

**M e m o r a n d u m****130.0094**

To: Mr. Jack D. Paulson

Date: September 14, 1972

From: Donald J. Hennessy

Subject: [X]  
Petition for Redetermination

[X] protests the inclusion in the measure of audited liabilities of \$88,930 in bad debts recovered through litigation. Attorneys for [X] view the \$88,930 as damages, not rent, and therefore not taxable rental receipts.

The general theory of damages in contract actions is that the injured party should be placed in the same situation as if the contract had been properly performed, at least so far as money can do this; i.e., give the plaintiff the benefit of his bargain insofar as possible. Therefore, to the extent a plaintiff suing on a leasing contract is given the benefit of his lease contract by damages, the damages are rental receipts on which use tax is due.

The problem in the [X] matter involves bad debt deductions. My review of the working papers in the petition file fails to make clear how [X] which the auditor states was not reporting on an accrual basis, could validly claim bad debt deductions as to rental receipts. I assume this matter was clarified at your preliminary hearing and shall further assume that the deduction was valid.

Regulation 1642(b)(2) makes clear that no deduction for bad debts is allowable as to expenses of collection. Section (d) of the Regulation makes clear that bad debts taken as deductions, which are subsequently in whole or partially collected, cost be reported. When the subsequent collection is through litigation, I do not believe the amount of the judgment satisfied may be reduced by attorney's fees or court costs when reported for sales and use tax purposes. Neither can the amount of the judgment satisfied be allocated between attorney's fees, court costs, and rental receipts. This would allow [X] to indirectly take a deduction for collection expenses which is prohibited by Regulation 1642(b)(2). The judgment amount should be reported and taxed without reduction by, or allocation to, attorney's fees or court costs which are merely "any other expenses" within the language of Sections 6011(a)(2) and 6012(a)(2).

While there is no mention of it in the petition file, I recall from our conversation that [X] claims part of the judgment amount should be allocated to installation labor. On the limited facts, I'm not completely convinced that an allocation here is proper, but at present, I would be inclined to allow a pro rata allocation of the judgment amount to installation on the strength of installation charges being excluded from "sales price" by section 6011(c)(3), and from "gross receipts" by section 6012(c)(3).

DJH:dih

cc: Petitions Unit