THE OHIO COUNCIL OF

Retail Merchants

The voice of retail since 1922

SALES TAX BAD DEBT LEGISLATION (HOUSE BILL 104)
FREQUENTLY ASKED QUESTIONS

Q-1. Why should we pass this bill?

A-1. Passing this bill would fix a current inequity in the state's law. The sales tax is to be paid by the customer; the retailer is only supposed to collect the tax from the customer and remit it to the state. Under current law, if a customer who uses a credit card owned by the retailer fails to pay his or her bill, the retailer is entitled to a credit or a refund of the sales tax. However, if that same customer uses a private label credit card, neither the retailer nor the private label credit card company is entitled to a credit or refund of the tax. This unfairly makes the retailer and/or the private label credit card company the guarantors of the public fisc, and results in a windfall for the State.

Q-2. Wouldn't this bill result in the state reimbursing the retailer for the cost of the merchandise?

A-2. No. This bill only pertains to the sales tax that the retailer advanced to the state on the customer's behalf. The retailer and the private label credit card company will continue to bear the loss for the cost of the merchandise and services that were purchased on an account that is ultimately charged off.

Q-3. The sales tax is levied on the transaction. Isn't the retailer's decision to grant credit for the transaction a separate event and, therefore, the tax should still be owed regardless of the default by the customer?

A-3. Every state in the country that imposes a sales tax grants a credit or refund of the tax on charged off accounts when the retailer owns its own credit card accounts. This is a policy decision that the legislature of this state adopted decades ago. There is no fundamental difference between retailers that own their own accounts and retailers that contract with a private label credit card company to issue their credit cards, and there is no policy reason to justify different treatment of the two. By denying credits or refunds in a private label credit card situation, the State is inequitably increasing the cost for retailers to do business in the state.

Q-4. How does the arrangement between the retailer and the private label credit card company work?

A-4. Every contract between a retailer and a private label credit card company is a bit different; however, here is how they generally work:

- When a cardholder makes a purchase with a private label credit card, the credit card company pays the retailer for the price of the merchandise, plus the sales tax, on the day after the sale occurs. Sometimes there is a discount (like an interchange fee) at this point, and sometimes not, depending on the particulars of the agreement.
- When an account is charged off, there is no direct charge back to the retailer. (This is necessitated by securitization rules.)

- The bank and the retailer share in the expenses of the program. This can occur in many forms, such as the interchange fee described above or an annual reimbursement of a portion of the total program expenses. The sales tax on bad debts, as well as the underlying cost of the merchandise associated with bad debts, is one of the types of expenses they share. Thus, while the retailer is "paid" by the bank at the front end for the amount of the tax, the retailer is indirectly repaying a portion of the sales tax back to the bank once the account is charged off.
- In states that permit recovery of sales tax on bad debts, the retailer and the bank typically share in the recovery.

Q-5. <u>Doesn't this bill provide for "double dipping"? Isn't this just a cost of doing business?</u>

A-5. No. Consider the following:

- Is getting robbed a cost of doing business for banks? If so, then why criminalize bank robbery?
- If someone embezzles money from a business, the business is typically covered by insurance. Thus, is it "double dipping" for a court to order the embezzler to repay the business (or its insurance company) when they're caught since the insurance company already paid the business?
- Many of these bad debts are situations where the person never had any intention of paying their bill—it's just another form of shoplifting. Would anyone suggest that retailers should be forced to pay a sales tax when someone shoplifts from them?
- The tax is owed by the customer. If a customer does not pay the tax, then why should the retailer or the private label credit card company be required to pay the customer's tax liability out of their own pocket? If someone owes taxes to the IRS and they fail to pay, would it be fair for the IRS to require another person to pay their tax liability?
- Even if the private label credit card company fully reimbursed the retailer, someone other than the person on whom the tax is imposed (i.e., the private label credit card company) is still out the money.
- Retailers incur significant cost to collect sales tax. Requiring retailers to dip into their pockets to pay someone else's tax liability substantially increases the cost of collecting sales tax.

Q-6. <u>What other states provide sales tax refunds or credits on bad debts from private label credit cards?</u>

A-6. California, Florida, Illinois, Michigan, Pennsylvania, Texas and Wisconsin have all passed legislation permitting such credits or refunds on private label credit cards.

Q-7. <u>Are credit card charge off rates increasing or decreasing?</u>

A-7. According to an August 6, 2013, report from Fitch Credit Ratings, charge off rates in July 2013 hit an 84-month low (see graph on page 4).

Q-8. <u>Would this bill apply to general use cards such as American Express, Master Card and VISA?</u>

A-8. No. The bill would only apply to private label credit cards (i.e., cards that only can be used at the retailer whose name is on the cards, or the retailer's affiliates). No state in the country provides for bad debt credits or refunds on general use cards and this bill does not seek any credits or refunds for those cards. Moreover, neither the retailer nor the general use credit card company has adequate data to be able to quantify the amount of the sales tax associated with the bad debts, whereas retailers and private label credit card companies possess this data with respect to private label credit cards.

Q-9. **How will retailers be able to determine the proper amount of the tax credit or refund under private label credit card arrangements?**

A-9. Current state law permits retailers that own their own credit cards to seek a credit or refund of sales tax on accounts that are charged off. This law has been in place for decades. The manner in which the sales tax on bad debts will be determined under this bill is the same as it is under current law, and the Department of Taxation has the same ability to audit as it does under current law. This bill simply modernizes the state's law to keep up with current business practices (i.e., that many retailers now use private label credit card companies to manage their proprietary credit card programs).

Q-10. **How do you know if the customer made a purchase from a store in our state?**

A-10. As is the case under current law for retailer-owned accounts, the location of the store is irrelevant for multistate retailers. For example, if someone makes a purchase from a store in Kansas but has the merchandise sent to an address in Ohio, the retailer collects Ohio tax. Conversely, if someone makes a purchase from a store in Ohio but has the merchandise sent to an address in Kansas, the retailer collects Kansas tax. The bad debt credits and refunds are based on the particular state's tax that was actually remitted. Methods have been in place for many years to accurately capture this data.

Q-11. **What happens if the customer pays some or all of its account balance after the account is charged off?**

A-11. As is the case under current law with respect to credit cards owned by the retailer, whenever there is a recovery of some or all of the charged off amount, this bill would require the retailer to immediately remit to the state the portion of the recovery that pertains to sales tax that was previously refunded.

Q-12. **Why should the State be on the hook when retailers issue credit to people who aren't likely to pay their bills?**

A-12. Retailers do not issue credit to everyone who walks through the door. To the contrary, retailers and private label credit card companies utilize very strict credit-worthiness standards, in accordance with the Dodd-Frank Act, when issuing credit. However, customers who were credit-worthy at the time their credit cards were issued sometimes have unforeseen circumstances that occur after a credit card was issued (such as loss of job, divorce, illness, death of a spouse, etc.) that prevent them from paying their bills. Retailers and private label credit card issuers have an incentive to be selective when issuing credit—while this bill pertains only to the sales tax associated with bad debts, the retailer is out the entire cost of the merchandise when the customer does not pay his or her bill.