



# PREPROPOSAL STATEMENT OF INQUIRY

**CR-101 (June 2004)**  
(Implements RCW 34.05.310)  
Do NOT use for expedited rule making

**Agency:** Department of Revenue

**Subject of possible rule making:** WAC 458-20-146 (Rule 146) National and state banks, mutual savings banks, savings and loan associations and other financial institutions.

**Statutes authorizing the agency to adopt rules on this subject:** RCW 82.32.300 and 82.01.060(2)

**Reasons why rules on this subject may be needed and what they might accomplish:** Rule 146 explains how national banks, states banks, mutual savings banks, savings and loan associations, and other financial institutions may be subject to business and occupation tax, retail sales and/or use taxes. It also provides examples of when retail sales tax should be collected from the taxpayers' customers and remitted to the state. The Department is considering revisions to the rule to incorporate information from legislation (ESB 6635, chapter 6, Laws of 2012) that limits which financial businesses are allowed a deduction for interest earnings on loans secured by first mortgages or deeds of trust on residential properties. The Department is also considering including information currently found in ETA 3076 that covers deductibility of interest received on investments or loans primarily secured by first mortgages or trust deeds on nontransient residential properties.

**Identify other federal and state agencies that regulate this subject and the process coordinating the rule with these agencies:** None.

**Process for developing new rule (check all that apply):**

- Negotiated rule making
- Pilot rule making
- Agency study
- Other (describe) Parties interested in this rule making may contact the individual listed below. The public may also participate by providing written comments throughout this rule making or giving oral testimony at the public meeting or public hearing.

**How interested parties can participate in the decision to adopt the new rule and formulation of the proposed rule before publication:**

A preliminary draft of possible rule changes is available via the Department's online [Rules Agenda](#).

Written comments may be submitted by mail and should be directed to Gayle Carlson at either of the following addresses: email: [GayleC@dor.wa.gov](mailto:GayleC@dor.wa.gov), or mailing address: ITA Division, PO Box 47453, Olympia, WA 98504-7453.

Written and oral comments will be accepted at the public meeting.

**Public meeting location:**

Capitol Plaza Building  
1<sup>st</sup> Floor Conference Room  
1025 Union Avenue SE  
Olympia, Washington

**Assistance for persons with disabilities:**

Contact Mary Carol LaPalm (360) 725-7499 or Renee Cosare (360) 725-7514 no later than 10 days before the meeting date. For Hearing Impaired please contact us via the Washington Relay Operator at (800) 833-6384.

*Call in option can be provided upon request no later than 3 days before the meeting date.*

**Date:** December 4, 2014 **Time:** 9:00 A.M.

**Date**  
October 22, 2014

**Name**  
Dylan Waits

**Signature**

**Title**  
Rules Coordinator

**CODE REVISER USE ONLY**

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STATE OF WASHINGTON  
FILED

**DATE:** October 22, 2014  
**TIME:** 7:30 AM

**WSR 14-21-161**

AMENDATORY SECTION (Amending WSR 10-06-069, filed 2/25/10, effective 3/28/10)

**WAC 458-20-146 National and state banks, mutual savings banks, savings and loan associations and other financial institutions.**

**(~~Business and Occupation Tax~~)**

~~The gross income of national banks, states banks, mutual savings banks, savings and loan associations, and certain other financial institutions is subject to the business and occupation tax according to the following general principles.~~

~~**Services and other activities.** Generally, the gross income from engaging in financial businesses is subject to the business and occupation tax under the classification service and other activities. Following are examples of the types of income taxable under this classification: Interest earned (including interest on loans made to nonresidents unless the financial institution has a business location in the state of the borrower's residence which rendered the banking service), commissions earned, dividends earned, fees and carrying charges, charges for bookkeeping or data processing, safety deposit box rentals. See WAC 458-20-14601 Financial institutions Income apportionment.~~

~~The term "gross income" is defined in the law 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 used, labor costs, interest, discount, delivery costs, taxes, or any other expense whatsoever paid or accrued and without any deduction on account of losses.~~

~~The law allows certain deductions from gross income to arrive at the taxable amount (the amount upon which the business and occupation tax is computed). Deductible gross income should be included in the gross amount reported on the excise tax return and should then be shown as a deduction and explained on the deduction schedules. The deductions generally applicable to financial businesses include the following:~~

~~(1) Dividends received by a parent from its subsidiary corporations (RCW 82.04.4281).~~

~~(2) Interest received on investments or loans primarily secured by first mortgages or trust deeds on nontransient residential properties. (See WAC 458-20-166 for definition of "transient.") (RCW 82.04.4292.)~~

~~(3) Interest received on obligations of the state of Washington, its political subdivisions, and municipal corporations organized pursuant to the laws thereof. (RCW 82.04.4291.) A deduction may also be taken for interest received on direct obligations of the federal government, but not for interest attributable to loans or other financial obligations on which the federal government is merely a guarantor or insurer.~~

(4) ~~Gross proceeds from sales or rentals of real estate (RCW 82.04.390). These amounts may be entirely excluded from the gross income reported and need not be shown on the return as a deduction.~~

~~**Retailing.** Sales of tangible personal property and certain services are defined as "retail sales" and are subject to the business and occupation tax under the classification retailing. Such sales are also subject to the retail sales tax which the seller must collect and remit to the department of revenue (department). Transactions taxable as sales at retail are not subject to tax under service and other activities.~~

~~Following are examples of transactions subject to the retailing classification of the business and occupation tax and to the retail sales tax: Sales of meals or confections, sales of repossessed merchandise, sales of promotional material, leases of tangible personal property, sales of check registers, coin banks, personalized checks (note: When the financial institution is not the seller of these items but simply takes orders as agent for the supplier, the supplier is responsible for reporting as the retail seller. The financial institution has liability for reporting the retail sales tax on sales made as an agent only if the supplier is an out of state firm not registered with the department), escrow fees, casual sales (occasional sales of depreciated assets such as used furniture and office equipment subject to retail sales tax but deductible from the business and occupation tax; see WAC 458-20-106 Casual or isolated sales Business reorganizations).~~

~~**Sales for resale.** When a financial institution buys tangible personal property for resale to its customers without intervening use, the sales tax is not applicable. In this case the financial institution should give the vendor a resale certificate for purchases made before January 1, 2010, or a reseller permit for purchases made on or after January 1, 2010, to document the wholesale nature of any sale as provided in WAC 458-20-102A (Resale certificates) and WAC 458-20-102 (Reseller permits). Even though resale certificates are no longer used after December 31, 2009, they must be kept on file by the seller for five years from the date of last use or December 31, 2014.~~

#### **Use Tax**

~~The use tax complements the retail sales tax by imposing a tax of like amount on the use of tangible personal property purchased or acquired without payment of the retail sales tax. Thus, when office equipment or supplies are purchased or leased from an unregistered out-of-state vendor who does not collect the Washington state retail sales tax, the use tax must be paid directly to the department. Space for the reporting of this tax will be found on the excise tax return. (For more information, see WAC 458-20-178 Use tax.)~~

~~**When tax liability arises.** Tax should be reported during the reporting period in which the financial institution receives, becomes legally entitled to receive, or in accord with the system of accounting regularly employed enters the consideration as a charge against the client, purchaser or borrower. Financial institutions may prepare excise tax returns to the department reporting income in periods which correspond to accounting methods employed by each institution for its normal accounting purposes in reporting to its supervisory authority.)~~

~~(1) **Introduction.** This rule explains how the gross income of national banks, state banks, mutual savings banks, saving and loan asso-~~

ciations, and certain other financial institutions is taxable. Effective June 1, 2010, Washington adopted new economic nexus thresholds and apportionment methods. Out-of-state businesses may now be required to register and report apportionable income to Washington under the service and other activities business and occupation (B&O) tax classification. For more information on economic nexus and apportionment see WAC 458-20-19401 (Minimum nexus thresholds for apportionable activities) and 458-20-19404 (Financial institutions—Income apportionment).

**What other rules might apply?** Readers may want to refer to the rules in the following list for additional relevant information:

(a) WAC 458-20-102, Reseller permits.

(b) WAC 458-20-14601, Financial institutions—Income apportionment, for tax liability incurred through May 31, 2010.

(c) WAC 458-20-178, Use tax.

(d) WAC 458-20-19401, Minimum nexus thresholds for apportionable activities.

(e) WAC 458-20-19404, Financial institutions—Income apportionment, for tax liability incurred on and after June 1, 2010.

(f) WAC 458-20-19405, CPI-U adjustments to minimum nexus thresholds for apportionable activities.

(2) **Definitions.** The following definitions apply to this rule.

(a) **Banking business.** "Banking business" means a person engaging in business as a national or state-chartered bank, a mutual savings bank, a saving and loan association, a trust company, an alien bank, a foreign bank, a credit union, a stock savings bank, or a similar entity that is chartered under Title 30, 31, 32, or 33 RCW, or organized under Title 12 U.S.C. See RCW 82.04.4281.

(b) **Financial institution.** "Financial institution" has the same meaning as found in WAC 458-20-14601 (prior to June 1, 2010) and 458-20-19404 (effective June 1, 2010).

(c) **Gross income of the business.** "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, discounts, 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 used, labor costs, interest, discounts, delivery costs, taxes, or any other expense whatsoever paid or accrued and without any deduction on account of losses.

(d) **Loan and extension of credit.** The terms "loan" and "extension of credit" do not include ownership of or trading in publicly traded debt instruments, or substantially equivalent instruments offered in a private placement. See RCW 82.04.4281.

(3) **Service and other business activities.** Generally the gross income of national banks, state banks, mutual savings banks, saving and loan associations, and certain other financial institutions is subject to the B&O tax under the service and other activities tax classification. Examples of the type of income taxable under service and other activities include, but are not limited to, interest earned (including interest on loans made to nonresidents), commissions earned, dividends earned, fees and carrying charges, charges for book-keeping, and safe deposit box rentals. Financial institutions must determine gains realized from trading in stocks, bonds, and other evidences of indebtedness on a net annualized basis.

(4) **Retail sales.** Sales of tangible personal property and certain services are defined as retail sales and are subject to the B&O tax under the retailing B&O tax classification. Sellers must collect the retail sales tax from the buyer and remit it and the B&O tax to the department of revenue (department).

(a) **Examples of retail sales include sales of:**

- (i) Meals or confections;
- (ii) Escrow services;
- (iii) Repossessed merchandise;
- (iv) Promotional materials;
- (v) Check registers;
- (vi) Coin banks; and
- (vii) Personalized checks.

When the financial institution is not the seller of personalized checks but takes orders as agent for the supplier, the supplier is responsible for reporting as the retail seller. The financial institution has liability for reporting the retail sales tax on sales made as an agent only if the supplier is an out-of-state firm not registered with the department.

(b) **True lease or financing lease.** For taxability of a "true lease," often referred to as an "operating lease" and a "financing lease," often referred to as a "capital lease," see WAC 458-20-211, Leases or rentals of tangible personal property, bailments.

(c) **Casual sales.** For occasional sales of depreciated assets such as used furniture and office equipment, see WAC 458-20-106 Casual or isolated sales—Business reorganizations.

(d) **Bank owned property repairs.** Gross income from cleaning, improving, repairing or the altering of real or personal property of bank owned, often referred to as real estate owned (REO) properties, is subject to the retailing B&O tax and retail sales tax. The financial institution owes use tax if the person providing the services does not collect retail sales tax, unless an exemption is available.

(5) **When tax liability arises.** Tax should be reported to the department for the reporting period in which the taxpayer receives, becomes legally entitled to receive, or in accord with the system of accounting regularly employed enters the consideration as a charge against the client, purchaser or borrower. A financial institution may report income in periods that correspond to accounting methods employed by the institution for its normal accounting purposes in reporting to its supervisory authority.

(6) **Wholesale sales.** Purchases of tangible personal property for resale in the regular course of business without intervening use are not subject to retail sales tax. Persons purchasing tangible personal property for resale must furnish a copy of their reseller permit to the seller to document the wholesale nature of the sale. Reseller permits replaced resale certificates effective January 1, 2010. See WAC 458-20-102 for additional information on reseller permits.

(7) **Use tax.** Use tax complements the retail sales tax, and in most cases mirrors the retail sales tax. Articles of tangible personal property used or certain services purchased in Washington are subject to use tax when the state's retail sales tax has not been paid, or where an exemption is not available. Tangible personal property or services used or purchased by the user in any manner are taxable including, but not limited to:

- (a) Purchases directly from out-of-state sellers;

(b) Purchases through the internet, telemarketing, and mail order;

(c) Acquisitions at casual or isolated sales; or

(d) Items purchased for use as gifts or incentives.

See WAC 458-20-178 for additional information on use tax.

(8) **Deductions.** Deductible amounts should be included in the gross income reported on the excise tax return and then identified on the appropriate deduction detail line of the excise tax return to determine the amount of taxable income.

(a) **Investments, dividends, interest on loans.** The following B&O tax deductions are generally applicable to financial businesses under RCW 82.04.4281:

(i) Amounts obtained as dividends or distributions from the capital account by a parent from its subsidiary entities; and

(ii) Amounts obtained from interest on loans between subsidiary entities and a parent entity or between subsidiaries of a common parent entity, but only if the total investment and loan income is less than five percent of gross receipts of the business annually.

(b) **Interest on investments or loans secured by mortgages or deeds of trust on nontransient residential properties.** RCW 82.04.4292 provides a deduction for interest from the measure of tax by those engaged in banking, loan, security or other financial businesses. For the interest to be deductible, the investments or loans must be primarily secured by first mortgages or trust deeds on nontransient residential properties. For purposes of this deduction, "nontransient residential property" includes, but is not limited to: Single-family residences (one to four units); apartments, nontransient trailer park sites.

(i) For purposes of this deduction, interest on first mortgages or trust deeds may qualify on the following three types of nontransient residential property:

(A) Property zoned for residential use with a residence located on it;

(B) Property zoned for residential use without a residence located on it; but where there is a commitment or requirement on the borrowers to construct nontransient residences on the property; and

(C) Property not so zoned but with a residence located on it. In these situations, where the values of the structure and the bare land are combined together for the loan, the value of the structure must exceed the bare land value in order for the deduction to apply.

(ii) First mortgages and deeds of trust secured by the following types of property do not qualify for the RCW 82.04.4292 deduction:

(A) Land zoned for residential use but undeveloped and where there is no commitment or requirement on the borrower to develop the property.

(B) Property such as permanent care nursing homes or permanent care convalescent homes regardless of the normal length of stay of the occupants; hotels or motels; transient apartments where occupants stay less than thirty days; or churches.

(C) Property used for both residential and business purposes will not be considered nontransient residential property if that part of the value of the property attributable to the business use exceeds twenty percent of the total value of the property.

(iii) Effective July 1, 2012, RCW 82.04.29005 limits the deduction. It does not allow deductions for loan interest received by persons who originated the loans and who (or affiliates) are located in more than ten states. The interest on these loans, primarily secured

by first mortgages or trust deeds on nontransient residential properties, is taxable under RCW 82.04.290.

(c) **Interest on obligations of the state, its political subdivisions, and municipal corporations.** RCW 82.04.4293 provides a deduction for those in banking, loan, security or other financial businesses, of interest received on all obligations of the state of Washington, its political subdivisions, and municipal corporations.

(d) **Interest on loans to farmers and ranchers.** RCW 82.04.4294 provides a deduction for interest received on loans to bona fide farmers and ranchers, producers or harvesters of aquatic products, or their cooperatives by a lending institution owned exclusively by its borrowers or members that is engaged solely in the business of making loans and providing finance-related services to bona fide farmers and ranchers, producers or harvesters of aquatic products, their cooperatives, rural residents for housing, or persons engaged in furnishing farm-related or aquatic-related services to those individuals or entities.

(e) **Interest earned by cooperative finance organizations.** RCW 82.04.43394 provides for a deduction for the interest income earned by a cooperative finance organization where the interest is earned on loans to rural electric cooperatives or other nonprofit or governmental providers of utility services organized under the laws of Washington state. This deduction is scheduled to expire July 1, 2017.

(9) **Exemptions.**

(a) **Sales of real estate.** RCW 82.04.390 provides a B&O tax exemption for gross proceeds derived from the sale of real estate. In addition, under current case law, the gross proceeds derived from rentals of real estate are immune from B&O tax. These amounts may be excluded from the gross proceeds reported on the excise tax return. The exemption and immunity do not include amounts received as commissions for the sale of real estate, nor as fees, handling charges, discounts, interest or similar financial charges resulting from, or relating to, real estate transactions. Also, see WAC 458-20-118, Sale or rental of real estate, license to use real estate. Sales of real property are generally subject to real estate excise tax. See chapter 458-61A WAC for general information and taxability of real property transfers.

(b) **Credit unions.**

(i) **Business and occupation tax.** RCW 82.04.405 provides a B&O tax exemption for gross income of credit unions organized under the laws of Washington, any other state, or the United States.

(ii) **Retail sales and use taxes.** Federally chartered credit unions are immune from paying retail sales and use taxes on goods and services. For additional information on sales to the federal government, see WAC 458-20-190. This immunity does not extend to contractors working for the federal government.

State credit unions are not exempt from retail sales and must pay the tax on purchases of goods and services. If sales tax is not paid at the time of purchase, use tax is due, unless an exemption is available.