OHIO BOARD OF TAX APPEALS

HYUNDAI MOTOR FINANCE COMPANY (NKA HYUNDAI CAPITAL AMERICA), (et. al.), Appellant(s), vs. JEFFREY A. MCCLAIN, TAX COMMISSIONER OF OHIO, (et. al.), Appellee(s).	))))))))))	CASE NO(S). 2015-785 (COMMERCIAL ACTIVITY TAX) DECISION AND ORDER

APPEARANCES:

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Entered Thursday, February 6, 2020

Mr. Harbarger, Ms. Clements, and Mr. Caswell concur.

This matter is considered upon a notice of appeal from a final determination of the Tax Commissioner that affirmed a commercial activity tax ("CAT") assessment against appellant. We proceed to consider the matter upon the notice of appeal, the statutory transcript ("S.T.") certified by the Tax Commissioner, the record of the hearing before this board ("H.R."), the parties' joint stipulation of facts, and the parties' written arguments.

Appellant, Hyundai Motor Finance Company (nka Hyundai Capital America) ("HCA"), is a captive automobile finance company that "provides indirect retail vehicle loan and lease financing by purchasing retail installment sale contracts ('RISCs') and leases from Hyundai and Kia dealers," and "also provides direct wholesale financing to these dealers by financing inventories and making loans for their facilities and working capital requirements." Appellant's Brief at 1. Following an audit conducted in 2011, appellant was assessed for CAT liability related to such transactions, broadly categorized as (1) receipts from sales of retired leased vehicles, (2) receipts from securitization transactions, and (3) subvention payments.

HCA purchases leases from automobile dealers, and upon doing so, also purchases the vehicles subject to such leases. Joint Stipulation at 2. During or at the conclusion of the lease term, the lessee may purchase the vehicle at a rate set in the lease agreement. H.R., Ex. 12. If the lessee does not purchase the vehicle, it is sold by HCA at an auction or to a dealer. H.R. at 39. HCA was assessed on the gross receipts from such sales to Ohio customers. S.T. at 1.

HCA also engages in securitization transactions with the RISCs it purchases. HCA packages RISCs to use as collateral to borrow funds through the issuance of notes backed by the RISCs. Appellant's Brief at 25. HCA transfers pools of RISCs to a wholly-owned special purpose entity/bankruptcy-remote entity (Hyundai ABS Funding Corporation ("HABS") or Hyundai BC Funding Corporation ("HBC")) that then transfers the pool to a trust (Hyundai Auto Receivables Trust); the trust then issues notes backed by the RISCs that receive a fixed rate of interest. In return, HCA receives the excess funds remaining from collections after the noteholders have been paid. Appellant's Brief at 25. The Tax Commissioner found HCA's gross receipts from these transactions to be subject to the CAT and sitused to Ohio based on the location where the loan was originated. S.T. at 4.

Finally, HCA receives payments for its role in special financing programs that allow

RISCs and leases to be made to customers at below-market interest rates. Appellant's Brief at 3. The automobile manufacturers, i.e., Hyundai Motor America ("HMA") and Kia Motor America ("KMA"), make interest subvention payments to HCA to "obtain HCA's participation in financing purchases from dealers under the incentive program by purchasing the RISCs with below-market interest rates." Id. Essentially, "the manufacturers subsequently reimbursed HCA for the difference between the interest HCA would have collected at market rate and the below-market rate interest HCA collected from subvented" RISCs and leases. S.T. at 2. Similarly, dealers may also offer below-market rate financing to their customers, and make subvention payments to HCA in exchange for HCA's financing of the purchase of the vehicles. Appellant's Brief at 3. The Tax Commissioner characterized the subvention payments as "subsidies," instead of interest as HCA argued. He sitused subvention receipts to Ohio "in the proportion that the manufacturers' *subvention-program-benefit* in Ohio bears to the manufacturers' *subvention-program-benefit* everywhere." (Emphasis sic.) S.T. at 2.

HCA challenged all three categories in its petition for reassessment, and the Tax Commissioner affirmed the assessment. HCA has appealed the commissioner's final determination as to all three categories.

We acknowledge that the findings of the Tax Commissioner are presumptively valid. *Alcan Aluminum Corp. v. Limbach*, 42 Ohio St.3d 121 (1989). It is incumbent upon a taxpayer challenging a decision of the Tax Commissioner to rebut the presumption and establish a clear right to the relief requested. *Kern v. Tracy*, 72 Ohio St.3d 347 (1995); *Ball Corp. v. Limbach*, 62 Ohio St.3d 474 (1992); *Belgrade Gardens v. Kosydar*, 38 Ohio St.2d 135 (1974). The burden is on the taxpayer to present credible evidence to support its claim that an assessment is in error. *Kern*, supra; *May Co. v. Lindley*, 1 Ohio St.3d 6 (1982); *Federated Dept. Stores v. Lindley*, 5 Ohio St.3d 213 (1983).

Initially, we note that HCA has made a number of constitutional arguments regarding this assessment. This board makes no findings with regard to constitutional questions, as such arguments may only be addressed, on appeal, by a court which has the authority to resolve constitutional challenges. See *MCI Telecommunications Corp. v. Limbach*, 68 Ohio St.3d 195 (1994); *Cleveland Gear Co. v. Limbach*, 35 Ohio St.3d 229 (1988). We therefore turn to HCA's remaining arguments on the three broad categories of receipts identified above.

We also note that the Tax Commissioner has objected to several documents and related testimony provided at this board's hearing, arguing they were not properly disclosed in discovery or in accordance with this board's rules regarding disclosure of witnesses and evidence prior to hearing. He also argues the documents, i.e., Authorities 6, 13, and 14, have little to no value in our consideration of this matter. Although we deny the motion to strike such evidence, we agree with the commissioner as to their value, and accord them no weight in our consideration herein. The commissioner also argues HCA's expert witnesses (Glenn Johnson and John Taylor) are biased and not credible given their representation of HCA; he also argues their testimony amounted to the interpretation of law and is therefore inappropriate. We find the arguments raised by the commissioner go to the credibility of the witnesses and the overall weight to be accorded to their testimony, and deny the motion to strike their testimony.

Receipts from sales of retired leased vehicles

HCA argues that the sales of vehicles at the termination of leases it holds are excluded from the definition of gross receipts under R.C. 5751.01(F)(2)(c), which provides that "[r]eceipts from the sale, exchange, or other disposition of an asset described in Section 1221 or 1231 of the Internal Revenue Code" are not "gross receipts" for purposes of the CAT. HCA asserts that the vehicles are Section 1231 assets, or "property used in the trade or business, of a character which is subject to the allowance for depreciation provided in section 167, held for more than 1 year *** which is not (A) property of a kind which would properly be includible in the inventory of the taxpayer if on hand at the close of the taxable year, [or] (B) property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business ***." 26 U.S.C. 1231(b).

The commissioner rejected HCA's argument, finding that the vehicles were "dual purpose property," and that, under *Recordak Corp. v. United States*, 325 F.2d 460 (Ct. Cl.1963) and Rev. Rul. 80-37, the sale of such assets is not income from the sale of a 1231 asset and thus not excluded from gross receipts under the CAT. "Dual purpose property" is property held simultaneously for sale or lease. *Recordak*, supra at 462. The commissioner argues that because the vehicles owned by HCA are always available for purchase by the lessees, pursuant to options to purchase in the lease agreements and buyout options at the end of the lease term at a pre-set price, they are dual purpose property and therefore not 1231 assets. The commissioner notes that 16.3% in 2009, and 21.3% in 2010, of HCA's vehicle sales were to lessees exercising such buyout options. Joint Stipulation at 3.

HCA argues that all its vehicles were depreciated under I.R.C. 167, a practice that was approved of by the IRS during audit. H.R. at 42-43. HCA points this board to the Third Circuit's opinion in *Philber Equipment Corporation v. Commr.*, 237 F.2d 129 (3rd Cir.1956), where the court held that vehicles which were purchased solely to fulfill existing leases and subsequently sold once they were no longer usable in leasing, were held primarily for sale to customers in the ordinary course of the taxpayer's business under the predecessor to I.R.C. 1231, and rejected the argument that the vehicles were dual purpose property. Id. at 131. It also cites to *Mafco Equipment Co. v. Commr.*, T.C. Memo 1983-637 (1983), where, similar to the facts presented here, leased property was available for purchase during the term of the lease pursuant to options to purchase, and was sold prior to the end of the lease terms. Rather than focusing on the mere fact that some of the leased property was sold, the court focused on the purpose for which the property was held, i.e., for lease. Id.

We agree with HCA that the vehicles are properly characterized as Section 1231 assets and not dual purpose property. As the *Mafco* court explained, "[t]he fact that assets are ultimately disposed of by sale is not necessarily decisive ***." Id. The vehicles were not includable in HCA's inventory. H.R. at 42. The vehicles were subject to the allowance for depreciation under I.R.C. 167. Id. The nature of HCA's holding of the vehicles was not for simultaneous offering for sale or lease; the buy-out options under which customers could purchase the vehicles were part of the leases originated by the dealers. We therefore reverse the Tax Commissioner and find that receipts from disposition of the sales of leased vehicles are properly excluded from those receipts subject to the CAT under R.C. 5751.01(F)(2)(c).

<u>Receipts from securitization transactions</u>

HCA argued below that any receipts from its securitization transactions are excluded as interest income under R.C. 5751.01(F)(2)(a); proceeds from repayment, maturity, or redemption of the principal of a loan under R.C. 5751.01(F)(2)(d); the principal amount received under a repurchase agreement or on account of a loan transaction under R.C. 5751.01(F)(2)(e); receipts from the sale of a 1221 or 1231 asset under R.C. 5751.01(F)(2)(c); or as amounts realized from the sale of an account receivable under R.C. 5751.01(F)(2)(ee). The commissioner rejected each contention, finding that no loan/borrowing occurred, that the notes receivable sold by HCA were ordinary assets under I.R.C. 1221, that the notes were neither held for more than 1 year nor depreciable as required by I.R.C. 1231, and that no amounts pertaining to the securitization transaction were previously reported as gross receipts. Moreover, the commissioner noted that "HCA's combined taxpayer group could have excluded the gross receipts at issue had it elected to file on a consolidated basis pursuant to R.C. 5751.011." S.T. at 4.

On appeal, HCA again characterizes the RISC pool transfer transactions as "secured financings," which are not treated as sales for federal income tax purposes. It explains the transactions in its brief: "The RISCs were merely segregated as collateral and held by a bankruptcy-remote entity to ensure that the noteholders were repaid." Appellant Brief at 29. HCA argues the transactions are properly characterized as loans and, therefore, the receipts at issue are not subject to the CAT pursuant to R.C. 5751.01(F)(2)(e). In the alternative, HCA argues that any receipts are properly excluded under R.C. 5751.01(F)(2)(c) as sales of 1221 or 1231 assets. Further, even if properly included in gross receipts, HCA argues that such receipts are not properly sitused to Ohio.

HCA relies on IRS Technical Advice Memorandum ("TAM") 9839001, which concluded that similar securitization transactions were secured financings – not sales – for federal income tax purposes under I.R.C. 1001. The commissioner argues the federal treatment of the transactions is not dispositive. See R.C. 5751.01(K). Further, the commissioner argues the transactions themselves, "the transfer of HCA's property to another, for consideration, *** to obtain operating capital" for HCA, are sales that create amounts realized properly characterized as gross receipts under the CAT. Appellee Brief at 23. He cites to language within the contract with the special purpose entity stating that the transfer of assets is a sale of ownership interest in the assets. H.R., Ex. 28 at 1433. However, HCA argues that the *substance* of the transaction should control, in accordance with R.C. 5703.56(C) and this board's decisions in *Associated Estates Corp. v. Limbach* (May 11, 1990), BTA Nos. 1987-H-743, et al., unreported, and *Park Poultry, Inc. v. Limbach* (May 3, 1991), BTA No. 1988-F-205, unreported.

We agree with HCA that the RISC pool transfer transactions are properly characterized as financings, rather than sales, and are properly excluded from the CAT under R.C. 5751.01(F)(2)(e). Looking at the substance of the transactions, it is clear that HCA is not selling assets, but rather collateralizing assets to create cash flow – a loan. While we acknowledge TAM 9839001 is not binding on this board, we find it persuasive in our determination given the similarity in factual scenarios. Further, we do not find that applying such reasoning leads to any wholesale adoption of federal income tax definitions for purposes of applying the CAT, as the commissioner warns. We hereby reverse the determination of the Tax Commissioner.

Having found the receipts from the securitization transactions are excluded from "gross receipts," we find the remainder of HCA's arguments moot.

<u>Subvention payments</u>

HCA argues that the interest subvention payments and other interest buydown payments it received from dealers are excluded from the definition of gross receipts under R.C. 5751.01(F)(2)(a). The commissioner rejected such characterization, because he found no borrowing transactions occurred from which interest could have accrued. S.T. at 2. Instead, the commissioner argues that the payments are more properly characterized as rebates: the auto manufacturers are "not being given a loan by HCA, and is not entitled to use of the money loaned. *** [The auto manufacturers are] paying an amount equivalent to *someone else's* *interest* to HCA as a subsidy to HCA for providing the consumer with the incentive of a reduced interest rate." (Emphasis sic.) Tax Commissioner's Brief at 54. HCA counters that the subvention payments are treated as interest for accounting and federal income tax purposes. Appellant's Brief at 5-6.

The Tax Commissioner does not appear to dispute that for GAAP and federal income tax purposes, the subvention payments are treated as interest. He focuses on the way HCA identifies the payments in their financial statements as "subsidy amounts," and the fact that HCA is paying someone else's interest. Appellee Brief at 54, citing S.T. at 278. We find such characterization is not dispositive. The payments are for the use of money. See *Black's Law Dictionary* 969 (11th Ed.2019). While we acknowledge the federal treatment is not necessarily controlling, we find the authorities cited by HCA persuasive, including FAS 91 (H.R., Ex. K; see also Ex. L) and I.R.C. 1272. We find the subvention payments are properly excluded from gross receipts under R.C. 5751.01(F)(2)(a) and reverse the Tax Commissioner's determination.

While the issue appears to be moot based on our finding above, HCA further argues that any subvention payments should be excluded as intercompany transactions, despite it not electing to file as a consolidated elected taxpayer group under R.C. 5751.011. HCA asserts that denying such exclusion to a combined taxpayer group violates the "unconstitutional conditions" doctrine, and the Commerce, Due Process, and Equal Protection Clauses of the U.S. Constitution. As indicated above, this board lack jurisdiction to consider constitutional arguments, see *MCI*, supra, and we make no finding relative thereto.

<u>Conclusion</u>

Based upon the foregoing, we find appellant has met its burden in this matter. Accordingly, the final determination of the Tax Commissioner is hereby reversed in accordance with the decision herein.

BOARD OF TAX APPEALS		
RESULT OF VOTE	YES	NO
Mr. Harbarger		
Ms. Clements		
Mr. Caswell		

I hereby certify the foregoing to be a true and complete copy of the action taken by the Board of Tax Appeals of the State of Ohio and entered upon its journal this day, with respect to the captioned matter.

Kathleen M. Crowley, Board Secretary