

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 Correction of Assessment of )  
) No. 89-146  
  
)  
    . . . ) Registration No. . . .  
) . . . /Audit No. . . .  
)

[1] **RULE 109 and RULE 118:** RCW 82.04.390 -- RCW 82.04.4292 -- B&O TAX -- DEDUCTION -- SALES OF REAL ESTATE -- INTEREST. Interest received from the sale of real estate is subject to Service B&O tax whether the sale is secured by a real estate contract, deed of trust or mortgage. Such interest is not deductible under RCW 82.04.4292 if it is not received as a result of a loan or investment made by one in a financial business.

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 correction of assessment of B&O tax on interest earned from real estate transactions.

FACTS AND ISSUES:

Johnson, A.L.J. -- Taxpayer is engaged in the business of developing and selling real estate. During an audit of its books and records for the period from January 1, 1983, through February 28, 1987, the auditor assessed Service B&O tax on interest income received on sales of real estate.

The auditor assessed tax on the interest income from the sales in which a real estate contract was used, but permitted deduction of the income in cases where a deed of trust secured

the sales. Taxpayer opines at length that interest income from all of the sales should be tax deductible, providing various definitions for mortgage and contracts which would fit the real estate contract sales into the statutory requirement that investments or loans must be secured by first mortgages or trust deeds.

#### DISCUSSION:

[1] The taxpayer in this case is involved in developing and selling real estate. As a regular part of its business activities, it sells properties and carries the financing itself. The sales are secured either by real estate contracts or by deeds of trust. The auditor believed that the sales in which the financing was secured by a deed of trust resulted in deductible interest income for the seller. Conversely, he believed that the sales in which a real estate contract was used resulted in taxable interest income to the seller.

With narrowly-circumscribed exceptions, the B&O tax owed is calculated based on the "gross income of the business". RCW 82.04.290. "Gross income of the business" is defined in RCW 82.04.080 to specifically include interest:

"Gross income of the business" means the 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, gains realized from trading in stocks, bonds, or other evidences of indebtedness, interest.  
. . (Emphasis supplied.)

Further, the legislature enacted RCW 82.04.390, which states that

[t]his chapter shall not apply to gross proceeds derived from the sale of real estate. This however, shall not be construed to allow a deduction of amounts received as commissions from the sale of real estate, nor as fees, handling charges, discounts, interest or similar financial charges resulting from, or relating to, real estate transactions. (Emphasis supplied.)

Finally, RCW 82.04.4292, relied upon by the taxpayer, provides:

[i]n computing tax there may be deducted from the measure of tax by those engaged in banking, loan,

security or other financial businesses, amounts derived from interest received on investments or loans primarily secured by first mortgages or trust deeds on nontransient residential properties. (Emphasis supplied.)

This provision specifically allows deduction of interest in only for those engaged in financial businesses and only where there are loans or investments primarily secured by first mortgages or deeds of trust on nontransient residential housing. RCW 82.04.4292.

In O'Leary v. Department of Rev., 105 Wn.2d 679, 682 (1986), the Washington Supreme Court upheld the assessment of B&O tax on the interest received from the sale of apartment complexes owned by the taxpayer. The court found that the real estate contracts held by the taxpayer, an investment partnership, were neither incidental investments nor made from surplus income of the partnership.

Additionally, the Washington Board of Tax Appeals has concluded that interest income from activities such as this taxpayer's does not qualify for deduction from B&O tax granted for investments:

. . . interest income is a financing charge, it occurs by allowing payments to be made over an extended period of time and as a result, a fee or interest is realized; this does not meet the test of an investment.

Donald F. Detlefsen v. Department of Rev., Docket No. 84-38 (1985).

The Washington Supreme Court directly addressed this issue in Clifford v. State, 78 Wn.2d 4, 8, 469 P.2d 549 (1970) stating:

The particular business activity of the appellants which is taxed is that of permitting deferred payment for the real estate which it sells. . . Making a loan and taking a land contract as security is not the same activity as selling a piece of land and accepting the payment in installments. In one activity, money is advanced. In the other, no money is advanced by the seller; rather he relinquishes the right to immediate payment. This is a sufficient distinction in fact to justify the difference in tax treatment.

This taxpayer develops and sells real estate. The transactions in this case are sales of land secured by either a real estate contract or deed of trust. Interest income is received in exchange for the seller's agreement to defer receipt of payment for the real estate. Taxpayer is not in the financial business. No money is loaned, and the activity does not qualify as investment of money. Because no deduction is permitted under RCW 82.04.4292, Service B&O tax is due on the interest whether the sale of the real estate is secured by a mortgage, deed of trust or real estate contract where the seller is not in the financial business and where a loan or investment of money is not made.

WACs 458-20-109 (Rule 109; persons receiving interest income are taxable under the Service B&O tax classification) and 458-20-118 (Rule 118; interest received by persons engaged in selling real estate on time or installment contracts is taxable) dispose of this issue, . . . .

Additionally, ETB 505 provides that no B&O tax deduction is permitted for interest or similar financial charges relating to real estate transactions:

Under the holding of the court in Sellen, income from the incidental investment of surplus or excess funds by persons who are not themselves in a security, investment, or financial business is not subject to tax.

However, no deduction is permitted with respect to

2. interest or similar financial charges relating to real estate transactions (see RCW 82.04.390). . .  
(Emphasis supplied.)

Whether taxpayer chooses to accept a real estate contract or deed of trust as security for its sales, the result should have been the same during the audit period. None of the interest should have been deductible here, because neither the taxpayer nor the transactions qualify under the statutes.

#### DECISION AND DISPOSITION:

Taxpayer's petition is denied. Additionally, for periods after the date of this Determination, all interest earned from sales of real estate by a person not in a financial business, regardless of whether the sale is secured by a real estate

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contract, mortgage, or deed of trust, is subject to Service  
B&O tax.

DATED this 20th day of March 1989.