

SUPERIOR COURT OF ARIZONA
MARICOPA COUNTY

TX 2006-000028

12/09/2010

HONORABLE DEAN M. FINK

CLERK OF THE COURT
S. Brown
Deputy

HOME DEPOT USA INC

PATRICK DERDENGER

v.

ARIZONA STATE DEPARTMENT OF
REVENUE

SCOT G TEASDALE

MINUTE ENTRY

Following oral argument on December 6, 2010, the Court took the following motions under advisement: Plaintiff's Partial Motion for Summary Judgment and Defendant's Cross-Motion for Summary Judgment. Upon further consideration, the Court rules as follows.

R15-5-2011(A)(1) provides that a bad debt may be deducted from gross receipts if three conditions apply: "1. The gross receipts from the transaction on which the bad debt deduction is being taken have been reported as taxable; 2. The debt arose from a debtor-creditor relationship based upon a valid and enforceable obligation to pay a fixed or determinable sum of money; and 3. All or part of the debt is worthless." The Court of Appeals has construed condition 1 to require that the taxpayer seeking the deduction be the taxpayer who reported the bad transaction as taxable and collected the gross receipts from it. *DaimlerChrysler Services North America, LLC v. Arizona Dept. of Revenue*, 210 Ariz. 297, 302 ¶ 16 (App. 2005). A similar limitation, requiring that the creditor in the debtor-creditor relationship be the taxpayer who reported the transaction as taxable and collected its gross receipts, is inherent in condition 2. R15-5-2011(C) prescribes the manner of calculating the deduction: it "shall be computed by subtracting the amounts received on the debt from the amount originally reported as taxable." This makes no sense unless the party receiving some amount on the debt is the party who originally reported the entire amount of the transaction as taxable, as it would require for each deduction analysis of the records of two separate companies with no reason to coordinate their accounting of the

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underlying transaction. Just as nonsensical for the same reason would be subsection F, which requires that, if all or part of a debt written off as bad is recovered, the recovery amount be reported as taxable gross proceeds.

Here, for Home Depot to compute its deduction, it would have to ascertain from the finance company which transactions went bad, determine for each the amount originally reported as taxable, and subtract from that the amount paid by the customer to the finance company (with the possibility of having to revise the total if the finance company subsequently recovers some amount). But Home Depot retains no involvement with the debt after the transaction. Instead, the finance company pays Home Depot the amount of each transaction, paying and non-paying alike (as it is impossible to know in advance which customers will fail to pay), less a negotiated percentage covering its costs in administering the PLCCs, including the cost of bad debts across the entire universe of transactions. The finance company is entitled to payment from the customer and bears the loss if the customer does not pay; Home Depot is out of it. There is at this point no bad debt, because the debt does not become due until the end of the billing cycle. *Compare id.* at 303 ¶ 22 (quoting *Chrysler Financial Co., LLC v. Wilkins*, 812 N.E.2d 948, 952 ¶ 25 (Ohio 2004): “Prior to the sale and assignment of the retail installment contract to Chrysler, the dealer had no claim to a bad-debt deduction, because the dealer had no bad debt.”). To be sure, as part of the fee it is charged by the finance company, Home Depot “pa[ys] in advance the costs of all anticipated bad debt losses from PLCC accounts on an aggregate, portfolio-wide basis.” Combined Reply at 5:9-10. But R15-5-2011(C) does not permit subtraction of bad debts from both paying and non-paying transactions on an aggregate, portfolio-wide basis of anticipated losses; it requires that the deduction be taken only against the non-paying transaction for the precise unpaid amount. Home Depot’s practice thus does not qualify for the bad debt deduction.

Home Depot urges that it and the finance companies administering its PLCCs act as a unit, thus entitling Home Depot to the deduction for bad debts. The record shows that the PLCCs are the product of arm’s length business transactions between Home Depot and the finance companies. At oral argument, Home Depot’s counsel acknowledged that, although the negotiation over the various fees is more intense with the PLCCs, the relationship between it and the PLCC issuer is not fundamentally different from its relationship with the issuers of non-branded credit cards. That the PLCCs are valid only at Home Depot has no bearing on the deductibility of debts incurred with them.

Home Depot’s claim of unjust enrichment fails because *it* is not impoverished. If a PLCC customer defaults, the issuing finance company has no recourse against the payment it has already made to Home Depot; if anyone is impoverished, it is. Allowing Home Depot to take the deduction would simply result in a windfall for it: the cost of bad debts to the finance company, and the fee charged to cover it, are unaffected by any reduction in Home Depot’s tax liability.

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Whether the bad debt deduction should be made available to the finance companies is, the *DaimlerChrysler Services* court held, a policy decision for the legislature. 210 Ariz. at 306 ¶ 35-36. Its denial to the finance companies does not, by default, entitle Home Depot to it.

As for the equal protection argument, it is not unreasonable to limit the deduction for a bad debt transaction to the party who actually incurred the loss from it. Tax deductions are strictly construed against the taxpayer. *Arizona Dept. of Revenue v. Raby*, 204 Ariz. 509, 511-12 ¶ 16 (App. 2003). Arizona's transaction privilege tax is levied on the privilege of conducting business in Arizona and is based on the gross receipts of the business. *DaimlerChrysler Services, supra* at 302 ¶ 15. Whether, and to whom, to allow an offset for non-paying transactions, an unfortunate but inescapable part of any business, are legitimate matters of legislative discretion.

Accordingly, and for the other reasons included in the State's briefing and oral argument,

IT IS ORDERED denying Home Depot's Motion for Partial Summary Judgment on Bad Deduction Legal Issue filed April 30, 2010.

IT IS FURTHER ORDERED granting the Arizona Department of Revenue's Cross-Motion for Summary Judgment.

Because this ruling is case dispositive, as discussed at oral argument,

IT IS ORDERED directing ADOR to: 1.) lodge a simple form of judgment for the Court's signature consistent with this ruling, 2.) file any statement of Taxable Costs, and 3.) file any Application and Affidavit for Attorneys' Fees (if applicable) no later than January 10, 2011.