

Cite as 11 WTD 1 (1980)

BEFORE THE DEPARTMENT OF REVENUE OF THE STATE OF WASHINGTON

In the Matter of the Petition)	<u>D</u> <u>E</u> <u>T</u> <u>E</u> <u>R</u> <u>M</u> <u>I</u> <u>N</u> <u>A</u> <u>T</u> <u>I</u> <u>O</u> <u>N</u>
For Correction of Assessment of)	
)	No. 80-121
)	
. . .)	Registration No. . . .
)	
)	
)	

[1] RULE 146: INTEREST -- FIRST MORTGAGE. Interest received on home improvement loans secured by second deeds of trust, or unsecured, is not entitled to exemption, even though lender holds the first trust deed or mortgage on the same residential property. Statute strictly construed.

**PORTIONS OF THIS DETERMINATION WERE NOT PRECEDENTIAL
AND HAVE NOT BEEN PUBLISHED.**

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.

DEPARTMENT OF REVENUE REPRESENTED BY
INTERPRETATION AND APPEALS DIVISION:

Edward L. Faker, Hearing Officer

DATE AND PLACE OF CONFERENCE: April 10, 1980; Seattle,
Washington

FACTS:

The taxpayer's business records were audited for the period from October 1, 1975 through March 31, 1979, revealing a total tax and interest deficiency of \$ Tax Assessment No. . . . in that amount was issued [in November 1979], and it remains unpaid.

TAXPAYER'S EXCEPTIONS:

The taxpayer protests the assessment of business and occupation tax under the Service classification . . . measured by interest income received on home improvement loans where the taxpayer holds the first mortgage on the property being improved.

* * *

Concerning interest income derived from home improvement loans, the taxpayer explains that it transacts two kinds of loans but only covering improvements to properties upon which the taxpayer already holds a first mortgage. They are:

1. Secured loans -- the taxpayer takes a deed of trust at the time of the improvement loan; and,
2. Unsecured loans -- no deed of trust is taken at the time of the improvement loan because the existing security is adequate.

To determine whether a second deed of trust should be taken the taxpayer looks to the security value of the property at the time of the initial loan and to the balance outstanding covered by that security. At the time of the April 10, 1980 hearing the taxpayer had some \$900,000.00 loaned on home improvement loans of which some \$870,000.00 was secured by second deeds of trust.

In response to questions from the hearing officer the taxpayer testified that the note or contract covering the improvement loan contains no internal reference to the original mortgage or trust deed. Also, the interest rates may vary between the two loans. Notwithstanding these differences, the taxpayer argues that the improvement loan should be treated merely as an extension of the first mortgage. The taxpayer's petition states:

Should there be a default on the home improvement loan, the lender should be completely protected from loss as it may look directly to the property acting as security for the loan without involving any other lender. The lender is not in a secondary position for recovery of these home improvement loans.

No case law or other supportive authority was cited for this "extension" concept. The taxpayer simply states that it looks to the security of the first lien when extending additional funds.

DISCUSSION:

RCW 82.04.430(11) [now 82.04.4292] provides the exemption sought by the taxpayer as follows:

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;

Thus, whereas the taxpayer is a loan business and the amounts in question are generated by loans secured by first nontransient residential mortgages, then if these amounts do constitute "interest", they are exempt.

* * *

. . . [T]he taxpayer's home improvement loans in question are not secured by first mortgages or first deeds of trust on nontransient residential property. As the taxpayer has itself characterized these transactions they simply do not meet the statutory criteria for exemption. There is no authority for the proposition that second deeds of trust taken as security for improvement loans merely constitute extensions of the first mortgages nor does the Department of Revenue have the discretion to interpret RCW 82.04.430(11) [now 82.04.4292] so liberally. This statute provides for an exemption and, under the principles of statutory construction, it must be strictly construed against the exemption and in favor of taxability. See Evergreen-Washelli vs. Revenue, 89 Wn.2d 660, 663, 574 P2d 735 (1978), and Group Health Cooperative vs. Tax Commission, 72 Wn.2d 422, 429, 433 P2d 201 (1967). As to the statutory language itself, it is important that the legislature adopted the terminology "primarily secured by first mortgages or trust deeds". Had the legislative intent been to extend the exemption to interest income from loans secured by secondary or subordinate security devices, the legislature would have done so. We must take administrative notice of the obvious intent to exempt interest income derived from secured transactions for the purchase of residential real property only, to the exclusion of subsequent and secondarily secured transactions not related to real property purchases. It is immaterial that the taxpayer claims to look to the security of the first lien in extending additional funds. The Department of Revenue has uniformly and consistently ruled, under this law, that only interest from loans secured by first mortgages

or first trust deeds is entitled to the statutory exemption. The tax is applicable to interest earned on loans which do not comply exactly with the statutory requirements such as interest earned on second mortgages or second trust deeds and interest earned on unsecured loans.

DECISION AND DISPOSITION:

The taxpayer's petition is denied with respect to interest income from loans secured by second mortgages or trust deeds and from unsecured loans.

DATED this 18th day of July, 1980.