

M e m o r a n d u m**490.0090**

To: Audit Review & Refund (GMD)

Date: June 21, 1972

From: Tax Counsel (JM) - Headquarters

Subject: O--- Q--- Paint Company

SR – XX-XXXXXX

This is in reply to your memo of May 25, 1972 in which you request our opinion concerning the propriety of allowing a deduction by the above-referenced taxpayer for amounts credited to a customer's account receivable under the circumstance described in your memo.

It is our opinion that the deduction should not be allowed.

In the first instance full credit for the return of the unusable paint was allowed by the taxpayer to the purchaser. This return, we understand was properly allowed and claimed.

In the second instance the paint is replaced and invoiced by the taxpayer to the purchaser at the regular sales price plus tax reimbursement.

Because the purchaser is a valued customer and complains that the delivery of the incorrect paint has caused him to suffer loss of time on the job, taxpayer credits the customer's account receivable based on so many dollars per hour of lost time.

The credit allowed is, in our opinion, in the nature of payment of damages incurred as a result of taxpayer's delivery of the improper paint under the original transaction. The allowance of the credit to the account is merely a method of satisfying the customer in lieu of paying the estimated damages in cash. The paint delivered in the second transaction was not defective merchandise and the sales transaction upon which sales tax reimbursement was computed did not result in a bad debt write off. The fact that the expense of the claim of damages was satisfied by an offset to accountant's receivable rather than by payment of cash does not constitute an allowance for defective merchandise nor a bad debt write off. The reduction of the account receivable under the circumstances constitutes a business expense of taxpayer which may not be deducted from gross receipts.

The credit is not a reduction of the sales price of the property to the purchaser but a reimbursement to him for expenses incurred by reason of the taxpayer's improper delivery of the original order.

We are returning the file and documents to you.

JM:smb

cc: Los Angeles Dist. – Dist. Admin.
Long Beach – Subdist. Admin.