested. The petition shall be accompanied by a copy of the final order.

A party may file a petition for judicial review only after the party has exhausted all administrative remedies available within the agency whose action is being challenged, and within any other agency authorized to exercise administrative review.

A petition for judicial review shall not automatically stay a final order pending the outcome of the review, unless:

- (a) An automatic stay is provided by statute upon appeal or at any point in the administrative proceedings;
- (b) A stay is permitted by the agency and granted upon request; or
- (c) A stay is ordered by the Circuit Court of jurisdiction upon petition.

Within twenty (20) days after service of the petition of appeal, or within further time allowed by the Circuit Court, the Kentucky Board of Tax Appeals shall transmit to the reviewing court the original or a certified copy of the official record of the proceeding under review in compliance with KRS 13B.140(3).

**DATE OF ORDER
AND MAILING: October 17, 2012**

**KENTUCKY BOARD OF TAX APPEALS
FULL BOARD CONCURRING**

**CECIL DUNN
CHAIR**