

# Termination fees

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## What are termination fees?

Termination fees, also known as cancellation fees, are charges consumers must pay when they decide to end their contract or agreement prior to the agreed upon date. The fee(s) can vary in amount, from a flat fee to several months' worth of payments.

## Are termination fees taxable?

Generally, yes. The amount that a vendor bills a customer for the early termination of a contract is taxable under the same tax classification used for reporting the payments made under the contract.

## Does sales tax apply to termination fees?

It depends. Sales tax applies to termination fees when the contract is considered a retail sale. However, when the contract is not a retail sale, sales tax does not apply to termination fees.

## Examples

The examples provided below are to be used only as a general guide. The tax results of other situations must be determined separately after review of all the facts and circumstances.

### ***Example 1***

Stacy signed a 24-month cell phone service plan at \$40 per month with *Provider A*. After seven months, Stacy decided to switch to *Provider B*. Under *Provider A*'s service agreement, Stacy owed a \$680 termination fee. The fee was calculated by multiplying the remaining amount of months in the contract with the monthly bill amount (17 months x \$40 = \$680).

*Provider A* must collect retail sales tax on Stacy's termination fee because charges for telecommunication services are retail sales. *Provider A* must include the \$680 termination fees in their gross income, which is reported under the retailing business and occupation (B&O) tax and retail sales tax.

### ***Example 2***

Larry signed a one-year office building lease. After eight months, Larry broke the lease and owed a \$1,000 termination fee. The termination fee must be reported in the same manner as the lease payments.

In this case, leases or real estate are exempt tax. As such, the \$1,000 lease termination fee does not need to be reported as it is exempt from tax.

### ***Example 3***

Bert signed a two-year agreement with a cloud-based company for digital storage. After the first year, Bert terminated the agreement and owed a \$500 termination fee. The termination fee must be reported in the same manner as the payments for the digital storage.

In this case, the purchase of mere digital storage is subject to B&O tax under the service and other activities classification. The cloud-based company must include the \$500 termination fee in their gross income, which is reported under the service and other activities B&O tax (retail sales tax would not apply).

## **References**

RCW 82.04.050 – Sale at retail, retail sale

RCW 82.04.290 – Tax on service and other activities

WAC 458-20-118 – Sale or rental of real estate, license to use real estate



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