STATE OF MAINE
CUMBERLAND, ss.

BUSINESS AND CONSUMER DOCKET
Location: Portland
Docket No. BCD-WB-AP-10-11

SEARS, ROEBUCK & CO.,

Petitioner

v.

DECISION AND ORDER

STATE TAX ASSESSOR,

Respondent

This matter was heard on April 30, 2011, on the applicability of the Law Court's decision in *Linnehan Leasing v. State Tax Assessor*, 2006 ME 33, 898 A.2d 408, to Petitioner's request for judicial review of Respondent's decision to uphold the Petitioner's tax assessed by Maine Revenue Services for the 2005, 2006, and 2007 tax years. In particular, the issue is whether the Law Court's decision regarding the bad debt sales tax credit applies to the tax years that predate the issuance of the decision.[1]

Linnehan Leasing v. State Tax Assessor

Linnehan Leasing (Linnehan) was an automobile dealer and a registered Maine retailer pursuant to 36 M.R.S. § 1754-B (2005). *Linnehan Leasing*, 2006 ME 33, ¶ 4, 898 A.2d at 411. Atlantic Acceptance Co. (Atlantic) was a financing company that worked exclusively with Linnehan. *Id.* ¶ 5, 898 A.2d at 411. The two companies were owned and controlled by the Linnehan family and shared office space, management, computer systems, and insurance coverage, but were separate corporate entities that filed separate tax returns. *Id.* ¶¶ 5-6, 898 A.2d

[1] After a case management conference, because this issue is potentially dispositive, the Court decided to consider this issue before the parties engaged in extensive discovery. To facilitate the Court's review of the issue, the Court requested that the parties file written argument on the issue. Although Petitioner's submission is entitled a motion for summary judgment, the Court will consider the issue based on the facts upon which the parties agree.

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at 411. When Linnehan auto customers requested financing and were approved by Atlantic, the customers would sign a financing agreement with Linnehan "which state[d] that he or she [would] pay the purchase price of the vehicle, applicable fees interest, and sales tax to Linnehan." *Id.* ¶ 6, 898 A.2d at 411. Linnehan then assigned the agreement to Atlantic in exchange for a discounted price; customers thereafter made payments to Atlantic. *Id.* ¶ 7, 898 A.2d at 411.

At the end of each month, Linnehan paid sales tax to the State on the full purchase price of each vehicle sold during the month. *Id.* ¶ 8, 898 A.2d at 411. Whenever a customer defaulted on a loan, Atlantic charged off the uncollectible amount as worthless accounts on their financial books, and deducted the charged-off amount for income tax purposes. *Id.* ¶ 9, 898 A.2d at 411. Linnehan calculated the percentage of sales tax outstanding on each account and credited that figure against its monthly sales tax liability. *Id.* Linnehan and Atlantic followed this practice—Atlantic writing off the bad debt and Linnehan taking the bad debt sales tax credit—for fourteen years before Maine Revenue Services audited Linnehan for the period May 1, 1999 to December 31, 2001. *Id.* ¶ 10, 898 A.2d at 411.

Eligibility for the bad debt sales tax credit is governed by 36 M.R.S. § 1811-A (2010),[2] which provides:

> The tax paid on sales represented by accounts charged off as worthless may be credited against the tax due on a subsequent return filed within 3 years of the charge-off, but, if any such accounts are thereafter collected by the retailer, a tax must be paid upon the amounts so collected.

A retailer is defined as "a person who makes retail sales or who is required to register by section 1754-A or 1754-B or who is registered under section 1756." 36 M.R.S. § 1752 (2010). A

[2] Title 36 M.R.S. § 1811-A (2010) has been amended since the publication of *Linnehan Leasing v. State Tax Assessor*, 2006 ME 33, 898 A.2d 408, but not in any substantive way. *See* P.L 2007, ch. 438, § 49 (effective September 20, 2007).

person, in turn, is "an individual, firm, partnership, association, society, club, corporation, financial institution, estate, trust, business trust, receiver, assignee or any other group or combination acting as a unit . . . ." 36 M.R.S. § 111(3) (2010).[3]

Maine Revenue Services determined that Linnehan was not eligible for the bad debt sales tax credit because it suffered no loss from a customer's default. *Linnehan Leasing*, 2006 ME 33, ¶ 10, 898 A.2d at 411. The Assessor upheld the determination, but the Superior Court reversed on Linnehans' request for judicial review in accordance with M.R. Civ. P. 80C. *Id.* ¶ 11, 898 A.2d at 411-12. The Superior Court concluded that "Linnehan and Atlantic were so intertwined that they could be considered one 'person' and thus a 'retailer' in order to qualify for the section 1181-A tax credit." *Id.* On the Assessor's appeal, the Law Court reversed. *Id.* ¶ 31, 898 A.2d at 415.

Citing a report of the Joint Standing Committee on Taxation, the Law Court explained that the "purpose of the bad debt sales tax credit . . . is to give a credit on a sales tax paid on a charge sale, the payment for which was not subsequently made." *Id.* ¶ 19, 898 A.2d at 413. To qualify for the credit, therefore, a retailer must pay the required sales tax on the purchase price of the vehicle *and* charge off the bad debt. *See id.* Given that Linnehan paid the sales tax, and then immediately transferred the customer account to Atlantic, Linnehan could not charge off the debt because it suffered no loss on a customer's loan default. Linnehan thus did not meet the statutory requirements for the sales tax credit. *See id.* The Law Court rejected the notion that Atlantic and Linnehan jointly could be considered one retailer because it would disregard their separate corporate entities. *Id.* ¶ 20, 898 A.2d at 413 (citing *Moline Properties, Inc. v. Comm'r*, 319 U.S. 436, 439 (1943). Accordingly, the Law Court held that Linnehan and Atlantic did not

[3] Person was defined similarly in the *Linnehan Leasing* decision, although the provision has been subsequently repealed. *See* 36 M.R.S.A § 1752(9) (1990); P.L. 2003, ch. 390, § 6 (effective Sept. 13, 2003.)

qualify for the sales tax credit for the tax years in question, and vacated the trial court's decision. *Id.* ¶ 31, 898 A.2d at 415.

Pertinent Facts

1. The time period in question is the year preceding the *Linnehan Leasing* decision, which was published on March 31, 2006.

2. Petitioner has paid the full amount of the sales tax on goods purchased by customers through a financing transaction with a third party; through the financing transaction, Petitioner received full payment for the goods, including the sales tax, from the third party; the customers were responsible for paying the third party for the full purchase price of the goods, sales tax, and interest; the third party charged off as bad debt the amounts that the customers failed to pay; and Petitioner claimed the bad debt sales tax credit for the amounts of sales tax that the customers failed to pay to the third party.

Discussion

Petitioner concedes that as "a general rule, judicial decisions are to be given full retroactive effect." *See, e.g., Bell v. New Jersey*, 461 U.S. 773, 777 n.3 (1983). Nevertheless, Petitioner asks the court to apply the criteria outlined by the United States Supreme Court in *Chevron Oil Co. v Huson*, 404 U.S. 97 (1971), when considering whether to give a judicial decision retroactive effect. There, the Court stated:

> First, the decision to be applied nonretroactively must establish a new principle of law, either by overruling clear past precedent on which litigants may have relied or by deciding an issue of first impression whose resolution was not clearly foreshadowed. Second, it has been stressed that we must . . . weigh the merits and demerits in each case by looking to the prior history of the rule in question, its purpose and effect, and whether retrospective operation will further or retard its operation. Finally, we have weighed the inequity imposed by retroactive application, for where a decision of this Court could produce substantial inequitable results if applied retroactively, there is ample basis in our cases for avoiding the injustice or hardship by a holding of nonretroactivity.

Id. at 106-07 (quotation marks and citations omitted). More recently, the Court has clarified that when it

> applies a rule of federal law to the parties before it, that rule is the controlling interpretation of federal law and must be given full retroactive effect in all cases still open on direct review and as to all events, regardless of whether such events predate or postdate our announcement of the rule.

Harper v. Va. Dep't of Taxation, 509 U.S. 86, 97 (1993). Thus, when the Supreme Court applies the new rule of law to the litigants in that case, the three-part test of *Chevron Oil* is arguably not applicable because retroactivity is presumptive. *See id.*

The Law Court has not specifically adopted the *Chevron Oil* test, but has stated that "[i]n general, a judicial holding applies to any case not terminated in a final manner" as of the time of its announcement. *Avery v. Avery*, 1998 ME 25, ¶ 5, 705 A.2d 714, 715 (affirming that the rule announced in *Long v. Long* regarding marital property applied retroactively); *accord Tuttle v. Raymond*, 484 A.2d 1353, 1364 (Me. 1985) (announcing a new standard for punitive damages in tort claims and applying that rule to the parties before the Court and retroactively); *MacDonald v. MacDonald*, 412 A.2d 71, 75 (Me. 1980) (announcing tort claims between husbands and wives to be actionable and applying that holding to the parties before the Court and retroactively). In certain cases, the Law Court has not applied a rule retroactively where there was substantial public reliance on the former rule and the change was unforeseeable. *See Myrick v. James*, 444 A.2d 987, 1002 (Me. 1982) (declaring the newly-adopted discovery rule in medical malpractice cases for surgical procedures to apply only to the parties and instances of alleged malpractice after the date of the opinion). For Petitioner to avoid retroactive application of *Linnehan Leasing*, therefore, it must show that the change in precedent or the new rule was

unforeseeable and that the public had substantially relied on the past precedent.[4] Petitioner must make this showing regardless of whether the Court strictly applies the three-part test in *Chevron Oil*, or whether the Court considers the principles articulated by the Law Court in *Myrick*.

In support of its argument against retroactive application of the *Linnehan Leasing* rule, Petitioner argues that *Linnehan Leasing* announced a new rule that was not clearly foreshadowed by the Law Court's precedent. The Court disagrees. *Linnehan Leasing* represents a logical and natural evolution from the Law Court's reasoning in *DaimlerChrysler Services North America v. State Tax Assessor*, 2003 ME 27, 817 A.2d 862. In *DaimlerChrysler*, the issue was whether a financing company that charged off bad debt on worthless accounts could qualify as a retailer and claim the bad debt sales tax credit. *Id.* ¶ 9, 817 A.2d at 865. The Court determined that "only the retailer who paid the sales tax can obtain the benefit of the statute." Id. In analyzing section 1811-A, the Court noted that:

> The only actor recited in the statute is the "retailer," and, thus, a logical and reasonable interpretation is that the Legislature intended the "retailer" to be the actor for all of the verbs. Thus, the statute can be read as follows:
>
> > The tax paid [by the retailer] on sales represented by accounts charged off [by the retailer] as worthless may be credited [by the retailer] against the tax due on a subsequent report filed [by the retailer] within 3 years of the charge-off, but, if any such accounts are thereafter collected by the retailer, a tax shall be paid [by the retailer] upon the amounts so collected.

Id. ¶ 12, 817 A.2d at 865.

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[4] More recently, when the Law Court has announced a new rule or overruled past precedent, it has not addressed the retroactive or prospective application of the rule at all. *See, e.g., Price v. State*, 2010 ME 66, ¶ 12, 1 A.3d 416, --- (overruling precedent regarding mootness and voluntary completion of sentence for petitions for post conviction review, but not addressing prospective or retroactive application of the rule); *Dyer v. Me. Drilling & Blasting, Inc.*, 2009 ME 126, ¶¶ 29-31, 984 A.2d 210, 219 (adopting a strict liability test for blasting and remanding the case for further proceedings, but not addressing prospective and or retroactive application of the new standard). The Law Court's forbearance in not addressing retroactive application of new rules or standards could be attributed to the parties failing to raise the issue, or could simply mean that the Court views this issue settled by the general rule favoring retroactive application and the exception laid out in *Myrick*.

Under *DaimlerChrysler*, in order to qualify for the bad debt sales tax credit, one must: 1) be a retailer that 2) paid the sales tax on the initial sale, 3) charged off the debt as uncollectible, and 4) applied for the credit within three years of the charge-off. *See id.* ¶¶ 9-16, 817 A.2d at 865-67. In *Linnehan Leasing*, citing *DaimlerChrysler*, the Law Court reinforced and reiterated this view: "Pursuant to section 1811-A, a 'retailer' can qualify for the credit if it: (1) pays the sales tax upon the sale; (2) later charges-off the buyer's account as worthless on its books; and (3) applies for the credit within three years of the account being charged-off." *Linnehan Leasing*, 2006 ME 33, ¶ 3, 898 A.2d at 410.

Petitioner maintains that despite the Law Court's decision in *DaimlerChrysler*, the law was unsettled prior to *Linnehan Leasing* because *DaimlerChrysler* did not address who would be considered the retailer in a situation such as existed in *Linnehan Leasing*. Petitioner's argument is unavailing. Although in *DaimlerChrysler* the financing company attempted to justify its use of the bad debt sales tax credit by arguing that it was a retailer, and in the present case, the Petitioner and its financing company are separate entities in an arms length transaction, the pivotal facts are the same. Under both arrangements, the retailer pays the sales tax to the State and the financing company pays the retailer the full amount of the purchase price, including the sales tax. Because it has been fully compensated by the financing company, the retailer does not, therefore, have a loss to "charge off" when the debt becomes uncollectible. In other words, in the event that the principle was not otherwise apparent, *DaimlerChrysler* made clear that a retailer must have paid the sales tax in full and charged off a loss in order to qualify for the bad debt tax credit. *Daimler Chrysler*, 2003 ME 27, ¶¶ 12-13, 817 A.2d at 865-66. The Law Court simply reinforced this basic concept in *Linnehan Leasing*. The decision was not, therefore, in any way unforeseeable.

Finally, the Court notes that even if *Linnehan Leasing* were construed to establish a new rule as Petitioner contends, because the Law Court applied that rule to the petitioner in *Linnehan*, the general rule of retroactivity would apply. *See Avery*, 1998 ME 25, ¶ 5, 705 A.2d at 715; *cf. Harper*, 509 U.S. at 97. Accordingly, the rule applies to the Petitioner in this matter.

Conclusion

Based on the foregoing analysis, the Court concludes and orders that the rule of law articulated in *Linnehan Leasing* applies to the time period that is the subject of this matter.

Pursuant to M.R. Civ. P. 79(a), the Clerk shall incorporate this Decision and Order into the docket by reference.

Date: 5/6/11

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Justice, Maine Business & Consumer Docket