STATE OF NEW YORK

TAX APPEALS TRIBUNAL

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| In the Matter of the Petition | : | |
| of | : | |
| **HOME DEPOT U.S.A., INC.** | : | DECISION<br>DTA NO. 821034 |
| for Revision of a Determination or for Refund of Sales and Use Taxes under Articles 28 and 29 of the Tax Law for the Period March 1, 1997 through July 31, 2003. | : | |

Petitioner, Home Depot U.S.A., Inc., filed an exception to the determination of the Administrative Law Judge issued on May 17, 2007. Petitioner appeared by Morrison & Foerster, LLP (Irwin M. Slomka, Esq. and Amy F. Nogid, Esq., of counsel). The Division of Taxation appeared by Daniel Smirlock, Esq. (James Della Porta, Esq., of counsel).

Petitioner filed a brief in support of its exception. The Division of Taxation filed a brief in opposition and petitioner filed a brief in reply. Oral argument, at petitioner's request, was heard on May 14, 2008 in Troy, New York.

After reviewing the entire record in this matter, the Tax Appeals Tribunal renders the following decision. Commissioner McDermott concurs for the reasons set forth in a separate opinion.

## *ISSUES*

I. Whether the Division of Taxation properly denied petitioner's claim for refund of sales and use taxes paid on transactions that were financed by third parties and subsequently were ascertained to be uncollectible.

II. Whether the Division of Taxation's regulation at 20 NYCRR 534.7(b)(3) should be determined to be invalid due to an inconsistency with the intent of Tax Law § 1132(e).

III. Whether petitioner is entitled to equitable relief if it is found that the State of New York is being unjustly enriched, contrary to the spirit and intent of Tax Law § 1132(e).

IV. Whether the Division of Taxation has violated petitioner's right to equal protection of the laws and its right to due process under the Federal and New York State constitutions by failing to refund the sales and use taxes remitted by petitioner.

## *FINDINGS OF FACT*

We find the facts as determined by the Administrative Law Judge except for finding of fact "25" which has been modified. The Administrative Law Judge's findings of fact and the modified finding of fact are set forth below.

Home Depot U.S.A., Inc. ("Home Depot") is a Delaware corporation headquartered in Atlanta, Georgia, which operated retail home improvement centers throughout the United States, including New York, during the period March 1, 1997 through July 31, 2003 (the "audit period").

During the audit period, Home Depot provided its customers with the option of purchasing merchandise through a private label credit card.

Home Depot entered into an Amended and Restated Consumer Credit Card Program Agreement with Monogram Credit Card Bank of Georgia ("Monogram"), dated August 4, 1997, to issue and finance Home Depot private label credit cards to consumers. In addition, Home Depot entered into an Amended and Restated Commercial Credit Program Agreement and an Amended and Restated Business Credit Card Program Agreement with General Electric Capital Corporation ("GECC"), both dated August 4, 1997, to issue and finance Home Depot private label credit cards to commercial businesses. Hereinafter, all three agreements are referred to

collectively as the "Credit Card Program Agreements." The Credit Card Program Agreements were complete documents reflecting the furnishing of private label credit card programs to Home Depot.

Monogram and GECC applied creditworthiness standards to the applications, issued to qualified customers private label credit cards bearing the "Home Depot" name and entered into credit card agreements with these customers. Monogram and GECC, in their sole discretion, determined the creditworthiness of all individual applicants for credit cards.

During the period in issue, Home Depot did not have an equity interest in either Monogram or GECC.

Home Depot was a vendor of tangible personal property or services as defined in Tax Law § 1131(1), was registered to collect New York State and local sales tax as required by Tax Law § 1134 and remitted sales tax to the Division of Taxation ("Division") on New York sales based on the full purchase price of taxable merchandise, including credit card sales of merchandise.

For each sale made to a customer using the Home Depot private label credit card, Monogram or GECC paid to Home Depot the purchase price and sales tax less a credit card service fee as provided in the Credit Card Program Agreements. The service fee varied depending on the type and amount of the sales transaction financed.

Home Depot recorded an accounts receivable from Monogram or GECC related to each sale subject to a Credit Card Program Agreement, but did not record an account receivable from the customer with respect to such credit card transactions.

Although not specified in the Credit Card Program Agreements, the parties agreed that the credit card service fees were determined by several factors, including the bad debt experience of Home Depot's credit card customers, the interest income that Monogram or GECC anticipated it

would earn and that Home Depot forwent on the credit card account, the value of Home Depot's credit card database given to Monogram and GECC, and the administrative costs associated with the managed credit accounts by Monogram and GECC.

Home Depot compensated Monogram and GECC in advance for anticipated bad debts through the credit card service fee. The actual bad debts written off by Monogram and GECC may have been equal to, greater than or less than the anticipated bad debts.

Eugene J. Thorncroft, Jr., Vice President of Risk Management for Monogram, who had knowledge of Monogram's financing of credit sales by Home Depot, attested that the negotiated purchase price of the accounts included an undisclosed bad debt loss component, among other costs and considerations listed above, which represented retention of an economic risk of loss on the accounts receivable by Home Depot.

The agreement between Monogram and petitioner, dated August 4, 1997, specifically listed "service fee" in its definitions, section 1.01, defining it as the meaning given in section 5.03(a), which merely said it was a fee applicable to all charge slips in the charge transaction data as indicated in an attached schedule (Schedule 5.03), which did not mention the components of the service fee.

In addition, the same agreement stated in section 6.02 that all credit losses on accounts were to be borne at the expense of Monogram and not passed on to petitioner except in chargeback situations not present herein.

The terms of the agreement with GECC were substantially similar, reflecting no explanation of the service fee and specifically indicating that losses on the accounts were borne by GECC and not passed on to petitioner.

The parties stipulated that to the extent anything in the stipulation contradicted the terms of the credit card agreements, the terms of the agreements controlled.

Home Depot deducted the credit card service fees for Federal income tax purposes on line "26" ("Other Deductions") of its Federal corporation income tax forms (forms 1120) but did not deduct the bad debts attributable to the Home Depot credit cards issued by Monogram or GECC on line 15 ("Bad Debts") of its Federal income tax returns (forms 1120).

Certain of the receivables related to sales made by Home Depot to its customers using the Home Depot private label credit card became worthless and uncollectible.

On December 13, 2003, petitioner filed three timely refund claims with the Division. One claim, for the period March 1, 1997 through February 28, 2000, requested a refund of $1,553,753.67 ("First Refund Claim"). The second refund claim, for the period March 1, 2000 through November 30, 2001, requested a refund of $1,643,593.81 ("Second Refund Claim"). The last claim, for the period December 1, 2001 through July 31, 2003, requested a refund of $2,573,056.61 ("Third Refund Claim"). The refund claims pertained to sales taxes paid by petitioner with respect to credit card sales, the receivables for which became uncollectible.

On December 28, 2004, the Division denied the First Refund Claim in its entirety.

On March 25, 2005, petitioner timely filed its Request for Conciliation Conference with respect to the December 28, 2004 refund denial.

The Division consolidated for review the Second Refund Claim and the Third Refund Claim, and on May 10, 2005, the Division issued one letter denying both refund claims in their entirety.

On August 3, 2005, petitioner timely filed its Request for Conciliation Conference with respect to the Division's denial of its Second and Third Refund Claims. On December 16, 2005,

the Bureau of Conciliation and Mediation Services issued two conciliation orders denying both of petitioner's requests for relief.

In its refund denial letters, the Division did not take issue with the bad debts underlying the refund claims. Instead, the Division based its denial on 20 NYCRR 534.7(b)(3), which prohibited generally a refund of sales tax for transactions that were financed by a third party or for a debt that had been assigned to a third party regardless of whether the third party had recourse to the vendor on the debt.

Home Depot provided substantiation to the Division detailing the actual worthless transactions underlying its refund claims.

Pursuant to the terms of their credit card agreements with Home Depot, Monogram and GECC own the Home Depot credit card accounts, and because of this, they recorded the receivables related to such accounts on their balance sheets.

For Federal income tax purposes, Monogram and GECC wrote off receivables, including those related to their credit card agreements with Home Depot, after they became uncollectible, and claimed a deduction on line "15" ("Bad Debts") on their Federal corporation income tax returns, as permitted by Internal Revenue Code § 166.

If either Monogram or GECC had filed claims for refund of sales taxes related to the sales made by Home Depot to customers using the Home Depot private label credit cards that became worthless and uncollectible, and which are the subject of this case, the Division would have denied those claims as well, consistent with the New York Court of Appeals decision in ***Matter of General Elec. Capital Corp. v. New York State Div. of Tax Appeals*** (2 NY3d 249 [2004]).

We modify finding of fact "25" of the Administrative Law Judge's determination to read as follows:

The parties agree that if it is determined that petitioner is entitled to a refund of the sales taxes paid with respect to sales subject to the Credit Card Program Agreements, the amounts claimed by it in its First, Second and Third Refund Claims will be refunded.[1]

***THE DETERMINATION OF THE ADMINISTRATIVE LAW JUDGE***

At the outset, the Administrative Law Judge discussed the law governing the outcome in this matter. Tax Law § 1132(e) authorizes the Commissioner of Taxation to promulgate regulations that would exclude from taxable receipts, "amounts representing sales where . . . the receipt . . . has been ascertained to be uncollectible or, in case the tax has been paid upon such receipt, for refund of or credit for the tax so paid."

Consistent with this grant of authority set forth, the Commissioner of Taxation and Finance promulgated 20 NYCRR 534.7(b)(1), which provides that "[w]here a receipt . . . has been ascertained to be uncollectible, either in whole or in part, the vendor of the tangible personal property . . . may apply for a refund or credit of the tax paid on such receipt." The Administrative Law Judge pointed out that the same regulation provides that no refund or credit is available where the transaction is financed by a third party or for a debt that has been assigned to a third party, regardless of whether the third party has recourse to the vendor on the debt (***see***, 20 NYCRR 534.7[b][3]).

The Administrative Law Judge observed that the scenario where the debt has been assigned to a third party was addressed by the Court of Appeals in ***Matter of General Elec. Capital Corp. v. New York State Div. of Tax Appeals (supra)***. The Court upheld the Division's denial of refund claims based upon the finding that Tax Law § 1132(e) granted the commissioner authority to

[1] We have modified finding of fact "25" to more accurately reflect the record. Also, we note that the second and third refund requests were consolidated and denied in one refund letter dated May 10, 2005.

promulgate regulations regarding uncollectible debts and placed no limitations on the commissioner's power to determine the types of parties that could qualify for tax refunds on uncollectible debts. Further, the Administrative Law Judge noted, the Court found that the commissioner's preclusion of refunds for parties that had not paid the taxes and were removed from the taxable transaction was necessary to avoid excessive administrative burdens and facilitate the orderly administration of the sales tax.

Accordingly, the Administrative Law Judge concluded that the Court's rationale is applicable to the instant matter, and determined that the commissioner acted within his authority under Tax Law § 1132(e) in denying petitioner's refund claims herein.

The petitioner in ***General Electric*** conceded that its refund claim fell within the prohibition of 20 NYCRR 534.7(b)(3) but argued that said restriction was not authorized by the statute. Petitioner in this case also claimed that the regulation's prohibition, as applied to it, was unreasonable, arbitrary and restrictive. The Administrative Law Judge rejected this claim, noting the language of the Court in ***General Electric***:

> The cornerstone of administrative law is derived from the principle that the Legislature may declare its will, and after fixing a primary standard, endow administrative agencies with the power to fill in the interstices . . . by prescribing rules and regulations consistent with the enabling legislation . . . . In so doing, an agency can adopt regulations that go beyond the text of that legislation, provided they are not inconsistent with the statutory language or its underlying purposes (Citations omitted).
>
> This regulatory authority is, of course, not unbridled. "As an arm of the executive branch of government, an administrative agency" . . . may adopt only rules and regulations which "are in harmony with the statute's over-all purpose," (citation omitted). That being said, where an agency adopts a regulation that is consistent with its enabling legislation and is not "so lacking in reason for its promulgation that it is essentially arbitrary" (citation omitted) the rule has the force and effect of law (Citation omitted) ***(Matter of General Elec. Capital Corp. v. New York State Div. of Tax Appeals***, ***supra***, at 254).

The Administrative Law Judge observed that the Court in ***General Electric*** found that Tax Law § 1132(e) permitted but did not require the Division to provide refunds for sales taxes paid on uncollectible debts and left to the discretion of the Department of Taxation and Finance, the formulation of regulations that would delineate the situations, if any, where uncollectible debts would be excluded from taxable receipts. The Court found the Division's regulation at 20 NYCRR 534.7(b) to be consistent with this charge, identifying the entities eligible to apply for the refund and under what circumstances a refund would be granted.

The Court of Appeals in ***General Electric*** also found that the Division's regulation that specified which entities would be permitted to seek refunds of the sales tax was necessary to avoid an excessive administrative burden and accomplish an orderly administration of the sales tax. The Court of Appeals considered this in the context of the sales tax statutory scheme and concluded that since retail vendors were in a special trustee relationship with the State, the fact that the Division granted them the benefit of a refund on sales taxes for uncollectible debts was clearly rational given the responsibilities imposed on vendors, and also to foster the trustee relationship with the State, encouraging accurate, timely reporting of taxable sales.

Further, the Administrative Law Judge pointed out that the Court in ***General Electric*** determined that Tax Law § 1132(e) did not limit the commissioner's power to determine the types of entities that qualified for the benefit (i.e., excluding uncollectible debts from taxable receipts). As a result, the Division's refusal to grant a refund to an entity that never paid taxes and was removed from the underlying taxable transaction was deemed both rational and consistent with Tax Law § 1132(e).

The Administrative Law Judge found the same rationale controlling in this matter. Petitioner made taxable sales of tangible personal property or services that customers purchased

using Home Depot private label credit cards supplied by either Monogram or GECC. The credit card companies paid petitioner the full amount of the receipt and the sales tax. Petitioner accepted the sales tax as the trustee for the State of New York and paid it over to the Division with its tax returns.

In consideration of the services provided to petitioner, the credit card companies subtracted from all receipts a service charge. The manner of the service charge calcualtion was not specifically defined in either the GECC or Monogram contract. However, the Administrative Law Judge noted that the parties stipulated that the service fees were determined taking several factors into consideration, including: the bad debt experience of Home Depot's credit card customers; the interest income that Monogram or GECC anticipated they would earn and that Home Depot forwent on the credit card account; the value of Home Depot's credit card database given to Monogram and GECC; and the administrative costs associated with the managed credit accounts by Monogram and GECC. However, the Administrative Law Judge found it significant that neither the agreements nor the stipulation apportioned the percentages of the service fee among the various components and that petitioner conceded it could not determine if the actual bad debts written off by Monogram and GECC were equal to, greater than or less than the anticipated bad debt figure used to estimate the bad debt component of the service fee. In sum, the Administrative Law Judge found that petitioner did not demonstrate, and acknowledged that it could not accurately account, that it had compensated GECC or Monogram for the accounts that ultimately became uncollectible.

The Administrative Law Judge also found significant that the credit card companies expressly stated in their agreements with petitioner that all credit losses on accounts were to be borne at the expense of Monogram and GECC and not passed on to petitioner except in

chargeback situations not present herein. The credit card companies, not petitioner, reported the bad debts as losses on their Federal corporate income tax returns. The Administrative Law Judge viewed this as an acknowledgment that GECC and Monogram incurred the losses in form as well as in economic substance. The Administrative Law Judge pointed out that it was not the intent of the parties that petitioner would share in the losses that GECC and Monogram represented to the Internal Revenue Service that they had incurred. The Administrative Law Judge found petitioner's argument contrary to the plain meaning of the terms of the agreements with the credit card companies, which specifically provided that all credit losses on accounts were to be borne at their expense and not passed on to petitioner. The Administrative Law Judge observed that this conclusion was further supported by the fact that the parties agreed that the terms of the agreements superseded any facts in the stipulation.

The Administrative Law Judge next addressed what part of the service fee was arguably dedicated to uncollectible accounts. The Administrative Law Judge pointed out that petitioner unequivocally stated that it did not know if the amount corresponded with the amount of bad debts, thus conceding that it was not possible to trace the amounts stated on specific receipts to its refund claims. In addition, as pointed out by the Court of Appeals decision in ***General Electric***, the limitations imposed by the commissioner in 20 NYCRR 534.7(b)(3) were necessary to avoid excessive administrative burden and to facilitate the orderly administration of the sales tax. The Administrative Law Judge found that since petitioner could not trace the source of the refund claims with specificity, a burden the Tax Law lays squarely on petitioners shoulders, the Division could not be expected to do so on audit.

Tax Law § 1132 was amended by chapter 664 of the Laws of 2006 to provide that where accounts are held by a lender, either the vendor or the lender, after filing an election with the

Department designating which party is entitled to claim the refund or deduction for bad debt, shall be entitled to a deduction or refund of tax that the vendor has previously reported and paid. (***see***, Tax Law § 1132[e-1][3][i], effective January 1, 2007).

Therefore, the Administrative Law Judge concluded that the rationale of the Court of Appeals in ***General Electric*** and the interpretation of the regulations discussed above are valid as applied to these facts and for the periods at issue herein. Consistent with this conclusion, the Administrative Law Judge also rejected petitioner's contention that the Division's denial of the refund claims was contrary to the spirit of the law and worthy of equitable relief.

The Administrative Law Judge next addressed petitioner's Constitutional claims. The Administrative Law Judge rejected petitioner's claim that it has been denied Equal Protection. The Administrative Law Judge pointed out that the Equal Protection clauses of the State and Federal Constitutions do not forbid classifications, but simply prohibit governmental decision makers from treating differently, persons who are in all relevant respects alike. The Administrative Law Judge noted that petitioner is not in all respects like a vendor who finances a sale. It did not maintain accounts receivable for its customers and did not incur bad debts when customers defaulted on their payments for property and services purchased from petitioner. In fact, petitioner received the purchase price and tax thereon, in full, from the credit card companies, less the credit card service charge. The Administrative Law Judge pointed out that there was a strong policy reason for treating petitioner differently from vendors who financed sales themselves, and as a result, petitioner's equal protection claim was rejected.

Petitioner also argued that the Division's refund denials were so unduly harsh or oppressive that they amounted to a denial of petitioner's due process rights under the Fourteenth Amendment of the US Constitution and article 1, § 6 of the New York Constitution. The

Administrative Law Judge also rejected this claim as being without merit. The Administrative Law Judge noted that petitioner voluntarily chose the form of its business transactions and was aware of the regulatory prohibition of refunds thereon. Given the conclusions reached above, the Administrative Law Judge found that the regulations were consistent with the enabling legislation and the refund denials proper.

Accordingly, petitioner's motion for summary determination pursuant to 20 NYCRR 3000.9(b) was denied, and there being no material and triable issue of fact in dispute, summary determination was granted in favor of the Division *sua sponte*.

***ARGUMENTS ON EXCEPTION***

Petitioner, on exception, argues as it did below, that the Division's regulation at 20 NYCRR 534.7(b)(3) conflicts with the statute pursuant to which it was promulgated, Tax Law § 1132(e), because it prohibits the refund of sales tax paid on purchases by bad debtors merely because the retailer entered into a financing arrangement with a third-party credit card bank. Petitioner asserts that the regulation's prohibition was unreasonable, arbitrary and restrictive.

Petitioner challenges the conclusion of the Administrative Law Judge which finds that the rationale of the Court of Appeals in ***General Electric*** i.e., that the Commissioner acted within his authority is applicable here. Petitioner argues that it is unreasonable to deny sales tax refunds to vendors that have established that sales tax was remitted on transactions that later became uncollectible just because the transactions were financed through third parties. Petitioner states that the court's decision in ***General Electric*** does not support the Administrative Law Judge's determination.

Petitioner maintains that recently-enacted chapter 664 of the Laws of 2006, which explicitly provides that the vendor or the issuer of a private-label credit card may receive refunds

on that portion of any such credit card account that is worthless and has been taken as a loss on Federal income taxes, should be given retroactive effect.

Finally, petitioner argues that since the Division's denial of its refund requests resulted in an unjust enrichment of the State, it should prevail herein on the basis of fairness. In addition, petitioner continues to argue that the Division, by treating similarly situated taxpayers differently, has violated petitioner's right to equal protection of the laws, and the denial of its refund requests resulted in a denial of petitioner's due process.

The Division counters that pursuant to ***General Electric***, the permissive language in Tax Law § 1132(e), which states that "the tax commissioner may provide, by regulation," for a refund of sales taxes paid on sales where the receipt has been ascertained to be uncollectible, does not require the Division to grant such refunds to any class of applicants. In other words, the Division believes that it has discretion to determine the scope of the credit it will allow. The Division argues that since the regulation it promulgated pursuant to Tax Law § 1132(e) prohibited a refund or credit in transactions financed by third parties, petitioner was not eligible for the refund it seeks. As such, the Division argues that the regulation was consistent with the statute's intent and within the statutory grant of power to the agency.

The Division also argues that it is impossible to determine which parties assumed the economic burden for the bad debts and to what extent, underscoring the reasonableness of the regulation in issue.

The Division contends that the equities of the tax scheme in issue have no bearing on the legal issue and it cannot be assumed that the Legislature intended the result of its statutory enactment to be a fair and balanced formula.

Finally, the Division urges that enactment of chapter 664 of the Laws of 2006 supports its position herein. It notes that the legislation specifically is not retroactive and also points out that the sponsor's memorandum candidly laments the failure of the prior law to provide such relief.

***OPINION***

We affirm the determination of the Administrative Law Judge for the reasons stated therein. The Administrative Law Judge fully and properly addressed each of the issues raised by petitioner. Petitioner has produced no evidence below, nor arguments on exception, that would justify our modifying the determination of the Administrative Law Judge in any respect.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of Home Depot U.S.A., Inc. is denied;

2. The determination of the Administrative Law Judge is affirmed;

3. The petition of Home Depot U.S.A., Inc. is denied; and

4. The denials of petitioner's refund claims, dated December 28, 2004 and May 10, 2005, are sustained.

DATED: Troy, New York
November 6, 2008

/s/ Charles H. Nesbitt
Charles H. Nesbitt
President

/s/ Carroll R. Jenkins
Carroll R. Jenkins
Commissioner

COMMISSIONER ROBERT J. McDERMOTT concurring:

I concur in the outcome of this case for the reasons discussed below.

When a retail customer brings a credit card to a store to pay for purchased goods, the nature of the transaction is much the same as if he instead brought his rich uncle. The customer pays the retailer in cash with funds borrowed by the customer from a third party, avuncular or commercial. If the customer fails to repay the borrowing from the lender, there is no basis for rescinding or otherwise recasting the sale of merchandise, since the customer paid and the merchant received the purchase price in cash. There is no "receipt . . . ascertained to be uncollectible" within the meaning of Tax Law § 1132(e). Imposition of the sales tax does not depend on how the purchaser raised the funds for the sales price.

A sale on the installment plan is quite different. There the merchant agrees with the customer to accept deferred payment of the purchase price. If the customer fails to make all of the promised payments, the merchant will in effect have sold the goods for a lower purchase price. In this situation, the Tax Law authorizes the Division to permit the merchant to claim a credit for sales taxes paid to the Division of Taxation on the portion of the purchase price that was not actually received (Tax Law § 1132[e]). Where, prior to default, the merchant has sold its accounts receivable to an unrelated person who takes on the risk of the customer's credit, the situation is ambiguous since the merchant may be indifferent to the customer's default depending on whether the purchaser of the accounts has any recourse to the merchant for bad debts. Situations in which the merchant has sold its accounts are the subject of the regulations discussed above (20 NYCRR 534.7[b]) and in the determination of the Administrative Law Judge and the ***General Electric Capital Corp.*** case. The present case, however, involves credit card transactions not installment sales. The retail customer makes a credit application to the credit card company providing details of his or her creditworthiness and, if approved, receives an extension of credit from that company, which may be drawn upon at the point of purchase in petitioner's stores. The fact that the retailer pays a fee to the credit card company for the

privilege of participating in this arrangement does not make the retailer a lender or a seller on the installment plan. The fact that these "private label" cards can be used only in petitioner's stores is also irrelevant. Accordingly, I would affirm the determination of the Administrative Law Judge for the reasons set forth herein.

DATED: Troy, New York
November 6, 2008

/s/ Robert J. McDermott
Robert J. McDermott
Commissioner