

M e m o r a n d u m**130.0145**

To: Oakland – Auditing (ODM)

November 3, 1972

From: Tax Counsel (GJJ) – Headquarters

Subject: --- --- ---

This is in reply to your memorandum of October 24, 1972, and in confirmation of our oral advice to your of October 27, 1972.

Taxpayer is engaged in the business of selling sailboats. Some of taxpayer's sales are made on a credit basis. Taxpayer sells its chattel paper, without recourse, to C--- - C--- National Bank under a C--- - C--- B--- Dealer Agreement. The bank agrees to purchase such contracts as are acceptable to it and pays taxpayer a sum equal to the Time Balance less the discount then agreed upon, and credits the difference between the discount and the Time Price Differential included in the contract to a B--- Loss Reserve in the taxpayer's name. C--- - C---'s has a security interest in this reserve account and may charge the account for (a) any indebtedness or obligation, existing or contingent, secured or unsecured, of taxpayer to C--- - C--- and (b) the deficiency on any contract in default which taxpayer fails to repurchase after five days' notice so to do by C--- - C---. "Excess" credit balances are to be paid from the account to taxpayer from time to time, and, upon termination of the B--- Dealer Agreement, C--- - C--- is required to pay any credit balance remaining in the B--- Loss Reserve to taxpayer. The B--- Loss Reserve is not subject to withdrawal or assignment by taxpayer and does not earn interest.

In your audit of taxpayer you have some \$XX,000 worth of deficiencies charged against taxpayer's B--- Loss Reserve account resulting from defaulted agreements. The question has arisen as to whether taxpayer is entitled to a bad debt deduction for these defaulted agreements.

Under our Regulation 1642 "Bad Debts," a retailer who sells his receivables, with recourse so that he will bear any bad debt loss on them, is entitled to a bad debt deduction to the same extent as if he had not sold them. In this case, however taxpayer has sold his receivables, as the agreement specifically provides, without recourse, and taxpayer is thus not entitled to a bad debt deduction. The B--- Loss Reserve feature functions as a kind of self-regulating discount provision and cannot be equated with a right of recourse in the purchaser of taxpayer's chattel paper.

GJJ/ab