

BEFORE THE INTERPRETATION AND APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition) D E T E R M I N A T I O N
For Refund of)
) No. 89-88)
)
) Registration No. . . .
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[1] **RULE 109:** B&O TAX -- SERVICE -- DEDUCTION --
INTEREST EXPENSE -- RELATED CORPORATION -- CONDUIT
FOR PAYMENT TO LENDER. Interest income received by
a corporation from overseas purchasers is deductible
and therefore is not subject to service B&O taxation
where the corporation is not competing with
financial institutions but is acting as a conduit
and transmitting the amount of the interest payment
to the lender. ACCORD: Howard S. Wright
Construction Co. et al v. Department of Rev, No. 79-
2-01310-0 (1981).

Headnotes are provided as a convenience for the reader and are
not in any way a part of the decision or in any way to be used
in construing or interpreting this Determination.

NATURE OF ACTION:

Taxpayer petitions for refund of taxes paid pursuant to
assessment of service B&O tax on amounts received from its
parent corporation as payments of interest on funds borrowed
to cover cost of goods sold to the overseas parent.

FACTS AND ISSUES:

Johnson, A.L.J. -- Taxpayer is the U.S.-based subsidiary of a
Japanese corporation. The parent corporation maintains
fifteen offices in the U.S., including one licensed to
transact business in Washington. In the case of the sales in
question, purchases were made by the subsidiary for immediate

shipment to the overseas parent or to a related company, also in Japan. The goods are shipped at the subsidiary-seller's risk and expense, with title passing at the delivery destination.

The taxpayer's system operates as follows:

1. The goods are shipped on a cost-plus 2% basis to the overseas corporation(s).
2. Terms of the sales are 90 days after the bill of lading date or 120 days. Interest is charged for this 3-4 month period. This amount is separately stated on the taxpayer's books and is separately billed to and paid by the overseas corporation(s).
3. After shipment of the goods, taxpayer submits a "Bill for Collection" [the bill of lading amount, presumably as proof that it is to receive the funds and will pay those amounts over to the bank on receipt] to a U.S. branch office of a Japanese bank, which remits the full invoice price to taxpayer. This amount does not include the interest amount. At the time of payment by the bank, taxpayer records an accrual on its books for interest expense. (Brackets supplied.)
4. When the payment is due, the overseas corporation pays the Japanese bank, which notifies its U.S. branch. The interest amount is paid separately, directly to the taxpayer, which remits the interest to the U.S. bank to pay off the interest charge.

Taxpayer contends that this method of accounting is used only for internal purposes to assist it in analyzing its cash flow and in anticipating its business needs; otherwise, it would have built the interest amount into the selling price and billed the overseas corporation for the full amount on the bill of lading. The sales in question are not B&O taxable because, under WAC 458-20-193, they are export sales, delivered to the buyer at a foreign destination.

DISCUSSION:

[1] Persons engaging in business in this state are taxable on the gross receipts received from such activities unless the

income is exempt or deductible. WAC 458-20-109 (Rule 109) specifically states that persons receiving finance charges, carrying charges, service charges, penalties and interest are taxable under the Services B&O tax classification on the income received.

Taxpayer contends that its position in this case is as a pass-through or conduit for transmittal of the interest amounts from its overseas purchasers to the local bank.

The auditor, correctly noting that the charging of interest or service fees is a local activity subject to the B&O tax even though the foreign sales are not, relied on the Department's position that amounts so received are taxable to the local seller.

After the case which gave rise to that Department position, the Thurston County Superior Court decided the case of Howard S. Wright Construction Co. et al v. Dept. of Rev., No. 79-2-01310-0 (1981). In that case, facts similar to those presented by this taxpayer resulted in a conclusion by the court that, although collection of interest may be a regular part of the taxpayer's normal business practice and such activity may be similar to activities conducted by financial institutions, where the taxpayer is acting basically as a conduit of funds and is not essentially in competition with financial businesses, it shall not be denied the deduction from gross income under RCW 82.04.4281 and Excise Tax Bulletin 505 (March 4, 1977).

Taxpayer in this case states that it is not charging more than the amount of the interest charged by the bank, that it forwards the amounts separately billed to its Japanese parent and an affiliate to the local bank, that the parent and affiliate pay interest based on LIBOR (London Interbank Borrowing Rates) standards and that any disparity in amounts "marginal and is attributable to overlapping time periods." On these facts, we find that the taxpayer is, indeed, a conduit for the local bank and that the amounts received are deductible by the taxpayer. Should the taxpayer's activities cross the line from being a conduit for a bank to charging service and interest fees for its own activities, this result could differ; and the taxpayer should be aware that its activities will be subject to scrutiny in future audit periods to determine whether such a change in activities has occurred.

DECISION AND DISPOSITION:

Determination No. (Cont.)
No. 89-88

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Taxpayer's petition is granted subject to the cautionary language above. The file will be remanded to the Audit Section for a determination of the amount of a refund to be issued.

DATED this 17th day of February 1989.