



Excise Tax Advisory

Excise Tax Advisories are interpretive statements authorized by RCW 34.05.230.

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Amounts Paid under a Penalty Clause

Contracts often contain penalty clauses which may be invoked if the contractor fails to complete a contract, or portion thereof, by a specified date. In these situations, the contracting party generally withholds the amount of the penalty from the contract proceeds due the contractor. Does the penalty reduce the measure of the retail sale and business and occupation (B&O) taxes?

Penalty clause amounts paid by, or withheld from, a contractor are not adjustments to the gross contract price. These amounts represent losses incurred by the contractor because it failed to provide required services and/or products by a specified date, and are considered costs of doing business.

The B&O and retail sales taxes are imposed on the gross income of the business, or selling price. These terms are defined very broadly by statute, with no allowance for the deduction of costs or expenses incurred by the seller. However, a bonus for early completion paid to the contractor is additional consideration in respect to the construction contract. The bonus is subject to B&O tax and also retail sales tax when the construction is a retail activity.

As costs of doing business, penalty clause losses may not be deducted from the gross contract price when determining the measure of tax liability.

All ETAs were cancelled on February 2, 2009 and those which had a continued use were rewritten and reissued using a new numbering system. The new ETAs are numbered using the following format 3nnn.yyyy. The Department of Revenue issued ETA 3001.2009 which includes a cross reference table showing the old and new ETA numbers for those ETAs that were rewritten.

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