**Opinion Letter**

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| **Letter Number:** | **O-2013-004** |

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| **Tax Type:** | **Kansas Retailers' Sales Tax** |
| **Brief Description:** | **Late fees charged to utility customers.** |
| **Keywords:** |  |
| **Approval Date:** | **09/12/2013** |

**Body:**

Office of Policy & Research

September 12, 2013

XXXXX
XXXXX
XXXXX

RE: Your e-mail received on July 18, 2013

Dear XXXXX:

Thank you for your recent letter. You ask if late fees charged to utility customers are subject to Kansas sales tax. The answer is yes. Utility late fees are required to be included in the tax base along with other taxable charges. *K.A.R. 92-19-3a(j)(2).*You also ask if a fee or penalty that a utility charges to a customer for a returned check or insufficient funds check should be included in the tax base for utility charges. The answer is no. *K.A.R. 92-19-3a(d)(5).*

In general, when a business extends consumer credit to a customer as an inducement to purchase its goods *(e.g. “buy now, pay later”)* and the customer fails to timely pay the minimum amount due on its credit balance, the late charge is not subject to Kansas sales tax. *K.S.A. 79-3602(ll)(3)(B); K.A.R. 92-19-3a(e).*This type of late charge is treated as a finance charge that a lender bills for the debtor’s untimely payment of its credit obligations. It is not part of the “sales or selling price” charged for the sale of goods and services. See K.S.A. 79-3602(ll)(3)(B)*(“(3) ‘Sales or selling price’ shall not include: . . . (B) interest, financing and carrying charges from credit extended on the sale of personal property or services, if the amount is separately stated on the invoice, bill of sale or similar document given to the purchaser. . . .”).*

This general rule does not apply to utility late fees. This is because utility late fees are not interest or penalties that are charged for the late payment of consumer credit.*Jones v. Kansas Gas & Elec. Co.,* 222 Kan. 390, 565 P.2d 597 (1977) *(“A late payment charge on a public utility bill is not interest.”);* see *Seaton v. City of Lexington,* 97 S.W.3d 72, 76-77 (Mo. Ct. App. 2002)*(“The statutorily authorized penalty in Ordinance No. 97–35 is designed to insure prompt payment of user charges and is not interest on the use or loan of money.”);* *Matter of City of Binghamton,*133 A.D.2d 988, 521 N.Y.S.2d 140, 141 (App.Div.3d 1987) *(“Here, respondent failed to pay his water and sewer assessments in a timely fashion. The Legislature has given local governments the authority to impose a penalty for payments which are in arrears. . . . This statutorily authorized penalty is designed to insure the prompt payment of assessments and is clearly not a loan or forbearance of money.”);* *State ex rel. Ashcroft ex inf. Pelzer v. Pub. Serv. Comm’n,* 674 S.W.2d 660, 663 (Mo. Ct. App. 1984) *(“Appellant cites no case authority supporting its claim that late charges are to be equated with interest and independent research has disclosed none.”);* *State ex rel. Guste v. Council of City of New Orleans,* 309 So.2d 290, 29 (La. 1975) *(“Hence, the late payment charge, which is part of the price paid for the commodity, is not usurious interest.”); Ferguson v. Electric Power Board of Chattanooga, Tennessee,* 378 F.Supp. 787 (E.D.Tenn. 1974); *State ex rel. Utilities Comm’n v. N. Carolina Consumers Council, Inc.,* 18 N.C. App. 717, 198 S.E.2d 98, 100-01 (1973) (Quotes *Coffelt,*quoted next); *Coffelt v. Arkansas Power & Light Co.,* 248 Ark. 313, 317, 451 S.W.2d 881, 884 (1970) *(“The late charge, far from being an exaction of excessive interest for the loan or forbearance of money, is in fact a device by which consumers are automatically classified to avoid discrimination. Its effect is to require delinquent ratepayers to bear, as nearly as can be determined, the exact collection costs that result from their tardiness in paying their bills.”).* Utility late payment fees are not taxable even though they look like interest charges when they are calculated as a percentage of the monthly utility charge. See *Volcanic Gardens Mgmt. Co., Inc. v. El Paso Elec. Co.,*No. 08-03-00208-CV, 2004 WL 1695890 (Tex. App.--El Paso July 29, 2004, pet. denied).

Utility late fees are one of the ways that public utilities avoid rate discrimination among customers. As the Arkansas Supreme Court explained,

The late charge, as approved by the Public Service Commission, is simply a practical method of preventing discrimination among the utility company’s customers. The prohibition against discrimination in utility rates is basic in public utility law. Pond, Public Utilities, s 270 (4th ed., 1932). That prohibition is incorporated in our statute governing public utilities. . .
The late charge, far from being an exaction of excessive interest for the loan or forbearance of money, is in fact a device by which consumers are automatically classified to avoid discrimination. Its effect is to require delinquent ratepayers to bear, as nearly as can be determined, the exact collection costs that result from their tardiness in paying their bills. The appellant’s argument actually means in substance not that the utility company be prevented from collecting excessive interest but that its customers who pay their bills promptly be penalized by sharing the burden of collection costs not of their making. *Coffelt v. Arkansas Power & Light Co.,*248 Ark. 313, 317, 451 S.W.2d 881, 883-84 (1970). (Underlining provided).

The Kansas Corporation Commission used the same rational that *Coffelt,* id, adopted to support its determination that late fees charged by Kansas utilities are not interest or penalty charges assessed on a debtor’s late payment of its consumer credit obligations. Compare *Coffelt,* id., with *Tennyson v. Gas Serv. Co.,* 506 F.2d 1135, 1143-44 (10th Cir. 1974).

Courts have recognized the common utility practice of billing the “Amount Due Now” and a higher “After Due Date” amount is a billing device that utilities may lawfully use to equalize utility rates for two different classes of customers. The first class consists of customers who pay their utility bills on time. The second class consists of customers who pay their bills after the due date. The “After Due Date” amount requires the delinquent customer to bear the additional costs the utility incurs because of the tardiness of their payment.

As the Kansas Supreme Court reasoned in *Jones v. Kansas Gas & Elec. Co.,* supra,

The legislature has declared that utility services are affected with a public interest. Every common carrier and public utility controlled by the Commission is required to serve all members of the general public without discrimination and must establish just and reasonable rates, fares, tolls and charges. (K.S.A. 66-107). Rates, regulations and charges must be published (K.S.A. 66-108), and must not be ignored except within strict exceptions. (K.S.A. 66-109). Utility cannot refuse to serve a slow-paying customer or a credit risk who might be turned away by a local merchant. In order to compensate for this factor utilities are allowed to require deposits and impose late charges to minimize the risk of bad debts. The operation of a public utility cannot be compared with an ordinary business. *Jones,*supra at 399-400. *(Underlining added).*

The difference between the “Amount Due Now” and a higher “After Due Date” amount that utilities charge is not the equivalent of interest, financing, and carrying charges that retailers bill to customers who fail to pay the minimum amount due on their credit balance. Accordingly, the amount customers pay for their utility services is fully taxable, whether paid as the “Amount Due Now” or the higher “After Due Date” amount. See *Kansas Department of Revenue Revenue Ruling Issued to All Kansas Gas, Water, Electrical and Heating Public Utilities (August 2, 1971).*

Fees and penalties that a utility charges for a customer’s returned check or insufficient funds check are not taxable and should not be included in the tax base for its taxable utility charges. K.A.R. 92-19-3a(d)(5) provides,

(5) A retailer shall not collect sales tax on charges to customers for insufficient funds checks or closed-account checks. The receipts from these charges shall not be included in the retailer’s report of gross receipts.

This provision applies to all Kansas retailers, including Kansas utilities. A utility customer that tenders an insufficient funds check may take corrective action quickly enough to timely pay the “Amount Due Now.” In addition, it can be assumed that Kansas Corporation Commission considered some of the costs utilities incur because of returned and insufficient funds checks when it authorized utilities to issue bills that reflect the “Amount Due Now” and a higher “After Due Date” amount.

Sincerely,

Thomas E. Hatten
Attorney/Policy & Research

**Date Composed: 09/24/2013 Date Modified: 09/24/2013**