Legislative Fiscal Bureau

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February 19, 2014

TO: Members
Joint Committee on Finance

FROM: Bob Lang, Director

SUBJECT: Assembly Bill 644 and Senate Bill 490: Sales and Use Tax Refund of Bad Debt for Private Label Credit Card Companies

Senate Bill 490 was introduced on January 10, 2014, and was referred to the Senate Committee on Workforce Development, Forestry, Mining, and Revenue. On January 22, 2014, that Committee adopted Senate Amendment 1 on a vote of 5 to 0 and recommended the bill, as amended, for passage on a vote of 5 to 0.

Assembly Bill 644 was introduced on January 21, 2014, and was referred to the Assembly Committee on Ways and Means. On February 6, 2014, that Committee adopted Assembly Amendment 1 on a vote of 10 to 0 and recommended the bill, as amended, for passage on a vote of 10 to 0. The bill was then referred to the Joint Committee on Finance.

Both the original and amended versions of AB 644 and SB 490 are identical.

CURRENT LAW

Under current law, a seller may claim a deduction on the seller's subsequent sales and use tax return for the amount of any bad debt that the seller writes off as uncollectible (such as a declined payment on a check or a default on a line of credit owned and extended by the seller) in the seller's books and records and that is eligible to be deducted as a bad debt for federal income tax purposes. If the seller does not have any taxable sales for that period, the seller may claim a refund for the amount of sales tax previously paid within four years of the due date of its corresponding Wisconsin income or franchise tax. If the seller subsequently collects, in whole or in part, any bad debt for which a deduction or refund was claimed, the seller must include the amount collected in the return filed for the period in which the amount was collected and must pay the tax with the return. These provisions do not apply to credit extended by third-party lenders.

SUMMARY OF BILLS

AB 644 and SB 490 would create the following provisions for laws governing return adjustments under the general sales and use tax, which would only apply with respect to credit sale transactions included in the account or receivable that is charged off on the lender's books and records for private label credit cards, dual purpose credit cards, and credit dealer programs.

The bills would permit a lender who extends credit through a private label credit card, dual purpose credit card, or dealer credit program to enter into an agreement with a seller so that the seller, the lender, or an affiliate of the lender could claim a sales and use tax deduction or a refund if all of the following apply:

a. The seller previously reported and paid the tax due related to the bad debt.

b. No deduction or refund was previously claimed by, or allowed to, either the seller or the lender on the bad debt.

c. The amount for which the seller or lender claims a deduction or refund is limited to credit sale transactions included in the account or receivable that is charged off on the lender's books and records after December 31, 2013, regardless of the date on which the credit sale transaction occurred.

d. The seller and lender designate which party is entitled to claim the deduction or refund, specify that designation on the written agreement between the seller and the lender, and make the agreement available for review by the Department of Revenue (DOR). The written agreement would have to also provide that if the party that is entitled to the deduction or refund is no longer in business, the other party could claim the deduction or refund.

A seller or lender who would be eligible to claim a deduction or a refund from the tax under these provisions would have to maintain adequate books, records, or other documents to support the deduction or refund. That seller or lender would have to use one of the following three methods to determine the amount of the deduction or refund:

a. An apportionment method that determines the amount of the sales or use tax included in the bad debt to which the deduction or refund applies using the seller's in-state and out-of-state sales, the seller's taxable and nontaxable sales, and the amount of the tax the seller remitted to the state.

b. A specified percentage of the accounts or receivables giving rise to the deduction or refund, if the specified percentage is derived from a sampling of the seller's or lender's records, as appropriate, in accordance with a methodology agreed on by DOR and the seller or lender, as appropriate. In order to compute the deduction or refund, payments on the accounts or receivables would have to be allocated based on the terms and conditions of the contract between the seller or lender and the consumer.

c. A direct method approved by DOR.

A seller or lender who claims a deduction or refund under these provisions and who subsequently collects, in whole or in part, any amount for which the deduction or refund was claimed, would have to include the taxable percentage of the amount collected and pay the tax on the return filed for the period corresponding to the date when the amount was collected. A seller's or lender's deduction for tax paid on bad debt could be claimed by an entity related to the seller or lender if the entity was related by a direct or indirect common ownership of 50% or more.

AB 644 and SB 490 would create the following definitions to apply to the provisions described above.

a. "Dealer credit program" would mean an arrangement for extending credit for a specific purchase from a seller, not including the purchase of an aircraft, a motor vehicle, a vessel, a motor home, or any other item for which a title is required.

b. "Dual purpose credit card" would mean a credit card that may be used as a private label credit card or to make purchases from persons other than the seller whose name or logo appears on the card or the seller's affiliates or franchises, if the credit card issuer is able to determine the sales receipts of the seller and the seller's affiliates or franchisees apart from any sales receipts of unrelated persons.

c. "Lender" would mean any person who owns a private label credit card account, a dual purpose credit card account, or a dealer credit program account, or an interest in a receivable from any such account, if: (1) the person purchased the account or interest directly from a seller who remitted the sales or use tax or from the seller's affiliate; (2) the person received the account or interest from a third party; or (3) the person originated the account or interest pursuant to the person's contract with the seller who remitted the sales or use tax or with the seller's affiliate. A "lender" would include any person who is a member of the same affiliated group for purposes of federal income tax law or who is an assignee or a transferee of a lender.

d. "Private label credit card" would mean any charge card or credit card that identifies a seller's name or logo on the card and that may be used only for purchases from that seller or from any of the seller's affiliates or franchisees.

e. "Seller's affiliate" would mean any entity that is a member of the same affiliated group for purposes of federal income tax law as the seller that may file a single consolidated return for federal income tax purposes.

These provisions would first apply to taxable years beginning on January 1, 2014.

The bills would permit certain types of third-party lenders (as described above) to enter into an agreement with a seller so that the seller, the third-party lender, or an affiliate of the third-party lender or the seller could claim a deduction or refund for bad debt in a manner similar to current law for the amount of sales tax remitted on taxable purchases that result in bad debt for the lender due to nonpayment by the purchaser. AB 644 and SB 490 would provide three methods for which these entities could apportion bad debt to the state (two of which would be based on estimated taxes paid by the seller rather than the actual amount of tax paid), whereas current law specifies that a taxpayer must apportion the amount of bad debt to the state in the manner prescribed by DOR.

SUMMARY OF ASSEMBLY AMENDMENT 1 AND SENATE AMENDMENT 1

AA 1 to AB 644 and SA 1 to SB 490 would specify that, in addition to the conditions that would have to be met under the bills for a lender to claim the proposed deduction or refund for bad debt, the credit sale transaction would have to have occurred with the seller's business or with the business of the seller's affiliate or franchisee. As a result, the amendments would clarify that a lender who had entered into an agreement with a seller to claim the proposed bad debt deduction or refund on a dual purpose credit card would not be permitted to claim a deduction for bad debt attributed to sales made to other sellers that are not affiliated with the seller with whom the lender had entered into an agreement.

FISCAL EFFECT

Based on information from state sales and use tax returns, Fitch Rating's Retail Credit Card Charge-off Index, and other information from the consumer lending industry, DOR estimates that these provisions would reduce sales and use tax revenues by approximately $8,000,000, annually. Since these provisions would apply retroactively for bad debts written off after December 31, 2013, regardless of the date on which the credit sale transaction actually occurred, it is estimated that the bills would reduce sales and use tax revenues by $4,000,000 in 2013-14 and by $8,000,000 in 2014-15. The amended version of the bills would clarify the bills' intent and is not anticipated to change the estimated fiscal effect; however, the amendments may prevent a lender from claiming additional bad debt deductions or refunds beyond what had been previously contemplated under the bills.

It should be noted that it is possible that the bills would violate certain provisions of the Streamlined Sales and Use Tax Agreement (SSUTA). DOR reports that the state collects approximately $4,000,000 annually from retailers who voluntarily remit use tax to the state (and other SSUTA member states) even though those retailers do not have a physical presence in Wisconsin. The Agreement requires that, to the extent a member state provides a bad debt deduction to any other party, the same procedures must apply. The bills would create a separate method for providing a bad debt deduction and, as a result, may be found out of compliance with the Agreement. If the state were to be found out of the compliance, it is possible that those retailers would no longer remit tax to the state and the bills could reduce state revenues by an additional $4,000,000, annually. In addition, pursuant to 2013 Wisconsin Act 20, if federal law were to expand the state's ability to require sellers without a physical presence in this state to collect and remit sales and use taxes on remote sales to Wisconsin residents, such revenues must be first used to eliminate the alternative minimum tax and then to further reduce income tax rates to result in an equal reduction in income tax revenue as the increased sales and use tax revenue resulting from the federal law change. Legislation pending in the U.S. Congress would permit SSUTA member states to require use tax collection from certain retailers that are not currently required to collect the tax on sales to Wisconsin residents. If the state were to be found out of compliance with the Agreement, were not longer a SSUTA member state, and Congress were to enact this pending legislation, the potential federal law change would not result in the state being able to collect such revenues and the automatic income tax deductions that were enacted in Act 20 would not occur.

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