

SENATE BILL REPORT

SB 5475

As Reported by Senate Committee On:
Financial Institutions & Insurance, February 5, 2015

Title: An act relating to the first mortgage interest business and occupation tax deduction.

Brief Description: Concerning the first mortgage interest business and occupation tax deduction.

Sponsors: Senators Benton, Hobbs, Litzow, Angel and Fain.

Brief History:

Committee Activity: Financial Institutions & Insurance: 2/04/15, 2/05/15 [DP-WM, DNP].

SENATE COMMITTEE ON FINANCIAL INSTITUTIONS & INSURANCE

Majority Report: Do pass and be referred to Committee on Ways & Means.

Signed by Senators Benton, Chair; Angel, Vice Chair; Fain, Hobbs and Litzow.

Minority Report: Do not pass.

Signed by Senators Mullet, Ranking Minority Member; Darneille and Pedersen.

Staff: Shani Bauer (786-7468)

Background: Business & Occupation (B&O) Tax. Washington's major business tax is the B&O tax. The B&O tax is imposed on the gross receipts of business activities conducted within the state, without any deduction for the costs of doing business. Revenues are deposited in the state general fund. A business may have more than one B&O tax rate, depending on the types of activities conducted. There are a number of different rates. Interest earned on loans by financial institutions is taxed at 1.5 percent. Credit unions are specifically exempt from B&O taxes.

First Mortgage Interest Deduction. Interest on loans secured by a first mortgage on residential real property, with one to four units, is eligible for a B&O tax exemption if the bank operates in fewer than ten states. Deductible interest includes the portion of fees charged to borrowers, including points and origination fees, that is recognized over the life of a loan as an adjustment to yield in the taxpayer's books and records according to generally accepted accounting principles. The statute provides for a nonexclusive list of items not subject to the deduction including any other fees, or portion of a fee.

This analysis was prepared by non-partisan legislative staff for the use of legislative members in their deliberations. This analysis is not a part of the legislation nor does it constitute a statement of legislative intent.

Since the late 1980s, the Department of Revenue has interpreted the first mortgage interest deduction to apply only to fees, or portions of fees, that are recognized in the taxpayer's books and records as interest. In 2010 the Legislature amended the first mortgage interest deduction to include language limiting the deduction to fees that are recognized over the life of the loan using generally accepted accounting principles and provide clarity in response to and consistent with the Washington Supreme Court Case, *Homestreet, Inc. v. Dept. of Revenue*, 210 P.3d 297 (2009). In 2012 the Legislature further limited the deduction to banks that operate in fewer than ten states.

By June 2015, the Joint Legislative Audit and Review Committee must review the first mortgage interest deduction and make a recommendation as to whether the deduction should be continued without modification, modified, or terminated immediately.

Summary of Bill: The interest deductible under the first mortgage interest deduction is stated to include point and loan origination fees; language referring to generally accepted accounting principles is removed.

As to the nonexclusive list of items not subject to the first mortgage interest deduction, "any other fees, or portion of a fee" is changed by adding "other than points and loan origination fees."

It is the intent of the Legislature that this bill is clarifying a technical inconsistency and is not intended to create a new or expanded tax preference under RCW 82.32.805.

Appropriation: None.

Fiscal Note: Available.

Committee/Commission/Task Force Created: No.

Effective Date: Ninety days after adjournment of session in which bill is passed.

Staff Summary of Public Testimony: PRO: This is identical to a bill that passed out last year. The issue has not been with the policy, but the price tag. Community banks with fewer than ten branches enjoy the B&O exemption for interest and expenses amortized over the life of the loan. There is a small technicality with regard to expenses incurred at the time of creating the loan. These are netted out before amortizing the loan and therefore may not be deducted. This fix would allow those small banks to deduct those costs. We don't believe that banks with fewer than ten branches represent 79 percent of the first mortgage market place. This deduction is extremely important to small vendors making these portfolio loans. We believe that the actual fiscal impact is closer to \$250,000 statewide.

Persons Testifying: PRO: Brad Tower, Community Bankers Assn.