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This Week in State Tax (TWIST)

February 16, 2026

Washington: Interchange fees not included in B&O tax base

A Washington State appeals court recently ruled that a credit card processing company should not include interchange fees in its gross income calculation for Washington Business & Occupation (B&O) tax purposes. The taxpayer is a processor of credit card transactions. Its business focuses on entering into agreements with a merchant's bank (called the acquiring bank) to perform "acquiring services" on their behalf, including the collection of electronic data from the merchant to submit to the various credit card networks. Processors such as the taxpayer then enter into contracts with merchants to enable the merchants to access network funding services. An interchange fee is the amount that networks permit an issuing bank (*i.e.*, the bank issuing the card to the consumer) to charge for funding approved credit card transactions, among other things. Once the transaction is approved, the issuing bank receives the relevant merchant information and funds the transaction, less the permitted interchange fee. During the processing of the transaction, the interchange fees are not distributed to the processor but instead are retained by the issuing bank when it funds the transaction.

The Washington Department of Revenue had issued an advisory stating that consideration accrued by processors is gross income for B&O purposes even if fees charged by other parties in the transaction are netted out prior to the processor receiving payment. Based on this guidance, the taxpayer originally included the interchange fees as gross income on its 2018 B&O return but later sought a refund for the portion of tax attributable to the interchange fees. Under Washington law, gross revenue for B&O tax purposes includes the "value proceeding or accruing" from all a taxpayer's services without deduction for any expenses. The "value proceeding or accruing" is defined as "consideration actually received or accrued." A trial court ruled in favor of the taxpayer, finding that the interchange fees were not "actually received" by the taxpayer; neither did the taxpayer "actually accrue" the interchange fees such that they should be included in gross revenue. The department then sought review by the appellate court.

On appeal, the court examined the trial court findings related only to whether the taxpayer "actually accrued" the interchange fees since the parties agreed the fees were not actually received by the taxpayer. The court stated that when determining the "consideration actually … accrued," for purposes of the B&O tax, the term should be applied according to the method of accounting regularly employed by the taxpayer. The taxpayer utilized Generally Accepted Accounting Principles, and applying this accounting method, interchange fees are not considered part of the taxpayer's revenue or gross income. The Department countered that its published guidance provides that value can be said to accrue for a taxpayer when the taxpayer becomes legally entitled to receive consideration, but because the statute requires that value *actually* accrue, the court turned to whether the

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taxpayer was actually entitled to receive interchange fees. The court noted that the interchange fees are deducted by the issuing bank prior to the taxpayer receiving the funds from the issuing bank and transferring those funds to the merchants. Accordingly, the appeals court affirmed the judgment of the lower court, finding that the taxpayer was entitled to a refund of the B&O tax paid on interchange fees. Please contact Michele Baisler for questions about *First Data Merchant Services LLC v. State of Washington Department of Revenue*, case number 40584-2-111.