SALT BUZZ HF

Hyundai Drives Three Issues to Win; Board Relies on Federal Income Tax and Accounting Treatment

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On Thursday, February 6th, the Ohio Board of Tax Appeals ("Board") issued a decision reversing the Tax Commissioner's Final Determination that affirmed a commercial activity tax ("CAT") assessment against Hyundai Motor Finance (nka Hyundai Capital America)("HCA"). *Hyundai Motor Finance Company (nka Hyundai Capital America) v. McClain*, BTA No. 2015-785.

HCA is a captive automobile finance company that provides indirect retail vehicle loan and lease financing by purchasing retail installment sales contracts ("RISCs") and leases from Hyundai and Kia dealers. Each of the three activities assessed by the Tax Commissioner are described separately herein.

Receipts from Sales of Retired Leased Vehicles Excludible IRC Sec. 1231 Property

HCA purchases leases from automobile dealers, including the underlying vehicles subject to lease. If the lessee does not purchase the vehicle during or at the end of lease term, HCA sells the vehicles at auction or to a dealer. HCA was assessed on the gross receipts from the sale of vehicles to Ohio customers.

The Board agreed that the vehicles were IRC Sec. 1231 assets, excluded from the definition of gross receipts for CAT purposes pursuant to R.C. 5751.01(F)(2)(c). The Board rejected the Tax Commissioner's contention that the vehicles were "dual purpose property" under *Recordak Corp. v. United States*, 325 F.2d 460 (Ct. Cl. 1963) and Rev. Rul. 80-37. Under this federal authority, the sale of "dual purpose property" is not income from an IRC Sec. 1231 asset.

Finding that the facts described in the federal income tax decision in *Mafco Equipment Co. v. Commissioner*, T.C. Memo 1983-637 (1983), were more apposite, the Board stated, "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. Further, the Board agree with *Mafco* that "[t]he fact that assets are ultimately disposed of by sale is not necessarily decisive ***." Id.

The Board noted that the vehicles were depreciated under IRC Sec. 167, a practice that the IRS approved during the federal income tax audit. Further, the Board noted that the vehicles were not simultaneously offered for sale or lease; the buy-out options under which customers could purchase the vehicles were part of the leases originated by the dealers. The Board, therefore, reversed the Tax Commissioner and found that the receipts from disposition of the sales of leased vehicles were properly excluded from those receipts subject to the CAT under the exclusion for gross receipts from the sale of IRC Sec. 1231 assets set forth in R.C. 5751.01(F)(2)(c).

Receipts from Securitization Transactions Excludible Because Transfer of RISCs Part of a Collateralized Borrowing, Not a Sale

HCA packages RISCs to use as collateral to borrow funds through the issuance of notes backed by RISCs. 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. HCA receives the excess funds remaining from collections after the noteholders have been paid. The entities at issue had not elected to be part of a Consolidated Elective Taxpayer group for CAT purposes. The Tax Commissioner had determined that gross receipts from these transactions were subject to CAT and sitused to Ohio based on the location where the loan was originated.

HCA cited IRS Technical Advice Memorandum ("TAM") 9839001 and its audited financial statements as support that the securitization was a financing, not a sale, for federal income tax purposes and for financial accounting purposes, applying Generally Accepted Accounting Principles ("GAAP"). The Board agreed with HCA that the RISC pool transactions are properly characterized as financings, rather than sales, and are properly excluded from the CAT under R.C. 5751.01(F)(2)(e), the loan exclusion: "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 the board, we find it persuasive in our determination given the similarity in factual scenarios." Thus, the Board reversed the determination of the Tax Commissioner.

Subvention and Interest Buydown Payments Excludible Interest

HCA received subvention payments and other interest buydown payments from its affiliated automobile manufacturers, Hyundai Motor America and Kia Motor America, for obtaining RISCs and leases at below-market interest rates. Essentially, "the manufacturers subsequently reimbursed HCA for the difference between the interest HCA would have collected

at market rate and the below-market interest rate HCA collected from subvented," RISCs and leases. The Tax Commissioner characterized the subvention payments as "subsidies," instead of interest as HCA argued. The Tax Commissioner sitused the subvention receipts to Ohio in proportion of the manufacturers' subvention-program-benefit in Ohio.

The Tax Commissioner argued that the subvention and interest buydown payments were rebates and not loans to HCA because the manufacturers were paying an amount equivalent to someone else's interest to HCA. HCA provided expert testimony and evidence that the payments were treated as interest for accounting and federal income tax purposes. The Board determined the payments were "for the use of money. See Black's Law Dictionary 969 (11 th 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)." Thus, the Board found that the subvention and interest buydown payments were interest properly excluded from gross receipts as interest under R.C. 5751.01(F)(2)(a) and reversed the Tax Commissioner's determination.

Conclusion

Although the Board stopped short of adopting the entire Internal Revenue Code, the decision clearly provides a strong reliance on the treatment of transactions and payments for federal income tax purposes and accounting purposes in accordance with GAAP.

ODT has the ability to appeal this decision to the Ohio Supreme Court or the 10th District Court of Appeals. The deadline for an appeal is 30 days or Monday, March 9th.

Richard C. Farrin and Debora (Dardinger) McGraw served as counsel on the case.

If you would like to discuss the *Hyundai* case or any other CAT issues, please contact Richard Farrin, Debora McGraw or any other ZHF professional.

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