

## **Seattle Rule 5-034**

Finance charges, carrying charges, interest and penalties.

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(1) Introduction. This rule explains the business license tax and utility taxation of finance charges, carrying charges, interest and/or penalties received by taxpayers in the regular course of business.

(2) Business license tax. Persons who receive finance charges, carrying charges, service charges, penalties and interest are taxable under the service and other business activities classification. Included in this are:

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

(b) Persons engaged in financial business activities. (Refer to Seattle Rule 5-520.)

(c) A penalty or interest charge assessed on a late payment on a lease payment.

(d) Interest or finance charges received from an installment sale.

Generally, amounts categorized as "interest" in a lease payment for tangible personal property are taxable in the retailing classification as part of the total lease payment for purposes of the business license tax. See Seattle Rule 5-536.

(3) Exemptions and deductions. SMC Chapter 5.45 provides an exemption for credit unions, international banking facilities and amounts derived from the sale of real estate. Deductions are also permissible pursuant to SMC Chapter 5.45 for interest on investments or loans secured by mortgages or deeds of trust and interest on obligations of the state, its political subdivisions, and municipal subdivisions.

(4) Utility Tax. Interest, late fees, non-sufficient fund fees, and other penalties received by persons receiving gross income from engaging in utility activities per Seattle Municipal Code Chapter 5.48 are taxable under the appropriate classification of the utility tax code.

(5) 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 not taxable under the

service and other business activities classification of the business license tax. Per Section 4 above, the late fees are taxable under the selling of electricity classification of the utility tax code pursuant to Chapter 5.48 of the Seattle Municipal Code.

(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 (12%) 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 (15) days late in making the lease payment, a five percent (5%) penalty will be charged. Jane Doe was more than fifteen (15) days late in making her March payment and was required to pay the five percent (5%) 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 business activities classification. Any interest included in the lease payment for the car is part of the lease payment and subject to the retailing business license tax.

(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 business license 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 Judy's property can be distinguished from the sale of real estate for others. Since this was a single sale of Judy's residence, it is a casual and isolated sale and the interest is not subject to business license 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 non-transients. The income which James Smith receives as interest from the sale of the real estate is subject to the service business license tax. The rental of the apartment units is not taxable for the business license 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 non-transient residential property (see 5.45.100 G). 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 Seattle rule 5-520.

(g) David Roe acquired four pieces of real property over a period of several years. These properties have been held for residential rental to non-transients. 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 license 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.

#### DIRECTOR'S CERTIFICATION

I, Glen M. Lee, Finance Director of the City of Seattle, do hereby certify under penalty of perjury of law, that the within and foregoing is a true and correct copy as adopted by the City of Seattle, Department of Finance and Administrative Services.

DATED this \_\_\_\_ day of July 2016.

CITY OF SEATTLE,

a Washington municipality

By: \_\_\_\_\_

Glen M. Lee, Finance Director

Department of Finance and Administrative Services

Effective date: July 14, 2016

Jul 14, 2016