



# Special Notice

WASHINGTON STATE DEPARTMENT OF REVENUE

JUNE 2, 2010

## Limits on Interest Deduction for First Mortgages

### Purpose and effect

Second Engrossed Substitute Senate Bill 6143, Part III (Chapter 23, Laws of 2010, 1st Special Session) clarifies which fees are deductible as interest and which fees are not deductible as interest. It also provides a limited deduction for the type of servicing fees that were at issue in *HomeStreet, Inc. v. Dept of Revenue*, 166 Wn.2d 444 (2009).

### Background

Under RCW 82.04.4292, persons engaged in banking, loan, security or other financial business may deduct interest received on loans primarily secured by first mortgages on non-transient residential properties from gross income. In the case of HomeStreet, the Washington State Supreme Court determined that when a financial business sells qualifying loans and then services those loans for the purchaser, the servicing fee is deductible from the business and occupation (B&O) tax as interest.

### Effective date

The effective date is June 1, 2010.

### Fees that qualify for deductible interest

Financial businesses remain entitled to a deduction for interest on loans or investments primarily secured by first mortgages or deeds of trust on non-transient residential real property. The following fees also constitute deductible interest.

#### ***Points and Loan Origination Fees***

Deductible interest includes the portion of fees charged to borrowers, including points and loan origination fees that are recognized over the life of the loan as an adjustment to yield in the taxpayer's books and records according to generally accepted accounting principles.

#### ***Servicing Fees***

Deductible interest also includes amounts received for servicing loans primarily secured by first mortgages or trust deeds on non-transient residential properties, including such loans that secure mortgage-backed or mortgage-related securities, but only if the person claiming the deduction:

- Originated the loans;
- Acquired the loans through a merger or acquisition of substantially all of the assets of the person who originated the loans; or
- Is under common control with the person that originated the loans

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In addition to the above limitations, the following criteria must be met:

- That person either sold the loans on the secondary market or securitized the loans and sold the securities on the secondary market; and
- The amounts received for servicing the loans are determined by a percentage of the interest paid by the borrower and are only received if the borrower makes interest payments.

**What is not deductible interest**

Deductible interest **does not** include:

- 1) Fees for specific services such as: document preparation fees; finder fees; broker fees; title examination fees; fees for credit checks; notary fees; loan application fees; interest lock-in fees if the loan is not made; servicing fees; and similar fees or amounts;
- 2) Fees received in consideration for an agreement to make funds available for a specified period of time at specified terms, commonly referred to as commitment fees;
- 3) Any other fees, or portion of a fee, that is not recognized over the life of the loan as an adjustment to yield in the taxpayers books and records according to generally accepted accounting principles;
- 4) Gains on the sale of valuable rights such as service release premiums, which are amounts received when servicing rights are sold; and
- 5) Gains on the sale of loans, except deferred loan origination fees and points, deductible as previously described are not to be considered part of the proceeds of the sale of the loan.

**For more information**

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