The Comptroller of Public Accounts proposes an amendment to §3.302, concerning accounting methods, credit sales, bad debt deductions, repossessions, interest on sales tax, and trade-ins. The title of this section will be amended to "Accounting Methods, Credit Sales, Bad Debt Refunds, Repossession Refunds, Interest on Sales Tax, and Trade-Ins" for clarity and consistency with the substantive changes made to the section, addressing the procedures for requesting bad debt refunds and repossession refunds. Corresponding changes are made throughout the section, where applicable. In addition, the comptroller proposes amendments to this section to memorialize longstanding agency policies, to revise agency policy with respect to taking credits on sales and use tax reports, and to define key terms in the Tax Code and this section that have previously been undefined.

New subsection (a) includes definitions previously located in other subsections throughout this section and adds definitions for terms not otherwise defined in the Tax Code and not previously defined for use within this section. Subsequent subsections are re-lettered accordingly. The definition of "affiliate" previously included in former subsection (d)(8) is relocated to paragraph (1) without change. Paragraph (2) draws the definition of "assignee" from *The American Heritage® Dictionary of the English Language, Fourth Edition* (2003) and *Black's Law Dictionary, Online Legal Dictionary Second Edition*. Paragraph (3) incorporates without substantive change the definition of "bad debt" previously included in former subsection (d)(1).

Paragraph (4) defines "bad debt refund" to reflect the comptroller's revised policy that, in order to claim a credit or reimbursement for tax paid on an account determined to be worthless and actually charged off for federal income tax purposes, in accordance with Tax Code, §151.426(c), all taxpayers must file a properly completed refund request. Tax Code, §151.426(e) provides that "[a] person is entitled to a credit or reimbursement provided by [Tax Code, §151.426(c)] only if…the retailer or person claiming the credit or reimbursement provides detailed records…." When claiming a credit on a sales tax return, taxpayers do not submit the supporting

documentation required by Tax Code, §151.426(e), and the comptroller is unable to verify or track the credits claimed for any given bad debt. For this reason, the comptroller interprets Tax Code, §151.426 to require all taxpayers to submit a refund request with supporting documentation to substantiate a bad debt credit or reimbursement for an account determined to be worthless and actually charged off for federal income tax purposes. Any other interpretation of the statute renders it unfeasible to administer, as the comptroller is unable to track and verify bad debt credits taken on a return, and the legislature is presumed to have intended feasible execution. See Government Code, §311.021(4). Moreover, this revised position is consistent with the apparent understanding of the Third Court of Appeals. See *MFC Fin. Co. v. Strayhorn*, 2008 Tex. App. LEXIS 3185 (Tex. App. Austin May 1, 2008) (referring to Tax Code, §151.426 as the "bad debt refund statute.") The revised policy is prospective from the effective date of the adoption of the amendment to the section, in accordance with Tax Code, §151.022 (Retroactive Effect of Rules).

The definitions of "cobranded credit agreement," "cobranded credit card," "private label credit agreement," and "private label credit card," included in paragraphs (5), (6), (8), and (9), respectively, were adapted from business dictionary websites such as www.creditcards.com/glossary and www.investopedia.com/terms. The definition of "credit sale" included in paragraph (7) is taken from former subsection (b)(1) without substantive change.

Paragraph (10) defines "private label credit provider" by reference to the terms "private label credit agreement" and "private label credit card," defined in paragraphs (8) and (9).

Paragraph (11) defines "repossession refund" to reflect the comptroller's revised policy that, in order to claim a credit or reimbursement for tax paid on the remaining unpaid sales price of a taxable item repossessed under a conditional sales contract, in accordance with Tax Code, §151.426(c), all taxpayers must file a properly completed refund request. Tax Code, §151.426(e)

provides that "[a] person is entitled to a credit or reimbursement provided by [Tax Code, <*>151.426(c)] only if…the retailer or person claiming the credit or reimbursement provides detailed records…" When claiming a credit on a sales tax return, taxpayers do not submit the supporting documentation required by Tax Code, §151.426(e), and the comptroller is unable to verify or track the credits claimed for any given repossession. For this reason, the comptroller interprets Tax Code, §151.426 to require all taxpayers to submit a refund request with supporting documentation to substantiate a repossession credit or reimbursement for an account determined to be worthless and actually charged off for federal income tax purposes. Any other interpretation of the statute renders it unfeasible to administer, as the comptroller is unable to track and verify repossession credits taken on a return, and the legislature is presumed to have intended feasible execution. See Government Code, §311.021(4). The revised policy is prospective from the effective date of the adoption of the amendment to the section, in accordance with Tax Code, §151.022 (Retroactive Effect of Rules).

Paragraph (12) defines "retailer" by reference to Tax Code, §151.008 ("Seller" or "Retailer").

Re-lettered subsection (c) deletes paragraph (1) to take into account the relocation of the definition of "credit sale" to new subsection (a) and subsequent paragraphs are renumbered.

Re-lettered subsection (e) revises the policy previously included in subsection (d), as it relates to bad debt refunds, and reorganizes these provisions for clarity and readability.

New paragraph (1)(A) – (G) combines provisions formerly found in subsections (d)(1)(A), (2), (3), (5), (6), (9), and (h)(1) together as provisions generally applicable to bad debt refunds. The definition of "bad debt" formerly found in subsection (d)(1) has been relocated and included in new subsection (a). Former subsection (d)(10) is deleted to improve readability of the section and minimize confusion. The principle expressed in this former paragraph remains true – credit

or installment sales may not be labeled as bad debts merely for the purpose of delaying the payment of the tax due – but it was not necessary to include this statement in light of the additional guidance provided on bad debts by the other proposed amendments to this section.

New paragraph (1)(B), formerly subsection (d)(2), revises the existing statement that "…all payments and credits to the account may be applied ratably against the various charges…" to explain that "…all payments and credits to the account must be prorated between the various taxable and nontaxable charges," in accordance with the holding in Comptroller's Decision No. 101,531 (2009). This paragraph also includes examples of payment application methodologies that will and will not be accepted as prorating payments between taxable and nontaxable charges for purposes of calculating bad debt refunds.

New paragraph (1)(C) incorporates former subsection (d)(3) without change.

New paragraph (1)(D), formerly subsection (d)(5), is revised to clarify and memorialize agency policy that the comptroller must approve alternate record-keeping procedures in writing and in advance before a taxpayer may utilize such procedures. In the absence of this preapproval, alternate record-keeping systems will not be allowed. See Tax Code, §151.426(f) (Credits and Refunds for Bad Debts, Returned Merchandise, and Repossessions) and Comptroller's Decision Nos. 43,718, 43,719, 43,720, 43,801, 43,802, 43,803, 43,804, 43,805, 43,806, 43,843, 43,844, 43,845, 44,247, 44,248, and 44,249, (2007) and 44,044 (2004). New paragraph (1)(D) further describes the steps necessary to request approval for alternate record-keeping systems permitted under Tax Code, §151.426(f). The paragraph explains that a request for pre-approval must be submitted to the comptroller's Audit Division and that any final decision about whether to approve the request will be made with input from both the Audit and Tax Policy Divisions.

New paragraph (1)(E) describes the steps necessary to request approval for an alternative method of calculating a bad debt refund permitted under Tax Code, §151.426(f).

New paragraph (1)(F) incorporates language from former subsection (d)(9) without substantive change.

New paragraph (1)(G) incorporates language from former subsection (h)(1) without change. Former subsection (h) is deleted to minimize redundancy. The remaining information in former subsection (h) and additional guidance related to interest accruing on credits and refunds, generally, appears in §3.325 of this title (relating to Refunds and Payments Under Protest).

New paragraph (2) incorporates and revises provisions found in former subsection (d)(1)(B), (C), and (4). This new paragraph explains that taxpayers must request a refund for tax paid on accounts later determined to be worthless and actually charged off for federal income tax purposes. Previously, retailers, private label credit providers, and assignees or affiliates could take credits for bad debt on sales and use tax reports. See STAR Accession No. 200106351L (June 1, 2001). This policy is being revised such that all taxpayers, whether retailers, private label credit providers, assignees, or affiliates, must request a refund for tax paid on bad debts. This change is intended to address the administrative infeasibility of verifying bad debt credits taken on returns and sets out the procedure for providing documentation necessary for verification. The revised policy and procedures are consistent with Tax Code, §151.426(e), which provides that a person is entitled to a bad debt credit or reimbursement *only if* supporting information and records are provided. To the extent the refund procedures in subsection (e) may conflict with §3.325 of this title, this section is intended to prevail. New paragraph (2)(G) incorporates and clarifies the limitation, previously set out in subsection (d)(7), that non-retailers may request a bad debt refund only for state sales and use tax imposed under Tax Code, Chapter 151, and not for local sales and use tax imposed under another Code or Chapter. New paragraph

(2)(H) explains that, if an assignee's or affiliate's bad debt refund claim is based on bad debt written off and actually charged off for federal income tax purposes by a retailer or private label credit provider, the assignee or affiliate must provide documentation to demonstrate that the assignee or affiliate has obtained the right to seek a refund from the retailer or private label credit provider and that the retailer and private label credit provider will not seek a refund on the same bad debt. This information is necessary for the comptroller to verify that the bad debt refund qualifies under Tax Code, §151.426. Former subsection (d)(8) is deleted and relocated to the definitions set out in subsection (a) of this section. The policy change set out in paragraph (2) is prospective from the effective date of the adoption of the amendment to the section in accordance with Tax Code, §151.022 (Retroactive Effect of Rules).

Re-lettered subsection (f) revises the policy set out in former subsection (e) as it relates to repossessions refunds, and reorganizes these provisions for clarity and readability. New paragraph (1)(A) – (C) combines provisions formerly found in subsection (e)(1), (2), and (4) together as provisions generally applicable to repossession refunds. New paragraph (1)(A) also includes examples of payment application methodologies that will and will not be accepted as prorating payments between taxable and nontaxable charges for purposes of calculating repossession refunds.

Paragraph (2) replaces former subsection (e)(3) and explains the procedures for requesting repossession refunds. Previously, retailers, private label credit providers, and assignees or affiliates could take credits for tax paid on repossessed items on sales and use tax reports. This policy is being revised such that all taxpayers must request a refund for tax paid on the remaining unpaid sales price of a taxable item that is repossessed under a conditional sales contract. This change is intended to address the administrative infeasibility of verifying repossession credits taken on returns because no supporting documentation is provided when credits are taken on a return and sets out the procedure for providing documentation necessary for verification. The

revised policy and procedures are consistent with Tax Code, §151.426(e), which provides that a person is entitled to a bad debt or repossession credit or reimbursement *only if* supporting information and records are provided. To the extent the refund procedures in subsection (f) may conflict with §3.325 of this title, this section is intended to prevail. New paragraph (2)(G) incorporates and clarifies the limitation, set out in Tax Code, §151.426(i), that non-retailers may request a repossession refund only for sales and use tax imposed under Tax Code, Chapter 151, and not for local sales and use tax imposed under another Code or Chapter. New paragraph (2)(H) explains that, if a requestor's bad debt refund claim is based on bad debt written off and actually charged off for federal income tax purposes by another person, the requestor must provide documentation to demonstrate that it has obtained the right to seek a refund from the person who actually charged the bad debt off for federal income tax purposes and that the the person who actually charged the bad debt off for federal income tax purposes will not seek a refund on the same bad debt. This information is necessary for the comptroller to verify that the bad debt refund qualifies under Tax Code, §151.426. Former subsection (d)(8) is deleted and relocated to the definitions set out in subsection (a) of this section. The policy change set out in paragraph (2) is prospective from the effective date of the adoption of the amendment to the section in accordance with Tax Code, §151.022 (Retroactive Effect of Rules).

Re-lettered subsection (g) is revised to substitute "credit sale," as defined in new subsection (a)(8) for "credit" in two places to utilize the defined term, provide consistency, and avoid confusion.

Additional revisions are proposed to improve clarity and ensure consistency with other sections within this title. Re-lettered subsection (b)(2) corrects the included reference to §3.294 of this title to reflect that section's revised name. Re-lettered subsection (c)(2)(B) adds an "and" and deletes a comma to improve readability. Re-lettered subsection (g)(3) revises the format of listed percentages for consistency with other sections in this title. "Texas" is deleted from re-lettered

subsection (g)(5) for consistency with citations included throughout the other sections in this title. "Of the seller" is added to re-lettered subsection (h)(1) and (2) to ensure consistency with existing comptroller policy. See, for example, Comptroller's Decision No. 104,720 (2013) and STAR Accession No. 200041974 (April 17, 2000). "Considered as" is deleted from re-lettered subsection (h) and "price" is deleted from subsection (h)(3) to improve readability. The referenced section in subsection (h)(4) is amended to reflect the correct name.

Public Benefit/Cost; Fiscal Implications for state or local government, small businesses, and individuals.

Comments on the proposal may be submitted to Teresa G. Bostick, Director, Tax Policy Division, P.O. Box 13528, Austin, Texas 78711. Comments must be received no later than 30 days from the date of publication of the proposal in the *Texas Register.*

This amendment is proposed under Tax Code, §111.002, which provides the comptroller with the authority to prescribe, adopt, and enforce rules relating to the administration and enforcement of the provisions of Tax Code, Title 2.

The proposed amendments implement Tax Code, §151.426 (Credits and Refunds for Bad Debts, Returned Merchandise, and Repossessions).

<rule>

§3.302. Accounting Methods, Credit Sales, Bad Debt <u>Refunds, Repossession Refunds</u><et>[Deductions, Repossessions], Interest on Sales Tax, and Trade-Ins.

(a) Definitions. The following words and terms, when used in this section, shall have the following meanings, unless the context clearly indicates otherwise.

(1) Affiliate--An entity that would be classified as a member of an affiliated group under 26 U.S.C. §1504.

(2) Assignee--A person to whom accounts receivable associated with bad debts are transferred.

(3) Bad debt--Any portion of the sales price of a taxable item that a retailer or private label credit provider cannot collect, and that has been determined to be worthless and actually charged off for federal income tax purposes.

(4) Bad debt refund--A refund claimed, and documented as set out in subsection (e) of this section, for tax remitted on an account that is later determined to be worthless and actually charged off for federal income tax purposes.

(5) Cobranded credit agreement--An agreement to extend credit for the purchase of items from any retailer or manufacturer, often using a cobranded credit card. Typically, such an agreement is sponsored by two parties; for example, one party may be a department store, gas retailer, or airline, and the other party may be a bank or card network. Debtors under such an agreement may earn merchandise discounts or rewards points when using the credit agreement to make purchases from the sponsoring merchant, but the debtors may also use the credit agreement to make purchases from other retailers or manufacturers that accept credit from the bank or network sponsoring the credit agreement. A cobranded credit agreement is not considered a private label credit agreement.

(6) Cobranded credit card--A credit card used to extend credit for the purchase of items from any retailer or manufacturer. Typically, such a credit card is sponsored by two parties; for example, one party may be a department store, gas retailer, or airline, and the other party may be a bank or card network. Cardholders may earn merchandise discounts or rewards points when using the cobranded credit card to make purchases from the sponsoring merchant, but the cardholders may also use the cobranded credit card to make purchases from other retailers or manufacturers that accept credit cards from the bank or network sponsoring the credit card. A cobranded credit card is not considered a private label credit card.

(7) Credit sale--Any sale in which the terms of the sale provide for deferred payments of the purchase price. Credit sales include installment sales, sales under conditional sales contracts and revolving credit accounts, and sales for which another person extends credit to the purchaser under a private label credit agreement.

(8) Private label credit agreement--An agreement to extend credit for the purchase of items from a single retailer, limited group of retailers, dealer, or manufacturer, only, often using a private label credit card. Private label credit agreements are branded for and limited to specific retailers, dealers, or manufacturers. If the retailer, dealer, or manufacturer does not manage the private label credit agreement, a third party issues the credit to and collects payments from the debtor. Terms and conditions for private label credit agreements may be set by contracts between the retailer, dealer, or manufacturer and the third party. A cobranded credit agreement is not considered a private label credit agreement.

(9) Private label credit card--A credit card used to extend credit for the purchase of items from a single retailer, limited group of retailers, dealer, or manufacturer, only. Private label credit cards are branded for and limited to specific retailers, dealers, or manufacturers. If the retailer, dealer, or manufacturer does not manage the private label credit card, a third party issues the credit card

to and collects payments from the cardholder. Terms and conditions for private label credit cards may be set by contracts between the retailer, dealer, or manufacturer and the third party. A cobranded credit card is not considered a private label credit card.

(10) Private label credit provider--A person who extends credit to a purchaser under a private label credit agreement or private label credit card.

(11) Repossession refund--A refund claimed, and documented as set out in subsection (f) of this section, for tax paid on the remaining unpaid sales price of a taxable item when the item is repossessed under a conditional sales contract.

(12) Retailer--This term has the meaning given in Tax Code, §151.008 ("Seller" or "Retailer").

(b)[(a)] Accounting methods.

(1) For sales and use tax purposes, retailers may use a cash basis, an accrual basis, or any generally recognized accounting basis that correctly reflects the operation of their business. Retailers who wish to use an accounting system to report tax that is not on a pure cash or accrual basis or that is not a commonly recognized accounting system must[should] obtain prior written approval from the comptroller.

(2) Paragraph (1) of this subsection does not apply to the reporting of sales tax on rentals and leases of tangible personal property. See §3.294 of this title (relating to Rental and Lease of Tangible Personal Property[Rentals and Leases of Taxable Items]) for the accounting of rentals and leases.

(c)[(b)] Credit sales.

[(1) Credit sales include all sales in which the terms of the sale provide for deferred payments of the purchase price. Credit sales include installment sales, sales under conditional sales contracts and revolving credit accounts, and sales by a retailer for which another person extends credit to the purchaser under a retailer's private label credit agreement.]

(1)[(2)] Sales tax is due on insurance, interest, finance charges, and all other service charges incurred as a part of a credit sale unless these charges are stated separately to the customer by such means as an invoice, billing, sales slip, ticket, or contract.

(2)[(3)] Tax is to be reported on a credit sale based upon the accounting method that the retailer uses.

(A) If the retailer is on an accrual basis, the entire amount of tax is due and must be reported at the time the sale is made.

(B) If the retailer is on a cash basis of accounting, the payment received from the customer includes a proportionate amount of tax and[,] sales receipts, and may also include finance charges. Tax must be reported based upon the actual cash collected during the reporting period, excluding separately stated finance charges.

(C) If the retailer uses an accounting basis that is not a pure cash or accrual basis, tax must be reported in a consistent manner that accurately reflects the realization of income from the credit sales on the retailer's books and records.

(d)[(c)] Transfer or sale of sales contracts and accounts receivable. A retailer may sell, factor, or assign to a third party the retailer's right to receive all payments due under a credit sale. At the

time the contract or receivable is sold, factored, or assigned, the tax becomes due on all remaining payments. The retailer is responsible for reporting all remaining tax due under the credit sale to the comptroller in the reporting period in which the contract or receivable is sold, factored, or assigned. No reduction in the amount of tax to be reported and paid by the retailer is allowed if the transfer to the third party is for a discounted amount. This subsection[section] does not apply to a seller's assignment or pledge of contracts or accounts receivable to a third party as loan collateral.

(e)[(d)] Bad debts.

(1) General provisions.[Any portion of the sales price of a taxable item that the retailer or private label credit provider cannot collect is considered to be a bad debt.]

(A) Deduction is for taxable charges only. A retailer is not required to report tax on any amount representing taxable charges that has been entered in the retailer's books as a bad debt during the reporting period in which the sale was made, and that will be taken as a deduction on the retailer's federal income tax return during the same or subsequent reporting period.

(B) Prorating taxable and nontaxable charges required. The amount of the bad debt may comprise both the sales price of the taxable item and nontaxable charges for finance charges, late charges, or interest that were separately billed to the customer. A bad debt refund may only be claimed on that portion of the sales tax remitted to the comptroller which corresponds to the portion of the bad debt representing only the amount of taxable charges that remains unpaid and that was determined to be worthless and actually charged off for federal income tax purposes. In determining the amount of the bad debt refund, all payments and credits to the account must be prorated between the various taxable and nontaxable charges included in the bad debt. For example, a customer submits a payment of $90 on a bad debt account with a balance of $1,500,

comprising $1,000 in nontaxable interest, fees, and other charges, and $500 in taxable charges. At the time of payment, the taxable charges represent one-third of the bad debt account. Thus, one-third of the payment received on this account, or $30, must be applied to reduce the taxable charges for purposes of calculating the bad debt refund for this account, regardless of how the credit agreement provides for payment or credit application. Private label credit agreements which utilize payment application methodologies that, for example, apply credits, first, to interest; next, to late fees, miscellaneous charges, cash items fees, merchant items fees, or credit life premiums; and, only then, to purchase balances do not comply with this subsection, regardless of whether this payment application methodology is included in a credit agreement.[A retailer is entitled to a credit for tax reported and paid on an account later determined to be a bad debt. A retailer may take a deduction on the retailer's report form, or obtain a refund from the comptroller, in the reporting period in which the retailer's books reflect the bad debt. Deductions and refunds due to bad debts are limited to four years from the date the account is entered in the retailer's books as a bad debt.]

(C) Expenses to collect bad debt are not deductible. A retailer, private label credit provider, or assignee or affiliate requesting a refund may not add to or deduct from the amount of taxable charges the expense of collecting a bad debt, or the amount that a third party has retained or which has been paid to a third party for the service of collecting a bad debt.[A retailer who extends credit to a purchaser on an account that is later determined to be a bad debt, a person who extends credit to a purchaser under a retailer's private label credit agreement on an account that is later determined to be a bad debt, or an assignee or affiliate of either who extends credit on an account that is later determined to be a bad debt, is entitled to a credit or refund for the tax paid to the comptroller on the bad debt.]

(D) Requirements to request alternate recordkeeping method. A person who is qualified to claim bad debt refund and wishes to use an alternative method of maintaining the records otherwise

required in paragraph (2)(E) of this subsection to substantiate the requested refund, must submit a request satisfying the following requirements.

(i) The request must be submitted in writing to the Audit Division of the comptroller's office and include the following:

(I) an explanation of the basis for the request, including a specific reference to this section by number or title;

(II) identification of the records currently maintained by the requestor;

(III) an explanation of the requestor's internal policy for determining when an account is considered to be bad debt including, but not limited to:

(-a-) the method for identifying accounts to be classified as bad debt;

(-b-) the method for identifying accounts to be sold to debt collection services;

(-c-) identification of documents substantiating accounts reclassified as bad debt;

(-d-) identification of documents substantiating accounts sold to debt collection services;

(-e-) an explanation of the accounting method used to document the sale of accounts to debt collection services;

(-f-) an explanation of the accounting method used to apply payments received on accounts reclassified as bad debt;

(-g-) an explanation of the accounting method used to apply or return payments received on accounts sold to debt collection services;

(IV) an explanation of the requestor's internal policy for reporting applicable sales tax for payments received on accounts reclassified as bad debt or sold to debt collection services;

(V) an explanation of the requestor's internal policy relating to the method for avoiding duplicate bad debt refunds for assignees, members of a combined group, or other related entities;

(VI) identification of the alternative records to be maintained;

(VII) an explanation of how the alternative records:

(-a-) substantiate the amount of Texas tax collected and remitted to the comptroller based on the original sale;

(-b-) prorate taxable and nontaxable charges of the bad debt;

(-c-) substantiate the amount of Texas tax collected and remitted to the comptroller with respect to the taxable charges that remain unpaid on the debt;

(-d-) substantiate all jurisdictions to which local taxes were reported;

(-e-) substantiate the period in which the related bad debt was charged off for federal income tax purpose;

(-f-) substantiate how duplication of a bad debt refund is avoided among assignees, members of a combined group, or other related entities; and

(-g-) substantiate payments or credits made to bad debt, the proration of payments or credits to taxable and nontaxable charges of the bad debt, and the remittance of applicable Texas tax from payments or credits to bad debt.

(ii) After consultation with the Tax Policy Division of the comptroller's office, the Audit Division shall issue a written determination approving or denying the requested alternative method of maintaining records regarding bad debt. Determinations resulting in a denial will include an explanation of why the request was denied.

(iii) Approval of an alternative method of maintaining records regarding bad debts is prospective only and may not be used to satisfy the requirements of paragraph (2)(E) of this subsection prior to the date of written approval.

(iv) Approval of an alternative method of maintaining records regarding bad debts is not transferable or assignable to any other person, regardless of affiliation, combined reporting requirements, or sale of the requestor for which approval was provided.

(v) Approval of a request for an alternative method of maintaining records regarding bad debts does not apply to any other records required to be maintained.

(vi) Approval of a request for an alternative method of maintaining records regarding bad debts pursuant to this subparagraph is effective for a period of four years from the date of written approval unless:

(I) there is a change in the law or interpretation of applicable laws or rule;

(II) there is a change in the requestor's business operations that affects the approved alternative method; or

(III) an alternative method for maintaining records regarding bad debts is approved in writing for the same requestor after a written approval was issued but prior to the expiration of four years from the date of the prior written approval.

(vii) A change in the circumstances on which the alternative method for maintaining records regarding bad debts was based requires a new request to be submitted in writing. The requirements set out in clause (i) of this subparagraph must be included in the new request.

(viii) An alternative method for maintaining records regarding bad debts that differs from an alternative method that has been approved in writing requires a new request to be submitted in writing. The requirements set out in clause (i) of this subparagraph must be included in the new request.

(ix) An alternative method for maintaining records regarding bad debts that has been revoked in writing may not be utilized after the date of written revocation. The comptroller will state in the notice of revocation the basis for the revocation.

(I) A person who wishes to reinstate the alternative method for maintaining records regarding bad debts must submit a new request for alternative method in writing. The requirements set out in clause (i) of this subparagraph must be included in the new request.

(II) The request must include an explanation of the resolution of the issues addressed in the notice of revocation and documentation demonstrating how the issues have been corrected or resolved.

(E) Requirements to request alternative method of calculating bad debt refunds. A person who is qualified to claim a bad debt refund and wants to use an alternative method of calculating the bad debt refund must submit a request satisfying the following requirements.

(i) The request must be submitted in writing to the Audit Division of the comptroller's office and include the following:

(I) an explanation of the basis for the request, including a specific reference to this section by number or title;

(II) identification of the current method for calculating bad debt, including mathematical examples;

(III) an explanation of the alternative calculation method proposed, including mathematical examples;

(IV) an explanation of how the alternative calculation method prorates payments or credits received on the account between taxable and nontaxable charges of the bad debt;

(V) an explanation of adjustments or the absence of adjustments to bad debt for payment application methodologies based on a hierarchy rather than by proration between taxable and nontaxable charges of the bad debt;

(VI) documents which demonstrate the historical basis for the proposed alternative calculation method;

(VII) an explanation of how all jurisdictions to which local taxes were reported are considered or affected by the proposed alternative calculation method;

(VIII) an explanation of how the proposed alternative calculation method includes only those accounts reclassified as bad debt;

(IX) an explanation of how the proposed alternative calculation method excludes those accounts sold to debt collection services;

(X) an explanation of how the proposed alternative calculation method relates to the bad debt deduction taken on the person's federal income tax return;

(XI) documents which demonstrate that the manner in which payments or credits are made to bad debt, the proration of payments or credits to taxable and nontaxable charges of the bad debt, and the remittance of applicable Texas tax from payments or credits to bad debt are included in the proposed alternative calculation method; and

(XII) an explanation and supporting documents which demonstrate how duplication of bad debt refunds is avoided among assignees, members of a combined group, or other related entities.

(ii) After consultation with the Tax Policy Division of the comptroller's office, the Audit Division shall issue a written determination approving or denying the proposed alternative calculation method regarding bad debt.

(iii) Approval of an alternative calculation method regarding bad debt is prospective only and may not be used to satisfy the requirements of paragraph (2)(E) of this subsection prior to the date of written approval.

<etb>(iv) Approval of an alternative calculation method regarding bad debt is not transferable or assignable to any other person regardless of affiliation, combined reporting requirements, or sale of the requestor for which approval was provided.<et>

(v) Approval of a request for an alternative calculation method regarding bad debts applies only to the calculation of bad debt refunds.

(vi) Approval of a request for an alternative calculation method regarding bad debts pursuant to this subparagraph is effective for a period of four years from the date of written approval unless:

(I) there is a change in the law or interpretation of applicable laws or rules;

(II) there is a change in the requestor's business operations that affects the approved alternative method; or

(III) an alternative calculation method regarding bad debts is approved in writing for the same person after a written approval was issued but prior to the expiration of four years from the date of the prior written approval.

(vii) A change in the circumstances on which the alternative calculation method regarding bad debts was based requires a new request to be submitted in writing. The requirements set out in clause (i) of this subparagraph must be included in the new request.

(viii) An alternative calculation method regarding bad debts that differs from an alternative calculation method that has been approved in writing requires a new request to be submitted in writing. The requirements set out in clause (i) of this subparagraph must be included in the new request.

(ix) An alternative calculation method regarding bad debts that has been revoked in writing may not be utilized by the person after the date of written revocation. The notice of revocation must state the basis for the revocation.

(I) A person who desires to reinstate the alternative calculation method regarding bad debts must submit a new request for alternative calculation method in writing. The requirements set out in clause (i) of this subparagraph must be included in the new request.

(II) The request must include an explanation of the resolution of the issues addressed in the notice of revocation and documentation demonstrating how the issues have been corrected or resolved.

(F) Collection of account for which bad debt refund is taken. If a retailer or private label credit provider later collects all or part of an account for which a bad debt refund was claimed, the amount collected must be reported as a taxable sale in the reporting period in which such collection was made.

(G) Tax paid on an account that is later determined to be worthless and actually charged off for federal income tax purposes is not tax paid in error and does not accrue interest.

(2) Bad debt refunds.

(A) Only the following persons are entitled to claim a bad debt refund for tax reported and paid on an account determined to be worthless and actually charged off for federal income tax purposes:

(i) a retailer who extends credit to a purchaser under a private label credit agreement on an account that is later determined to be worthless and is actually charged off for federal income tax purposes;

(ii) a private label credit provider who extends credit to a purchaser on an account that is later determined to be worthless and is actually charged off for federal income tax purposes; or

(iii) an assignee or affiliate of either of the persons listed in clause (i) or (ii) of this subparagraph.

(B) A person who extends credit to a purchaser under a cobranded credit agreement is not eligible to claim this refund.

(C) Bad debt refund claims may be submitted up to, but not later than, four years from the date the account is actually charged off for federal income tax purposes. Subsequent assignments do not extend this limitation.

(D) Only one person may request a refund for tax paid on each bad debt.

(E) To claim a bad debt refund, the person who claims the refund must:

(i) submit a written refund request including the following information:

(I) the date of original sale and the name and Texas sales tax permit number of the retailer who made the sale;

(II) the name and address of purchaser;

(III) the amount that the purchaser contracted to pay;

(IV) identification of taxable and nontaxable charges to the purchaser;

(V) the amount on which the retailer reported and paid Texas tax;

(VI) all payments or other credits applied to the account of the purchaser;

(VII) the jurisdictions to which local taxes were reported;

(VIII) the unpaid portion of the assigned sales price;

(IX) evidence that the bad debt relates to a private label credit agreement account; and

(X) evidence that the uncollected amount has actually been determined to be worthless and charged off for federal income tax purposes; and

(ii) include a statement, signed by the person claiming the refund or an authorized representative of that person, acknowledging that the bad debt refund for a particular bad debt may not be taken or claimed by another person, and that the bad debt refund has not previously been and will not be claimed by another person as a bad debt refund.

(F) Failure to submit the information listed in subparagraph (E) of this paragraph, and any other necessary information the comptroller requests to verify the refund claimed, may result in the denial of the refund claim. The comptroller will notify the requestor if the comptroller determines that a refund claim cannot be granted in part or in full and will also notify the requestor which requirements of subparagraph (E) of this paragraph were not met. The requestor may then request a refund hearing within 30 days of the denial.

(G) A retailer may claim a refund authorized by this paragraph for remitted state and local sales or use tax. A person who is not a retailer may claim a refund authorized by this paragraph only for state sales and use taxes imposed by Tax Code, §151.051 (Sales Tax Imposed) or §151.101 (Use Tax Imposed) and may not claim a refund for any local sales or use tax imposed under another code or chapter.

(H) If a person seeks to claim a refund on a bad debt that has been actually charged off for federal income tax purposes by another person, the person seeking the refund must submit with its refund claim evidence satisfactory to the comptroller showing that the refund claimant has obtained the right to the refund from the person who actually charged off the debt, and that the person who actually charged off the debt will not seek a refund on the same bad debt.

[(2) The amount of the bad debt may include both the sales price of the taxable item and nontaxable charges, such as finance charges, late charges, or interest that were separately billed to the customer. A deduction may only be claimed on that portion of the bad debt that represents the amount reported as subject to tax. In determining that amount, all payments and credits to the account may be applied ratably against the various charges that comprise the bad debt, except as provided by paragraph (3) of this subsection.]

[(3) A retailer, private label credit provider, or assignee or affiliate may not deduct from the amount subject to tax to be reported the expense of collecting a bad debt, or the amount that a third party has retained or which has been paid to a third party for the service of collecting a bad debt.]

[(4) To claim bad debt deductions, the records of the person who claims the bad debt deduction must show:]

[(A) date of original sale and name and Texas sales tax permit number of the retailer;]

[(B) name and address of purchaser;]

[(C) amount that the purchaser contracted to pay;]

[(D) taxable and nontaxable charges;]

[(E) amount on which the retailer reported and paid Texas tax;]

[(F) all payments or other credits applied to the account of the purchaser;]

[(G) evidence that the uncollected amount has been designated as a bad debt in the books and records of the person who claims the bad debt deduction, and that the amount has been or will be claimed as a bad debt deduction for income tax purposes;]

[(H) city, county, transit authority, or special purpose district to which local taxes were reported; and]

[(I) the unpaid portion of the assigned sales price.]

[(5) A person who is otherwise qualified to claim a bad debt deduction, and whose volume and character of uncollectible accounts warrants an alternative method of substantiating the reimbursement or credit, may:]

[(A) maintain records other than the records specified in paragraph (4) of this subsection if:]

[(i) the records fairly and equitably apportion taxable and nontaxable elements of a bad debt, and substantiate the amount of Texas sales tax imposed and remitted to the comptroller with respect to the taxable charges that remain unpaid on the debt; and]

[(ii) the comptroller approves the procedures used; or]

[(B) implement a system to report its future tax responsibilities based on a historical percentage calculated from a sample of transactions if:]

[(i) the system utilizes records provided by the person claiming the credit or reimbursement and the person who reported and remitted such tax to the comptroller; and]

[(ii) the comptroller approves the procedures used.]

[(6) The comptroller may revoke the authorization to report under paragraph (5)(B) of this subsection if the comptroller determines that the percentage being used is no longer representative because of:]

[(A) a change in law, including a change in the interpretation of an existing law or rule; or]

[(B) a change in the taxpayer's business operations.]

[(7) A person who is not a retailer may claim a credit or reimbursement authorized by paragraph (1)(C) of this subsection only for taxes imposed by Tax Code, §151.051 or §151.101.]

[(8) For purposes of this section, "affiliate" means any entity or entities that would be classified as a member of an affiliated group under 26 U.S.C. §1504.]

[(9) If a retailer or other person later collects all or part of an account for which a bad debt deduction or write-off was claimed, the amount collected must be reported as a taxable sale in the reporting period in which such collection was made.]

[(10) Credit or installment sales may not be labeled as bad debts merely for the purpose of delaying the payment of the tax.]

(f)[(e)] Repossessions.

(1) General provisions.

(A) Deduction is for taxable charges only.[(1)] When taxable items upon which the retailer or private label credit provider[other person] has paid tax are repossessed, the retailer, private label credit provider, or assignee or affiliate of either may request[or other person is allowed] a refund[credit or deduction] for that portion of the sales tax paid on the actual purchase price that remains unpaid when the taxable item is repossessed. The refund request[deduction] must not include any nontaxable charges that were a part of the original conditional sales contract. Any payments that the purchaser made prior to repossession must be prorated between the various

taxable and nontaxable charges[applied ratably against the various charges] in the original sales contract. For example, prior to repossession, a customer submits a payment of $90 on a conditional sales contract with a balance of $1,500, comprising $1,000 in nontaxable interest, fees, and other charges, and $500 in taxable charges. At the time of payment, the taxable charges represent one-third of the conditional sales contract charges. Thus, one-third of the payment received on this contract, or $30, must be applied to reduce the taxable charges for purposes of calculating the repossession refund for this contract, regardless of how the contract or credit agreement provides for payment or credit application. Conditional sales contracts which utilize payment application methodologies that, for example, apply credits, first, to interest; next, to late fees, miscellaneous charges, cash items fees, merchant items fees, or credit life premiums; and, only then, to purchase balances do not comply with this subsection, regardless of whether this payment application methodology is included in a conditional sales contract or credit agreement.

(B) Expenses to repossess or sell an item are not deductible.[(2)] A retailer, private label credit provider, or assignee or affiliate requesting a refund[or other person] may not add to or deduct from the amount of taxable charges the expense of repossessing or selling the item or[tax to be reported the expense of collecting an account receivable, or] the amount that a third party has retained or that has been paid to a third party for the service of [collecting an account or]repossessing or selling a repossessed item.

[(3) To claim a deduction or credit the person who claims the deduction or credit must be able to provide detailed records that show:]

[(A) date of original sale and name and Texas sales tax permit number of retailer;]

[(B) name and address of purchaser;]

[(C) amount that the purchaser contracted to pay;]

[(D) taxable and nontaxable charges;]

[(E) amount on which retailer reported and paid Texas tax];

[(F) all payments or other credits applied to the account of the purchaser;]

[(G) city, county, transit authority or special purpose district to which local taxes were reported; and]

[(H) the unpaid portion of the sale price assigned].

(C)[(4)] Sales tax is due on the sale of a repossessed item, irrespective of whether a vendor, mortgagee, secured party, assignee, trustee, sheriff, or an officer of the court has sold the item, unless the sale is otherwise exempt. If the vendor, mortgagee, secured party, assignee, trustee, sheriff, or officer of the court does not collect the tax, the purchaser must remit the tax directly to the comptroller.

(2) Repossession refunds.

(A) Only the following persons are entitled to claim a repossession refund for tax reported and paid on a taxable item later repossessed under a conditional sales contract:

(i) a retailer who extends credit to a purchaser under a private label credit agreement for the purchase of a taxable item that is later repossessed under a conditional sales contract;

(ii) a private label credit provider who extends credit to a purchaser for the purchase of a taxable item that is later repossessed under a conditional sales contract; or

(iii) an assignee or affiliate of either of the persons listed in clause (i) or (ii) of this subparagraph.

(B) A person who extends credit to a purchaser under a cobranded credit agreement is not eligible to claim this refund.

(C) Repossession refund claims may be submitted up to, but not later than, four years from the date the taxable item is repossessed. Subsequent assignments do not extend this limitation.

(D) Only one person may request a refund for tax paid on each taxable item.

(E) To claim a repossession refund, the person who claims the refund must:

(i) submit a written refund request including the following information:

(I) the date of original sale and the name and Texas sales tax permit number of the retailer who made the sale;

(II) the name and address of purchaser;

(III) the amount that the purchaser contracted to pay;

(IV) identification of taxable and nontaxable charges to the purchaser;

(V) the amount on which the retailer reported and paid Texas tax;

(VI) all payments or other credits applied to the account of the purchaser;

(VII) the jurisdictions to which local taxes were reported;

(VIII) the unpaid portion of the sales price;

(IX) the date of repossession of the taxable item for which a refund is claimed;

(X) evidence that the repossession relates to a conditional sales contract under a private label credit agreement; and

(ii) include a statement, signed by the person claiming the refund or an authorized representative of that person, acknowledging that the repossession refund for a particular taxable item may not be taken or claimed by another person, and that the repossession refund has not previously been and will not be claimed by another person as a repossession refund.

(F) Failure to submit the information listed in subparagraph (E) of this paragraph, and any other necessary information the comptroller requests to verify the refund claimed, may result in the denial of the refund claim. The comptroller will notify the requestor if the comptroller determines that a refund claim cannot be granted in part or in full and will also notify the requestor which requirements of subparagraph (E) of this paragraph were not met. The requestor may then request a refund hearing within 30 days of the denial.

(G) A retailer may claim a refund authorized by this paragraph for remitted state and local sales or use tax. A person who is not a retailer may claim a refund authorized by this paragraph only for state sales and use taxes imposed by Tax Code, §151.051 (Sales Tax Imposed) or §151.101

(Use Tax Imposed) and may not claim a refund for any local sales or use tax imposed under another code or chapter.

(H) If an assignee's or affiliate's repossession refund claim is based on tax paid by a retailer or private label credit provider on the remaining unpaid sales price of a taxable item that is repossessed under a conditional sales contract, the assignee or affiliate must provide documentation to demonstrate that the assignee or affiliate has obtained the right to seek a refund from the retailer or private label credit provider and that the retailer and private label credit provider will not seek a refund on the same repossessed item.

(g)[(f)] Interest on sales tax. This section will refer to the terms "interest" and "time price differential" as interest. [The term "credit" includes all deferred payment agreements.]

(1) Sellers on a cash basis of accounting who sell taxable items by means of a credit sale[on credit] and charge interest on the amount of credit extended, including sales tax, are required to remit to the comptroller a portion of the interest that has been collected on the state and local taxes.

(2) If the amount of interest charged on the tax is 18% or less, the seller must remit to the comptroller one-half of the interest charged on the tax.

(3) If the amount of interest charged on the tax is greater than 18%, the seller must remit the amount of interest charged less 9.0%[9%]. For example, 21% charged less 9.0%[9%] deduction equals 12% interest remitted. A seller will not be allowed the 9.0%[9%] deduction if the interest rate charged on sales tax differs from the interest rate charged on the sales price of the taxable item.

(4) In determining the amount of interest to be remitted to the comptroller, a seller does not need to calculate the interest on each individual account. A formula for the calculation may be used if the formula correctly reflects the amount of interest collected. The formula will be subject to verification upon audit of the taxpayer's records.

(5) Except for the provisions of [Texas]Tax Code, §151.423 and §151.424, all reporting, collection, refund, and penalty provisions of [Texas]Tax Code, Chapter 151, including assessment of penalty and interest, apply to interest due.

(h)[(g)] Trade-ins. In this subsection, a trade-in is [considered as]a taxable item that is being used to reduce the purchase price of another taxable item.

(1) The sales price of a taxable item does not include the value of a trade-in that a seller takes as all or part of the consideration for a sale of a taxable item of the same type that is normally sold in the regular course of business of the seller. For example, sales tax will be due only on the difference between the amount allowed on an old piano taken in trade and the sales price of a new piano.

(2) The sales price of a taxable item does include the value of a trade-in that a seller takes as all or part of the consideration for the sale of a taxable item, if the trade-in is a different type from the type normally sold in the regular course of business of the seller. For example, a seller of pianos who takes a desk in trade as part of the sales price of a piano would collect sales tax on the retail sales price of the piano without any deduction for the value of the desk. In this situation, the seller and buyer are considered to be bartering. However, if a seller of pianos is also a seller of desks, the value of the desk would be allowed as a trade-in.

(3) Persons who remove items from a tax-free inventory for use as a trade-in owe sales tax on the cost [price]of the items. If both parties to a transaction remove items from a tax-free inventory to trade for other items that each party will use, the transaction will be regarded as barters by both parties. Each party to the barter will be required to collect sales tax on the retail sales price of the item being transferred. For example, a retailer of drill pipe trades pipe to a retailer of aircraft in exchange for an aircraft. Both retailers are trading the respective items for use, not resale. The pipe retailer must collect sales tax on the retail sales price of the pipe. The aircraft retailer must collect sales tax on the retail sales price of the aircraft.

(4) See §3.336 of this title (relating to [Sales of]Gold, Silver, Coins, and Currency) for information on persons who barter for taxable items with gold, silver, diamonds, or precious metals.

[(h) Tax Code, §111.064, provides that interest will be paid on tax amounts found to be erroneously paid and claimed on a request for refund or in an audit. See also §3.325 of this title (relating to Refunds, Interest, and Payments Under Protest).]

[(1) Tax paid on an account that is later determined to be uncollectible and written off as a bad debt for federal tax purposes is not tax paid in error and does not accrue interest.]

[(2) A request for refund, or an overpayment of tax in an audit, for a report period due before January 1, 2000, does not accrue interest.]

This agency hereby certifies that the proposal has been reviewed by legal counsel and found to be within the agency's authority to adopt.

Issued in Austin, Texas, on

LITA GONZALEZ
General Counsel
Comptroller of Public Accounts
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