



Volume 13 Number 10

October 2006

# State Tax Return

## Bad Debt, Good News: Finance Company Entitled To Michigan Sales Tax Refund

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Like many states, Michigan provides a sales tax refund opportunity for retailers who remitted tax with respect to receipts they are unable to collect. Since it is not uncommon for an installment purchase of goods to be financed by an affiliate of the dealer rather than the dealer itself, how does this impact the ability to receive a refund? In a recent case, *Daimler Chrysler Services of North America LLC v. Michigan Department of Treasury*,<sup>1</sup> the Michigan Court of Appeals held that a finance company affiliated with a car dealer was entitled to a sales tax refund. Although this case specifically dealt with the bad debt deduction provision in effect prior to 2004, a similar result should apply to finance companies under the current version of the statute.

### Michigan's Sales Tax Deduction for Bad Debts

Bad debts that are charged off as uncollectible on a taxpayer's books and records may be deducted from gross proceeds in computing sales tax.<sup>2</sup> A bad debt is defined under current law as:

any portion of a debt that is related to a sale at retail *taxable under this act* for which gross proceeds are not otherwise deductible or excludable and that is eligible to be claimed, or could be eligible to be claimed if the taxpayer kept accounts on an accrual basis, as a deduction pursuant to section 166 of the internal revenue code, 26 USC 166.<sup>3</sup>

The phrase "taxable under this act" was added when the statute was amended in 2004. Other subsections of the statute were amended in 2004, but are not relevant to the issues discussed in *Daimler Chrysler Services of North America LLC*.

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<sup>1</sup> *Daimler Chrysler Services of North America LLC v. Michigan Department of Treasury*, \_\_ N.W.2d \_\_, 2006 WL 2060449 (Mich. Ct. App., July 25, 2006).

<sup>2</sup> Mich. Comp. Laws Ann. § 205.54i(2).

<sup>3</sup> Mich. Comp. Laws Ann. § 205.54i(1) (emphasis added).

## Finance Companies – Refund Eligible

The Taxpayer in *Daimler Chrysler Services of North America LLC* is a finance company affiliated with a car dealer. When customers want to purchase a car, the dealer contacts the Taxpayer to determine whether the customer is approved for financing. Upon approval, the dealer enters into a contract with the customer, transfers the car to the customer, and takes a security interest in the vehicle. The dealer then assigns the contract and the security interest to the Taxpayer in exchange for the purchase price of the vehicle, plus Michigan sales tax. The dealer remits the sales tax to Michigan and the customer makes payment on the installment loan to the Taxpayer. When a customer fails to make payment, the Taxpayer repossesses the vehicle at issue and charges off the uncollected portion of the debt. At issue in *Daimler Chrysler Services of North America LLC*, is whether the Taxpayer is entitled to a refund under Michigan's bad debt deduction statute for sales tax paid on the uncollected portion of the debt.

The Michigan Court of Appeals, in *Daimler Chrysler Services of North America LLC*, reversed the lower court's decision and granted a sales tax refund to the Taxpayer. First, the Michigan Court of Appeals held that the lower court erroneously analyzed the facts under the current version of the statute, which contains the phrase "taxable under this act," rather than the statute in place when the cause of action accrued. Second, the court held that the term "taxpayer" as used in the bad debt deduction statute includes a group or combination acting as a unit.<sup>4</sup> The court found that the Taxpayer acted as a unit with its affiliated dealers to effectuate sales, thus the Taxpayer is a "taxpayer" under the act. Third, the court held that the Taxpayer's bad debt was related to a sale at retail because the sales themselves were transactions by which transfer of tangible property occurred. The financing was integral to the sale at retail; the sales would not have taken place but for the financing provided by the Taxpayer.

## Is the Good News Still Good Law?

The *Daimler Chrysler Services* decision is common sense. If a sale only occurs because of financing, and the company that provides the financing is related to and acts in concert with the dealer, the finance company should be entitled to a bad debt deduction. The dealer cannot take the deduction; the dealer receives the sales price in full and thus does not have any debt to write off. Only the finance company, which has the bad debt, is in a position to take a deduction. The Michigan Court of Appeals got this one right, but is it still good law?

Although the language of the bad debt deduction statute was revised in 2004, the changes in language do not appear to be sufficient to render the *Daimler Chrysler Services* decision irrelevant to current law. It seems unlikely the Michigan Court of Appeals would reach a different conclusion merely because the phrase "taxable under

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<sup>4</sup> See Mich. Comp. Laws Ann. §§ 205.51(1)(h) (a "taxpayer" means "a person subject to a tax under this act"); 205.51(1)(a) (a "person" means "an individual, firm, partnership, . . . or any other group or combination acting as a unit.").

this act" has been added to the statute. The other grounds upon which the Michigan Court of Appeals based its decision are sound and should be just as applicable were the case decided on current law. Thus, the *Daimler Chrysler Services* should be good law.■



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