**STATE OF NORTH CAROLINA**
**COUNTY OF WAKE**

**BEFORE THE NORTH CAROLINA**
**DEPARTMENT OF REVENUE**
**OAH 10 REV 00826**

**Office Depot, Inc.** )
**Petitioner,** )
**v.** )
)
**N.C. Department of Revenue,** )
**Respondent.** )

**FINAL AGENCY DECISION**

THIS MATTER comes before the North Carolina Department of Revenue ("Department") for Final Agency Decision pursuant to N.C. Gen. Stat. § 150B-36. This matter was heard by Administrative Law Judge Melissa Owens Lassiter ("ALJ") on July 8, 2015 in the Office of Administrative Hearings ("OAH") in Raleigh, North Carolina upon the parties' cross motions for summary judgment on the issue of whether Petitioner is entitled to claim a refund under N.C. Gen. Stat. § 105-164.13(15). The ALJ's Recommended Decision granting summary judgment for Petitioner was filed on September 24, 2015. The official administrative record was transmitted by OAH to the Department on October 5, 2015. After a full review of the entire record of this matter, including the official record as defined in N.C. Gen. Stat. § 150B-37(a), and upon consideration of the cross motions for summary judgment by the parties, the briefs, exceptions, written arguments, proposed orders, and other documents filed or submitted by the parties, the Department makes this Final Agency Decision as follows:

Deletions from the Issue, Findings of Fact, and Conclusions of Law in the ALJ's Recommended Decision are marked with ~~strikethroughs~~ and additions/modifications are in **bold**.

## APPEARANCES

For Petitioner: Douglas W. Hanna, Attorney at Law, 4350 Lassiter at North Hills Avenue, Suite 375, Raleigh, North Carolina 27609; Michael J. Bowen, Esq., Akerman, LLP, 50 North Laura Street, Suite 3100, Jacksonville, FL 32202.

For Respondent: Tenisha S. Jacobs, **Special Deputy** ~~Assistant~~ Attorney General, North Carolina Department of Justice, 9001 Mail Service Center, Raleigh, North Carolina 27699-9001.

## ISSUE

~~Is there a genuine issue of material fact, and is either movant entitled to a judgment as a matter of law on the issue whether Petitioner is entitled to claim a $115,873.61 refund under N.C. Gen. Stat. § 105-164.13(15) for sales taxes collected and remitted on bad debts incurred on private label credit card accounts from August 1, 2000 through December 31, 2003?~~

**Is either movant entitled to judgment as a matter of law on the issue of whether Petitioner is authorized to claim a refund under N.C. Gen. Stat. § 105-164.13(15) when: (1) Petitioner contracts with a third-party bank ("the Bank") to extend credit to its customers in the form of private label credit cards ("PLCC"); (2) the PLCC Card Accounts are owned by the Bank; (3) the Bank reimburses Petitioner for the purchase price plus the applicable sales tax on each PLCC transaction; (4) the Bank charges Petitioner a Reserve Fee for each PLCC transaction; (5) the Bank owns and manages the Reserve Fees Account; (6) the Bank debits the Reserve Fees Account for PLCC losses on Card Account balances deemed worthless by the Bank; and (7) the Bank not Petitioner charged off the PLCC worthless accounts for federal income tax purposes?**

## FINDINGS OF FACT

**The Department adopts Findings of Fact numbers 1-5 in the ALJ's Recommended Decision as follows:**

### Appeal from Notice of Final Determination

1. This contested case is an appeal by Petitioner from Respondent's December 31, 2009 Notice of Final Determination denying Petitioner's refund claim for $115,873.61, under N.C. Gen. Stat. § 105-164.13(15), for sales taxes collected and remitted on bad debt incurred on private label credit card accounts from August 1, 2000 through December 31, 2003 **("Period at Issue")**. In its Notice of Final Determination, Respondent denied Petitioner's request for a refund claim, because Petitioner "cannot establish the existence of any 'accounts of purchasers, representing taxable sales' between Petitioner and its customers, which Petitioner charged off" as worthless. (Stipulation of Facts and Documents; December ~~19~~ **31**, 2009 Notice of Final Determination)**.**

### Stipulation of Facts and Documents

2. The parties' Stipulation of Facts and Documents are hereby incorporated by reference into this Order.

### Undisputed Findings of Fact

3. These Findings of Facts are merely a summation of the undisputed facts in this case which are the basis of the Conclusions of Law and summary judgment stated herein. (See *Noel Williams Masonry, Inc. v. Vision Contractors*, 103 N.C. A~~o~~pp. 597, 406 S.E.2d 605 (1991))**.**

4. As a national retailer of office products and supplies, Petitioner owns and operates retail stores throughout the United States, including in North Carolina. Petitioner is a registered retailer in North Carolina for sales and use tax purposes. From August 1, 2000 through

December 31, 2003, Petitioner reported and remitted sales and use taxes on an accrual basis to Respondent.

5. On September 30, 1999, Petitioner entered into a Merchant Services Agreement ("MSA") with Associates Capital Bank, Incorporated ("the Bank"), a third-party issuer of credit. Pursuant to the MSA, the Bank extended credit to Petitioner's approved commercial customers by issuing private label credit cards ("PLCC"), and creating an underlying account ("Card Account") for each cardholder under either a commercial revolve program or commercial invoice card plan. Each Card Account was the property of the Bank. Subsequently, Citibank USA, N.A. ("Citibank") acquired Associates Capital Bank, inherited the MSA at issue in this case, is now the legal owner of the accounts from the MSA, and is now "the Bank" in this contested case.

**The Department determines that Petitioner's statements concerning the selection of a third-party issuer of credit shall be included in the Findings of Fact. As shown by the record cites below, the additional Finding of Fact is supported by the preponderance of the admissible evidence in the record and is not inconsistent with any Finding of Fact recommended by the ALJ that is adopted by the Department. Therefore, the Department includes the following evidence from the admissible record, which is denoted as Finding of Fact number 6 in this Final Agency Decision as follows:**

6. **Petitioner desired to offer its commercial customers the convenience of using a credit card but was unwilling "to make the investment in obtaining the infrastructure both intellectually and materially" necessary to operate a credit card program for its commercial customers. (Witt Dep. 59:14-18). By entering into the MSA with the Bank, Petitioner does not itself have to comply with general collection and billing law nor various federal and state lending laws. (Witt Dep. 60:9-17).**

**The Department rejects Finding of Fact number 6 in the ALJ's Recommended Decision, renumbered as Finding of Fact number 7 in this Final Agency Decision, as incomplete and finds that it should be appended in light of the preponderance of the admissible evidence in the record. As shown by the record cites below, the additions made to Finding of Fact number 6 in the ALJ's Recommended Decision are supported by the preponderance of the admissible evidence in the record and are not inconsistent with any Finding of Fact recommended by the ALJ that is adopted by the Department. Thus, the Department modifies said Finding of Fact as follows:**

7. Under the MSA, Petitioner agreed to accept PLCCs which PLCC cardholders rendered for payment of authorized goods sold by Petitioner, including any applicable North Carolina state and local sales and/or use taxes (collectively "North Carolina taxes") due thereon. **Petitioner "recorded an account receivable due from the [B]ank, not the customer." (Witt Dep. 21:18-22; Dep. Ex. 6 p. 2 ¶ 6). To receive payment for its**

**account receivables from the Bank, Petitioner submitted a "daily settlement file" to the Bank containing "account numbers, the associated amount charged…[and] the items the customer purchased."** ***Id.*** **at 22:12-17.** Per the terms of the MSA, the Bank reimbursed Petitioner for the full sales price of the authorized goods Petitioner sold to the cardholders, and any applicable North Carolina taxes Petitioner collected on such sales charged to the cardholders' PLCC Card Accounts. (Stipulation no. 7)**.**

**The Department determines that Petitioner's statements concerning the relationship between Petitioner and the cardholders and the Bank and the cardholders shall be included in the Findings of Fact. The Department also determines the express language of the MSA regarding the relationship between Petitioner and the Bank shall be included in the Findings of Fact. As shown by the record cites below, the additional Finding of Fact is supported by the preponderance of the admissible evidence in the record and is not inconsistent with any Finding of Fact recommended by the ALJ that is adopted by the Department. Therefore, the Department includes the following evidence from the admissible record, which is denoted as Finding of Fact number 8 in this Final Agency Decision as follows:**

8. **Petitioner had a retail relationship with the cardholders, and the Bank had a lender relationship with the cardholders. (Witt Dep. 57:9-18). The relationship between Petitioner and the Bank was one of independent contractors. (Witt Dep. 56:20-24). The MSA specifically stated, "[t]his agreement is not intended to create, nor does it create and shall not be construed to create, a relationship of partner or joint venture or an association for profit between [the Bank] and [Petitioner]." (Stipulation of Facts and Documents, MSA, Art V, § 5.5, p. 17).**

**The Department adopts Findings of Fact numbers 7-8 in the ALJ's Recommended Decision, renumbered as Findings of Fact numbers 9-10 in this Final Agency Decision, as follows:**

9. Petitioner remitted North Carolina ~~T~~taxes to Respondent for the North Carolina taxes charged on sales to Petitioner's commercial customers who used their PLCCs issued by the Bank to pay for such goods during the **P**~~p~~eriod at **I**~~i~~ssue.

10. Subsequent to Petitioner's remittance of North Carolina taxes to Respondent, the Bank determined that certain unpaid PLCC Card Account balances constituted a "loss" under the criteria set forth under the MSA. (See MSA, Article 1, § 1.1, definition of "~~Account~~" **"Losses"**) Under the MSA, the Bank retained the sole right to determine whether an unpaid PLCC Card Account constituted a "loss."

**The Department rejects a portion of Finding of Fact number 9 in the ALJ's Recommended Decision, renumbered as Finding of Fact number 11 in this Final Agency Decision, as clearly contrary to the preponderance of the admissible evidence in the record.**

**Said portion is marked with strikethroughs. Per the MSA, the Settlement Account was not offset by the Bank for marketing expenses. Instead, the Bank credited the Marketing Fund, which was used to promote sales growth for the Card Plan. (*See* Stipulation of Facts and Documents, MSA, Art. III, § 3.3, p. 12).**

**The Department rejects a portion of Finding of Fact number 9 in the ALJ's Recommended Decision, renumbered as Finding of Fact number 11 in this Final Agency Decision, as incomplete. The portion rejected as incomplete is appended. As shown by the record cites below, the additions made to Finding of Fact number 9 in the ALJ's Recommended Decision are supported by the preponderance of the admissible evidence in the record and are not inconsistent with any Finding of Fact recommended by the ALJ that is adopted by the Department. Thus, the Department modifies said Finding of Fact as follows:**

11. The MSA established two different accounts between Petitioner and the Bank-a Settlement Account, and a Reserve Fees Account. (MSA, **Art. I,** Section~~s~~ 1.1 and **Art. IV, §** 4.1) On a daily basis, the Bank credited the Settlement Account with a dollar value of all amounts financed by customers on their PLCC Card Accounts, including the purchase price of the goods the PLCC customer acquired, and the applicable sales tax thereon. The MSA also authorized the Bank to offset amounts, otherwise credited to the Settlement Account, for items such as "Merchant Fees" and **a "Reserve Fee."** ~~fees relating to joint marketing expenses.~~ (MSA, Art. III, § 3.1(a) and ~~3.3~~ **3.2).** One of the ~~primary~~ offsets to the amounts paid to the Settlement Account was for Reserve Fees. (MSA, Art. III, § 3.1(a)). **The Merchant Fees were 0.64% of the net Commercial Revolve Card Plan Card Sales and 2.67% of the net Commercial Invoice Card Plan Card Sales. (Stipulation of Facts and Documents, MSA, Art III, § 3.1(a), pp. 10-11). The Merchant Fees were subject to revision as determined by the prevailing Commercial Paper Rate. (Stipulation of Facts and Documents, MSA, Art III, § 3.1(a)-(b), pp. 10-11).** The Merchant Fees were not the basis for Petitioner's refund claim in this case.

**The Department rejects Finding of Fact number 10 in the ALJ's Recommended Decision, renumbered as Finding of Fact number 12 in this Final Agency Decision, as incomplete and finds that it should be appended in light of the preponderance of the admissible evidence in the record. As shown by the record cites below, the additions made to Finding of Fact number 10 in the ALJ's Recommended Decision are supported by the preponderance of the admissible evidence in the record and are not inconsistent with any Finding of Fact recommended by the ALJ that is adopted by the Department. Thus, the Department modifies said Finding of Fact as follows:**

12. The Reserve Fees Account is an account separate and apart from the Settlement Account, and is owned **and managed** by the Bank. (MSA, Art. IV, §§ 4.1, **4.2).** The purpose of the

Reserve Fees Account was to offset losses incurred **by the Bank** on worthless PLCC Card Accounts. ~~The Bank charged Petitioner a fixed percentage per PLCC Card Account to fund the Reserve Fees Account~~. **The Reserve Fees Account was funded as follows: (1) 0.95% of all Commercial Revolve Card Plan Card Sales, and (2) 0.40% of all Commercial Invoice Card Plan Card Sales. (Stipulation of Facts and Documents, MSA, Art III, § 3.2, p. 12). The Bank offset the Settlement Account monthly for these fees. (Witt Dep. 46:2-8; 88:20-25).**

**The Department rejects the stricken portion of Finding of Fact number 11 in the ALJ's Recommended Decision, renumbered as Finding of Fact number 13 in this Final Agency Decision, as clearly contrary to the preponderance of the admissible evidence in the record. There is no express language in the MSA provision cited requiring a debit from the next day's Settlement Account for losses exceeding recoveries from accounts previously determined worthless. Thus, the Department modifies said Finding of Fact as follows:**

13. Each month, the Bank debited all bad debt losses incurred on the PLCC Card Accounts from the Reserve Fees Account during the immediately preceding month. (MSA, Art. IV, § 4.1)**.** If the Bank recovered amounts related to the PLCC Card Accounts that it had previously determined worthless, the Bank was required to credit the recovered amounts to the Reserve Fees Account. *Id.* ~~If the PLCC Card Accounts losses exceeded recoveries, Petitioner was required to make up the difference by making a payment to the Reserve Fees Account. *Id.* To accomplish this reimbursement, the Bank would debit the shortfall from the next days' credit to the Settlement Account. *Id.* In other words, amounts otherwise due and payable to Petitioner for the PLCC Card Account sales were used by the Bank, on a dollar-for-dollar basis, to offset losses incurred on the PLCC Card Accounts.~~

**The Department rejects Finding of Fact number 12 in the ALJ's Recommended Decision, renumbered as Finding of Fact number 14 in this Final Agency Decision, as incomplete and finds that it should be appended in light of the preponderance of the admissible evidence in the record. As shown by the record cites below, the additions made to Finding of Fact number 12 in the ALJ's Recommended Decision are supported by the preponderance of the admissible evidence in the record and are not inconsistent with any Finding of Fact recommended by the ALJ that is adopted by the Department. Thus, the Department modifies said Finding of Fact as follows:**

14. ~~Similarly, at the end of the month~~, **[I]**f the Reserve Fees Account fell below ~~a level specified in the MSA~~ **4% of the applicable Card Account balances at the end of the month**, the Bank ~~may~~ **was authorized by the MSA to** debit the Settlement Account or otherwise collect such amounts from Petitioner to make up the shortfall. (MSA, Art. IV, § 4.1)**.** Regularly, the Bank had to ask Petitioner to pay additional Reserve Fees into the Reserve Fees Account above and beyond the percentage of any card sale. (Fred Witt

Deposition pp. 92-93)**. The Bank withheld the funds for this additional Reserve Fee payment from the net daily Settlement Account on a monthly basis. (Witt Dep. 45:21-23; 46:7-8). If the balance in the Reserve Fees Account every three months was more than 4% of the applicable Card Account balances plus the sum of all applicable Card Account balances that were 90 days or more past due, the Bank was required to rebate Petitioner the excess. (Stipulation of Facts and Documents, MSA, Art IV, § 4.1, p. 12).**

**The Department adopts Finding of Fact number 13 in the ALJ's Recommended Decision, renumbered as Finding of Fact number 15 in this Final Agency Decision, as follows:**

15. Section 4.2 of the MSA explicitly states that the Bank would hold and manage the balance of the Reserve Fees Account until the MSA is terminated. Upon termination of the MSA, the Bank will rebate the amount remaining in the Reserves Fees Account to Petitioner by cash payment.

**The Department rejects Finding of Fact number 14 in the ALJ's Recommended Decision, renumbered as Finding of Fact number 16 in this Final Agency Decision, as incomplete and finds that it should be appended in light of the preponderance of the admissible evidence in the record. As shown by the record cite below, the addition made to Finding of Fact number 14 in the ALJ's Recommended Decision is supported by the preponderance of the admissible evidence in the record and is not inconsistent with any Finding of Fact recommended by the ALJ that is adopted by the Department. Thus, the Department modifies said Finding of Fact as follows:**

16. During all times relevant to this case, the Bank and Petitioner have consecutively renewed the MSA with a consecutive series of MSAs, so the subject Reserve Fees Account has remained intact, and the Bank has never rebated any amount remaining in the Reserve Fees Account to Petitioner. (Fred Witt Deposition pp. 98-99)**. During all times relevant to this case, the petitioner never showed the balance in the Reserve Fees Account as an asset on its books and records. (Witt Dep. 50:11-16; 98:11-23).**

**The Department rejects a portion of Finding of Fact number 15 in the ALJ's Recommended Decision, renumbered as Finding of Fact number 17 in this Final Agency Decision, as clearly contrary to the preponderance of the admissible evidence in the record. Said portion is marked with strikethroughs.**

**The Department rejects a portion of Finding of Fact number 15 in the ALJ's Recommended Decision, renumbered as Finding of Fact number 17 in this Final Agency Decision, as incomplete. The portion rejected as incomplete is appended. As shown by the record cites below, the additions made to Finding of Fact number 15 in the ALJ's Recommended Decision are supported by the preponderance of the admissible evidence in**

**the record and are not inconsistent with any Finding of Fact recommended by the ALJ that is adopted by the Department.**

**Accordingly, the Department modifies Finding of Fact number 15 in the ALJ's Recommended Decision as follows:**

17. ~~After Petitioner become aware, at the end of 2006-2007, that it was missing [tax] credits it could take~~, **After being audited by the North Carolina Department of Revenue**, Petitioner ~~claimed~~ **filed a claim for refund to offset the audit liability initially assessed for a portion** ~~the sum~~ of the Bank's debits to the Reserve Fees Account, in the amount of $115,873.61 **claimed** as an "other deduction" on line 26 of ~~its~~ **Petitioner's** 2001, 2002, and 2003 federal income tax returns. (See Exhibits 2 and 3 of Memorandum in support of Respondent's Motion for Summary Judgment; **Tate Dep. 14:11-15:5). The Bank, not Petitioner, charged off the PLCC worthless accounts for federal income tax purposes (Hr'g Tr. 7:6-11).**

**The Department rejects a portion of Finding of Fact number 16 in the ALJ's Recommended Decision, renumbered as Finding of Fact number 18 in this Final Agency Decision, as incomplete. The portion rejected as incomplete is appended. As shown by the record cite below, the additions made to Finding of Fact number 16 in the ALJ's Recommended Decision are supported by the preponderance of the admissible evidence in the record and are not inconsistent with any Finding of Fact recommended by the ALJ that is adopted by the Department.**

**The Department rejects a portion of Finding of Fact number 16 in the ALJ's Recommended Decision, renumbered as Finding of Fact number 18 in this Final Agency Decision, as clearly contrary to the preponderance of the admissible evidence in the record. Said portion is marked with strikethroughs. The Reserve Fees are a set percentage of Card Sales. (*See* Finding of Fact number 12 in this Final Agency Decision). The Reserve Fees Account balance is subject to rebate if it exceeds a sum definite as defined by the MSA or upon termination of the MSA. (*See* Findings of Fact numbers 14 and 15 in this Final Agency Decision). Thus, the finding that the Reserve Fees Account is directly tied to "losses" is clearly contrary to the preponderance of the admissible evidence in the record as the Reserve Fees Account is subject to an excess that must be refunded to Petitioner.**

**Accordingly, the Department modifies Finding of Fact number 16 in the ALJ's Recommended Decision as follows:**

18. Petitioner filed a claim for refund with Respondent for the **North Carolina** amounts Petitioner claimed **as an "other deduction"** on line 26 of Petitioner's federal income tax ~~refunds~~ **returns** for tax years 2001, 2002, and 2003 for $115,873.61. (**Dep. Ex. 9A).** The amounts paid to the Reserve Fees Account ~~is over-and-above~~ **are in addition to** the payment of Merchant Fees due from Petitioner to the Bank. ~~The amounts Petitioner paid~~

~~into the Reserve Fees Account are directly tied to "losses" incurred with respect to the PLLC Card Accounts under the express terms of the MSA~~.

**The Department adopts Finding of Fact number 17 in the ALJ's Recommended Decision, renumbered as Finding of Fact number 19 in this Final Agency Decision, as follows:**

19. Respondent agrees that N.C. Gen. Stat.§ 105-164.7 clearly mandates that the retailer is ultimately responsible for the payment of sales taxes on its taxable sales regardless whether it actually collected such amounts from its customer.

**The Department rejects Finding of Fact number 18 in the ALJ's Recommended Decision, renumbered as Finding of Fact number 20 in this Final Agency Decision, because it contains a conclusion of law. As a general rule, any determination requiring the exercise of judgment or the application of legal principals is more precisely classified as a conclusion of law. *In re Helms,* 127 N.C. App. 505, 510, 491 S.E.2d 672, 676 (1997). A trial court's "mislabeling" a determination, however, is "inconsequential" as the appellate court may simply reclassify the determination and apply the appropriate standard of review. *In re R.A.H*., 182 N.C. App. 52, 60, 642 S.E.2d 404, 409 (2007).**

**A "beneficial owner" is a legal concept defined as "one recognized in equity as the owner of something because use and title belong to that person even though legal title may belong to someone else…." *Black's Law Dictionary* 508 (2nd Pocket ed. 2001). Thus, a determination of beneficial ownership requires the exercise of judgment and application of legal principles.**

20. ~~Although Petitioner is not technically the legal owner of the Reserve Fees Account, Petitioner is a defacto or beneficial owner, or holder of the Reserve Fees Account, because pursuant to the terms of the MSA, Petitioner bears the economic burden of the loss on all bad debts relating to the PLCC Card Accounts on a dollar-for-dollar basis.~~

## CONCLUSIONS OF LAW

**With regard to the Conclusions of Law contained in the ALJ's Recommended Decision and based upon the foregoing Findings of Fact, the Department decides as follows:**

**The Department adopts Conclusions of Law numbers 1-5 in the ALJ's Recommended Decision as follows:**

1. Summary judgment is appropriate "if the pleadings, depositions, answers to interrogatories and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that any party is entitled to judgment as a

matter of law." *Forbis v. Neal*, 361 N.C. 519, 523-24, 649 S.E.2d 382, 385 (2007) (citing N.C. Gen. Stat. § 1A-1, Rule 56(c)).

2. Pursuant to N.C. Gen. Stat. §§ 1A-1, Rule 56, 150B-36 and 26 N.C.A.C. 3.0115, the ~~undersigned~~ **ALJ** has the authority to grant summary judgment in this matter.

3. Because there are no genuine issues of material fact, the only question is whether Petitioner has satisfied its burden of bringing itself within the scope of the deduction authorized under N.C. Gen. Stat. § 105-164.13(15), the "bad debt" deduction.[1]

4. Under the North Carolina Sales and Use Tax Act ("the Act"), N.C. Gen. Stat. § 105-164.1 *et. seq*., a sales tax is imposed upon retailers engaged in the business of selling tangible personal property in the State as a privilege tax for the right to engage in that business. *See* N.C. Gen. Stat. § 105-164.4; *Piedmont Canteen Service, Inc. v. Johnson*, 256 N.C. 155, 161, 123 S.E.2d 582, 586 (1962) (holding that "it is clear the Legislature intended that the sales tax be primarily a privilege or license tax on retailers").

5. Pursuant to N.C. Gen. Stat. § 105-164.4(a), the sales tax is levied on a retailer's "net taxable sales" or gross receipts, as appropriate. For purposes of the Act, "net taxable sales" is defined as "the gross retail sales of the business of the retailer taxed under this [Act] after deducting exempt sales and nontaxable sales." N.C. Gen. Stat. § 105-164.3 (24).

**The Department, exercising its discretion, modifies Conclusion of Law number 6 in the ALJ's Recommended Decision to reflect a more accurate statement of the law as follows:**

6. N.C. Gen. Stat. § 105-164.13 **sets forth various exceptions and exclusions to the sales and use taxes imposed under the Act. Specifically, subdivision (15)** allows a retailer ~~to deduct tangible personal property, digital property, and services~~ **to deduct the following** from its gross sales when the retailer is determining its North Carolina sales tax liability, and calculating its "net taxable sales"**:** ~~including:~~

    > (15) Accounts of purchasers, representing taxable sales, on which the tax imposed by this Article has been paid, that are found to be worthless and actually charged off for income tax purposes.

**The Department adopts Conclusions of Law numbers 7-9 in the ALJ's Recommended Decision as follows:**

7. Since N.C. Gen. Stat. § 105-164.13(15) ("the Bad Debt Statute") allows a retailer to deduct bad debts from its gross sales, it represents a deduction from sales taxation. *See*

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[1] All statutory references are to those statutes in effect during the **P**~~p~~eriod at **I**~~i~~ssue.

*Midrex v. Lynch*, 50 N.C. App. 611, 614, 274 S.E.2d 853, 855 (1981) (recognizing that a deduction is "something that is or may be subtracted") **(internal citations and quotation marks omitted)**. As such, the bad debt deduction allowed under ~~N.C. Gen. Stat. § 105-164.13(15)~~ **the Bad Debt Statute** is a privilege, and not a right; it is a benefit that "the [S]tate gratuitously confers," and "has the concomitant power to limit[.]" *Aronov v. Secretary of Revenue*, 323 N.C. 132, 138, 371 S.E.2d 468, 471-72 (1987)**.**

8. Petitioner, therefore, bears the burden of bringing itself within the statutory provisions authorizing the bad debt deduction under **the Bad Debt Statute** ~~N.C. Gen. Stat. § 105-164.13(15~~). *See Wal-Mart Stores East, Inc. v. Hinton*, **197** N.C. App. **30**, **54-55**, 676 S.E.2d 634, 651 (2009) (recognizing that "a taxpayer claiming a deduction must bring himself within the statutory provisions authorizing the deduction") (internal citations omitted).

9. Under N.C. Gen. Stat. § 105-164.7, a "retailer's failure to charge the tax to or to collect the tax from the purchaser does not affect" its sales tax liability. Thus, the fact that a customer does not pay the sales tax is therefore irrelevant in determining a retailer's sales tax liability. Although the sales tax is designed to be passed on to the consumer, the legal incidence of the sales tax is on the retailer. *Piedmont Canteen Service*, 256 N.C. at 161-162, 123 S.E.2d at 586 (holding that despite the retailer's ability to pass the sales tax on to and collect it from the purchaser, it is the retailer that remains liable for the sales tax).

**The Department rejects Conclusions of Law numbers 10-12 in the ALJ's Recommended Decision as erroneous as a matter of law.**

10. ~~In this contested case, there is no dispute and no genuine fact that pursuant to the terms of the MSA, the Bank debits the balance of all bad debt losses, incurred from the PLCC Card Accounts for the immediately preceding month, from the Reserve Fees Account on a monthly basis. Pursuant to that same MSA, Petitioner is required to fund the Reserve Fees Account for the exact dollar value of all worthless PLCC Card Accounts. The cash balance of the Reserve Fees Account ultimately reverts back to Petitioner. Although Petitioner is not legal owner of the PLCC Card Accounts, it is the defacto or beneficial owner of the PLCC Card Accounts, because it bears the risk of loss on all bad debts relating to the PLCC Card Accounts on a dollar-for-dollar basis. Under the MSA, when the PLCC Card Account holder defaults on its account, the Petitioner, as the retailer, suffers the true and quantifiable economic loss~~.

11. ~~The purpose of N.C. Gen. Stat. § 105-164.13(15) is to provide relief to retailers who comply with the tax laws of North Carolina, but suffer economic losses and uncollectible debt due to situations beyond their control, i.e. the customer's default on the credit account. In this case, the relief Petitioner seeks is premised on a set of factual circumstances entirely consistent with the legislative intent behind N.C. Gen. Stat. § 105-~~

~~164.13. Under the terms of the MSA, Petitioner suffers the exact economic loss that the General Assembly seeks to remedy through the enactment of the N.C. Gen Stat. § 105-164.13(15)~~.

12. ~~Respondent's interpretation that Petitioner is not owner or holder of the Reserve Fees Account, and thus not an "account of purchaser" is a narrow and strict interpretation that runs contrary to the legislative intent for N.C. Gen. Stat. § 105-164.13(15)~~.

**The Department, exercising its discretion, modifies Conclusion of Law number 13 in the ALJ's Recommended Decision to reflect a more comprehensive and accurate statement of the rules of statutory construction as follows:**

13. **"A long-standing rule of statutory construction declares that a facially clear and unambiguous statute requires no interpretation."** ***Cape Hatteras Elec. Membership Corp. v. Kenneth R. Lay, Sec'y of the N.C. Dep't of Rev.*****, 210 N.C. App. 92, 97, 708 S.E.2d 399,402 (2011) (internal citations omitted). The goal of statutory construction is [t]**o ascertain **the** legislative intent. **To ascertain legislative intent,** courts should consider the language of the statute, the spirit of the statute, and what it seeks to accomplish; other indicia considered by the court in determining legislative intent are the legislative history of an act and the circumstances surrounding its adoption. *Cape Hatteras Electric Membership Corporation v. Kenneth R. Lay, Secretary of the North Carolina Department of Revenue*, 210 N.C. App. 92, 708 S.E.2d 399 (2011) **(internal citations and quotation marks omitted**). "**In all tax cases, the construction placed upon the statute by the [Secretary] of Revenue, although not binding, will be given due consideration by a reviewing court."** ***Id*****. at 404.**

**The Department adopts Conclusion of Law number 14 in the ALJ's Recommended Decision as follows:**

14. A part of a statute may not be interpreted out of context so as to render it inharmonious to the intent of the act, but must be construed as part of the whole. *Watson Industries v. Shaw*, 235 N.C. 203, **210**, 69 S.E.2d 505, **511-512** (1952).

**The Department rejects Conclusions of Law numbers 15-18 in the ALJ's Recommended Decision as erroneous as a matter of law.**

15. ~~N.C. Gen. Stat. § 105-164.13(15) is one component of the much larger provision of N.C. Gen. Stat. § 105-164.13 that outlines several categories of sales tax exemptions. N.C. Gen. Stat. § 105-164.13(15) is part of the group titled, "Transactions Group." The language in N.C. Gen. Stat. § 105-164.13(15) does not explicitly state who can claim the exemption in N.C. Gen. Stat. § 105-164.13(15). Neither does it require that the retailer either "own" or "hold" the "accounts of purchasers" in order for the retailer to claim relief under that statutory section. Instead, N.C. Gen. Stat. § 105-164.13(15) merely~~

~~requires the claimant provide evidence of the existence of the accounts with the defined characteristics~~.

16. ~~In contrast, under N.C. Gen. Stat. § 105-164.13(16), the General Assembly expressly identified an exemption for the "act" of "sales of an article repossessed," and the "actor" required to complete the repossession-the vendor. The General Assembly could have limited relief under the Bad Debt Statute to a particular actor as it did in N.C. Gen. Stat. § 105-164.13(16), but it chose not to do so. The absence of any "actor" reference in N.C. Gen. Stat. § 105-164.13(15) is consistent with the legislative intent to provide relief based on who sustained the economic loss associated with the bad debt incurred~~.

17. ~~Although the bad debt charge-offs in this case were associated with private label credit cards issued by a third-party, the undersigned~~ **ALJ** ~~finds that its previous holding in *Home Depot, Inc. v. North Carolina Department of Revenue*, 09 REV 4211 is inapposite as the recourse nature of the bad debts in this case distinguishes it from the *Home Depot, Inc.* case. In this case, the amounts Petitioner paid to the Reserve Fees Account were over-and above the Merchant Fees Petitioner paid the Bank, and were directly tied to the "losses" incurred with respect to the PLCC Card Accounts under the express terms of the MSA. Petitioner bore the economic loss of all bad debts from the PLCC Card Accounts in default, and thus, was the defacto owner of the "accounts of purchasers." Whereas, Petitioner Home Depot paid only service fees, but not Reserve Fees, to their Bank as part of~~ **[their]** ~~financing agreement, and Home Depot was not ultimately responsible for the bad debt losses incurred by the PLCC Card Accounts in its case. Due to the different substance of Home Depot's financing arrangement with its Bank, Home Depot did not hold or own any "accounts of purchasers~~."

18. ~~By virtue of the Reserve Fees Account, Petitioner has demonstrated that its refund claim for the~~ **P**~~period at~~ **I**~~issue is an overpayment of sales taxes on bad debt charge-offs that were recourse to Petitioner. Due to its finding of recourse, the Court need not render an opinion on Petitioner's other arguments and contentions in its Motion for Summary Judgment~~.

**The Department makes the following additional Conclusions of Law regarding the issue of whether Petitioner satisfied the statutory provisions of the Bad Debt Statute as follows**:

19. **The North Carolina Supreme Court has recognized that "when words of general import, the subject of a statute, are followed by words of particular or restricted import relating to the same subject matter, the later will operate to limit or restrict the former."** ***In re Steelman*****, 219 N.C. 306, 311, 13 S.E.2d 544, 547 (1941) (internal citations omitted).**

20. **The Bad Debt Statute requires no statutory interpretation because the unambiguous language of the statute read in the context of the entire Act requires that worthless accounts deducted be held by the retailer. The use of the terms "of purchasers" and "representing taxable sales" is intended to limit the subject of the Bad Debt Statute- the "account." The limitation requires that the accounts held represent taxable sales. Under the Act, taxable sales are defined in terms of "the gross sales of the business of the retailer." Therefore, the retailer is the only person under the Act that has taxable retail sales and can create "accounts of purchasers, representing taxable sales" by extending credit itself for the sale of taxable goods.**

21. **The General Assembly "is always presumed to act with full knowledge of prior and existing law."** ***Polaroid Corp. v. Offerman*****, 349 N.C. 290, 303, 507 S.E.2d 284, 294 (1998). When the General Assembly has chosen not to amend a statutory provision that has been interpreted in a specific way, it is proper for the court "to assume that it is satisfied with the interpretation."** ***Id*****.**

22. **The Department's interpretation of the Bad Debt Statute contemplates a retailer taking a bad debt deduction for only those accounts it owns as evidenced by its books and records. N.C. Dep't of Rev. Dir. SD-03-2, Worthless Accounts/Bad Debts (Oct. 15, 2003) (noting that, for purposes of the Bad Debt Statute, the "account must be written off as uncollectible on the claimant's books and records"); 17 N.C. Admin. Code 7B.4802 (1976) (requiring the retailer to "maintain records disclosing separately that portion of bad accounts representing taxable sales and that portion representing nontaxable sales" in order to claim a bad debt deduction).**

23. **The Department's directive and administrative rule have been simultaneously in effect since October 15, 2003. From October 2003 through current, the General Assembly has made significant revisions to the Act, specifically N.C. Gen. Stat. § 105-164.13, but left the provisions of subdivision (15), the Bad Debt Statute, untouched.**

    a. ***See*** **2004 N.C. Sess. Laws 124; 2005 N.C. Sess. Laws 276; 2005 N.C. Sess. Laws 435; 2006 N.C. Sess. Laws 19; 2006 N.C. Sess. Laws 33; 2006 N.C. Sess. Laws 66; 2006 N.C. Sess. Laws 162; 2006 N.C. Sess. Laws 168; 2006 N.C. Sess. Laws 252; 2007 N.C. Sess. Laws 244; 2007 N.C. Sess. Laws 323; 2007 N.C. Sess. Laws 368; 2007 N.C. Sess. Laws 383; 2007 N.C. Sess. Laws 397; 2007 N.C. Sess. Laws 491; 2007 N.C. Sess. Laws 500; 2007 N.C. Sess. Laws 527; 2008 N.C. Sess. Laws 107; 2009 N.C. Sess. Laws 451; 2009 N.C. Sess. Laws 511; 2010 N.C. Sess. Laws 91; 2010 N.C. Sess. Laws 147; 2011 N.C. Sess. Laws 330; 2012 N.C. Sess. Laws 79; 2013 N.C. Sess. Laws 316; 2013 N.C. Sess. Laws 360; 2013 N.C. Sess. Laws 414; 2014 N.C. Sess. Laws 3; 2014 N.C. Sess. Laws 100.**

24. **Thus, assuming, *arguendo*, that the Bad Debt Statute is ambiguous, the General Assembly's willingness to amend N.C. Gen. Stat. § 105-164.13 numerous times while leaving subdivision (15), the Bad Debt Statute, untouched compel a conclusion that the General Assembly approves of the Department's long standing interpretation requiring that the "accounts of purchasers" eligible for deduction be held by the retailer who assumed the risks and responsibilities of extending credit directly to its retail customers. In this case, Petitioner, not the Bank, was the retailer-a fact Petitioner itself acknowledges.**

25. **The history surrounding the adoption of the Bad Debt Statute further supports the Department's long standing interpretation.**

    a. **A sales tax deduction for worthless accounts was first authorized in 1933, during the Great Depression, as part of the Emergency Revenue Act to provide additional funding to public schools. *See* Revenue Act, 1933 Article V, Schedule E, §§ 400 and 401.**

    b. **At the time of adoption, the deduction was included in the definition of a retail merchant's "gross sales"- the measure upon which the sales tax was levied in 1933. *Id*. at §§ 404.10 and 406. In 1935, the General Assembly moved the worthless account deduction from the definition of "gross sales" into the "Exemptions" section of Article V. *See* Revenue Act, 1935 Article V, Schedule E, § 405. Since 1935, the deduction for worthless accounts has existed in substantially the same form it takes today.**

    c. **Thus, the Bad Debt Statute, as it exists today, was enacted by the General Assembly prior to the advent of third-party credit cards, which did not come into existence until the late 1940s. *See* Lewis Mandell, the Credit Card Industry: A history xiii (1990).**

    d. **Therefore, the Bad Debt Statute was intended to provide relief to a retailer who itself assumed the risks and responsibilities of extending credit directly to its customers and suffered economic loss when its customers defaulted. *See Home Depot U.S.A., Inc. v. N.C. Dep't of Rev.*, 09 REV 4211, 6 (N.C. OAH 2010); *Home Depot U.S.A., Inc. v. Ariz. Dep't of Rev.*, 287 P.3d 97, 99-100 (Ariz. Ct. App. 2012); *Home Depot U.S.A., Inc. v. State Dep't of Rev.,* 215 P.3d 222 (Wash. Ct. App. 2009).**

26. **The United States Supreme Court has stated: "while a taxpayer is free to organize his affairs as he chooses, nevertheless, once having done so, *he must accept the tax consequences of this choice, whether contemplated or not, and not enjoy the benefit of some other route he might have chosen to follow but did not*." *Commissioner v. Nat'l***

***Alfalfa Dehydrating and Milling Co*., 417 U.S. 134, 149 (1974) (internal citations omitted) (emphasis added).**

27. **In applying the principal of *National Alfa,* courts, including the Fourth Circuit, '"have established very strict standards' for a taxpayer who elects a 'specific course of action and then when finding himself in an adverse situation [seeks to] extricate himself by applying the age old theory of substance over form."' *United States v. Bergbauer*, 602 F.3d 569, 576 (4th Cir. 2010) (internal citations omitted) (brackets in original).**

28. **Petitioner negotiated with and hired the Bank to act as its lender. In doing so, Petitioner benefited by being able to deduct the Reserve Fees as a *business expense* (emphasis added) while simultaneously avoiding the obligations and responsibilities of various federal and state lending laws as well as general areas of law such as collection and billing. Petitioner cannot now rely on a substance over form argument in an attempt to bring itself within the statutory provisions of the Bad Debt Statute.**

29. **Petitioner's argument that it is the beneficial owner of the PLCC Card Accounts is unpersuasive.**

    a. **Per the terms of the MSA, and stipulated to by Petitioner itself, each PLCC Card Account was the property of the Bank. Accordingly, Petitioner did not record an account receivable from the cardholder in its books and records when accepting a PLCC as payment for goods sold.**

    b. **Rather, by the terms of the MSA, the Bank reimbursed Petitioner for the full sales price of the authorized goods Petitioner sold the cardholders and any applicable North Carolina taxes Petitioner collected on such sales charged to the cardholders' PLCC Card Accounts.**

    c. **The Bank, not Petitioner, inured the benefits of holding the PLCC Card Account receivables including the right to payment for interest and finance charges associated with each PLCC transaction and the ability to charge off bad debt on its federal income tax return when a cardholder defaulted.**

    d. **Therefore, equity does not entitle Petitioner to a refund for Reserve Fees Account debits under a theory of beneficial ownership when Petitioner negotiated such fees as part of the MSA from which it benefited. Neither can equity usurp the rules of statutory construction whereas here such rules require that the "accounts of purchasers" be held by Petitioner.**

30. **Further, assuming, *arguendo*, Petitioner bore an economic loss on the PLCC Card Accounts via its payment of Reserve Fees, Petitioner cannot satisfy all the requirements of the Bad Debt Statute.**

    a. **The Bad Debt Statute requires that the accounts be "found to be *worthless* and actually charged off for income tax purposes." N.C. Gen. Stat. § 105-164.13(15) (emphasis added).**

    b. **For purposes of the Bad Debt Statute, the term "bad debt," also known as "worthless accounts," has the same meaning as under the Federal Bad Debt Statute. *See* I.R.C. § 166.**

    c. **The regulations to the Federal Bad Debt Statute provide, in part: "[o]nly a bona fide debt qualifies for purposes of section 166. A bona fide debt is debt which arises from a debtor-creditor relationship based upon a valid and enforceable obligation to pay a fixed or determinable sum of money." 26 C.F.R. § 1.166-1(c).**

    d. **Therefore, Petitioner cannot and did not deduct the Reserve Fees, which are merely based on a percentage of Petitioner's PLCC sales, under the Federal Bad Debt Statute on its federal income tax returns for the Period at Issue because the debtor-creditor relationship existed between the cardholder and the Bank not the cardholder and Petitioner.**

    e. **Finally, Petitioner cannot rely on the argument that it acted as a unit with the Bank to satisfy the requirements of the Bad Debt Statute when it negotiated the terms of the MSA containing an express provision stating "[t]his agreement is not intended to create, nor does it create and shall not be construed to create, a relationship of partner or joint venture or an association for profit between [the Bank] and [Petitioner]."**

**The Department strikes Conclusion of Law number 19 in the ALJ's Recommended Decision, renumbered in this Final Agency Decision as Conclusion of Law number 31, as contrary to the preponderance of the admissible evidence in the record and erroneous as a matter of law. The Department rewrites Conclusion of Law number 31 as follows:**

31. ~~For the above reasons, there is no genuine issue of material fact, and Petitioner is entitled to the judgment as a matter of law under N.C. Gen. Stat. § 105-164.13(15) in the amount of $115,876.61 for the period of August 1, 2000 through December 31, 2003, plus interest pursuant to N.C. Gen. Stat. § 105-241.21~~.

31. **For the above reasons, there is no genuine issue of material fact, and Respondent is entitled to judgment as a matter of law under N.C. Gen. Stat. § 105-164.13(15).**

**ALJ's RECOMMENDED DECISION**

~~Based on the foregoing Findings of Fact and Conclusions of Law, the undersigned~~ **~~ALJ~~** ~~recommends that Petitioner's Motion for Summary Judgment be GRANTED and Respondent's Motion for Summary Judgment be DENIED~~.

**FINAL AGENCY DECISION**

**Based upon the foregoing undisputed Findings of Fact and the Conclusions of Law, the Department rejects the ALJ's Recommended Decision. The Department determines, for the reasons set out herein, that Respondent is entitled to summary judgment as a matter of law. Accordingly, the Notice of Final Determination ("Notice") issued by the Department to Petitioner on December 31, 2009 is SUSTAINED. Thus, Petitioner's refund claim discussed in this Notice is hereby DENIED.**

**APPEAL**

Pursuant to N.C. Gen. Stat. § 150B-45, a party wishing to appeal the final agency decision of the Department in a contested tax case arising under N.C. Gen. Stat. § 105-241.15 may commence such an appeal by filing a Petition for Judicial Review in the Superior Court of Wake County and in accordance with the procedures for a mandatory business case set forth in N.C. Gen. Stat. § 7A-45.4(b) through (f) within 30 days after being served with a written copy of this Final Agency Decision.

Under N.C. Gen. Stat. § 150B-47, the Department is required to file the official record in the contested case under review, any exceptions, proposed findings of fact, or written arguments submitted to the Department, as well as the Department's Final Agency Decision, with the reviewing court within 30 days of receipt of the Petition for Judicial Review. Consequently, a copy of the Petition for Judicial Review must be sent to the following address: North Carolina Department of Revenue, Attn: David Lingerfelt, PO Box 871, Raleigh, NC 27602-0871, at the time the appeal is initiated to insure timely filing of the record.

This the 9th day of November, 2015.

NORTH CAROLINA DEPARTMENT OF REVENUE

/s/ C. David Lingerfelt

C. David Lingerfelt
Assistant Director
North Carolina Department of Revenue