

WAC 458-20-109 Finance charges, carrying charges, interest, penalties. (1) **Introduction.** This section explains the B&O and public utility taxation of finance charges, carrying charges, interest and/or penalties received by taxpayers in the regular course of business. This section also explains when these amounts are not part of the selling price for retail sales tax purposes.

(2) **Business and occupation tax.** Persons who receive finance charges, carrying charges, service charges, penalties and interest are taxable under the service and other business activities classification on the receipt of amounts from these sources.

(a) Amounts received from these sources include but are not limited to:

(i) Interest received by persons engaged in public utility activities; and

(ii) Interest received by persons regularly engaged in the business of selling real estate.

(b) Persons engaged in financial business activities should refer to WAC 458-20-146.

(c) Amounts categorized as "interest" in a lease payment are generally taxable in the retailing classification as part of the total lease payment and part of the selling price for retail sales tax purposes. See WAC 458-20-211.

(d) Interest or finance charges received from an installment sale are taxable under the service classification.

(3) **Retail sales tax.** Retail sales tax applies as follows.

(a) Finance charges, carrying charges, service charges, penalties and/or interest from installment sales are not considered a part of the selling price of such property and are not subject to the retail sales tax, when:

(i) The amount of such finance charges, carrying charges, service charges, penalty, or interest is in addition to the usual or established cash selling price; and

(ii) The amount is segregated on the taxpayers' accounts; and

(iii) The amount is billed separately to customers.

(b) Amounts designated as finance charges, carrying charges, service charges or interest in a lease of tangible personal property must be included in the measure of retail sales tax regardless of the fact that such charges may be billed separately to customers. However, a penalty or interest charge for failure of the customer to make a timely lease payment is taxable under the service and other business activities classification and not subject to retail sales tax.

(4) **Examples.** The following examples identify a number of facts and then state a conclusion as to whether the situation results in taxable interest or finance charges. These examples should be used only as a general guide. The tax status of each situation must be determined after a review of all of the facts and circumstances.

(a) ABC Electric Company, who sells electricity to consumers, receives \$9,000.00 in late charges in the month of November. These fees are taxable under the service and other classification of the business and occupation tax. The public utility tax would not apply to this income.

(b) XYZ Furniture Company sells furniture and allows its customers to pay for the furniture over a twelve-month period. The seller charges interest at twelve percent per annum for allowing the customer to defer immediate payment. The interest charged the customer is a separate activity from the sale of the furniture and is taxable under the service and other business activities classification.

(c) Jane Doe is leasing a car from ABC Leasing, Inc. The lease contract provides that if the customer is more than fifteen days late in making the lease payment, a five percent penalty will be charged. Jane Doe was more than fifteen days late in making her March payment and was required to pay the five percent penalty. The penalty amount received by ABC Leasing is a separate activity from the lease of the vehicle and is taxable under the service and other activity business and occupation tax. Retail sales tax does not apply to this amount.

(d) John Doe sold his personal residence on contract. He receives monthly interest and principal payments. The interest is received in exchange for the seller's deferring receipt of immediate payment. The sale of the residence was not related to any other business activities and John Doe has sold no other real estate. The interest is not taxable under the B&O tax since the transaction was a casual and isolated sale.

(e) Judy Smith is engaged in business as a real estate broker and regularly sells real estate for others. Judy Smith sold her personal residence on contract. She receives monthly interest and principal payments. She receives no other interest from real estate contracts. The sale of her own residence can be distinguished from the sale of real estate for others. Since this was a single sale of her own residence, it is a casual and isolated sale and the interest is not subject to B&O tax.

(f) James Smith sold on contract seventeen of twenty-three apartment complexes which he owned during a four-year period. He receives payment of principal and interest every month from these sales. The only other income he receives is from the rental of apartment units to nontransients. The income which James Smith receives as interest from the sale of the real estate is subject to the service and other B&O tax. The rental of the apartment units is not taxable for the B&O tax. The courts have held that the selling and financing of sales of capital assets by means of real estate contracts does not constitute an investment within the meaning of RCW 82.04.4281. James Smith is engaged in a taxable business activity. A deduction is provided to sellers who are engaged in banking, loan, security, or other financial businesses if the sale is primarily secured by a first mortgage or trust deed on nontransient residential property. However, James Smith is not engaged in these types of business, nor was the loan secured in this manner. Persons in a financial business should refer to WAC 458-20-146.

(g) David Roe acquired four pieces of real property over a period of several years. This property has been held for residential rental to nontransients. David Roe sold all of the real estate in 1991 and is receiving payments of principal and interest pursuant to sales contracts. The determination of whether the interest received is subject to the business and occupation tax depends on all facts and circumstances and cannot be made based on the limited facts set forth in this example. Additional facts and circumstances would include, but not be limited to, the extent to which David Roe has purchased and sold real property in the past, the number of other sales contracts held by David Roe aside from the ones mentioned here, whether the property may have been acquired by inheritance, and the type of business in which David Roe regularly engages.

[Statutory Authority: RCW 82.32.300. WSR 91-23-038, § 458-20-109, filed 11/13/91, effective 1/1/92; Order ET 70-3, § 458-20-109 (Rule 109), filed 5/29/70, effective 7/1/70.]