THE BOARD OF TAX APPEALS
STATE OF WASHINGTON

KOHL'S DEPARTMENT STORES INC., Appellant, v. STATE OF WASHINGTON, DEPARTMENT OF REVENUE, Respondent.	Docket No. 13-107-2 RE: Excise Tax Appeal FINAL DECISION ON CROSS MOTIONS FOR SUMMARY JUDGMENT ON REMAND

This matter came before the Board of Tax Appeals (the Board), on October 4, 2022, Claire Hesselholt, Chair, presiding, with Board Chair Claire Hesselholt and Vice Chair Lisa Marsh, participating on the panel.[1] Gregg D. Barton, of Perkins Coie LLP, represented the Appellant, Kohl's Department Stores Inc. (Taxpayer). Charles Zalesky and Andrew Krawczyk, Assistant Attorneys General, represented the Respondent, State of Washington, Department of Revenue (Department). The hearing record was kept open until October 25, 2022, for the parties to submit arguments regarding the confidentiality of certain exhibits.

Pursuant to WAC 456-09-545 and the Board's Pre-Hearing Order / Order Establishing Procedural Dates, issued on April 19, 2022, the Taxpayer timely filed a motion for summary judgment. In its Response, the Department requested summary judgment in its favor. The Board heard the oral arguments of counsel and considered all of the written materials provided.

In the original case, the Taxpayer had requested that the specific percentage identified in Schedule 9.2 of the Private Label Credit Card Program Agreement between the Taxpayer and Chase Bank, along with various other parts of the agreement. The Board agreed to "seal" Schedule 9.2 and have the specific percentage redacted from the various documents in the record.[2] The original exhibits, however, do not include Schedule 9.2, or various other parts of the Agreement. In this proceeding, the Department filed new exhibits (which are essentially renumbered versions of its original exhibits), but did not redact the percentage from any of the

[1] Board Member Rosann Fitzpatrick was recused because of her prior involvement in this case while employed by the Office of the Attorney General.
[2] Board's Order on Appellant's Motion to File Documents Under Seal, dated February 29, 2016.

exhibits, and included all the previously redacted information. At the October 4, 2022, hearing, the Board inquired of the parties what their intentions were regarding the previously "sealed" information. The Board allowed the parties time post-hearing to provide written arguments.

The Taxpayer argues that the original order remains in effect and that the Department has not requested any modifications to the order, and requests that the Board take no action on the previous order.[3] The Taxpayer noted that the percentage was unredacted in two of the Department's 2016 exhibits.[4] The Department did not respond.

The Board modifies the 2016 order to be explicit regarding the requirements of the public disclosure act. The Board will maintain the Confidential Materials (the pages in the submitted evidence with the percentage, along with Schedule 9.2) in its files in accordance with the Board's normal practices for confidential materials and the state's records retention policies. The Board will keep the Confidential Materials confidential, subject to the limitations provided in this paragraph. All records within the possession of the Board are public records. If the Board receives a subpoena, court order, or records request that the Board believes will require disclosure of the Confidential Materials, the Board will notify the Taxpayer and counsel of record as soon as possible, at the last addresses on file with the Board, to allow that party ten days to obtain a protection order in superior court prior to any disclosure.

Based on the parties' written submissions and oral arguments, the Board concludes that "there is no genuine issue as to any material fact and that a party is entitled to judgment as a matter of law."[5] The Board grants the Department's motion for summary judgment and denies the Taxpayer's motion for summary judgment.

ISSUE

Is the Taxpayer eligible for RCW 82.08.037's bad debt sales tax credit and RCW 82.04.4284's B&O tax deduction? Short answer: No.

[3] Appellant's Memorandum re Protective Order dated October 17, 2022.
[4] *Id.* The Board has located three pages showing the percentage in the 2016 exhibits.
[5] WAC 456-09-545.

FINDINGS OF FACT

1. The Department audited the Taxpayer's books and records for the period January 1, 2007, through March 31, 2010, and issued an assessment of retail sales and retailing business and occupation (B&O) tax, plus interest. The Taxpayer appealed the assessment, which the Department affirmed in Determination No. 13-0178.
2. The Taxpayer timely appealed that determination to this Board. In Docket No. 13-107, the Board granted summary judgement to the Department, denying the Taxpayer's claim.
3. The Taxpayer appealed that decision to the Thurston County Superior Court. The Superior Court stayed the appeal pending the outcome of another case raising some of the same issues. After the Supreme Court issued its decision in that case, the Superior Court remanded this appeal to back to the Board, and the parties have again requested summary judgment.
4. The Taxpayer owned and operated more than a dozen retail department stores in Washington during the audit period.[6] During that time, the Taxpayer offered its customers a store-branded private label credit card that was issued to its customers by Chase Bank.[7]
5. Under the agreement between Chase and the Taxpayer, signed in March 2006, the Taxpayer agreed to accept the credit card as payment for purchases, including sales tax, made at its stores.[8] The Taxpayer transmits transaction data to Chase daily, and Chase daily pays the Taxpayer the total amounts of any credits less any returns or card payments received.[9]
6. Under the contract, Chase was "the sole and exclusive owner" of all the credit accounts and documentation.[10] The Taxpayer had no "right, title or interest" in any of the accounts or account documentation or any proceeds of the accounts.[11]

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[6] *Kohl's Department Stores, Inc., v. Dep't of Revenue*, Docket No. 13-107, at 2, (2016).
[7] *Id.* There was a brief part of the audit period where the Taxpayer issued its own cards, but those accounts were transferred to Chase when the contract was signed. *See also* Exhibit R3-006.
[8] *Id. See also* Exhibit R3-029, §8.1.
[9] Exhibit R3-030, §§ 8.4 and 8.5.
[10] Exhibit R3-019.
[11] *Id.*

7. The contract provided that Chase would pay a percentage of risk adjusted yield monthly to the Taxpayer for its work in servicing the accounts.[12] *Risk adjusted yield* is contractually defined as "financing income" minus program net losses.[13] *Financing income* is finance charges, late fees, accrued interest and similar fees, minus "concessions and reversals (but not write-offs)."[14] "Risk adjusted yield," therefore, means financing income minus program net losses.[15] *Program net losses* means the amounts written off in accordance with GAAP, less any amount recovered that had previously been written off, "(excluding sales tax recoveries)."[16] The percentage is fixed.[17] Put more simply, Chase pays the Taxpayer a percentage of net finance and interest charges on the account for its servicing activities.

Any Conclusion of Law that should be deemed a Finding of Fact is hereby adopted as such.

APPLICABLE LAW

During the audit period, RCW 82.08.037 provided a credit for sales taxes paid on bad debts:

> (1) A seller is entitled to a credit or refund for sales taxes previously paid on bad debts, as that term is used in 26 U.S.C. Sec. 166, as amended or renumbered as of January 1, 2003.
> (2) For purposes of this section, "bad debts" does not include:
> (a) Amounts due on property that remains in the possession of the seller until the full purchase price is paid;
> (b) Expenses incurred in attempting to collect debt;
> (c) Repossessed property.
> (3) If a credit or refund of sales tax is taken for a bad debt and the debt is subsequently collected in whole or in part, the tax on the amount collected must be paid and reported on the return filed for the period in which the collection is made.
> (4) Payments on a previously claimed bad debt are applied first proportionally to the taxable price of the property or service and the sales or use tax thereon, and secondly to interest, service charges, and any other charges.

The corresponding B&O tax deduction, at RCW 82.04.4284, provides:

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[12] Exhibit R3-119. In the first eight months of the contract, the formula was slightly different.
[13] Exhibit R3-061.
[14] *Id.*
[15] *Id.*
[16] *Id.*
[17] Exhibit R3-119.

> (1) In computing tax there may be deducted from the measure of tax bad debts, as that term is used in 26 U.S.C. Sec. 166, as amended or renumbered as of January 1, 2003, on which tax was previously paid.
> (2) For purposes of this section, "bad debts" do not include:
> (a) Amounts due on property that remains in the possession of the seller until the full purchase price is paid;
> (b) Expenses incurred in attempting to collect debt;
> (c) Sales or use taxes payable to a seller; and
> (d) Repossessed property.
> (3) If a deduction is taken for a bad debt and the debt is subsequently collected in whole or in part, the tax on the amount collected must be paid and reported on the return filed for the period in which the collection is made.
> (4) Payments on a previously claimed bad debt must be applied under RCW 82.08.037(4) and 82.12.037, according to such rules as the department may prescribe.

In 2020, the Washington Supreme Court issued a decision in a similar case, *Lowe's Home Centers, LLC v. Dept. of Revenue.*[18] In that case, the court explained that Lowe's contracted with two different banks to offer private label credit cards to its customers, and "agreed to repay the banks for losses they sustained on defaulting customer accounts."[19]

> The banks undertook the majority of the risk of defaulting cardholders, and Lowe's contracted to mitigate this risk by acting as guarantor. When credit card holders failed to repay the purchase price and sales tax, Lowe's agreed to reimburse the banks. The contract calculated Lowe's share of the banks' finance income by providing that Lowe's "shall be responsible for Net Write-Offs during such year up to a maximum of 7.0% of Average Net Receivables." Clerk's Papers (CP) at 140. The contract termed these repayments "bad debt guarantees" and stated that Lowe's alone could claim bad debt relief. *E.g., id.* at 454. Each month the banks subtracted amounts it had written off as uncollectible (up to the 7.0 percent cap) from the amounts it could collect from cardholders.[20]

The court explained that eligibility requires that the taxpayer "(1) be a seller (2) making sales at retail and (3) entitled to a refund for sales taxes previously paid on bad debts (4) that are federally deductible."[21]

[18] *Lowe's Home Centers, LLC v. Dept. of Revenue,* 195 Wn.2d 27, 455 P.3d 659 (2020).
[19] *Id.* at 30-31.
[20] *Id.* at 31-32 (internal footnote omitted).
[21] *Id.* at 32.

The court found that "no one questions that Lowe's was the seller and that Lowe's assumed the legal liability for losses attributable to its customers who defaulted, including unpaid sales tax. That "the bad debt was created in two steps rather than one is of no moment" because the policy of the bad debt deduction is to provide relief to sellers holding uncollectable sales tax.[22]

Finally, the court noted that under 26 CFR §1.166-9(a), "[t]hese provisions entitled Lowe's to the sales and B&O tax credits because its payments, in the form of the banks' deductions from its profit share and made pursuant to an agreement executed before the debt became worthless, discharged its legal obligation as a guarantor of the sales and B&O tax bad debt."[23]

The federal regulations provide that a taxpayer may treat a payment of principal in discharge of an obligation as a guarantor as a worthless business debt, assuming it meets the requirements under subsections (c), (d), or (e).[24]

As relevant to this case, 26 C.F.R. §1.166(9)(d)(2) provides that a debt is treated as worthless if "[t]here was an enforceable legal duty upon the taxpayer to make the payment (except that legal action need not have been brought against the taxpayer)."

ARGUMENTS OF THE PARTIES

The Taxpayer asserts that it is entitled to a refund of $130,559.44, representing sales and B&O taxes paid on bad debts. The Taxpayer argues that it satisfies each requirement set out in *Lowe's*, and that the Department has conceded that it met the first two requirements.[25]

The Taxpayer compares itself to Lowe's, and argues that it also agreed to guarantee a part of Chase's bad debt because of the deduction from the amount used to calculate its payments for the servicing activities.[26] The Taxpayer also argues that the *Lowe's* reasoning on the applicability of 26 C.F.R. § 1.166-9 (a) and (d) applies equally here.

The Board's initial decision relied heavily on *Home Depot, USA, Inc. v. Dep't of Revenue.*[27] The Board explained that under *Home Depot*, the taxpayer claiming the bad debt had

[22] *Id.* at 41-42.
[23] *Id.* at 42.
[24] 26 C.F.R. §1.166-9 (a).
[25] Taxpayer's MSJ at 12.
[26] *Id.* at 14.
[27] *Home Depot, USA, Inc. v. Dep't of Revenue,* 151 Wash. App. 909, 215 P.3d 222 (2009).

to be the one to whom payment would be made, and in this case, the Taxpayer was not the entity entitled to payment.[28]

The Board concluded that because Chase could "claim the unpaid sales tax as a bad debt does not transform the Taxpayer's reduced servicing income into a refundable sales tax debt."[29] The Board was unconvinced that the Taxpayer was the guarantor of the debts because it agreed "to absorb a portion of [Chase's] losses."[30]

The Board's decision also found "unpersuasive" that the Taxpayer was the guarantor of the debts. The Board found that the Taxpayer did not qualify under 26 C.F.R. §1.166-9 (c) because it found that regulation required that the taxpayer have an enforceable legal duty to make the payment and the Taxpayer had no such duty to make any payments to Chase, nor did the Taxpayer have any intention of making a claim against its customers for any payments.[31]

The Taxpayer argues that the *Lowe's* finding that Lowe's was entitled to bad debt deductions for sales and B&O taxes because its payments "in the form of the bank's deductions from its profit share . . . discharged its legal obligation as a guarantor of the sales and B&O tax bad debt."[32] The Taxpayer argues that its agreement with Chase is the same as the agreements in *Lowe's*, and that it also, like Lowe's, took a bad debt deduction on its federal returns.[33]

The Department argues that the Taxpayer is not entitled to the refund it seeks because it does not "meet the requirements for claiming a bad debt loss under Internal Revenue Code §166 and Treasure Regulation § 1.166-9."[34] Secondly, if it is entitled to claim the deduction and credit, it has not "met its burden of proving the correct amount of bad debt it is entitled to claim" because it cannot disentangle the amounts it paid in exchange for consideration and the amounts previously collected in finance fees from any claimed 'guaranty payments.'"[35]

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[28] *Kohl's Department Stores, Inc. v. Dept of Revenue*, Docket No. 13-107, at 7 (2016).
[29] *Kohl's,* at 8.
[30] *Id.*
[31] Docket No. 13-107, at 9, citing to 26 C.F.R. § 1.166-9 (d)(2) and (3).
[32] Taxpayer's MSJ, at 14, citing *Lowe's,* 195 Wn.2d at 42.
[33] Taxpayer's MSJ at 15.
[34] Department's Response to Taxpayer's Motion for Summary Judgment (Department's Response), at 3.
[35] *Id.* at 3-4.

ANALYSIS AND CONCLUSIONS

Summary Judgment Standard. The purpose of summary judgment "is to avoid a useless trial."[36] Summary judgment is appropriate where "the written record shows that, viewing the evidence in a light most favorable to the nonmoving party, [1] there is no genuine issue as to any material fact and that [2] a party is entitled to judgment as a matter of law"[37] A *material fact* is one upon which the outcome of the litigation depends.[38] The Board's role in this appeal is to determine, in light of the facts and the applicable law, whether either party is entitled to judgment as a matter of law. A genuine issue of material fact exists only if reasonable minds could differ on the facts that control the result of the litigation.[39] With each party requesting summary judgment in its favor, the parties necessarily agree that there is no genuine issue of material fact that would make an evidentiary hearing necessary.[40] Thus, the only issues left to be resolved are legal issues.

The Taxpayer argues that this case is controlled by the Washington Supreme Court's decision in the *Lowe's* case. The Department agrees that *Lowe's* applies, but disputes whether the Taxpayer has met the requirements outlined in that case.

The dispute hinges on whether the Taxpayer is guaranteeing the payments for uncollectable accounts to Chase. Uncollectable amounts are deducted from the amount used in the calculation of the Taxpayer's compensation for servicing the accounts. The Taxpayer is not directly paying Chase for the uncollectable amounts, but claims that it is indirectly paying because of the reduction in its compensation.

In *Lowe's,* the court noted that "if a taxpayer agrees in the course of business to act as a *guarantor* of a debt obligation and makes a payment of principle or interest in discharge of that obligation as a guarantor" then the payment is treated as a business debt in the taxable year under 26 C.F.R §1.166-9(a).[41] The court noted that Lowe's had contracted to act as guarantor for its customers who defaulted on credit payments: "no one questions that Lowe's was the seller and that Lowe's assumed the legal liability for losses attributable to customers who defaulted,

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[36] *Balise v. Underwood*, 62 Wn.2d 195, 199, 381 P.2d 966 (1963).
[37] WAC 456-09-545; *see also* CR 56(c).
[38] *Haines-Marchel v. Dep't of Correc*tions, 183 Wn. App. 655, 662, 334 P.3d 99 (2014).
[39] *Ranger Ins. Co. v. Pierce County*, 164 Wn.2d 545, 552, 192 P.3d 886 (2008).
[40] *See Pleasant v. Regence Blue Shield*, 181 Wn. App. 252, 261, 325 P.3d 237 (2014), citing *Tiger Oil Corp. v. Dep't of Licensing*, 88 Wn. App. 925, 930, 946 P.2d 1235 (1997).
[41] *Lowe's*, 195 Wn.2d at 36.

including unpaid sales tax."[42] The court distinguished *Home Depot* by noting that "the financier was completely responsible for all its bad debt relating to nonpayment of retail sales tax and never agreed to act as Home Depot's guarantor, while here Lowe's agreed to guarantee a portion of the banks' credit card related bad debt for sales taxes previously paid that were 'written off as uncollectible.'"[43]

In *Home Depot*, the appellate court specifically found that the statutory sales tax debt transferred to the financing entity when the account was transferred.[44] Home Depot also argued that it bore the loss for the defaulted accounts, because the fees were set with consideration of the bad debt expense.[45] Because the court found that Home Depot was not legally responsible for the bad debts, it was not entitled to the credit.

There is nothing in the contract between the Taxpayer and Chase to indicate that the Taxpayer is guaranteeing payments from the defaulting accounts. The contract explicitly states that the Taxpayer has no right, title or interest in the accounts. The contract also provides revenue to the Taxpayer for its servicing of the accounts. As part of the calculation of that revenue, Chase deducts uncollectable accounts, and then multiplies that amount by a percentage to determine the Taxpayer's revenue.

Here, as in *Home Depot*, the parties incorporated the anticipated uncollectable debt into the revenue for the Taxpayer's servicing activities. But that financial decision does not turn the calculation into a guarantee of payment to Chase. Because the Board finds that the Taxpayer is not a guarantor of the accounts to Chase, it is not eligible for either the sales tax credit or B&O tax deduction. Given this resolution, it is unnecessary to reach the Department's other arguments about the Taxpayer's eligibility for federal debt relief under 26 C.F.R. §1.166(9), or whether the Taxpayer has adequately documented the refund it claims.

CONCLUSIONS OF LAW

1. The Board has jurisdiction over this appeal.[46]
2. The purpose of summary judgment "is to avoid a useless trial."[47]

[42] *Id.* at 41.
[43] *Id.* at 42.
[44] *Home Depot*, 151 Wash. App. at 922.
[45] *Id.* at 923.
[46] RCW 82.03.130.
[47] *Balise v. Underwood*, 62 Wn.2d at 199.

3. Summary judgment is appropriate where " "the written record shows that, viewing the evidence in a light most favorable to the nonmoving party, [1] there is no genuine issue as to any material fact and that [2] a party is entitled to judgment as a matter of law"[48]
4. The Board's role in this appeal is to determine, in light of the facts and the applicable law, whether either party is entitled to judgment as a matter of law. Factual issues may be decided on summary judgment when reasonable minds could reach but one conclusion from the evidence presented.[49] A *material fact* is one upon which the outcome of the litigation depends.[50] A genuine issue of material fact exists only if reasonable minds could differ on the facts that control the result of the litigation.[51] With each party requesting summary judgment be granted in its favor, the parties necessarily agree that there is no genuine issue of material fact that would make an evidentiary hearing necessary.[52]
5. Exemptions to a tax law are narrowly construed, taxation is the rule and exemption is the exception.[53] Anyone claiming a benefit or deduction from a taxable category has the burden of showing that he qualifies for it.[54] To be exempt, property must meet the qualifications for exemption by the time the tax is imposed on the property.[55] In a case addressing a claim of property tax exemption, the taxpayer bears the burden of proving it qualifies for the tax exemption.[56]
6. RCW 82.08.037 provides a credit for sales taxes previously paid on bad debts.
7. RCW 82.04.4284 provides a deduction for B&O taxes previously paid on bad debts.
8. Washington's Supreme Court has explained eligibility for the credit and deduction as follows: "(1) be a seller (2) making sales at retail and (3) entitled to a refund for sales taxes previously paid on bad debts (4) that are federally deductible."[57]

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[48] WAC 456-09-545; *see also* CR 56(c).
[49] *Lane v. Harborview Med. Ctr.,* 154 Wn. App. 279, 288, 227 P.3d 297 (2010).
[50] *Haines-Marchel*, 183 Wn. App. at 662.
[51] *Ranger Ins.*, 164 Wn.2d at 552.
[52] *See Pleasant v. Regence*, 181 Wn. App. at 261, citing *Tiger Oil*, 88 Wn. App. at 930.
[53] *Budget Rent-A-Car of Washington-Oregon, Inc. v. Dep't of Revenue*, 81 Wn.2d 171,174, 500 P.2d 764 (1972).
[54] *Id.* at 175, citing *Group Health Coop. of Puget Sound v. Tax Comm'n,* 72 Wn.2d 422, 433 P.2d 201 (1967).
[55] *See Timber Traders, Inc. v. Johnston*, 87 Wn.2d 42, 45, 548 P.2d 1080 (1976); RCW 84.36.005; *see also* RCW 84.40.020 (listing of taxable property); RCW 84.40.175 (listing of exempt property).
[56] *See In re Sehome Park Care Ctr., Inc.*, 127 Wn.2d 774, 778, 903 P.2d 443(1995).
[57] *Lowe's,* 195 Wn.2d. at 32.

9. In *Lowe's*, the Court explained that to be federally deductible, the taxpayer had to be the guarantor of the debt; and in that case, Lowe's was the guarantor and therefore qualified for the federal deduction.[58]
10. The agreement between the Taxpayer and Chase bank transfers "all right, title and interest" in the accounts to Chase, and Chase is the "sole and exclusive" owner of the account, and the Taxpayer has no interest in those accounts.
11. Nothing in the agreement designates the Taxpayer as a guarantor of the accounts to chase, or provides that the Taxpayer has any obligation to pay Chase any amounts for uncollectable accounts.
12. The deduction of uncollectible amounts in the calculation of payment for the Taxpayer's servicing of the accounts does not make the Taxpayer a guarantor of the uncollectable accounts.
13. If the Taxpayer is not the guarantor of the uncollectable debts, it is does not qualify for the sales tax credit under RCW 82.08.037 or the B&O tax deduction under RCW 82.04.4284.

Any Finding of Fact that should be deemed a Conclusion of Law is hereby adopted as such.

DECISION

For the forgoing reasons, and pursuant to WAC 456-09-545, the Board hereby grants the Department's Motion for Summary Judgment and denies the Taxpayer's Motion for Summary Judgment, upholding the holding of the Department's Determination No. 13-0178, issued June 13, 2013.

ISSUED November 28, 2022.

BOARD OF TAX APPEALS

CLAIRE HESSELHOLT, Chair

LISA MARSH, Vice Chair

[58] *Id.* at 42.

Right of Reconsideration of a Final Decision

You may file a petition for reconsideration of this Final Decision.[59] The petition must be filed within 14 days of the date the Final Decision is issued.[60] You also must serve a copy of your petition on all other parties.[61]

The petition must clearly state the specific grounds for relief.[62] It may not exceed 3,000 words (approximately 6 pages), and must be typed and double-spaced.[63] No new evidence or arguments may be raised unless the written decision is based on a fact or facts that the parties did not already have an opportunity to address.

Any party may submit a response to the petition within 10 days of the petition being served.[64] The Board will either accept or deny the petition within 30 days.[65]

Note that when an appeal is made to superior court, the appealing party is responsible for ordering and paying for a transcript of the Board's hearing.[66]

[59] WAC 456-09-955.
[60] WAC 456-09-955(2).
[61] WAC 456-09-345.
[62] WAC 456-09-955(2).
[63] WAC 456-09-557(1)(a-b) and (2)(d).
[64] WAC 456-09-955(3).
[65] WAC 456-09-955(4).
[66] WAC 456-09-960.