WELLS FARGO FINANCIAL ALA., INC., WELLS FARGO FINANCIAL ACCEPTANCE ALABAMA, INC., and CONSECO FINANCE CORPORATION,	§	STATE OF ALABAMA DEPARTMENT OF REVENUE ADMINISTRATIVE LAW DIVISION
Petitioners,	§	DOCKET NOS. S. 01-479
	§	S. 01-510
v.		S. 01-426
STATE OF ALABAMA DEPARTMENT OF REVENUE.	§	

FINAL ORDER

Wells Fargo Financial Alabama, Inc., Wells Fargo Financial Acceptance Alabama, Inc., and Conseco Finance Corporation ("Petitioners") petitioned the Revenue Department for refunds of sales tax. The Wells Fargo Financial Alabama, Inc. and Conseco Finance Corporation petitions are for January 1998 through December 2000. The Wells Fargo Financial Acceptance Alabama, Inc. petition is for December 1997 through October 2000. The Department denied the petitions. The Petitioners appealed to the Administrative Law Division pursuant to Code of Ala. 1975, §40-2A-7(c)(5)a. The appeals were consolidated and heard together on June 4, 2002. Peter Larsen, Larry Harmon, Scott Powell, and Sue Stanton represented the Petitioners. Assistant Counsels Wade Hope and Margaret McNeill represented the Department.

ISSUES

This case involves an issue of first impression in Alabama. The Petitioners are finance companies that purchased installment sales contracts from various retail businesses in Alabama during the subject periods. The

Petitioners paid the retailers the full amounts financed, which included applicable State and local sales tax. The retailers in turn assigned their rights under the installment contracts to the Petitioners. Some purchasers failed to pay the Petitioners the full amounts due on the assigned contracts. The primary issue is whether the Petitioners are entitled to refunds of the sales tax the retailers paid to the Department on the uncollected amounts. If the Petitioners are entitled to refunds, a second issue is how should the refunds be computed.

FACTS

The Petitioners contract with various retail businesses in Alabama to finance purchases by the retailers' customers. Wells Fargo Financial Acceptance finances the purchase of jewelry, electronics, and other consumer goods. Wells Fargo Financial Alabama finances the purchase of motor vehicles. Conseco finances the purchase of manufactured homes, boats, and other items. The Petitioners do not make retail sales, and thus are not licensed with the Department for sales tax purposes pursuant to Code of Ala. 1975, §40-23-6.

The Petitioners' financing arrangements are substantially the same. In a typical transaction, a retailer sells goods at retail and executes an installment sales contract with the purchaser. The purchaser also completes a credit application, which the retailer forwards to a Petitioner. If the Petitioner approves the application, it pays the retailer the amount financed, which includes applicable sales tax. The retailer is required by Alabama law to remit the sales tax to the State and the appropriate city and county, if applicable. In return, the retailer contemporaneously assigns to the Petitioner, without recourse, all rights, title, and interest in the installment sales contract, including the right to receive payments under the contract and the right to repossess the property and sue if the purchaser defaults on the contract. Conseco and Wells Fargo Financial Acceptance also obtain a security interest in the underlying collateral.

Numerous purchasers failed to pay the Petitioners the full amounts due on the assigned contracts during the periods in issue. The Petitioners eventually deemed the unpaid amounts to be uncollectible, and deducted the amounts on their federal income tax returns.

The Petitioners calculated the amounts they had paid the retailers that represented sales tax on the uncollected amounts. They then applied to the Department for refunds of those amounts. They claim they are entitled to refunds because the retail sellers assigned them the right to receive the refunds pursuant to the Department's sales tax "bad debt" regulation, Reg. 810-6-4-.01.

The Department argues that refunds are not due because the sales tax in issue was not erroneously paid, and the Petitioners are otherwise not entitled to refunds under Alabama's refund statute, Code of Ala. 1975, §40-2A-7(c). I agree with the Department.

ANALYSIS

Issue (1). Are the Petitioners entitled to refunds?

The statutory right to a refund is a matter of legislative grace, and like exemptions and deductions, must be strictly construed for the government. *Patterson v. Gladwin Corp.*, [Ms. 1001747, May 12, 2002] _____ So.2d _____, (Ala. 2002), citing *Board of Revenue & Road Comm'rs of Mobile County v. Jones*, 181 So. 908 (Ala. 1938); *Department of Revenue v. Bank of America, N.A.*, 752 So.2d 637 (Fla. 2000).

Tax refunds are governed in Alabama by §40-2A-7(c). That statute provides that any "taxpayer" may file a petition for refund with the Department "for any overpayment of tax or other amount erroneously paid to the department . . . ." "Taxpayer" is defined in pertinent part as "[a]ny person subject to or liable for any state or local tax; any person required to file a return. . . ." Code of Ala. 1975, §40-2A-3(22). The Petitioners were not liable to the State for the sales tax

in issue, nor were they licensed retailers required to file sales tax returns with the Department. Consequently, the Petitioners were not taxpayers as defined by Alabama law, and thus were not entitled to petition the Department for refunds under the specific language of §40-2A-7(c). *Ex parte Madison County, Alabama*, 406 So.2d 398 (Ala. 1981) (the plain language of a statute must be followed).[1]

The Petitioners contend they were assigned the retailers' inchoate right to petition the Department for refunds under Alabama's common law right of assignment. I agree that Alabama recognizes the right of assignment, which "gives the assignee the same rights, benefits, and remedies that the assignor possesses." *Nissan Motor Acceptance Corporation v. Ross*, 703 So.2d 324, 326 (Ala. 1997). However, the only rights assigned by the retailers to the Petitioners were the right to receive payments under the contracts and the right to repossess and sell the property and sue the purchasers for any unpaid balance due. The retailers did not assign to the Petitioners a statutory or other right to a refund, nor did they assign to the Petitioners their status as a "taxpayer" for Alabama tax purposes.

The above finding is supported by the holding in *SunTrust Bank, Nashville v. Ruth Johnson*, 46 S.W.3d 216 (Tenn. App. 2000). The facts in *SunTrust Bank* are in substance identical to the facts in this case. As in this case, the Bank argued that as the assignee of the rights of the retail dealers under the installment contracts, it should "be deemed to be the same as a 'dealer who has paid the tax imposed by this chapter.'" *SunTrust Bank*, 46 S.W.3d at 222. The Tennessee Court of Appeals recognized that there had been a broad assignment

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[1]Because the Petitioners are not taxpayers under Alabama law, they also were not entitled to appeal the denied refunds to the Administrative Law Division pursuant to §40-2A-7(c)(5)a. Only a "taxpayer" may appeal pursuant to that section.

of rights, but rejected the Bank's claim that the assignment included the dealers' right to a bad debt credit.

> While the assignment transfers all the dealer's "right, title, interest and remedies" under the retail installment contract, it authorizes the bank "to do every act and thing . . . [the bank] may deem advisable to enforce the terms of said contract." Nowhere in the assignment does the dealer explicitly assign to the bank its right to obtain a bad debt sales tax credit under Tenn. Code Ann. §67-6-507(e)(1).

SunTrust Bank, 46 S.W.3d at 226.

In any case, refunds would be due only if there was an "overpayment of tax or other amount erroneously paid to the department . . . ." Section 40-2A-7(c)(1). The tax in issue was not erroneously paid. The retailers sold goods at retail. They collected the gross proceeds and applicable sales tax due on the sales, and correctly remitted the sales tax to the Department as required by Alabama law. Code of Ala. 1975, §40-23-8 (gross proceeds of credit sales must be reported and tax paid thereon when collected). It is irrelevant that the retailers collected the amounts from the Petitioners, not the retail purchasers. Having correctly remitted the tax, the retailers are not entitled to refunds. Consequently, even if the Petitioners had been assigned the right to petition for refunds, no refunds are due.

The above rationale is consistent with the New York Tax Appeal Tribunal's holding in *In re General Electric Capital Corp.*, DTA No. 816785 (N.Y. Tax Appeals Tribunal, Dec. 27, 2001). In that case, New York vendors assigned credit accounts to a finance company, GE Capital. As in this case, GE Capital paid the vendors an amount equal to the sales price, plus applicable sales tax. New York law required the vendors to immediately remit the sales tax due to the State. Some of the accounts became worthless. GE Capital applied to New

York for a refund of the sales tax paid by the vendors on the uncollected amounts. The Tax Appeals Tribunal affirmed the State's denial of the refund, holding that no refund was due because the retail vendors had properly paid the tax.

> As a result of the retail sales transactions which generated the sales tax at issue herein, the Retail Vendor was in a trustee relationship with the Department and had an obligation to collect and remit the applicable sales and use taxes. Petitioner, however, had no such trust relationship and no obligation to do so either contractually as a result of its agreement with the Retail Vendor or under any provision of the Tax Law. The Retail Vendor could not avoid its liability to collect and remit taxes by attempting to assign its obligation to petitioner. At the time that the Retail Vendor assigned its rights in and to the credit accounts to petitioner, it assigned "all Accounts and all Eligible Indebtedness." However, at no time did the Retail Vendor assign a right to apply for a refund premised on the existence of an uncollectible receipt on which sales and use tax had already been paid, because none existed at the time of the assignment. Nor, as a result of the financing arrangement, could the Retail Vendor ever have an uncollectible receipt which would give rise to the right to apply for a refund which might have been assigned to petitioner. On remittance of the tax, the Retail Vendor discharged its obligation as trustee arising from its collection of the sales from its customers. In addition, it received payment in full for the receipts from its sales of tangible personal property. Therefore, once the Retail Vendor assigned the credit account to petitioner and received payment therefor, the Retail Vendor had no basis for claiming a refund based on an uncollectible receipt.
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> . . . Further, the tax is paid to the person required to collect it "as trustee for and on account of the state." The Retail Vendor's trust obligation to collect and pay over the tax on the sale was discharged when it remitted the tax to the Division. The reimbursement by petitioner did not represent a payment of a purchase price for goods and the tax thereon but a lump sum reimbursement for assignment of the underlying debt.

GE Capital, No. 816785 at 9, 10.

The Petitioners attempt to distinguish *GE Capital* because a New York regulation prohibits a refund for a bad debt assigned to a third party, 20 NYCRR 534.7(b)(3). But the above quoted rationale is not dependent on that regulation. The Tax Appeal Tribunal simply held that once the retail vendor collected the tax due and correctly remitted it to the State, there was no longer a right or potential right to a refund for an uncollected amount. The same rationale applies in this case. Once the retailers collected the subject tax and correctly remitted it to the Department, there was no inchoate right to a future refund.

For other decisions supporting the above conclusion, see *Chrysler Financial Co., LLC v. State Tax Assessor*, Docket No. AP-00-41 (Me. Super. Ct. June 13, 2002) (Chrysler, as the assignee of rights under installment sales contracts, was not entitled to refunds on uncollected amounts because it was not a "retailer" under Maine Law); *Sprint Communications Co. L.P. v. Director of Rev., State of Missouri*, 64 S.W.3d 832 (Mo. S.Ct. 2002) (petition for refund denied because under Missouri law, as under Alabama law, only the party legally required to pay the tax to the State may petition for a refund); North Carolina Department of Revenue, Administrative Tax Hearing, No. 2001-276 (Feb. 28, 2002) (finance company that was assigned retail sales contracts was not entitled to a refund under North Carolina law because it was not the party that remitted the tax); *Department of Revenue v. Bank of America N.A.*, *supra*, (finance company that was assigned installment sales contracts by retailers was not entitled to petition for refund on bad debts under specific language of Florida statute); and *SunTrust Bank*, *supra*, (bank not entitled to refunds because only retail dealer who paid the tax may obtain a refund or credit for bad debts under Tennessee law).

The bad debt rule relied on by the Petitioners, Dept. Reg. 810-6-4-.01, also does not apply. Under §40-23-8, an Alabama retailer is not obligated to

remit sales tax to the Department until the gross proceeds of the sale are collected. However, recognizing that in some cases a retailer will erroneously report and remit sales tax on credit sales before collection, the Department promulgated Reg. 810-6-4-.01. That regulation, at paragraph (5), provides that if a retailer pays sales tax on credit sales that later become uncollectible and are written off for federal income tax purposes, the retailer shall be allowed a credit or refund of the tax paid on the uncollected amount.[2]

But just as only a "taxpayer" has the statutory right to a refund pursuant to §40-2A-7(c), only a "retailer" has the right to claim a bad debt refund under Reg. 810-6-4-.01. The Petitioners are neither taxpayers nor retailers under Alabama law. Reg. 810-6-4-.01(1) also specifies that the term "bad debt" does not include "debts sold or assigned to third parties for collection." The retail installment sales contracts in issue were in substance debts that were sold or assigned by the retailers to the third party Petitioners for collection. The uncollected amounts in issue thus were not "bad debts" within the scope of the regulation.

The clear intent of Reg. 810-6-4-.01 is to allow a retailer that has erroneously prepaid sales tax on credit sales to later get a refund or credit if the sale proceeds are never collected.[3] It was not intended to apply to tax that was

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[2]The requirement in Reg. 810-6-4-.01 that the debt must first be charged off as uncollectible for federal income tax purposes would be a reasonable timing requirement if, like most states, Alabama required the prepayment of sales tax on credit sales and then allowed for a statutory refund for bad debts. But any sales tax paid in Alabama before collection is erroneously paid, and thus should be immediately refunded under the general refund statute, §40-2A-7(c)(1), regardless of whether the underlying debt is collectible or uncollectible. Reg. 810-6-4-.01 is thus superfluous.

[3]As discussed in footnote 2, *supra*, Reg. 810-6-4-.01 is unnecessary because retailers already have a statutory right to a refund of any sales tax erroneously paid on credit sales before collection.

properly paid, as in this case, nor to third party finance companies such as the Petitioners.

The Petitioners cite *Puget Sound National Bank v. Dept. of Revenue*, 868 P.2d 127 (Wash. 1994) in support of their case.

Puget Sound involved essentially the same facts as this case. The Washington Supreme Court held that the Bank/assignee was entitled to refunds on the uncollected amounts based on the following rationale: A seller is entitled to a refund under Washington law. "Seller" is defined as "every person . . . making sales at retail or retail sales to a buyer or consumer." A "person" is defined in part as an "assignee." Connecting the definitional dots, the Court concluded that the Bank, as an assignee, was a person, and thus also a seller entitled to a refund under Washington law. *Puget Sound*, 868 P.2d at 130.

I respectfully disagree with the Court's rationale because, as pointed out by the dissent, at p. 133, to be a "seller" entitled to refunds, the person must also have made retail sales to a buyer. The Bank did not make retail sales, and thus was not a seller entitled to refunds.[4]

To overcome the fact that the Bank did not make retail sales, the majority found that the Bank had been assigned "the dealers' prior tax attribute of 'making sales at retail.' Since the assignment of the installment contracts carried with it the 'making sales at retail' requirement, the Bank is entitled to a sales tax refund. . . ." *Puget Sound*, 868 P.2d at 132.

I again respectfully disagree with the Court's rationale.

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[4]Likewise, in *Chrysler Financial*, *supra*, the Maine Court rejected Chrysler's claim that as an assignee, it was a person under Maine law, and thus a retailer entitled to refunds. "What Chrysler's argument neglects is the fact that it is not just any 'person' who becomes a retailer; it must be a 'person <u>who makes retail sales</u>'" (emphasis in original). *Chrysler Financial*, No. AP-00-41 at 7.

A tax attribute is generally recognized as an NOL carryover, a capital loss carryover, or other item that has a continuing tax consequence for the entity in question. *In re Bradley*, 222 B.R. 313 (Bankr. M.D. Tenn. 1998). Making retail sales is an act or event, not a tax attribute. The Bank may have stepped into the retailers' shoes by acquiring all contractual and statutory rights under the contracts, but the acquisition of certain rights did not make the Bank a retailer making retail sales. The Maine Court reached the same conclusion in *Chrysler Financial* - "The court concludes that while Chrysler can take assignment of the conditional credit sales from the automobile dealers, this does not make Chrysler a retailer and does not qualify it to obtain credits under (Maine law)." *Chrysler Financial*, No. AP-00-41 at 7.

Puget Sound can also be distinguished based on the difference in Washington and Alabama law. Washington requires that a retailer must remit sales tax on credit sales at the time of sale, before collection. The retailer then has a statutory right to a refund if the debt later becomes uncollectible. Consequently, when a Washington retailer prepays sales tax on credit sales, it retains an inchoate statutory right to a refund if the underlying debt becomes worthless.

However, an Alabama retailer is obligated to pay sales tax on credit sales only when the amount due is collected. But after a retailer collects the sale proceeds and correctly remits the tax to the State, as in this case, the retailer's obligation under the sales tax law is satisfied. And importantly, the retailer retains no outstanding statutory or other inchoate right to a refund that can be assigned. That is the primary flaw in the Petitioners' rationale. They incorrectly assume that after the retailers correctly paid the tax in issue, they still had an outstanding assignable right to a refund.

The other cases cited by the Petitioners can also be distinguished. *Chrysler Financial Co., LLC v. Indiana, Dept. of State Revenue*, 761 N.E.2d 909 (Ind. Tax Court 2002), can be distinguished because Indiana, like Washington, requires the prepayment of sales tax on credit sales and then provides a statutory right to a refund for bad debts. *WFS Financial Inc.*, Case I.D. 56535 (Cal. Bd. of Equal. 2002) can be distinguished because unlike Alabama law, California law specifies that a successor that pays full consideration for receivables may claim a bad debt deduction to the same extent as the predecessor. Finally, *Slater Corp. v. South Carolina Tax Commission*, 314 S.E.2d 31 (S.C. 1984) is distinguishable on its facts. Slater erroneously paid sales tax to various vendors, which remitted the tax to the State. The vendors assigned to Slater their statutory right to petition for refunds of the overpaid amounts. The South Carolina Court held that the assignments were valid. In *Slater*, however, there was unquestionably an erroneous overpayment of tax. There was no such overpayment in this case.

Refunds also should not be issued because the Department cannot verify that the retailers remitted the tax in issue to the Department. While the retailers were legally required to remit the tax to the Department, some may not have done so. As a practical matter, the Department cannot audit all of the retailers with which the Petitioners did business to verify that they properly remitted the tax to the Department.

The problem with allowing an unlicensed entity to apply for a refund was discussed by the Maine Superior Court in *Chrysler Financial*, as follows:

> This reading of legislative intent (allowing only registered retailers to apply for a refund or credit) also makes good administrative sense. If those who may apply for the tax credit are limited to businesses doing retail sales and paying sales tax in Maine, it would be relatively easy for State revenue officials to match the sales, the tax payments and credits. The process would inevitably become more

> difficult and fraught with opportunities for error if the entity claiming the credit has little contact with the State other than the fact that it is a holder in due course of the paper generated by the conditional or installment sale (which is not limited to automobiles).

Chrysler Financial, No. AP-00-41 at 7.

Another problem is that an amount charged off by a Petitioner as uncollectible may later be collected by the Petitioner. The Petitioners assert that all amounts collected up to when the refund claims in issue were computed were taken into account. (T. at 153.) They also contend that any amounts that are later collected will be picked up in subsequent refund claims. (T. at 154.) As discussed, however, the Petitioners are not licensed with the Department, and any subsequent claim or filing by the Petitioners would be purely voluntary. The Petitioners may not file subsequent claims, which may result in tax being refunded (which may never have been remitted to the Department in the first place) on amounts that are later collected by the Petitioners. Also, because the Petitioners are not "taxpayers" for Alabama sales tax purposes, they are not required to keep records evidencing their collections.

The Department's denial of the refunds is affirmed.

Issue (2). The computation of the refund amounts.

This issue is moot given the holding in Issue (1). But even if the refunds were due, the amounts claimed include some city or county sales tax that is not administered by the Department. The Department certainly would not be responsible for refunding those amounts.

This Final Order may be appealed to circuit court within 30 days pursuant to Code of Ala. 1975, §40-2A-9(g).

Entered September 17, 2002.