

Cite as Det. No. 17-0239, 38 WTD 57 (2019)

BEFORE THE ADMINISTRATIVE REVIEW AND HEARINGS DIVISION  
DEPARTMENT OF REVENUE  
STATE OF WASHINGTON

In the Matter of the Petition for Correction of )	<u>D E T E R M I N A T I O N</u>
Assessment of )	
) )	No. 17-0239
) )	
. . . )	Registration No. . . .
) )	

RCW 82.04.080(1): B&O TAX – VALUE PROCEEDING OR ACCRUING – GROSS INCOME OF THE BUSINESS – OFFSET AGAINST SELLING PRICE. Fees charged by federal government sponsored entities and netted against gross proceeds from the sales of loans prior to payment of the net amount may not be deducted in determining the value proceeding or accruing to taxpayer from the sales of the loans.

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.

Gabriella Herkert, T.R.O. – A residential mortgage lender protests inclusion in gross income of the business certain fees required by federal government-sponsored enterprises upon purchase of residential mortgages when determining its service and other activities business and occupation (B&O) tax liability. We deny taxpayer’s petition.<sup>1</sup>

### ISSUE

. . . [In determining the “gross income of the business” under RCW 82.04.080(1), is Taxpayer permitted to deduct certain fees imposed by the Federal Home Mortgage Corporation and the Federal National Mortgage Association when those fees are offset against the amount received by Taxpayer for the sale of mortgage loans prior to remitting the net amount to the Taxpayer on its sales of mortgage loans to these purchasers]?

### FINDINGS OF FACT

. . . (Taxpayer) originates residential first mortgages on non-transient real property. Taxpayer’s corporate headquarters are located [out-of-state]. During the audit period, Taxpayer originated mortgages through offices in Washington and across the United States.

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<sup>1</sup> Identifying details regarding the taxpayer and the assessment have been redacted pursuant to RCW 82.32.410.

Once originated, Taxpayer immediately resells mortgage loans in the secondary market to federal government-sponsored enterprises (GSEs) such as [the Federal National Mortgage Association (Fannie Mae)] and [the Federal Home Mortgage Corporation (Freddie Mac)]. The [amount Taxpayer received from the GSEs upon sale of the mortgages to them] . . . depends on a variety of factors including type of property, loan attributes, credit score, and other risk factors . . . . [In addition,] Freddie Mac imposes a credit fee<sup>2</sup> . . . [and] Fannie Mae imposes a loan level pricing adjustment [on sellers of mortgage loans] . . . . Freddie Mac and Fannie Mae publish schedules of the credit fee and loan level pricing adjustment applicable to all sellers[, and retains these amounts as an offset from the gross selling price of the mortgage loans being purchased before remitting payment of the net amount to the seller]. . . .

The Department of Revenue's (Department) Audit Division (Audit) reviewed Taxpayer's books and records for the tax period January 1, 2011, through September 30, 2014. Taxpayer keeps its books using the accrual method. Taxpayer's general ledger account 5125 . . . [records the gross proceeds from its sales of] mortgages to the GSEs . . . . Audit calculated Taxpayer's gross income from the business using general ledger account 5125. Taxpayer argued that its gross income from the business should be reduced by certain contra accounts. Taxpayer claimed that the contra accounts reflected "discounts" given to Freddie Mac and Fannie Mae deductible from gross income of the business. Audit determined that the contra accounts did not reflect bona fide discounts but, rather, were risk-related fees charged by the GSEs and netted before actual payment. On that basis, Audit assessed Taxpayer \$ . . . .<sup>3</sup> Taxpayer timely requested review.

### ANALYSIS

Washington levies and collects from every person with substantial nexus to the state a tax for the act or privilege of engaging in business activities. RCW 82.04.220.<sup>4</sup> Persons are taxed according to their business activity. Generally, business activities that are not otherwise classified are taxed under the "service and other activities" classification. RCW 82.04.290 and WAC 458-20-224. The tax is measured by the application of rates against the value of products, gross proceeds of sales, or gross income of the business as the case may be. *Id.* "Business" includes "all activities engaged in with the object of gain, benefit, or advantage to the taxpayer or another person or class, directly or indirectly." RCW 82.04.140.

RCW 82.04.080(1) defines "gross income of the business" as follows:

"Gross income of the business" means the value proceeding or accruing by reason of the transaction of the business engaged in and includes gross proceeds of sales, compensation for the rendition of services, gains realized from trading in stocks, bonds, or other evidences of indebtedness, interest, discount, rents, royalties, fees, commissions, dividends, and other emoluments however designated, all without any deduction on account of the cost of tangible property sold, the cost of materials

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<sup>2</sup> In previous versions of the Freddie Mac Single-Family Seller/Servicer Guide, these fees were referred to as post-settlement delivery fees.

<sup>3</sup> Document No. . . . includes \$ . . . in Service and Other Activities B&O tax, \$ . . . in interest and a \$ . . . 5% assessment penalty.

<sup>4</sup> RCW 82.04.220 changed in 2017 in ways having no bearing on the issue at hand.

used, labor costs, interest, discount, delivery costs, taxes, or any other expense whatsoever paid or accrued and without any deduction on account of losses.

(Emphasis added).<sup>[5]</sup>

RCW 82.04.090 defines “value proceeding or accruing” as:

"Value proceeding or accruing" means the consideration, whether money, credits, rights, or other property expressed in terms of money, actually received or accrued. The term shall be applied, in each case, on a cash receipts or accrual basis according to which method of accounting is regularly employed in keeping the books of the taxpayer . . . .

Taxpayer's . . . [accounting records report] the [gross sales price] . . . of the mortgages sold to Freddie Mac and Fannie Mae. Offsetting fees and loan level adjustments . . . [are reported] in separate contra asset . . . accounts, which tie the expenses incurred by Taxpayer in selling the asset . . . [to the revenue generated from the sale].

. . . The consideration . . . [received by Taxpayer] in this case includes . . . [both the] amount of money the GSE actually remits to Taxpayer [and the amount retained by the GSEs as payment of the credit fee and loan level price adjustment.] . . . The [amounts retained by the GSEs are] . . . reflected in [Taxpayer's] contra . . . accounts. The credit fee and loan level pricing adjustment are . . . [business expenses that are not deductible from gross income of the business]. Freddie Mac and Fannie Mae only purchase higher risk loans when the seller . . . [agrees to pay these fees]. Taxpayer is in the business of selling its loans. Taxpayer incurs these expenses as part of its business as a seller of mortgages. Audit correctly determined the value proceeding or accruing to Taxpayer from the business included both the consideration actually received and the amount . . . [retained by the GSEs] for selling expenses netted against consideration prior to remittance, which are the amounts reflected in Taxpayer's contra account 5125 under RCW 82.04.090. We deny Taxpayer's petition.

#### DECISION AND DISPOSITION

Taxpayer's petition is denied.

Dated this 29th day of September 2017.

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<sup>5</sup> In its response to Taxpayer's request for review, the Audit Division [asserted] that RCW 82.08.010(1) and WAC 458-20-108 apply in this case. [We disagree.] Those provisions are inapplicable [here. RCW 82.08.010(1) defines “selling price” for purposes of the Washington sales tax code. WAC 458-20-108(5)] explain[s] that certain bona fide discounts are not included in the “selling price” [when] determining the amount subject to retail sales tax. The service & other activities B&O tax is measured by the “gross income of the business,” not the selling price or sales price.