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State and Local Tax Alert: Ohio House Committee Amends Legislation to Expand Sales Tax Deduction for Bad Debt

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The Ohio House Finance and Appropriations Committee recently amended Amended Substitute Senate Bill 263 (SB 263) to expand the bad debt sales tax deduction. The amendment would extend the sales tax deduction to retailer vendors that make sales to customers through private label credit cards when the consumers later default, i.e., fail to pay the full purchase price to the credit card lender. Thus, in these special circumstances, the bad debt may be incurred by the lender, not just the vendor.

Under current law, a vendor is liable for the entire amount of sales tax due at the time of sale, even if the vendor made the sale on credit. However, a vendor may deduct "bad debts" from the retailer's total taxable sales so long as the amount deducted is charged off as uncollectible on the vendor's books. A bad debt is a debt that has become worthless or uncollectible since the vendor filed its most recent sales tax return, has been uncollected for at least six months, and may be claimed as a deduction for federal income tax purposes by the vendor. To the extent a vendor's bad debts in a reporting period exceed its taxable sales, the vendor may request a refund.

Under Ohio law as its exists today, if a vendor sells an account receivable to a third party lender and the consumer defaults, neither the vendor nor the lender may receive a refund of the sales tax the vendor paid at the time of sale despite the fact that the consumer never paid the full purchase price.

Key law changes proposed by the amendment to SB 263 are:

- A vendor would be able to claim a bad debt deduction, including a refund, for accounts or receivables that become bad debt in the hands of a "lender" who has charged off the debt on the lender's books.
- A lender would include a person with an interest in a private label credit card receivable provided the interest was transferred from a third party, purchased directly from a vendor that remitted tax or from an affiliate of such vendor, or originated according to a written

agreement between the person and the vendor or a vendor affiliate.

- The definition of bad debt would be unchanged, but the requirement of a bad debt being deducted for federal income tax purposes would be determined with respect to the private label credit card lender.
- A private label credit card would mean a charge or credit card bearing the name or logo of a vendor.
- A vendor's deduction or refund would be limited to accounts or receivables bad debt from purchases from the vendor whose name or logo is on the credit card or from any of the vendor's affiliates or franchisees.

Allowing the vendor to use the lender's bad debt to reduce sales tax liability likely will change the economies of the credit program arrangement between the vendor and the lender. The benefit of this potential tax deduction should be considered when establishing or amending credit program terms.

The Ohio General Assembly may further amend these provisions. Vorys will follow developments closely. If you'd like to discuss how these amendments could impact your business, contact your Vorys attorney or Tony Ehler, David Froling, or John Petzinger at (614) 464-6400.