

## Ohio Supreme Court Denies Home Depot A Sales Tax Deduction For Bad Debts

*(Ohio Sales Tax Deduction for Bad Debts is Not Available  
to Retailers with Private Label Credit Card Sales where the Extension  
of Credit is Provided by an Unrelated Third Party)*

If you have any questions about this client alert, please contact:

Anthony L. Ehler  
tlehler@vorys.com  
614.464.8282

David A. Froling  
dafroling@vorys.com  
614.464.3022

On April 2, 2009, the Ohio Supreme Court issued a decision styled *The Home Depot USA, Inc., v. Levin*, Case No. 2009-Ohio-1431. This case involved the applicability of the Ohio sales tax deduction for bad debts as applied to private label credit card sales where the extension of credit was outsourced to an unrelated third party. In a 7-0 decision the Court affirmed the Ohio Board of Tax Appeals decision denying such deduction to Home Depot. See, *Home Depot USA, Inc., v. Wilkins*, Ohio B.T.A. Case Nos. 2006-M-206, 207 (May 20, 2008).

This case arose after Home Depot filed sales tax refund claims covering the period January 1, 1998 to July 31, 2003. Relying on the statutory requirements within R.C. 5739.121 and the Court's earlier decision in *Chrysler Financial Co. LLC v. Wilkins* (2004), 102 Ohio St.3d 639, Home Depot argued that it was entitled to a sales tax deduction for bad debts incurred on sales where its customer used a Home Depot private label credit card to purchase merchandise.

Home Depot's private label credit card program was administered by an unrelated third party, specifically certain affiliates of GE Capital Corporation ("GE"). The Court observed that Home Depot did not extend credit to its customers and Home Depot did not administer its private label credit card program. GE did that and GE charged Home Depot a monthly service fee for doing so. This service fee was set by

contract. One factor in setting the fee was GE's anticipated bad debt losses.

The Court held that R.C. 5739.121 conditions a vendor's entitlement to a bad debt deduction on the vendor writing off a debt on the vendor's own books. Home Depot did not write off any debt because Home Depot did not carry consumer debt on its books. The Court also noted that one requirement of the statutory definition of "bad debt" under Ohio tax law is that the bad debt may be claimed as a bad debt deduction under section 166 of the Internal Revenue Code. Home Depot deducted the service fee it paid GE for federal income tax purposes as an ordinary business expense; not as a bad debt deduction.

GE carried the consumer debt on its books. When the debts became uncollectible GE wrote them off and GE properly claimed the corresponding bad debt deduction for federal income tax purposes. The Court was not persuaded by Home Depot's argument that the economic reality of GE's monthly service fee was that Home Depot bore the economic burden of the bad debt since GE's anticipated bad debt losses were one factor in setting the monthly fee amount.

The Court also determined that Home Depot's reliance on *Chrysler* was misguided. *Chrysler* precludes GE from claiming a sales tax deduction for bad debts because GE is a finance company and not a "vendor." The holding of

*Chrysler* does not mean Home Depot must therefore qualify for the deduction as Home Depot argued for. While Home Depot is the vendor in this instance, it is GE that incurs the bad debt, not Home Depot.

This case may prove to be important for several reasons. The obvious lesson is to avoid doing what Home Depot did. There may be planning opportunities that retailers can use to provide alternative (and we hope better) legal justifications for taking the bad debt deduction. These opportunities should be explored.

Perhaps more important is the possibility that this case shines light on major retailers in a way that attracts Ohio audit attention. There are the everyday compliance concerns such as applying accurate local tax rates and making sure that sales data recorded and reported is accurate. However, this case may give tax agents a reason to dig deeper in a sales exam and investigate bad debt deductions and factoring arrangements. It may be time to review these issues and identify any potential compliance weakness before the Ohio Department of Taxation knocks on your door.

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