



Excise Tax Advisories (ETA) are interpretive statements issued by the Department of Revenue under authority of RCW 34.05.230. ETAs explain the Department's policy regarding how tax law applies to a specific issue or specific set of facts. They are advisory for taxpayers; however, the Department is bound by these advisories until superseded by Court action, Legislative action, rule adoption, or an amendment to or cancellation of the ETA.

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THIS ADVISORY HAS BEEN REPEALED EFFECTIVE JUNE 30, 2002

INTEREST RECEIVED ON FUNDS PROCURED FOR AFFILIATED COMPANIES

Revised: March 1, 1993

This Excise Tax Bulletin explains the Department's position on interest received for loans made to affiliated companies when the business making the loans has procured these funds from a third party lending source. This is a clarification and does not indicate a change in the Department's position.

Many businesses procure funds from third party lending sources for the benefit of affiliated companies. These funds are then loaned to the affiliated companies, which in turn make interest payments to the procuring business. Is the interest received by the procuring business subject to tax? If so, may the business deduct the interest it pays to the third party lending source when reporting the tax liability?

The business and occupation tax is imposed upon the gross income of the business and collected from every person conducting business activities within this state. RCW 82.04.220. The term "gross income of the business" is defined by RCW 82.04.080 to mean:

[T]he value proceeding or accruing by reason of the transaction of the business engaged in and includes gross proceeds of sales, compensation for the rendition of services, . . . interest, discount, rents, royalties, fees, commissions, dividends, and other emoluments however designated, all without any deduction on account of the cost . . . or any other expense whatsoever paid or accrued

RCW 82.04.4281 does provide a deduction for ". . . amounts derived by persons, other than those engaging in banking, loan, security, or other financial businesses, from investments or the use of money" However, under the holding of the State Supreme Court in Sellen Construction Co. et al v. Revenue, 87 Wn. 2d 878 (1976), the Department has consistently held that this deduction is not permitted with respect

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to income from activities which are in competition with financial businesses, where such activities are a regular part of the business' normal business practice.

A business making loans to affiliated companies on a regular basis is considered to be engaging in activities essentially in competition with financial businesses. The fact that loans are not offered to the general public, or the making of loans is not the business' principal business activity, does not affect the tax consequences of the activity.

The interest derived from these activities is subject to the service B&O tax. The procuring business may not claim a deduction under RCW 82.04.04281, nor may it deduct the interest paid to the third party lending institution.

However, there are certain circumstances under which a business may obtain funds for affiliated companies without incurring a tax liability. Interest received by a business merely acting as a conduit in procuring loans from a third party lending source, for the benefit of affiliated companies and on a straight pass-through (conduit) basis, is not considered to be taxable. To be considered as acting in such a manner, the following conditions must be met:

1. The source of funds loaned to the affiliated companies must be procured from third party lending sources;
2. The interest rate charged by the procuring business must be the same as that paid to the third party lending institution;
3. The interest paid to the procuring business by the affiliated companies must in turn be repaid to that business' third party lender;
4. There must be no object of financial gain or benefit to the procuring business.