
Finance Committee

HB 1539

Brief Description: Narrowing the business and occupation tax deduction, and sales and use tax credit and refund, for bad debts available to sellers.

Sponsors: Representative Frame; by request of Department of Revenue.

<p style="text-align: center;">Brief Summary of Bill</p> <ul style="list-style-type: none">• Limits the bad debts sales and use tax credit and business and occupation tax deduction to apply only to bad debts incurred as a result of the nonpayment to a taxpayer by its customers.

Hearing Date: 3/11/21

Staff: Nick Tucker (786-7383).

Background:

Business & Occupation Tax.

Washington's major business tax is the business and occupation (B&O) tax. The B&O tax is imposed on the gross receipts of business activities conducted within the state, without any deduction for the costs of doing business. Businesses must pay the B&O tax even though they may not have any profits or may be operating at a loss.

A taxpayer may have more than one B&O tax rate, depending on the types of activities conducted. Major B&O tax rates are 0.471 percent for retailing; 0.484 percent for manufacturing, wholesaling, and extracting; and 1.5 percent (businesses with taxable income of less than \$1 million) or 1.75 percent (businesses with taxable income of \$1 million or more) for services and for activities not classified elsewhere. Several preferential rates also apply to specific business activities. In addition, a taxpayer may be eligible to utilize other tax

This analysis was prepared by non-partisan legislative staff for the use of legislative members in their deliberations. This analysis is not part of the legislation nor does it constitute a statement of legislative intent.

preferences, including credits and deductions, to reduce their tax liability.

Retail Sales and Use Tax.

Retail sales taxes are imposed on retail sales of most articles of tangible personal property, digital products, and some services. A retail sale is a sale to the final consumer or end user of the property, digital product, or service. If retail sales taxes were not collected when the user acquired the property, digital products, or services, then use tax applies to the value of property, digital product, or service when used in this state.

Credit, Refund, and Deduction for Bad Debts.

A taxpayer is entitled to a credit or refund for sales or use taxes it previously paid on bad debts. In addition, bad debts may be deducted from the measure of tax when computing the B&O tax. For purposes of these credits, refunds, and deductions, “bad debts” has the same meaning as provided in 26 U.S.C. §166, for federal tax purposes.

"Bad debts" does not include:

- amounts due on property that remains in the possession of the seller until the full purchase price is paid;
- expenses incurred in attempting to collect debt;
- for the B&O tax deduction, sales or use taxes payable to a seller;
- debts sold or assigned by the seller to third parties, where the third party is without recourse against the seller; and
- repossessed property.

In *Lowe's Home Centers, LLC v. Dep't of Revenue*, 195 Wn.2d 27 (2020), the Washington Supreme Court held that a taxpayer is entitled to the bad debt sales and use tax credit and B&O tax deduction on uncollectible debts from a private-label credit card customer's failure to pay when the taxpayer contractually guaranteed the private-label credit card's uncollectible debt up to a certain percentage of the original sale amount. Prior to the *Lowe's* decision, the Department of Revenue interpreted the bad debt sales and use tax credit and B&O tax deduction to only apply if the taxpayer itself incurred the loss of the bad debt from the customer failing to pay the taxpayer, as opposed to a third party incurring the loss.

Summary of Bill:

For purposes of the bad debts sales and use tax credit or refund and the bad debts B&O tax deduction, the term bad debts is defined to mean a debt obligation unpaid by the debtor, or that debtor's guarantor, to the taxpayer that:

- qualifies for the federal bad debt deduction under 26 U.S.C. §166; and
- has been written off as uncollectible in the taxpayer's books and records.

Amounts paid by a seller to a third-party creditor of the buyer in reimbursement of that buyer's nonpayment of an obligation to that third-party creditor is excluded from the definition of bad debt, in conformance with the Department of Revenue's historical interpretation of the term.

The provisions of the bill apply only to bad debts that were written off as uncollectible on or after the effective date of the bill.

Appropriation: None.

Fiscal Note: Available.

Effective Date: The bill contains an emergency clause and takes effect immediately.