



This Week in State Tax (TWIST)

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Washington State: Department Addresses Taxability of Termination Fees; Licenses to Use Real Property

The Washington State Department of Revenue recently issued guidance on their website on the taxability of termination or cancellation fees that consumers are required to pay when they decide to end a contract or agreement prior to the agreed upon date. In the guidance, the Department confirms that the amount that a vendor bills a customer for the early termination of a contract is generally taxable under the same tax classification used for reporting the payments made under the contract. As to whether sales tax applies to termination fees, the Department states that when the contract is considered a retail sale, sales tax will apply. However, when the contract is not a retail sale, sales tax would not apply. The guidance includes three examples of certain types of contracts, such as a cell phone service plan that is cancelled prior to the end of the service agreement.

The Department also issued guidance clarifying the taxability of a rental of real property versus a license to use real property. A lease or rental of real property is not subject to business and occupation (B&O) tax or retail sales tax, but a license to use real property is subject B&O tax and may be subject to retail sales tax. A rental or lease of real property is present provided the following elements are met: (1) there must be a landlord/tenant relationship; (2) the lessee must have exclusive use of the rented space; (3) the rental period must be one complete month or 30 days, or longer; (4) the lessee must have the exclusive right of continuous possession; and (5) the lessee must have dominion and control over the rented space. The guidance explains that a license to use real property is distinguishable in that the licensee does not have exclusive dominion or control over the property. Generally, the owner, not the licensee, controls items such as lighting, heating, cleaning, repairing, and opening and closing the premises.

Generally, gross receipts from a license to use real property are subject to B&O tax under the service and other activities classification; however, in some scenarios, gross receipts would be subject to retail sales tax and B&O tax under the retailing classification. Examples of such scenarios include sales of lodging/accommodations, meeting facilities provided by a lodging business, storage garages, and automobile parking (except designated spots leased for 30 days or more). Please stay tuned to TWIST for more Washington updates!

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