No. 89367-5

SUPREME COURT
OF THE STATE OF WASHINGTON

No. 42514-9-II

DIVISION II, COURT OF APPEALS
OF THE STATE OF WASHINGTON

CASHMERE VALLEY BANK,

Appellant,

v.

STATE OF WASHINGTON,
DEPARTMENT OF REVENUE,

Respondent.

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APPELLANT'S PETITION FOR REVIEW

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I. IDENTITY OF PETITIONING PARTY

Petitioner Cashmere Valley Bank ("Cashmere"), Appellant in the Court of Appeals, petitions for review of the decision terminating review identified below.

II. COURT OF APPEALS DECISION TO BE REVIEWED

Cashmere seeks review of the Published Opinion ("Decision") issued on July 9, 2013. A copy of the Decision is attached as Appendix A.[1] Cashmere timely moved for reconsideration, which was denied on August 16, 2013. A copy of the order denying reconsideration is attached in Appendix B.

III. STATEMENT OF ISSUE PRESENTED FOR REVIEW

The issues presented for review arise out of RCW 82.04.4292, which reads as follows:

> In computing tax there may be deducted from the measure of tax 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.

RCW 82.04.4292; *see* Decision at 4.[2] The Court of Appeals held that Cashmere did not qualify for this deduction because it had no legal recourse against the first mortgages and deeds of trust on nontransient

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[1] All citations are to the Slip Opinion version (App. A), which is reported at ___ P.3d ___, 2013 WL 3456752 (Wash. App. Div. 2 2013).

[2] RCW 82.04.4292 quoted above is the version in effect in the years 2004 to 2007. *See* Decision at 1, n.1. RCW 82.04.4292 was amended in 2010 and 2012. *Id.* (citing LAWS OF 2010, 1ST Spec. Sess., ch. 23, § 301; LAWS OF 2012, 2d Spec. Sess., ch. 6, § 102). Except as otherwise noted, this petition will refer to the statute as it existed in the years 2004-2007.

residential properties that secured its investment. *See* Decision at 1. As explained more fully below, this decision conflicts with this Court's decision in *HomeStreet, Inc. v. Dep't of Revenue*, 166 Wn.2d 444, 210 P.3d 297 (2009), the Court of Appeals' decision in *Dep't of Revenue v. Security Pacific Bank*, 109 Wn. App. 795, 38 P.3d 354 (2002), and involves issues of substantial public interest. *See* RAP 13.4(b)(1), (2) and (4).

IV. STATEMENT OF THE CASE

Cashmere is a Washington bank that was established in Cashmere, Washington in 1932, and still maintains its principal place of business in that city. CP 12 (First Amended Complaint ¶ 1). Cashmere operates branches in several Central Washington cities and also has a municipal banking office in Bellevue. CP 13 (Complaint ¶ 4); *see* https://www.cashmerevalleybank.com/history.htm. Cashmere's business includes personal and business banking, mortgage, insurance, investment, leasing and municipal services. *Id.*

The respondent Department of Revenue ("Department") audited the books and records of Cashmere for the period January 1, 2004, through December 31, 2007 (sometimes referred to as the "Audit Period"), and issued an audit report and tax assessment on May 12, 2009. CP 13 (First Amended Complaint ¶¶ 5, 6; *see* CP 22-32). The audit assessed additional business and occupation ("B&O") taxes under the Service classification (RCW 82.04.290) in the amount of $349,726.00 (including interest).

CP 22 (Tax Assessment Number 200918044).[3] Cashmere paid the assessment in full on June 4, 2009. CP 13 (First Amended Complaint ¶ 7).

During the Audit Period, Cashmere maintained a portfolio of investments, the purpose of which was to optimize Cashmere's earnings within a comprehensive risk management structure balancing earnings, risk, and liquidity. CP 124 (Crain Declaration ¶ 4). Cashmere's investments were guided by an Investment Policy (CP 209-225) that permitted Cashmere to invest in certain securities, including Collateralized Mortgage Obligations ("CMOs") and Real Estate Mortgage Investment Conduits ("REMICs"). CP 123-124 (Crain Declaration ¶¶ 3, 5).[4] The Investment Policy required these securities to be issued either by the U.S. Government or a government-sponsored agency such as Ginnie Mae, Fannie Mae, or Freddie Mac, or under a private label if the security was of sufficient quality and maturity so as not to expose the Bank to unnecessary risk of principal. CP 124 (¶ 4); CP 215-18.[5]

Mortgage-backed securities like CMOs and REMICs are pools of mortgages in which investors receive an interest in a payment stream of principal and/or interest from mortgage loans on a pass-through basis. CP 124 (Crain Declaration ¶ 6). REMICs diversify the risk by carving up

[3] Cashmere made a payment of $3,548.00 against the assessment on October 24, 2008, making the net amount of the tax assessment $346,178.00. CP 22.

[4] CMOs and REMICs are essentially the same type of investment instrument with REMICs enjoying certain federal tax benefits and being of a more recent vintage. *See* Decision at 7, n.7.

[5] Thus, Cashmere neither could nor did invest in pools containing the so-called "subprime" loans that became the source of much controversy following the financial market crash of September 2008.

the cash flows into specific classes (known as "tranches"), from which investors receive payments of principal and/or interest over a shorter period of time (5 years, 10 years, 15 years) than the 30 years that is the term or payment period of a typical mortgage. *Id.*[6] In all cases, the underlying loans that made up the REMICs in which Cashmere invested were primarily secured by first mortgages or deeds of trust on nontransient residential real properties. CP 125 (Crain Declaration ¶ 8).[7]

On July 22, 2009, Cashmere filed a complaint in Thurston County Superior Court (CP 3-11), alleging it overpaid its B&O taxes from three specific revenue sources: (1) mortgage service fees; (2) interest income from investments in SBA Pools Certificates; and (3) interest income from investments in REMICs and CMOs. CP 5. Shortly before Cashmere Valley Bank filed its complaint this Court decided *HomeStreet*. Since the mortgage service fees at issue in the Cashmere audit were identical to the fees at issue and decided in *HomeStreet*, the Department agreed to refund

[6] In addition to actual REMIC documents, the record includes a number of descriptions of how REMICs are created and operate. One such description was from the global investment firm PIMCO. *See* CP 277-78 (citing *Mortgage-Backed Securities* (Feb. 2009) (http://www. pimco.com/Pages/MortgageBackedSecurities.aspx)). Another example came from Freddie Mac. *See* CP 278 (citing Kelman, A., *Mortgage-backed Securities & Collateralized Mortgage Obligations: Prudent CRA INVESTMENT Opportunities* (March 2002)).

[7] The record contains numerous instances confirming this fact, including representative samples of the REMICs in which Cashmere invested during the Audit Period. One of those was Fannie Mae REMIC Trust 2000-38. CP 355-379. The Prospectus Supplement of this REMIC stated: "The mortgage loans underlying the Fannie Mae MBS [mortgage backed security] and the Ginnie Mae certificates are first lien, single family, fixed-rate loans." CP 355 (bracketed inclusion added). Another Fannie Mae Single-Family REMIC Prospectus, in the record at CP 697-753, likewise stated: "The assets of the trust will include certain underlying securities typically issued and guaranteed by us or by Ginnie Mae. These underlying securities represent the ownership of pools of residential mortgage loans secured by single-family properties." CP 697.

the B&O taxes Cashmere paid on mortgage service fees, and a Notice of Partial Resolution accordingly was filed with the trial court. CP 905-906. The SBA Pool issue was decided in a summary judgment proceeding in favor of the Department, CP 299-301, and from which Cashmere did not appeal. On July 22, 2011, in a second summary judgment proceeding, the Superior Court (Hon. Paula Casey) heard the CMO and REMIC issue and ruled for the Department (*see* VRP 50-53), holding that Cashmere was not entitled to deduct the interest it received from investments in REMICs because:

> Cashmere [Valley] Bank had no ownership interest in the underlying loans or the mortgages on the real estate. In fact, it is clear and no one disputes that the REMICs themselves are unsecured investments. Accordingly, I find that they are not entitled to a deduction under RCW 82.04.429(2) [*sic*].

VRP at 52.[8]

An order denying Cashmere's motion for summary judgment and granting summary judgment to the Department of Revenue was entered at

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[8] Contrary to the statement of the court, the record is replete with instances that describe Cashmere's *beneficial* ownership interest in the underlying loans and mortgages, including the following from the representative REMIC prospectus documents:

> Each series of Certificates . . . represent the *beneficial ownership interest in the series trust* created by the Trust Agreement . . . . *Each series trust will consist of (i) underlying securities which represent (directly or indirectly) all or part of the beneficial ownership **in pools of single-family residential mortgage loans** generally* in first-lien position and (ii) the trust account, including all cash and investments in the trust account (the "Trust Account").
>
> . . .
>
> In general, each underlying security will represent a direct or indirect *beneficial ownership interest **in a pool of mortgage loans**.*

CP 710, 723; *see* Appellant's Reply Brief at 14 (italic and bold emphasis added). The Court of Appeals expressly acknowledged Cashmere's beneficial ownership interest. *See* Decision at 8, n.10.

the conclusion of the hearing. CP 896-98.[9] Cashmere then timely appealed to the Court of Appeals. CP 899-902. The Court of Appeals issued the Decision on July 9, 2013, holding that "[b]ecause Cashmere does not have any legal recourse to the mortgages and trust deeds underlying its investments, its investments are not primarily secured by them" and, therefore, the trial court was affirmed. Decision at 1. Cashmere timely moved for reconsideration, which the Court of Appeals denied on August 16, 2013. *See* App. B.

V. ARGUMENT IN SUPPORT OF GRANTING REVIEW

A. The Decision Is In Conflict With Decisions of the Supreme Court and the Court of Appeals.

Prior to this case, the Department's interpretation of RCW 82.04.4292 had come before the courts in two previous published decisions. The first was *Dep't of Revenue v. Security Pacific Bank*, 109 Wn. App. 795, 38 P.3d 354 (2002), in which the Court of Appeals ruled that Security Pacific Bank ("Security") was entitled to the RCW 82.04.4292 deduction for interest received on loans primarily secured by first mortgages or trust deeds on nontransient residential properties. In that case Security earned interest on advances it made to mortgage companies. *Id.* at 798. The mortgage companies used the advances to fund loans to third party borrowers. *Id.* The advances were primarily secured by first lien deeds of trust on nontransient residential properties

[9] The interest income Cashmere received from CMO and REMIC investments during the Audit Period was $17,837,861, and the amount of the Department's assessment, representing the B&O tax on this income, was $267,568. Decision at 2, n.2.

and the court held that Security qualified for the deduction on the interest it received from these loans.

The second, and more recent, case was *HomeStreet*. 166 Wn.2d 444, 210 F.2d 297 (2009). In that decision, HomeStreet made residential mortgage loans which, in some cases, were sold to secondary lenders with HomeStreet retaining the right to service the loan. *Id.* at 447-48. In exchange for the servicing rights HomeStreet received a fee, which was paid from a portion of the interest paid by the borrower on the loan. This Court held that "[u]nder the plain meaning of RCW 82.04.4292 tax deductions are allowed for 'amounts derived from interest,' and the amount HomeStreet retained when servicing the loans is derived from the interest on the loans." *Id.* at 455. HomeStreet therefore was entitled to the RCW 82.04.4292 deduction "because the amounts it receives are derived from interest." *Id.* at 451.

1. The Decision Is In Conflict With This Court's Decision in *HomeStreet*.

In *HomeStreet* this Court stated that RCW 82.04.4292 "contains five elements" and "[a]ll five elements of the statute must be met for the taxpayer to receive a deduction." *HomeStreet*, 166 Wn.2d at 449.[10] In

[10] "1. The person is engaged in banking, loan, security, or other financial business;

2. The amount deducted was derived from interest received;

3. The amount deducted was received because of a loan or investment;

4. The loan or investment is primarily secured by a first mortgage or deed of trust; and

5. The first mortgage or deed of trust is on nontransient residential real property."

Id.

HomeStreet, only the second element was in dispute. *Id.* In this case, only the fourth element is in dispute.[11] Regardless, this Court held that RCW 82.04.4292 contains *only* five elements and *only* these five elements (*see* n.10, *supra*) must be satisfied for a taxpayer to receive the tax deduction.

The Decision conflicts with *HomeStreet* because it ignores the plain language of the statute and creates a ***sixth*** element to qualify for the deduction -- that the taxpayer must have "legal recourse to the mortgages and trust deeds underlying [the] investments." Decision at 1. In other words, the Decision holds that if the investor has no "legal recourse" the "investments are not primarily secured by" them and because Cashmere itself cannot foreclose on the underlying collateral it "has no recourse to that ultimate source of payments." *Id.* at 1, 14. In making this ruling the Court of Appeals reads an element into RCW 82.04.4292 which is not found in the plain language of the statute and conflicts with this Court's decision in *HomeStreet*.

This Court previously declared RCW 82.04.4292 to be "unambiguous." *HomeStreet*, 166 Wn.2d at 454.[12] "Statutory

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[11] Decision at 5 ("As Cashmere correctly points out, the only element in question here is the fourth -- whether the investments Cashmere made in REMICs and CMOs were primarily secured by first mortgages or deeds of trust").

[12] The Court of Appeals held the statute to be "ambiguous" because there were "two reasonable interpretations" for the phrase "investments or loans." *See* Decision at 11. Yet, there was never a dispute over the phrase "investments or loans." Instead, the only dispute was "whether the investments Cashmere made in REMICS and CMOs were primarily secured by first mortgages or deeds of trust." *Id.* at 5. The Court of Appeals looked to the Legislature's 2010 amendment to RCW 82.04.4292 to resolve this "ambiguity." *See* Decision at 12 (citing LAWS OF 2010, 1st Spec. Sess., Ch. 23, § 301). The 2010 amendment, however, had nothing to do with the issue presented in this case, but was in response to the *HomeStreet* decision of this Court, which dealt with loans and mortgage service fees, a fact made perfectly clear by the amendment's legislative history.

(Footnote is continued on next page.)

interpretation begins with the plain language of the statute." *Security Pacific Bank*, 109 Wn. App. at 804, n.5 (citing *Lacey Nursing Ctr., Inc. v. Dep't of Revenue*, 128 Wn.2d 40, 53, 905 P.2d 338 (1995)). When the "statute is unambiguous and subject to only one interpretation, it is unnecessary to look any further." *HomeStreet*, *supra*. Under the plain language of RCW 82.04.4292, the deduction is available to any bank if all five elements of the statute are met, including the requirement that the investment or loan be "primarily secured by first mortgages or trust deeds on nontransient residential properties." RCW 82.04.4292. As the statute plainly and unambiguously states, the deduction covers investments *or* loans primarily secured by mortgages and trust deeds on nontransient residential properties. The deduction, by its terms and as outlined by this Court in *HomeStreet*, does not depend on whether the investor itself has "recourse" to the "underlying mortgages and trust deeds" and to the "ultimate source of payments." Decision at 14. The deduction depends on whether the investments themselves are secured by first mortgages and trust deeds on nontransient residential properties, and there is no requirement in RCW 82.04.4292, as the statute was interpreted by this Court in *HomeStreet*, to

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See Appendix C, *Department of Revenue Fiscal Note*, at page 6 ("Recently the Washington Supreme Court held that the deduction includes amounts retained as servicing fees by lenders after the loan is sold on the secondary market. . . . This bill limits the first mortgage interest deduction by providing that certain fees for services and gains on the sale of loans or other valuable rights are not deductible. However, a deduction is allowed for certain loan servicing fees"). There is nothing in this amendment to suggest that it was intended to clarify the supposedly ambiguous meaning of the phrase "investments or loans."

require the investor to personally have "some recourse against [the] collateral." *See* Decision at 3.

The underlying mortgages and trust deeds in the CMO and REMIC investments here were unquestionably secured by first mortgages and trust deeds, and the Court of Appeals even acknowledged this fact.[13] But, according to the Court of Appeals, it does not follow that mortgage-backed securities like CMOs and REMICs are secured investments if the investor does not have recourse against the security. Yet while the investors themselves may not be allowed to foreclose, there is a trustee who is obligated to protect the investors' interests and the trustee does have the right -- indeed, the obligation -- to foreclose. CP 763. The Decision rests on the evidently false premise that Cashmere is not protected by this obligation of the trustee if the homeowner defaults in making the payments. *See* Decision at 1, 14. The right to foreclose is undeniably present and it should not matter if that right is exercised by the trustee, instead of by Cashmere or any of the other investors or beneficiaries.

Had the Legislature intended the investor to have recourse against the collateral, it would have written RCW 82.04.4292 to impose that requirement. In that case, the statute would have read something to the effect, "In computing tax there may be deducted from the measure of tax . . .

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[13] Decision at 9 ("Cashmere points out that the mortgages underlying these [CMO and REMIC] investment instruments were primarily secured by first mortgages or deeds of trust and that the interest income Cashmere received was traceable to the interest payments borrowers made on these mortgages. Cashmere's observations are correct.").

amounts derived from interest received on investments . . . primarily secured by first mortgages or trust deeds on nontransient residential properties *in which the investor has direct recourse against the underlying security*" (new language in italics). But the Legislature did not write the statute in this manner, nor did it impose this additional element upon a bank to qualify for the deduction. Courts are not allowed to add language to a statute, and to do so violates "the rule of statutory interpretation prohibiting courts from adding words or clauses to an unambiguous statute when the legislature has chosen not to include that language." *State v. Kintz*, 169 Wn.2d 537, 549-550, 238 P.3d 470 (2010) (citing *State v. Delgado*, 148 Wn.2d 723, 727, 63 P.3d 792 (2003); *State v. Thompson*, 151 Wn.2d 793, 800-01, 92 P.3d 228 (2004)).

The Court of Appeals never explains why it believes that having a trustee exercise the right of foreclosure, rather than the investor directly, should render Cashmere, or any other similarly situated investor, unsecured. The fact remains that there *is* a right to foreclose, and the trustee has a fiduciary duty to exercise that power to protect the interests of the investors as beneficiaries of the interest payments. Nothing in the plain and unambiguous language of RCW 82.04.4292, as interpreted by this Court in *HomeStreet*, supports the Court of Appeals' conclusion that the investor must be able to exercise the right of foreclosure directly, rather than be able to rely upon a trustee to exercise it, to claim the status of a "secured" investment. The Decision thus conflicts with *HomeStreet* and warrants review under RAP 13.4(b)(1).

2. The Decision Conflicts With the Decision of the Court of Appeals in *Security Pacific Bank*.

The Decision conflicts in several ways with the Court of Appeals' prior decision in *Security Pacific Bank.*

- First, even though the Court of Appeals acknowledges that investments in REMICs represent "beneficial ownership interests in . . . trust[s] holding the underlying mortgages" (Decision at 8, n. 10), it went on to dismiss this fact based on the erroneous assumption that the investment and resulting security was solely represented by a mortgage note:

> . . . the nature of investments in REMICs and CMOs [are] essentially interests in bonds (debt), not ownership (equity); the issuer is still the owner of the respective mortgage *notes*. *See*, *e.g.*, CP at 845 ("Fannie Mae is at all times the owner of the mortgage *note*, whether the note is in of portfolio or whether we own it as trustee for [a mortgage-backed security] trust.").

Decision at 8, n.10 (emphasis added).[14] This conclusion conflicts with *Security Pacific Bank* -- and also *HomeStreet*, for that matter -- because the B&O deduction is not dependent on who owns the security, but on whether the investment is primarily secured by first mortgages or trust deeds on nontransient residential properties. RCW 82.04.4292.

- Second, the Decision conflicts with the holding of *Security Pacific Bank* that a promissory note is not a mortgage or deed of trust and that the note, by itself, provides no security at all because a "promissory note is merely a promise to pay -- it is not security." *Security Pacific*

[14] In acknowledging that Cashmere has a beneficial ownership interest in the loans and mortgages, the Court of Appeals effectively overruled the trial court's finding that Cashmere "had no ownership interest in the underlying loans or the mortgages on the real estate." VRP 51-52.

Bank, 109 Wn. App. at 808, n.11 (citing *Reid v. Cramer*, 24 Wn. App. 742, 744, 603 P.2d 851 (1979) ("As between the maker and the payer, a promissory note is but a simple contract to pay money"); *Vancouver Nat'l Bank v. Katz*, 142 Wash. 306, 313, 252 P. 934 (1927) (same)). "A deed of trust . . . provides security to back a promise to pay and can be foreclosed after default on the note." *Security Pacific Bank*, *supra*, n.12 (citing *Kezner v. Landover Corp.*, 87 Wn. App. 458, 464-465, 942 P.2d 1003 (1997), *review denied*, 134 Wn.2d 1020 (1998) (deeds of trust are a "security device" that "may be enforced by nonjudicial foreclosure"); *cf.* RCW 70.105D.020 (27) ("Security interests include deeds of trusts[.]").

The Decision suggests that the CMOs and REMICs here were secured by promissory notes. *See* Decision at 8, n.10. But the courts, including the Court of Appeals in *Security Pacific Bank*, have made it quite clear that promissory notes do not represent collateral or security. In *Security Pacific Bank*, the Department argued that the loans made by Security were secured only by promissory notes (and not deeds of trust) and, therefore, the bank was not entitled to the B&O tax deduction for the interest income it received. The Court of Appeals found that argument "unpersuasive" for the reason that there is a fundamental legal distinction between promissory notes and deeds of trust:

> If the Department's argument were correct, then Security received no real property collateral for the millions of dollars it advanced to the mortgage companies. The Board [of Tax Appeals] rejected this absurdity [footnote omitted] and found that "[t]he assigned collateral consisted of a first lien deed of trust originated by the mortgage company, together with the home buyer's promissory notes that were endorsed in blank."

Security Pacific Bank, 109 Wn. App. at 808-09 (internal citations omitted). Here the record reflects that, if a borrower defaults on a loan that is part of a CMO or REMIC pool, the trustee *on behalf of the investors,* will resort to the underlying security (the mortgages or deeds of trust) pledged to secure the loans. CP 763. The Decision effectively concludes that Cashmere received no real property collateral for the hundreds of millions of dollars invested in the CMO and REMIC securities.[15] In the Court of Appeals' prior words, this is an "absurdity" (*Security Pacific Bank*, 109 Wn. App. at 808) because it assumes that Cashmere, a small community bank would make investments of this magnitude without appropriate collateral underlying those investments.

The undisputed evidence before the courts below was that Cashmere invested in "*mortgage* derivative securities" and "*mortgage* backed securities" consisting of a "pool of *mortgages*." CP 124 (Crain Decl. ¶¶ 5, 6) (emphasis added). CMO is an acronym for *Collateralized Mortgage* Obligation; REMIC is an acronym for Real Estate *Mortgage* Investment Conduit. The use of the words "collateralized" and "mortgage" in the description of these investments is obvious and clear evidence that such securities were *collateralized* by *mortgages*, because that's the nature of a mortgage -- it represents a security interest in collateral, consisting of real

[15] Cashmere purchased CMO and REMIC investments totaling $330,788,767 during the Audit Period. CP 125 (Crain Decl. ¶ 9).

property.[16] And, if the investment was secured by first mortgages or deeds of trust on nontransient residential properties, then RCW 82.04.4292 was satisfied. Indeed, the Court of Appeals previously held that the RCW 82.04.4292 tax deduction:

> . . . does not depend on whether the advances it made were short-term or whether the mortgage companies sold the loans they originated within days. Instead, *the deduction depends on whether the loans were secured by trust deeds on nontransient residential properties.*

Security Pacific Bank, 109 Wn. App. at 805 (emphasis added).

In the context of this case, the deduction does not depend on whether the ultimate investors in the pooled loans through the CMO or REMIC security have "recourse" to the collateral securing the loan; instead, entitlement to "the deduction depends on whether the [investments themselves] were secured by trust deeds on nontransient residential properties." *Security Pacific Bank* at 805. This latter requirement was fully satisfied and, accordingly, the Decision warrants review by this Court because it conflicts with the Court of Appeals' decision in *Security Pacific Bank*.

B. The Decision Also Presents Issues of Substantial Public Importance That Should Be Determined By This Court.

The Decision reflects a fundamental misapprehension of the nature of what constitutes a "secured" investment and, as such, presents an issue

[16] A "mortgage" is a lien, "pledge or security of particular property for the payment of a debt or the performance of some other obligation, whatever form the transaction may take." BLACK'S LAW DICTIONARY 1162 (4th ed. 1968).

of substantial public importance that should be determined by this Court under RAP 13.4(b)(4). The notion that an investment or loan is not secured unless the investor or lender itself has direct recourse against the security is not limited to RCW 82.04.4292, but has broader implications beyond the tax deduction in question. The most vivid example, for which this Court can take judicial notice, is a common deed of trust, in which the lender (grantee) transfers the duty and power to foreclose to a trustee. There are other examples, including Commercial Mortgage Backed Securities (CMBS), which are secured by commercial real estate (hospitals, office buildings, industrial sites and warehouses) and related securities collateralized by multi-family mortgage-backed securities (*i.e.*, commercial property of five or more residential units in a building).

In sum, there are markets for many other types of Asset Backed Securities (ABS), all of which could be adversely impacted by the Decision.[17] In each case, bondholders or investors have an undivided,

[17] The following analysis illustrates the fundamental problem created by the Decision:

> An asset-backed security [footnote omitted] is a security that is collateralized, (or backed,) by some financial asset, such as receivables on credit cards, automobile loans, home equity loans, student loans, and so on. In principle, an asset-backed security can be created from almost any stream of receivables. For example, there are securities backed by music royalties, movie revenues, mutual fund fees, and tobacco settlement fees. In practice, for a somewhat active market to exist in securities backed by a particular class of assets, it is important that there be sufficient demand and supply to support ongoing costs of monitoring collateral performance and evaluating structural supports, and sufficient standardization of securities to facilitate price transparency and trading liquidity. Examples of asset-backed securities in which there is a market with some regular trade include credit card-backed securities, automobile-backed securities, and home equity-backed securities.

Sabarwal, Tarun. "Common Structures of Asset-Backed Securities and Their Risks." *Corporate Ownership & Control*, Vol. 4, No. 1 (Fall 2006) at 258.

collateralized position, but only an agent/trustee has the authority to actually commence a foreclosure on the collateral. Likewise, lenders who are participants in a syndicated credit facility have collateral (again on an undivided basis) backing up the credit obligations, but only the agent for the lenders has the authority to foreclose. As a practical matter, there may be hundreds of investors in an individual ABS and thousands, if not millions, in the aggregate, and it would wreak havoc if any one of them could foreclose on the collateral at any time.

The Decision effectively holds that these bondholders and investors are not secured parties because they cannot directly foreclose on the collateral. The Decision has the potential to undermine the credit and investment industries in Washington, since no one will make these kinds of investments if they are deemed unsecured. Cashmere invested in REMICs, which provided a trustee with the obligation to foreclose on the collateral in the event of a payment default, but the Decision holds this structure means Cashmere was not "secured." This holding thus has implications beyond the tax deduction in question and warrants review because it presents an issue of substantial public interest to the investment and lending -- indeed, the entire financial -- community.

Finally, the Decision ignores the policy reasons behind the original enactment of RCW 82.04.4292. The Court of Appeals described the purpose behind the statute in *Security Pacific Bank*:

> The purpose of RCW 82.04.4292 "was to stimulate the residential housing market by making residential loans available to home buyers at lower cost through the vehicle of a B&O tax [deduction]

> on interest income received by home mortgage lenders." CP at 33. Under the plain language of the statute, [footnote omitted] the deduction created by RCW 82.04.4292 is available to any bank if its loan is "primarily secured by first mortgages or trust deeds on nontransient residential properties."

Security Pacific Bank at 804. In Security's case, the bank was advancing funds to undercapitalized mortgage companies so that the latter could extend mortgage loans. *Id.* at 798. This stimulated the housing market because it allowed companies, who otherwise lacked sufficient working capital, to obtain that capital from banks, like Security, to finance the home mortgage origination activities of the mortgage companies. *Id.* Security's loans to the mortgage companies, under revolving lines of credit, helped "to stimulate the residential housing market by making residential loans available to home buyers." *Id.* at 804.

Cashmere stands in shoes similar to Security. Cashmere purchased interests in various REMICs, which are pools of loans secured by first mortgages or trust deeds on nontransient residential properties. The secondary market lenders (like Fannie Mae and Freddie Mac) take the money from investors like Cashmere and purchase new pools of residential loans. Once the loans are sold in the secondary market by the original lenders, the "[o]riginators use the cash they receive to provide additional mortgages in their communities." CP 278 (citing Kelman, A., *Mortgage-backed Securities & Collateralized Mortgage Obligations: Prudent CRA INVESTMENT Opportunities* (March 2002)). This continuous cycle of money flowing from investors to the pools and from the home buyers into the pool (via the latter's payments of principal and interest) likewise create a stimulus to the residential housing market, because it makes "residential loans available to home buyers at lower cost through the vehicle of a B&O tax [deduction] on interest income received by home mortgage lenders." *Security Pacific Bank*, 109 Wn. App. at 804.

Cashmere is itself a home mortgage lender. CP 13. It makes loans to home buyers but also participates in the home lending process by investing in CMOs and REMICs, which hold loans secured by first mortgages or trust deeds on nontransient residential properties. As the Court of Appeals once said, the plain language of this statute creates a deduction for *any bank* if the loan (or the investment) is primarily secured with a first mortgage or trust deed on nontransient residential property. *Security Pacific Bank*, 109 Wn. App. at 804. So ultimately, the Decision frustrates the admitted purpose of the statute, which by its terms was to allow banks to take a deduction for interest earned *either* on investments *or* loans, so long as the investment or loan is secured by first mortgages or deeds of trust, and thereby reducing the transaction costs related to the mortgages themselves.

CMOs and REMICS are securities, which allow the bundling of mortgages into pools to the ultimate benefit of consumers. Denying investors like Cashmere the benefit of the B&O tax deduction for interest income earned from CMOs and REMICS would reduce the pool of investors interested in making such investments, to the ultimate detriment of those consumers. That is precisely the kind of increased transaction cost that the deduction was intended to avoid. Cashmere's receipt of interest from investments in CMOs and REMICs not only satisfied each and every requirement of the plain and unambiguous language of RCW 82.04.4292, it satisfied the Legislature's intent in enacting this B&O tax deduction in the first place. The policy repercussions created by the Decision further justifies review by this Court under RAP 13.4(b)(4).

VI. CONCLUSION

The Court should grant review to address the conflicts between the Decision and decisions of this Court and the Court of Appeals, as well as the important public policy implications of the Decision.

RESPECTFULLY SUBMITTED this 13th day of September, 2013.

CARNEY BADLEY SPELLMAN, P.S.

By: ______________________
George C. Mastrodonato, WSBA No. 7483
Michael B. King, WSBA No. 14405
Attorneys for Appellant Cashmere Valley Bank

APPENDIX A

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DIVISION II

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STATE OF WASHINGTON

BY
DEPUTY

IN THE COURT OF APPEALS OF THE STATE OF WASHINGTON

DIVISION II

CASHMERE VALLEY BANK, Appellant, v. STATE OF WASHINGTON DEPARTMENT OF REVENUE, Respondent.	No. 42514-9-II PUBLISHED OPINION

PENOYAR, J. — The Washington State Department of Revenue (Department) audited Cashmere Valley Bank (Cashmere) for the years 2004 through 2007 and assessed additional business and occupation (B&O) tax for interest income Cashmere had received on investments in real estate mortgage investment conduits (REMICs) and collateralized mortgage obligations (CMOs).

Cashmere paid the additional tax and then filed a complaint for refund in superior court, claiming that the interest income was deductible under RCW 82.04.4292.[1] On summary judgment, the trial court denied Cashmere the deduction. Cashmere appeals, arguing that the interest income qualifies for the deduction as interest on investments primarily secured by first mortgages or trust deeds on nontransient residential property. Because Cashmere does not have any legal recourse to the mortgages and trust deeds underlying its investments, its investments are not primarily secured by them. Thus, we affirm.

[1] Unless noted otherwise, RCW 82.04.4292 refers to the 1980 version of the statute, which was in force during the audit period. The legislature amended the statute in 2010 and 2012. *See* LAWS OF 2010, 1st Spec. Sess., ch. 23, § 301; LAWS OF 2012, 2d Spec. Sess., ch. 6, § 102.

FACTS

I. Factual Background

Cashmere operates 11 branch banks in several central Washington cities, a loan production office in Yakima, and a municipal banking office in Bellevue. Cashmere's business includes personal and business banking and mortgage, insurance, investment, and leasing services.

In 2009, the Department audited Cashmere for the period January 1, 2004, through December 31, 2007. As a result of the audit, the Department assessed Cashmere for $346,178, including interest, in unpaid tax. Cashmere paid this amount in full on June 4, 2009. A large part of this tax assessment was B&O tax on interest income Cashmere received from investments in REMICs and CMOs.[2]

II. Procedural Background

In July 2009, Cashmere filed a notice of appeal and complaint for refund in superior court, claiming that the interest income Cashmere received from the REMICs and CMOs was deductible under RCW 82.04.4292. Cashmere sought summary judgment on this issue. The trial court denied Cashmere's motion and ruled for the Department. Cashmere timely appeals.

ANALYSIS

Cashmere challenges the denial of an interest income deduction under RCW 82.04.4292 for income derived from REMIC and CMO investments. Under RCW 82.04.4292, interest income a bank receives from investments primarily secured by first mortgages or trust deeds on nontransient residential properties is deductible from its B&O tax calculations. A bank's

[2] During the audit period, Cashmere received a net amount of $17,837,861 in interest income from investments in REMICs and CMOs. The Department assessed $267,568 in B&O tax on this amount.

qualifying "secured" investment must be backed by collateral and the bank must have some recourse against that collateral.

REMICs and CMOs are investment instruments of pooled mortgage loans that have been broken down into the individual principal payments and interest payments associated with each mortgage. The issuer repackages the principal and interest payments according to their payout and risk characteristics into "tranches" or slices of the mortgage pool. A bank invests in REMICs and CMOs by purchasing bonds that correspond to the different classes that the various tranches represent and that have stated payment terms.

If a payment default occurs on a bond, the bank's recourse is against the issuer and, to some extent, the class collateral or tranche for the bond. But the bank has no recourse against the original mortgages or trust deeds underlying the tranches—the bank cannot, for example, foreclose any of those mortgages. The bank's investments are not secured by these mortgages or trust deeds. Accordingly, Cashmere's investments in REMICs and CMOs are not primarily secured by first mortgages or deeds of trust, and Cashmere cannot take the deduction for interest income received from these investments.

I. STANDARD OF REVIEW

We review summary judgment de novo. *American Best Food, Inc. v. Alea London, Ltd.*, 168 Wn.2d 398, 404, 229 P.3d 693 (2010). We also review statutory interpretation, which is a question of law, de novo. *HomeStreet, Inc. v. Dep't of Revenue*, 166 Wn.2d 444, 451, 210 P.3d 297 (2009).

II. THE B&O TAX DEDUCTION

Washington State imposes a B&O tax on a business's gross income "for the act or privilege of engaging in business activities." RCW 82.04.220(1). A business may be able to deduct certain income from its gross income when calculating its B&O tax, but the business has the burden of showing that it qualifies for those deductions it claims. *See HomeStreet*, 166 Wn.2d at 455. Importantly, courts construe statutes granting tax deductions strictly, but fairly, against the taxpayer. *Activate, Inc. v. Dep't of Revenue*, 150 Wn. App. 807, 813, 209 P.3d 524 (2009).

The B&O tax deduction at issue is found at RCW 82.04.4292: "In computing tax there may be deducted from the measure of tax 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."

In *HomeStreet*, our Supreme Court analyzed this deduction as having five essential elements:

1. The person is engaged in banking, loan, security, or other financial business;
2. The amount deducted was derived from interest received;
3. The amount deducted was received because of a loan or investment;
4. The loan or investment is primarily secured by a first mortgage or deed of trust; and
5. The first mortgage or deed of trust is on nontransient residential real property.

166 Wn.2d at 449. In that case, HomeStreet had originated mortgage loans that it then sold to secondary market lenders like the Federal National Mortgage Association (Fannie Mae), the Government National Mortgage Association (Ginnie Mae), and the Federal Home Loan Mortgage Corporation (Freddie Mac). HomeStreet, 166 Wn.2d at 447-48. Some of these loans HomeStreet sold in their entirety, but some loans HomeStreet sold only in part, retaining rights to service the loans and receive a portion of the interest due on the loans as servicing fees. *HomeStreet*, 166 Wn.2d at 447-48.

The court underscored in *HomeStreet* that the only element of RCW 82.04.4292 in question was the second—whether the servicing fees HomeStreet received on the loans it partially retained were derived from interest received. 166 Wn.2d at 449. The court held that these fees were derived from interest and that HomeStreet was therefore entitled to deduct them from its B&O tax. *HomeStreet*, 166 Wn.2d at 455-56.

But the second element is not in question here. As Cashmere correctly points out, the only element in question here is the fourth—whether the investments Cashmere made in REMICs and CMOs were primarily secured by first mortgages or deeds of trust.[3] This inquiry requires understanding the nature of mortgage-backed securities generally, and REMICs and CMOs specifically as a type of mortgage-backed security.

III. MORTGAGE-BACKED SECURITIES

Understanding REMICs and CMOs requires a basic understanding of how mortgages[4] are converted into different kinds of mortgage-backed securities. This process begins when a person borrows money from a lender—like a bank or mortgage lender—to purchase a home. As security for this loan, the borrower gives the lender a mortgage on the home. If the borrower fails to pay the loan's principal and interest on the terms to which the borrower and lender agreed, the lender may foreclose on the home and sell it to recover the money it lent to the borrower.

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[3] The first three elements are not in dispute, nor is the fifth. With respect to the fifth element, the mortgages or deeds of trusts underlying Cashmere's investments in REMICs and CMOs at issue here were in fact on non-transient residential real property.

[4] For purposes of this explanation, "mortgages" entails both mortgages and deeds of trust.

The lender, however, will not always retain the mortgage. Often, the lender will sell the mortgage to a buyer on the secondary market. This buyer, usually a large private firm or government-affiliated agency, acquires the right to receive the borrower's principal and interest payments on the home loan, and also the right to foreclose on the home if the borrower does not timely make those payments.[5]

A secondary-market buyer "securitizes" the mortgages it purchases from various lenders by first pooling the mortgages and then issuing interests based on those pools to investors. These interests—that is, these mortgaged-backed securities—vary, however, with respect to how they are structured and what kind of interest the investors receive.

Two types of mortgage-backed securities are mortgage participation certificates and mortgage pass-through securities. Mortgage participation certificates appeared early in the history of mortgage-backed securities. The certificate consists of one party selling a pool of whole loans to another party. The seller warrants that it will repurchase any loan in the pool that does not conform to its representations and warranties. The buyer fully owns the loans, however, and has recourse only against the original borrower for losses on conforming loans. Investors' desires for greater security led to the development of mortgage pass-through securities.

Mortgage pass-through securities are a form of mortgage-backed securities represented by share certificates that grant the certificate holder a proportionate ownership interest in a pool of mortgages held in trust. The certificate holder receives cash flow from the underlying mortgages as borrowers make their principal and interest payments to the holding trust—that is,

[5] The borrower, however, may not be aware that the lender sold the mortgage—the lender may have contracted with the buyer to continue servicing the mortgage vis-à-vis the borrower. The lender, then, may be receiving the borrower's payments and passing them along to the buyer for a fee. Or, in the event of the borrower's default, the lender may foreclose on the property and pass along the proceeds of the foreclosure sale, less the lender's fee or share, to the buyer.

the trust passes the proportionate interest in the underlying payments to the certificate holder. The return an investor in this security receives thus mirrors the payments borrowers make on the mortgages in the pool.

Under both participation certificates and pass-through securities, the investor owns a share of the borrowers' mortgage obligations and receives whatever payments the borrowers make. The Department has concluded that such mortgage-backed securities are primarily secured by first mortgages or trust deeds because "[d]efault by any borrower in the repayment of an underlying loan will give the security holder [the investor] the rights to the proceeds of sale of the property in foreclosure." Clerk's Papers (CP) at 877 (quoting Wash. Dep't of Revenue, Determination No. 90-288, 10 Wash. Tax Dec. 314, 317 (1990)). The first mortgages or trust deeds remain the first level of recourse for investors in such securities even if the issuer of the securities has given a guaranty of repayment because "guarantors are only secondarily liable in the event foreclosure proceeds are insufficient to repay the defaulted loans." CP at 877 (quoting Revenue Determination No. 90-288, 10 Wash. Tax Dec. at 317).[6]

REMICs and CMOs[7] represent a further step in this process of mortgage securitization, but remove investor rights in the underlying mortgages. With mortgage participation certificates and mortgage pass-through securities, the mortgages underlying these securities remain largely intact; any division of interest between parties is accomplished through warranties on or

[6] Cashmere alleges that if we hold that investments in REMICs and CMOs do not qualify for the deduction, we will have effectively read "investments" out of RCW 82.04.4292. While we do not address in this opinion whether the Department's above-cited ruling allowing the deduction for mortgage-backed securities like participation certificates and pass-through securities is correct, even if investments in such mortgage-backed securities may qualify for the deduction, Cashmere's argument here under different circumstances fails.

[7] In essence, REMICs and CMOs are the same type of investment instrument; REMICs are more recent, as they enjoy certain federal tax benefits.

proportionate ownership of those whole loans. In contrast, the mortgages in the pools underlying REMICs and CMOs[8] are divided into the individual principal payments and interest payments due under each mortgage.[9] The issuer of the REMIC or CMO then reconfigures these payments into new combinations of principal and interest called "tranches." Each tranche, or class, represents a new security that can be traded separately on the secondary market. Investors purchase fractional shares in the different classes. But rather than representing a proportionate ownership in pools of mortgages,[10] these fractional shares take the form of different classes of bonds issued against and corresponding to the reconfigured mortgage payments that constitute each tranche of the REMIC or CMO.[11]

IV. INVESTMENTS "PRIMARILY SECURED" BY FIRST MORTGAGES OR TRUST DEEDS

Cashmere asserts that the interest income it received during the audit period from its investments in REMICs and CMOs should be deductible from its B&O tax because these

[8] The assets underlying REMICs and CMOs can be whole mortgage loans or, to make matters even more complicated, other mortgage-backed securities.

[9] For example, a 30-year fixed-rate mortgage requiring monthly principal and interest payments would consist of 720 individual payments—360 principal payments and 360 interest payments. A pool with 1,000 of these kinds of mortgages would thus have 720,000 separate payments of principal and interest.

[10] Issuers may designate investments in REMIC classes as representing beneficial ownership interests in the trust holding the underlying mortgages. But such a designation does not change the nature of investments in REMICs and CMOs as essentially interests in bonds (debt), not ownership (equity); the issuer is still the owner of the respective mortgage notes. *See, e.g.*, CP at 845 ("Fannie Mae is at all times the owner of the mortgage note, whether the note is in our portfolio or whether we own it as trustee for [a mortgage-backed security] trust.").

[11] To illustrate, consider a theoretical REMIC with four tranches: A, B, C, and Z. Each tranche represents a different level of risk and a different payout period. If an investor, based on its investment preferences, purchased Z-class bonds, those bonds would be issued against tranche Z, which would comprise those reconfigured mortgage payments that corresponded to the risk and return associated with investment in the Z tranche. Tranche Z, for example, could comprise the principal and interest payments due in the last five years of the mortgages involved.

investments were, in the plain language of RCW 82.04.4292, "primarily secured by first mortgages or trust deeds." To support this position, Cashmere points out that the mortgages underlying these investment instruments were primarily secured by first mortgages or deeds of trust and that the interest income Cashmere received was traceable to the interest payments borrowers made on these mortgages. Cashmere's observations are correct, but the conclusion it reaches from those observations is not—Cashmere incorrectly conflates the mortgages underlying its investments with the investments themselves. Equating investments with the mortgages underlying them may work for some mortgage-backed securities for purposes of taking the deduction at issue here, but not for REMICs and CMOs.

Whereas the mortgages underlying investments in REMICs and CMOs may in some economic sense serve to secure those investments, from a legal standpoint the investor in REMICs and CMOs has no recourse to those underlying mortgages as security for the investment. To the extent investments in REMICs and CMOs are secured in a legal sense by any collateral, that collateral is the tranches or classes that an issuer can separately trade as securities in fulfillment of its financial obligations to an investor.

To analyze Cashmere's claim, we must first return to the statutory language granting the deduction: "In computing tax there may be deducted from the measure of tax 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." RCW 82.04.4292. Again, the only issue here is whether the income for which Cashmere is claiming the deduction consisted of "amounts derived from interest received on investments or loans primarily secured by first mortgages or trust deeds."

In addressing this issue, we first look to the statute's plain language. *HomeStreet*, 166 Wn.2d at 451. If the statute is subject to multiple reasonable interpretations, it is ambiguous. *HomeStreet*, 166 Wn.2d at 452. And if the statute is ambiguous, we may resort to statutory construction, which includes considering statutory context and legislative history, to resolve the ambiguity. *Dep't of Revenue v. Bi-Mor, Inc.*, 171 Wn. App. 197, 203, 286 P.3d 417 (2012), *review denied*, 177 Wn.2d 1002 (2013)); *Wells Fargo Bank, N.A. v. Dep't of Revenue*, 166 Wn. App. 342, 350-51, 271 P.3d 268, *review denied*, 175 Wn.2d 1009 (2012).

The first question is whether the "investments or loans" the statute mentions refer to transactions entered into by the taxpayer, or to investments or loans to which the taxpayer might not have been a party but from which the taxpayer has derived earnings from interest. At oral argument, Cashmere affirmed its position that an amount earned on any transaction is deductible under RCW 82.04.4292 if the amount's origin can be traced back to interest payments on residential home loans. Thus, amounts earned on an investment in the last car of a long "tranche train" of reconfigured and resold interests is deductible if the engine driving the train is homeowners' interest payments on their respective home loans. The Department maintains that the deduction is available only to taxpayers who have an ownership interest in the investments or loans themselves.

The legislature's use of the phrase "amounts derived from interest" instead of just the word "interest" appears to favor Cashmere's tranche-train argument. The phrase implies that earnings that flow to a taxpayer from interest on investments or loans are deductible even if the taxpayer was not a party to the investment or loan transactions. Because we cannot interpret the phrase "amounts derived from" right out of the statute,[12] this phrase would appear to allow us to interpret "investments or loans" as referring to those in which the taxpayer may not have been involved as a party and, consequently, in which the taxpayer may not have acquired any ownership interest.

While we acknowledge that the above interpretation of "investments or loans" is a reasonable one, the statute's language alone allows for another reasonable interpretation of "investments or loans" as referring rather to transactions into which the taxpayer itself has entered. Because these two reasonable interpretations render the statute ambiguous, we look beyond the statute's language and note that chapter 82.04 RCW is tax code that not only assesses tax on certain business activities but also guides a business in knowing which of its activities are taxable and which are deductible. In this context, RCW 82.04.4292 would appear to speak directly to Cashmere—the taxpayer—and its activities, namely, the investment or loan transactions into which it has entered and from which it is generating earnings from interest income.

[12] We are to give each word in a statute meaning and significance. *HomeStreet*, 166 Wn.2d at 452.

We are further persuaded that this second interpretation is the right one because the legislature removed the phrase "amounts derived from" from RCW 82.04.4292 in 2010.[13] LAWS OF 2010, 1st Spec. Sess., ch. 23, § 301. Removing this phrase indicates to us that the legislature intends "investments or loans" to refer to the taxpayer's investments or loans, and not to investments or loans from which a taxpayer farther down the tranche train is deriving earnings sourced from interest payments. Especially taken in light of the judicial precedent of construing statutes granting tax deductions strictly but fairly against the taxpayer, this statutory context and legislative history lead us to conclude that "investments or loans" refer to those entered into by the taxpayer.

Because "investments or loans" in RCW 82.04.4292 refer to Cashmere's own investments in REMICs and CMOs, Cashmere cannot, in taking the deduction, rely on the nature of the original home loans that underlie its investments as being "primarily secured" by first mortgages or trust deeds. Instead, Cashmere, if it is to take the deduction, must show that its investments are themselves "primarily secured" by first mortgages or trust deeds. Analyzing whether these investments are secured in this way first requires an understanding of what "secured" means here.

[13] This amendment followed the Supreme Court's ruling in *HomeStreet*. In that case, a bank partially sold mortgage loans it had originated to secondary-market buyers, but retained rights to service the loans; as a servicing fee, the bank kept a portion of the interest payments borrowers made on their loans. 166 Wn.2d at 448. In determining whether the bank was entitled to the deduction at RCW 82.04.4292, the court analyzed the phrase "amounts derived from interest," concluding that it permitted the bank to take the deduction because "[t]he revenue at issue here is received from a source, and the source is interest. The revenue is therefore 'derived from interest' because it is taken from the interest the borrowers pay on their loans." 166 Wn.2d at 454. The court further concluded that "[u]nder the statute it is not essential to determine why the money is received or taken from a source." 166 Wn.2d at 454.

The statute does not define "secured," and neither party offers a definition of the term. We note, however, that "secured" is a familiar legal term, and "[a] familiar legal term used in a statute is given its familiar legal meaning." *Rasor v. Retail Credit Co.*, 87 Wn.2d 516, 530, 554 P.2d 1041 (1976). When referring to a debt or obligation, as is the case here, "secured" means "supported or backed by security or collateral." BLACK'S LAW DICTIONARY 1475 (9th ed. 2009). "Security," in turn, means "[c]ollateral given or pledged to guarantee the fulfillment of an obligation." BLACK'S LAW DICTIONARY 1475 (9th ed. 2009). A party with a "secured" investment is therefore a "secured" party "protected by a pledge, mortgage, or other encumbrance of property that helps ensure financial soundness and confidence" with respect to the party's investment. BLACK'S LAW DICTIONARY 1475 (9th ed. 2009). Thus a "secured" party necessarily has some recourse to collateral securing its investment. In the context of real estate transactions, a secured party has the right, for example, to foreclose on the collateral (such as with a mortgage or real estate contract) or to require another to foreclose for them (such as with a deed of trust) if payment obligations are not met.

We accept that homeowners' payments on their mortgages and trust deeds are the source of the REMIC and CMO trustees' payments to Cashmere for the bonds it has purchased. And we acknowledge that in an overall economic sense the homeowners' payments may be considered the primary underlying security for the return Cashmere receives on its investments. But our analysis and review are legal, not economic. From this legal position, Cashmere's investments—and Cashmere itself—are not secured at all, much less primarily secured, by the mortgages and trust deeds underlying those investments because Cashmere has no recourse against those mortgages and trust deeds. Cashmere has no right to proceed directly against homeowners who fail to make payments under the mortgages or trust deeds. And Cashmere does not have a right to require the respective trustees of its investments to proceed against homeowners to satisfy the trustees' financial obligations to Cashmere.

Cashmere has rights against the trustees that issued bonds to Cashmere, but these rights do not extend to actions on the underlying mortgages or trust deeds. In the event of a trustee's default (perhaps because of homeowners' defaults under their mortgages or trust deeds), Cashmere may be able to replace the trustee, but the successor trustee still takes legal title to the underlying mortgages and trust deeds. And, as the Department observed in a 1990 ruling, Cashmere may have the right to require a trustee to sell tranches or classes to satisfy its obligation to Cashmere, but Cashmere does not have the right to require the sale of the underlying mortgages or trust deeds:

> [T]he bond issuer secures its obligation by pledging readily tradeable securities in trust for the benefit of the bondholder. Upon default of the bonds, the bondholder's sole right is to require the trustee to sell the mortgage-backed security itself. The occurrence of an event of default under the terms of the trust indenture does not give the bond holder rights of foreclosure against the property securing the mortgage-backed security.

CP at 878 (quoting Revenue Determination No. 90-288, 10 Wash. Tax Dec. at 318.)

If Cashmere's investments in REMICs and CMOs were primarily secured by any collateral, that collateral would be the separately traded mortgage-backed securities represented by tranches or classes. But to simply argue that Cashmere's ultimate source of return—the underlying mortgages and trust deeds—is its primary source of security ignores the fact that Cashmere has no recourse to that ultimate source of payments. Because Cashmere does not have such recourse, Cashmere cannot show that its investments were primarily secured by first mortgages or trust deeds, and thus Cashmere cannot take the deduction.

42514-9-II

We affirm.

Joel Penoyar

Penoyar, J.

We concur:

Van Deren, J.

Van Deren, J.P.T.

Worswick, CJ

Worswick, C.J.

APPENDIX B

IN THE COURT OF APPEALS OF THE STATE OF WASHINGTON

DIVISION II

CASHMERE VALLEY BANK, Appellant, v. DEPARTMENT OF REVENUE OF THE STATE OF WASHINGTON, Respondent.	No. 42514-9-II ORDER DENYING MOTION FOR RECONSIDERATION

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APPELLANT moves for reconsideration of the Court's **July 9, 2013** opinion. Upon consideration, the Court denies the motion. Accordingly, it is

SO ORDERED.

PANEL: Jj. Worswick, Van Deren, Penoyar

DATED this 16th day of August, 2013.

FOR THE COURT:

Worswick, CJ

CHIEF JUDGE

Reporter of Decisions

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APPENDIX C

Department of Revenue Fiscal Note

Bill Number: 6143 2E S SB AMC CONF H5847.5	Title: Excise tax law modifications	Agency: 140-Department of Revenue

Part I: Estimates

☐ **No Fiscal Impact**

Estimated Cash Receipts to:

Account	FY 2010	FY 2011	2009-11	2011-13	2013-15
GF-State-State 00 - 00 -		35,774,000	35,774,000	77,353,000	
GF-State-State 01 - Taxes 01 - Retail Sales Tax	380,000	67,098,000	67,478,000	151,465,000	36,062,000
GF-State-State 01 - Taxes 05 - Bus and Occup Tax	51,822,000	448,100,000	499,922,000	1,130,934,000	724,412,000
GF-State-State 01 - Taxes 36 - PUD Privilege Tax	91,000	1,091,000	1,182,000	2,248,000	2,339,000
GF-State-State 01 - Taxes 57 - Real Estate Excise		4,361,000	4,361,000	9,754,000	11,079,000
Publ Works Assist-State 01 - Taxes 57 - Real Estate Excise		289,000	289,000	646,000	735,000
City County Asst-State 01 - Taxes 57 - Real Estate Excise		90,000	90,000	200,000	225,000
Performance Audit-State 01 - Taxes 01 - Retail Sales Tax	1,000	138,000	139,000	309,000	62,000
Total $	52,294,000	556,941,000	609,235,000	1,372,909,000	774,914,000

Estimated Expenditures from:

	FY 2010	FY 2011	2009-11	2011-13	2013-15
FTE Staff Years	6.5	32.4	19.4	22.5	18.2
Account					
GF-STATE-State 001-1	1,230,200	2,784,300	4,014,500	3,808,300	2,860,200
Total $	1,230,200	2,784,300	4,014,500	3,808,300	2,860,200

This bill was identified as a proposal governed by the requirements of RCW 43.135.031 (Initiative 960). Therefore, this fiscal analysis includes a projection showing the ten-year cost to tax or fee payers of the proposed taxes or fees.

The cash receipts and expenditure estimates on this page represent the most likely fiscal impact. Factors impacting the precision of these estimates, and alternate ranges (if appropriate), are explained in Part II.

Check applicable boxes and follow corresponding instructions:

[X] If fiscal impact is greater than $50,000 per fiscal year in the current biennium or in subsequent biennia, complete entire fiscal note form Parts I-V.

[ ] If fiscal impact is less than $50,000 per fiscal year in the current biennium or in subsequent biennia, complete this page only (Part I).

[ ] Capital budget impact, complete Part IV.

[X] Requires new rule making, complete Part V.

Legislative Contact:		Phone:	Date: 04/12/2010
Agency Preparation:	Diana Tibbetts	Phone: 360-570-6085	Date: 04/15/2010
Agency Approval:	Don Gutmann	Phone: 360-570-6073	Date: 04/15/2010
OFM Review:	Ryan Black	Phone: 360-902-0417	Date: 04/15/2010

Part II: Narrative Explanation

II. A - Brief Description Of What The Measure Does That Has Fiscal Impact

Briefly describe, by section number, the significant provisions of the bill, and any related workload or policy assumptions, that have revenue or expenditure impact on the responding agency.

This fiscal note reflects the bill as passed by the Legislature.

Part I - Minimum Nexus Standards

Part I of this bill establishes, for business and occupation (B&O) tax purposes, nexus standards in statute and a single sales factor apportionment method for many service businesses and businesses receiving royalty income from the use of intangible property in this state.

BACKGROUND:

A tax on businesses engaging in interstate commerce is valid under the Commerce Clause of the United States Constitution as long as it:

(1) Is applied to an activity with a substantial nexus with the taxing state;
(2) Is fairly apportioned;
(3) Does not discriminate against interstate commerce; and
(4) Is fairly related to the services provided by the state.

This part relates to the nexus and apportionment requirements.

With respect to nexus, Washington does not at present impose B&O tax on businesses that conduct business in this state unless they have a physical presence in the state, such as tangible personal property or real property, or have either employees or non-employee representatives enter the state for business reasons. However, a number of states have successfully asserted that nexus is established by intentionally entering the state's marketplace to engage in business without physically entering the state. This is sometimes referred to as "economic nexus."

At least thirty states currently apply some form of economic nexus, and case law trends have shown a strong move toward judicial approval of economic nexus standards for the imposition of taxes on business income. It is important to note that the constitutionality of economic nexus is not definitively settled. Some tax practitioners argue that physical presence is required by the U.S. Constitution for all state taxes, but the vast majority of state case law upholds economic nexus for business activity taxes. The federal courts have not ruled directly on the issue, but the U.S. Supreme Court has refused on at least six occasions to review state court rulings sustaining economic nexus.

With respect to apportionment, most service businesses that engage in business both within and without Washington are eligible to use a cost apportionment method. The cost apportionment method assigns a portion of worldwide service income to Washington based on a ratio of the cost of doing business in Washington as compared to the total cost of doing business worldwide. Financial institutions use a three-factor apportionment formula, which is the average of three ratios: (1) property in Washington compared to property everywhere, (2) payroll in Washington compared to payroll everywhere, and (3) receipts sourced to Washington compared to worldwide receipts. Royalty income is not apportioned in this state. Rather, royalties are allocated to the domicile of the taxpayer. Businesses that are domiciled outside of Washington, but authorize the use of their intangible property in Washington, do not pay any B&O taxes in Washington on royalties received from the use of their intangible property in this state. This has led some Washington-domiciled taxpayers to transfer their intangible assets to wholly-owned subsidiaries whose sole place of business is outside of Washington. Sometimes these subsidiaries are domiciled in states, such as Nevada, that do not tax income from the use of intangibles.

Many states have been moving to a sales-only formula for apportioning income. In general, a sales-only apportionment formula would reduce taxes for in-state businesses that sell mostly to out-of-state customers.

SUMMARY OF PART I:

This proposal establishes nexus standards in statute for the B&O tax. Under the bill, a person has nexus if:
- The person is an individual who is a resident or domiciliary of this state,
- The person is a business entity that is organized or commercially domiciled in this state, or
- The person is a nonresident individual or a business entity that is organized or commercially domiciled outside of this state and in any tax year the business has:
  - More than $50,000 dollars of property in this state,
  - More than $50,000 of payroll in this state,
  - More than $250,000 of receipts from this state, or
  - At least 25 percent of the business's total property, total payroll, or total receipts are in this state.

The dollar thresholds above will be adjusted by the consumer price index (CPI) whenever the cumulative change in the CPI reaches five percent. A person who has nexus with this state in any tax year will be deemed to have nexus with this state for the following tax year.

Even though a business may have nexus by having more than $250,000 of receipts from this state or at least 25 percent of its total receipts from this state, the business will not be required to pay B&O taxes on certain activities unless it has a physical presence. Those activities for which a physical presence is required for B&O tax purposes include: retail sales, wholesale sales, manufacturing, processing for hire, extracting, extracting for hire, printing, public road construction and other construction activities that are not considered retail or wholesale sales, certain warehousing activities, radio and television broadcasting, day care providers, and chemical dependency services.

This part also establishes a single factor apportionment method based on receipts. Under this apportionment method, a business determines the portion of its income taxable in this state by multiplying its taxable income by a fraction. The numerator of the fraction is gross income assigned to Washington, and the denominator is the business's total gross income. In general, gross income is assigned to Washington if the benefit of the service or, in the case of royalties, the intangible property is located in this state. If a business is unable to assign gross income using this method, the bill provides other methods for determining the location of gross income. For apportioning the service income of financial institutions, the bill directs the department to provide by rule a single-factor apportionment methodology based on receipts.

The apportionment method provided in this bill is available primarily for businesses that report under the "service and other activities" B&O tax classification or the "royalties" B&O tax classification. It also applies to several other tax classifications including real estate brokers, insurance agents, travel agents and tour operators, and the printing and publishing classification-but only with respect to advertising income.

The bill also exempts from B&O taxes amounts received by financial institutions from affiliates if the transactions are required to be at arm's length under sections 23A or 23B of the Federal Reserve Act. In addition, the bill exempts from B&O taxes amounts received by investment conduits and securitization entities from cash and securities. Also, the bill provides a new B&O tax deduction for interest and fees on loans secured by certain commercial aircraft. The deduction is not available if the taxpayer has a physical presence in this state.

This part also amends RCW 82.04.2907, the statute imposing B&O tax on royalties. The amendments: (1) make technical changes, and (2) extend royalty tax treatment to compensation received for the licensing of digital goods, digital codes, or digital automated services (digital products) to a person who is not the end user of the digital product.

If a court holds the nexus provisions relating to property, payroll, or receipts unconstitutional or otherwise invalid, Part I is null and void in its entirety. Part I takes effect June 1, 2010, and applies to gross income generated on and after that date. However, for purposes of determining nexus under the property, payroll, and receipts factors for the 2010 tax year, property, payroll, and receipts are based on the entire 2010 tax year.

Part II - Tax Avoidance Transactions

The Department of Revenue (Department) must disregard certain specified tax avoidance transactions for tax periods on or after January 1, 2006. These transactions are described in section 201(3).

In determining whether a transaction or arrangement must be disregarded, the Department may consider:

(1) whether the transaction changes the taxpayer's economic position in a meaningful way, apart from the transaction's tax effects; (2) whether the taxpayer has a substantial nontax purpose for entering into the transaction; (3) whether the transaction is a reasonable means of accomplishing the substantial nontax purpose; (4) an entity's relative contributions to the work that generates income; (5) the location where the work is performed; and (6) other relevant factors.

If the Department finds a tax deficiency due to a disregarded tax avoidance transaction, the Department must assess a 35 percent penalty.

The Department must adopt rules to assist in determining when to disregard a tax avoidance transaction.

Section 205(2) requires the Department to conduct a review of the state's tax policy with respect to the taxation of transactions between affiliated entities. The Department must report its findings to the legislative fiscal committees on December 1, 2010, or if the review is not incomplete, a brief status report by December 1, 2010, with a final report by December 1, 2011.

Section 206 amends RCW 82.12.020 to allow for the imposition of use tax on the use of tangible personal property (TPP) acquired in any manner. Under current law, use tax on TPP only applies if the TPP is acquired through a retail sale, lease, gift, repossession, bailment, or is manufactured or extracted by the person using the property, or is otherwise furnished to a person engaged in any business taxable under RCW 82.04.280(2) or (7).

Part II of the bill also closes loopholes and clarifies ambiguities related to real estate excise tax (REET).

For the purpose of determining whether, pursuant to an option, a controlling interest was transferred or acquired within a 12-month period, the date that the option agreement was executed is the date on which the transfer or acquisition of the controlling interest is deemed to occur.

The Department may, at its option, collect REET on the transfer or acquisition of a controlling interest in an entity from the buyer of the controlling interest, the seller of the controlling interest, or the entity itself in which a controlling interest is transferred, except that for publicly traded companies REET may not be collected from the shareholders who transferred the controlling interest in the corporation.

A parent corporation of a wholly-owned subsidiary is responsible for REET if the subsidiary transfers real property to a third party and then dissolves before payment of the tax. Buyers are no longer absolved from REET liability by simply providing notice of a real estate sale to the Department.

Section 209 clarifies that a lien for payment of REET attaches to each parcel of property in this state owned by an entity in which a controlling interest has been transferred.

This part of the bill takes effect May 1, 2010. Section 201 of this bill applies to tax periods beginning January 1, 2006.

Part III - Modifying the First Mortgage Deduction

Currently, financial businesses are allowed to deduct from their B&O tax amounts derived from interest received on investments or loans primarily secured by first mortgages or trust deeds on nontransient residential properties (RCW 82.04.4292). Recently the Washington Supreme Court held that the deduction includes amounts retained as servicing fees by lenders after the loan is sold on the secondary market.

This bill limits the first mortgage interest deduction by providing that certain fees for services and gains on the sale of loans or other valuable rights are not deductible. However, a deduction is allowed for certain loan servicing fees.

This part of the bill is effective June 1, 2010.

Part IV - Direct Seller Business and Occupation Tax Exemption

Current law (RCW 82.04.423) provides a B&O tax exemption for sales by certain out-of-state-persons to or through seller's representatives. The Department's position had been that the "direct seller" exemption was limited to those businesses that only sold consumer products through a direct seller's representative in the home or otherwise in permanent retail establishments (stores). A recent Washington Supreme Court decision expands the exemption to businesses that sell nonconsumer products, some of which are sold in stores.

This bill:
1) Eliminates the exemption in its entirety effective May 1, 2010; and
2) Revises the definition of "direct seller's representative" to conform to the Department's interpretation of the exemption as noted above. This change applies retroactively to tax periods before May 1, 2010.

Part V - Business and Occupation Tax Preferences for Manufacturers of Products Derived from Certain Agricultural Products

Part V of the bill changes the application of the B&O tax to manufacturers and wholesalers of certain meat products, meat byproducts, or fruit and vegetable products by clarifying and narrowing the definitions of activities that are subject to the preferential tax treatment.

Currently, processors of perishable meat products are subject to a reduced B&O tax rate of 0.138 percent. A 2005 decision by the Washington Supreme Court held that this reduced B&O tax rate applied to the processing of perishable meat into a nonperishable finished product.

Current law also provides a B&O tax exemption for canning, preserving, freezing, processing, or dehydrating fresh fruits or vegetables. Beginning July 1, 2012, this exemption is replaced with a reduced B&O tax rate for these activities.

This bill modifies the activities eligible for the reduced B&O tax rate for processing perishable meat products by requiring that the end product be: a perishable meat product; a nonperishable meat product that is comprised primarily of animal carcass by weight or volume, other than a canned meat product; or a meat by-product manufactured in a rendering plant.

This bill also modifies the B&O tax preferences for canning, preserving, freezing, processing, or dehydrating fresh fruits or vegetables by requiring the end product to be:
- Comprised exclusively of fruits, vegetables, or both fruits and vegetables, or
- Comprised of fruits, vegetables, or both fruits and vegetables, where the amount of all ingredients contained in the product, other than fruits, vegetables, and water, does not exceed the amount of fruits and vegetables contained in the product measured by weight or volume.

These changes take effect June 1, 2010.

Part VI - Suspending the Sales and Use Tax Exemption for Livestock Nutrient Equipment and Facilities

Current law provides a retail sales and use tax exemption for the purchase and use of certain equipment and services related to the management of livestock nutrients. Eligible operations include licensed dairies with a certified dairy nutrient plan, animal feeding operations that have a waste disposal permit issued under RCW 90.48, and animal feeding operations that have a nutrient management plan approved by a conservation district meeting certain requirements. This part of the bill temporarily suspends this exemption between July 1, 2010, and June 30, 2013.

Part VII - Ending the Preferential Business and Occupational Tax Treatment Received by Directors of Corporations

Beginning July 1, 2010, compensation received by members of corporate boards of directors is taxed under the service and other activities B&O tax classification at a rate of 1.8 percent, which includes the additional 0.3 percent tax rate in Part XI of this bill). An exemption is provided retroactively for director compensation received before July 1, 2010.

Part VIII- Tax Debts

Currently, certain individuals can be held personally liable for collected but unremitted sales tax when a corporation or limited liability company goes out of business. To be held personally liable, the Department must prove that an individual willfully failed to pay or caused to be paid to the Department sales taxes collected by the business. This bill would impose personal liability on an entity's chief executive and chief financial officer regardless of fault or whether those individuals were aware of the unpaid sales tax liability.

This part of the bill is effective May 1, 2010.

Part IX - Repealing the Sales and Use Tax Exemptions for Bottle Water and Candy

Currently candy, bottled water, and most other food is exempt from the state and local sales and use taxes. This bill extends the sales and use taxes to candy and bottled water. "Candy" is defined as a preparation of sugar, honey, or other sweeteners in combination with chocolate, fruits, nuts, or other ingredients or flavorings in the form of bars, drops, or pieces. However, candy does not include any preparation containing flour, nor any products that require refrigeration. Bottled water includes water that is delivered to the buyer in a reusable container that is not sold with the water. The sales or use of water sold pursuant to a prescription or to persons who do not otherwise have a readily available source of potable water are exempt from the sales and use tax.

This part of the bill also provides a B&O tax credit to candy manufacturers. The credit equals $1,000 for each full-time employment position maintained in this state on a full-time basis for a continuous period of at least 12 consecutive months, and $1,000 for each full-time equivalent seasonal employee hired by a seasonal employer.

These changes are effective June 1, 2010. The retail sales and use tax imposed on purchases of bottled water expires July 1, 2013.

Part X - PUD Privilege Tax Clarification

The public utility district (PUD) privilege tax compensates for PUDs' exemption from property tax as public entities. The measure of the tax is "gross revenue," which is defined as "the amount received from the sale of electric energy excluding any tax levied by a municipal corporation upon the district pursuant to RCW 54.28.070."

This bill amends the definition of gross revenue to clarify that the term includes all amounts received from the sale of electric energy, including any regularly recurring charge to customers as a condition of receiving electric energy, and excluding any tax levied by cities under the authority of RCW 54.28.070.

This is effective May 1, 2010.

Part XI - Temporarily Increasing the Business and Occupation tax on Service Businesses while Increasing the Small Business Credit for the Same Businesses

Beginning May 1, 2010, through June 30, 2013, this bill imposes an additional rate of B&O tax of 0.3 percent on contests of chance (RCW 82.04.285), real estate brokers (RCW 82.04.255), and other services (RCW 82.04.290(2)(a)). The new total B&O rates for these activities will be 1.8 percent. Businesses reporting at least 50 percent of their taxable activities under RCW 82.04.285, RCW 82.04.255, and RCW 82.04.290(2)(a) may be entitled to a small business credit not to exceed $70 per month. The credit amount is reduced as the B&O liability exceeds $70 per month and is phased out completely when the tax liability reaches $140. There is no expiration date for the increased credit.

Part XII - Property Management Salaries

Current law provides a B&O tax exemption for amounts received by property management companies if the payments are received from a property management trust account for payment of wages and benefits to on-site personnel. This bill narrows this exemption by making for-profit property management companies ineligible for the exemption except on payments from a city or county housing authority.

This part is effective June 1, 2010.

Part XIII - Temporarily Increasing Beer Taxes

Brewers or wholesalers of beer are taxed an additional $0.50 per gallon. The additional tax does not apply to the sale of the first sixty thousand barrels of beer each year by breweries that are entitled to a reduced rate of tax under 26 U.S.C. Sec. 5051 of the federal internal revenue code

This tax is in effect June 1, 2010, through June 30, 2013.

Part XIV - Temporarily Imposing Taxes on Carbonated Beverages

A tax of two cents per 12 ounces is imposed on the wholesale or retail sale of carbonated beverages, except carbonated water. The tax does not apply to successive sales of previously taxed carbonated beverages. The first $10 million of carbonated beverages sold in this state by a bottler or distributor during each calendar year is exempt from this tax.

This tax is in effect July 1, 2010, through June 30, 2013.

Part XV - Limiting the Bad Debt Deduction

The Washington State Supreme Court ruled in Puget Sound National Bank v. Department of Revenue, 123 Wn.2d 284 (1994) that banks purchasing installment contracts from a retail seller are entitled to a bad debt credit or refund for sales taxes paid to the Department by the retail seller when the bank incurred a bad debt because the buyer defaulted on the contract. This bill limits the bad debt credit or refund to the original retail seller, effective for claims for credit or refund filed with the Department after June 30, 2010.

Part XVI - Data Centers

Chapter 1, Laws of 2010 1st Special Session (ESSB 6789) provides a sales and uses tax exemption for eligible server equipment and power infrastructure for eligible computer data centers located in a rural county.

This bill amends that program by (1) clarifying that for purposes of measuring the required increase in jobs, the date that the department issued an exemption certificate is the start date and (2) providing that leased space newly dedicated to housing working servers at an eligible computer data center may qualify for a sales and use tax exemption if it creates three family wage employment positions for each 20,000 square feet.

This part of the legislation is effective May 1, 2010.

II. B - Cash receipts Impact

Briefly describe and quantify the cash receipts impact of the legislation on the responding agency, identifying the cash receipts provisions by section number and when appropriate the detail of the revenue sources. Briefly describe the factual basis of the assumptions and the method by which the cash receipts impact is derived. Explain how workload assumptions translate into estimates. Distinguish between one time and ongoing functions.

ASSUMPTIONS/DATA SOURCES

Part I: Minimum Nexus Standards

Data Sources:
Department of Revenue excise tax data; Department of Financial Institutions; U.S. Census Bureau; U.S. Bureau of Economic Analysis; The Federal Reserve Board; Securities and Exchange Commission; Price, Waterhouse, Coopers; the Nielson Company; the Washington Implan Model, the Washington Input-Output Model, and other sources.

Assumptions:
A compliance rate of about 100 percent is assumed in the first year for businesses currently registered with the Department. For businesses not registered with the Department, it's assumed that compliance rates for large, nationwide franchise businesses will be 90 percent. Compliance rates for credit card issuers are assumed to be 50 percent the first year, 75 percent the second, 90 percent the third, and about 100 percent in the fourth year. Compliance rates for other financial institutions are assumed to be 25 percent the first year, 50 percent the second, 75 percent the third, and about 100 percent in the fourth year. Compliance rates for small, out of state businesses are assumed to be 13 percent the first year, 26 percent the second, 39 percent the third, and 52 percent in the fourth year and thereafter. It is assumed that 90 percent of the non-franchise, royalty receipts from the out of state affiliates of Washington domiciled businesses will be apportioned outside of Washington.

The effective date for this part of the bill is June 1, 2010, so the Fiscal Year 2011 impact is based on 12 months of collections.

Revenue Impact:
General fund revenues are estimated to rise by $84.7 million in Fiscal Year 2011 and $176.2 million in Fiscal Year 2012. There is no local impact.

Part II - Tax Avoidance Transactions

Data Sources:
Department of Revenue
Employment Security Department
Statistics of Income for corporations

Assumptions:
For the provision extending use tax to tangible personal property acquired by any means, this fiscal note assumes that this provision primarily impacts the acquisition of tangible personal property through a step transaction. An example of a step transaction is one where tangible personal property is transferred by a business to a wholly owned subsidiary, the subsidiary is then sold to another business, followed by a merger of the transferred entity into the acquiring business. To estimate the impact of extending use tax on tangible personal property acquired through a step transaction, multiple successorship information from the Employment Security Department was used to determine the level of assets transferred from businesses with no assets in their final year of liquidation. This estimate uses a compliance adjustment of 13 percent for 2011, 26 percent for 2012, 39 percent for 2013, and 52 percent for 2014.

This estimate assumes three taxpayers avoided REET in Fiscal Year 2009 through the use of options and subsidiaries that are dissolved before REET is paid, increasing to between 5 to 12 taxpayers by Fiscal Year 2015.

This estimate assumes taxpayers avoiding REET by transferring an ownership interest of less than 50 percent, but including a binding option to purchase an additional ownership interest that would result in a transfer of more than a 50 percent interest, to be exercised more than 12 months after the option was granted, would be avoiding the average amount of REET paid on controlling interest transfers from Fiscal Years 2005, 2006, 2008, and 2009.

This estimate assumes taxpayers avoiding REET through the use of a subsidiary would owe REET of over $1 million.

This estimate assumes that each year, the amount of REET avoided through the use of a subsidiary must increase by about four percent in order for it to be worth the taxpayer's time and effort to transfer the property in the manner described.

Revenue Impact:
This proposal will result in a state revenue increase of an estimated $8.2 million for Fiscal Year 2011, the first full fiscal year of impact. Local governments will see an estimated $2.8 million in Fiscal Year 2011.

Part III - Modifying the First Mortgage Deduction

Data Sources and assumptions:
Estimates are based on Department of Revenue tax reporting information, information from financial institutions as reported in their Report of Condition and Income (Call Report) to federal agencies, and forecasts of mortgage activity derived from data provided by the Economic and Revenue Forecast Council.

Revenue Impact:
This part will result in a state general fund revenue increase of an estimated $3.6 million for Fiscal Year 2011. There is no local impact.

Part IV - Direct Seller Business and Occupation Tax Exemption

Data Sources:
Department of Revenue

Revenue Impact:
The Washington Supreme Court decision regarding sales by certain out-of-state-persons to or through seller's representatives is final and the state general fund revenue forecast has been adjusted downward for the effect of this court decision. Effective May 1, 2010, the exemption is eliminated. The revenue gain from the elimination of this exemption is included in the amounts shown on the front page of this fiscal note.

State government would gain $122.1 million in Fiscal Year 2011.

Part V - Business and Occupation Tax Preferences for Manufacturers of Products Derived from Certain Agricultural Products

Assumptions:
It is assumed that the changes to the tax preferences for processors of fresh fruits or vegetables would cause about ten percent of the amount currently exempted to become taxable.

Revenue Impact:
State revenues will increase by over $4 million per fiscal year due to this legislation. Approximately $4.1 million will be realized during Fiscal Year 2011, the first full fiscal year of impact.

Part VI - Suspending the Sales and Use Tax Exemption for Livestock Nutrient Equipment and Facilities

Revenue Impact:
The temporary suspension of this exemption will generate an estimated $1.3 million for state government in Fiscal Year 2011, and an estimated $1.4 million in Fiscal Year 2012, the first full fiscal year. Local governments will gain approximately $395,000 per fiscal year through Fiscal Year 2013.

Part VII - Ending the Preferential Business and Occupation Tax Treatment Received by Directors of Corporations

Data Sources:
Department of Revenue
Secretary of State's Office

Assumptions:
The tax will be on directors' fees of corporations based or headquartered in Washington. It is assumed that 200 Washington-based firms that are publicly traded.

It is assumed that the 100 highest grossing firms that are not publicly traded have directors who are compensated. Based on a sampling of the top 30 of these firms, it is assumed that 50 firms that are not publicly traded have directors in Washington.

The average annual compensation for a director is estimated to be $61,000 per year. It is assumed that all the director activities will be in Washington, therefore, no apportionment will apply. The average number of directors is assumed to be 10 members per firm.

The amount of directors' fees paid is assumed to be constant through Fiscal Year 2015. A large portion of director compensation is based upon stock options and cannot be estimated due to market volatility.

Revenue Impact:
State government will gain an estimated $2.1 million in Fiscal Year 2011.

Part VIII - Tax Debts

Data Sources:
Department of Revenue

Revenue Impact:
State government will gain an estimated $1.0 million in Fiscal Year 2011.

Part IX - Repealing the Sales and Use Tax Exemptions for Bottled Water and Candy

Data sources:
2008 Beverage Digest Fact Book, the National Confectioners Association, the Office of Financial Management, the U.S. Department of Commerce, and the Department of Revenue

Assumptions:
Bottled water that contains vitamins and minerals, but no sweeteners, is considered subject to sales and use tax under this section. However, products that are traditionally thought of as "vitamin water," including drinks with sweeteners and/or calories, are considered soft drinks and are not affected by this bill. Bottled water containing flavoring elements, such as fruit essences, but not sweeteners and/or calories, would be subject to sales and use tax under this bill.

The per capita consumption of candy is relatively consistent over time, so this estimate assumes candy consumption growth follows population growth.

The overall price elasticity of demand for bottled water and candy is assumed to equal 0.9.

This part of the legislation is effective June 1, 2010.

Revenue Impact:
In Fiscal Year 2011, state general fund revenue will gain approximately $63.0 million and local governments will gain $12.4 million.

Part X - PUD Privilege Tax Clarification

Assumption:
This fiscal note assumes that all PUDs will separate their kilowatt-hour charges from other charges and pay the privilege tax on only the kilowatt-hour charges. A recent Washington State Court of Appeals decision held that gross revenue for purposes of PUD privilege tax only applies to charges for electricity and not other separately stated charges.

Revenue Impact:
This legislation modifies the definition of gross revenue for the PUD privilege tax and results in a gain in general fund revenue of $1.1 million in Fiscal Year 2011 and local governments will gain approximately $1.3 million.

Part XI - Temporarily Increasing the Business and Occupation tax on Service Businesses while Increasing the Small Business Credit for the Same Businesses

Data Source:
Department of Revenue
Economic and Revenue Forecast Council

Revenue Impact:
State government will gain an estimated $223.3 million in Fiscal Year 2011.

Part XII - Property Management Salaries

Data Sources:
Department of Revenue
Employment Security Department

Revenue Impact:
State government will gain an estimated $6.9 million in Fiscal Year 2011.

Part XIII - Temporarily Increasing Beer Taxes

The estimated fiscal impact of temporarily increasing beer taxes will be included in the fiscal note prepared by the Washington State Liquor Control Board.

Part XIV - Temporarily Imposing Taxes on Carbonated Beverages

Data Source:
Department of Revenue

Assumptions:

Overall price elasticity of demand is equal to 0.9. The volume of soda wholesaled in the state is roughly equal to the volume consumed so that consumption approximates wholesale sales. A business would spread the tax in their price over the year to cover the cost of the tax, even if any given unit is not taxed. All subsequent sales of exempted units will also be exempt.

Business-level data for in-state bottlers was adjusted to reflect the portion that is likely attributable to carbonated beverages (as opposed to bottled water or other goods). In net, it is estimated that approximately 74percent of taxable sales by bottlers are attributable to carbonated beverages.

Revenue Impact:
This proposal will generate about $33.5 million for state government in Fiscal Year 2011.

Part XV - Limiting the Bad Debt Deduction

Data Source:
Department of Revenue

Revenue Impact:
This proposal will generate about $1.7 million for state government in Fiscal Year 2011.

Part XVI - Data Centers

There is no revenue impact as a result of this part of the bill.

REVENUE ESTIMATES

The estimated state revenue gain resulting from this bill is $556.9 million in Fiscal Year 2011. Local governments will gain over $16.9 million in Fiscal Year 2011.

TOTAL REVENUE IMPACT:

State Government (cash basis, $000):

FY 2010 -	$	51,822
FY 2011 -	$	556,941
FY 2012 -	$	646,036
FY 2013 -	$	726,873
FY 2014 -	$	378,000
FY 2015 -	$	396,914

Local Government, if applicable (cash basis, $000):

FY 2010 -	$	220
FY 2011 -	$	28,248
FY 2012 -	$	30,470
FY 2013 -	$	32,966
FY 2014 -	$	9,394
FY 2015 -	$	9,794

II. C - Expenditures

Briefly describe the agency expenditures necessary to implement this legislation (or savings resulting from this legislation), identifying by section number the provisions of the legislation that result in the expenditures (or savings). Briefly describe the factual basis of the assumptions and the method by which the expenditure impact is derived Explain how workload assumptions translate into cost estimates. Distinguish between one time and ongoing

The expenditure estimate assumes that the Department will not incur any cost in the implementation of Tax Debt (Part VIII), PUD Privilege Tax Clarification (Part X), Temporarily Increasing Beer Taxes (Part XIII), and Data Centers (Part XVI).

To implement this legislation the Department will incur costs of $1,230,200 in Fiscal Year 2010. Time and effort equates to 6.5 FTEs.

The Department will incur costs of $2,784,300 in Fiscal Year 2011. Time and effort equates to 32.3 FTEs.

The Department will incur ongoing costs of $3,808,300 in the 2011-2013 Biennium and $2,860,200 in the 2013-2015 Biennium. Time and effort equates to 23.9 FTEs in Fiscal Year 2012, 21.1 FTEs in Fiscal Year 2013, 20.3 FTEs in Fiscal Year 2014, and 16.1 FTEs in 2015.

The following expenditure estimates may include multiple parts of the bill in which similar activities occur. Parts of the bill with larger costs are described separately. Costs and FTEs shown for these are included in the yearly or biennial totals above.

Minimum Nexus Standards (Part I)

To implement this part of the legislation, the Department will incur costs of $507,900 in Fiscal Year 2010. The Department will identify impacted businesses, including those located out of state, to provide them with information on the change in how the state determines nexus for out-of-state based businesses conducting operations in Washington. This will include creating and mailing a special notice to impacted businesses and tax practitioners, both within Washington and out of state, and updating online and printed information. Additional staff will be needed to handle an expected increase in telephone inquiries.

The cost of printing and mailing special notices to taxpayers and practitioners is $321,000. Time and effort equates to 2.3 FTEs.

The Department will incur costs of $1,842,400 in Fiscal Year 2011. The Department will create and conduct workshops to assist taxpayers with reporting questions in several places around the state. Additional calls from taxpayers to the Telephone Information Center are also expected, as well as additional email questions and requests for letter rulings. Adopting a new nexus standard for service income will increase the number of taxpayers filing returns, creating additional error and out of balance returns, amended returns, requests for penalty waivers, and telephone questions. Additional new taxpayers will require an increase in the staff to locate, explain, examine, assess taxes due, and verify compliance. A change in the nexus standard is also expected to increase the number of appeals. The Department will amend three administrative rules and create one new administrative rule. The non-labor cost of informational workshops is $12,000, printing and mailing additional tax returns is $29,000, and the non-labor cost of setting up new taxpayers with electronic payment is $12,000. Time and effort in Fiscal Year 2011 equates to 20.4 FTEs.

The Department will incur ongoing costs of $2,971,000 in the 2011-2013 Biennium and $2,343,200 in the 2013-2015 Biennium. Time and effort equates to 17.6 FTEs in Fiscal Year 2012, 17.4 FTEs in Fiscal Year 2013, and 14.4 FTEs in the 2013-2015 Biennium. The cost of printing and mailing additional tax returns is $29,000 each fiscal year.

Tax Avoidance Transactions (Part II)

To implement this part of the legislation, the Department will incur costs of $49,000 in Fiscal Year 2010. The Department will make modifications to the excise tax and e-file systems to accommodate the new penalty, including programming to setup, test, and verify the computer systems. A special notice will be prepared and mailed to tax practitioners. The non-labor cost of the notice is $10,600. Time and effort equates to 0.4 FTE.

The Department will incur costs of $87,200 in Fiscal Year 2011. The Department will continue updating the computer systems as noted for Fiscal Year 2010. The Department will amend three administrative rules and adopt one new rule. Time and effort equates to 0.8 FTE.

Modifying the First Mortgage Deduction (Part III) and Business and Occupation Tax Preferences for Manufacturers of Products Derived from Certain Agricultural Products (Part V)

To implement these parts of the legislation, the Department will amend two administrative rules in Fiscal Year 2011.

Direct Seller Business and Occupation Tax Exemption (Part IV), Suspending the Sales and Use Tax Exemption for Livestock Nutrient Equipment and Facilities (Part VI), Property Management Salaries (Part XII), and Limiting the Bad Debt Deduction (Part XV)

To implement these parts of the legislation, in Fiscal Year 2010 the Department will prepare and mail a special notice to taxpayers impacted by each part. The non-labor cost of the notices is $23,000.

In Fiscal Year 2011 the Department will amend three administrative rules to administer these parts of the legislation, with the exception of property management salaries.

Ending the Preferential Business and Occupation Tax Treatment Received by Directors of Corporations (Part VII)

To implement this part of the legislation the Department will incur costs of $1,900 in Fiscal Year 2010. These are non-labor costs for printing and mailing a special notice to those businesses and individuals impacted by the legislation.

The Department will incur costs of $20,000 in Fiscal Year 2011. The Department expects that there will be an increase in telephone calls and error and out of balance tax returns related to ending the preferential business and occupation tax treatment received by directors of corporations. This will result in additional desk audits and amended returns being processed. The Department will need to amend one administrative rule.

The Department will incur ongoing costs of $20,300 in the 2011-2013 Biennium and $13,800 in the 2013-2015 Biennium. Time and effort equates to 0.2 FTE in Fiscal Year 2012 and .01 FTE in Fiscal Years 2013 through 2015.

Repealing the Sales and Use Tax Exemptions for Bottled Water and Candy (Part IX)

To implement this part of the legislation, the Department will incur costs of $304,000 in Fiscal Year 2010. The Department will create and mail a special notice to businesses identified as selling these types of products, informing them of the reporting changes. Online web information, printed guides, and other information for taxpayers will be updated. Additional staff will be needed to handle an expected increase in inquiries concerning the change in application of sales tax. The Department will make modifications to the excise tax and e-file systems for the candy manufacturer's business and occupation tax credit for jobs. This will include new system indicators, new credit codes, a credit buy-down process for when credit is used, revised summary reports, and programming to setup, test, and verify the computer systems. The non-labor cost to print and mail special notices is $180,900. Time and effort equates to 1.3 FTEs.

The Department will incur costs of $221,300 in Fiscal Year 2011. Online web and other information as noted for Fiscal Year 2010 will continue to be revised. The Department expects a continued high level of phone, email, and written inquiries. This change is also anticipated to increase the number of error and out of balance returns, resulting in additional amended returns, credits, tax assessments, refunds, and telephone calls concerning returns filed. Refund of taxes paid by those with prescriptions for bottled water or no potable water will be processed. The Department will amend one administrative rule. Time and effort equates to 3.0 FTEs.

The Department will incur ongoing costs of $361,800 in the 2011-2013 Biennium and $117,300 in Fiscal Year 2014. Costs for the 2011-2013 Biennium and Fiscal Year 2014 include working at a reduced level with taxpayers on error and out of balance returns and refunds as described for Fiscal Year 2011. A special notice will be created and mailed in Fiscal Year 2013 to those identified as selling bottled water, informing them that sales tax should no longer be collected on the sale of these products. Online web information, printed guides, and other information for taxpayers will be revised for the change in collection of tax on bottled water. Time and effort equates to 1.7 FTEs in Fiscal Year 2012, 1.5 FTEs in Fiscal Year 2013, and 1.8 FTEs in Fiscal Year 2014.

Temporarily Increasing the Business and Occupation Tax on Service Businesses while Increasing the Small Business Credit for the Same Businesses (Part XI)

To implement this part of the legislation, the Department will incur costs of $244,900 in Fiscal Year 2010. These costs are for programming to set up, test, and verify the systems to handle the new small business tax credit and the change in tax rate. Online and printed materials will be updated, and a special notice will be created and mailed to taxpayers impacted by the changes. The Department expects an increase in phone and written correspondence concerning these changes and an increase in error and out of balance returns, which will result in additional amended returns, credits, tax assessments, and refunds. The non-labor cost to print and mail the special notice is $105,000. Time and effort equates to 1.6 FTEs.

The Department will incur costs of $493,800 in Fiscal Year 2011. These costs are for handling taxpayer questions and telephone calls and correcting error and out of balance returns, as described for Fiscal Year 2010, and for the collection of delinquent accounts. The Department will amend one administrative rule. Time and effort equates to 6.4 FTEs.

The Department will incur ongoing costs of $381,400 in the 2011-2013 Biennium and $359,600 in the 2013-2015 Biennium. These costs are for handling error and out of balance returns and the collection of delinquent accounts as noted for Fiscal Year 2011. These costs are reduced after Fiscal Year 2011 as taxpayers become more educated on application of the credit, but increase for Fiscal Year 2014 after elimination of the additional tax. Time and effort equates to 3.8 FTEs in Fiscal Year 2012, 1.7 FTEs in Fiscal Year 2013, 3.8 FTEs in Fiscal Year 2014 and 1.4 FTEs in Fiscal Year 2015.

Temporarily Imposing Taxes on Carbonated Beverages (Part XIV)

To implement this part of the legislation, the Department will incur costs of $101,900 in Fiscal Year 2010. These costs are for changes in the excise tax and e-file systems for the new tax and exemption. This would include the creation of a new reporting line and associated line codes, error and out of balance and issuance codes, a beverage sales line to monitor the exemption, electronic reports, and programming to setup, test, and verify the computer systems. Time and effort equates to 1.0 FTE.

The Department will incur costs of $93,200 in Fiscal Year 2011. These costs are for monitoring reports and processing returns including the new tax. The new tax is expected to increase the number of error and out of balance returns, resulting in additional amended returns, credits, tax assessments, refunds, and telephone calls concerning returns filed. Additional desk audits will be made for verification that the exemption is applied correctly. The Department will amend one administrative rule. Time and effort equates to 1.2 FTEs.

The Department will incur ongoing costs of $74,200 in the 2011-2013 Biennium and $26,800 in the 2013-2015 Biennium. Costs are for working at a reduced level with taxpayers on error and out of balance returns and desk audits as described for Fiscal Year 2011. Time and effort equates to 0.6 FTE in Fiscal Year 2012, 0.5 FTE in Fiscal Year 2013, and 0.2 FTE in Fiscal Years 2014 and 2015.

Part III: Expenditure Detail

III. A - Expenditures by Object Or Purpose

	FY 2010	FY 2011	2009-11	2011-13	2013-15
FTE Staff Years	6.5	32.4	19.4	22.5	18.2
A-Salaries and Wages	351,400	1,595,200	1,946,600	2,314,500	1,776,500
B-Employee Benefits	87,900	398,900	486,800	578,700	444,000
E-Goods and Services	741,300	529,900	1,271,200	799,800	534,300
G-Travel	5,300	36,600	41,900	70,200	69,000
J-Capital Outlays	44,300	223,700	268,000	45,100	36,400
Total $	$1,230,200	$2,784,300	$4,014,500	$3,808,300	$2,860,200

III. B - Detail: *List FTEs by classification and corresponding annual compensation. Totals need to agree with total FTEs in Part I and Part IIIA*

Job Classification	Salary	FY 2010	FY 2011	2009-11	2011-13	2013-15
COMMUNICATIONS CNSLT 4	53,146	0.1		0.1		
EXCISE TAX EX 2	42,583	1.7	11.7	6.7	8.4	7.7
EXCISE TAX EX 3	50,563	0.5	1.0	0.7	0.6	0.7
EXCISE TAX EX 4	55,839	0.6		0.3		
HEARINGS SCHEDULER	32,688		0.1	0.0		
IT SPEC 4	63,195	0.4	0.5	0.4		
IT SPEC 5	69,756	1.7		0.9		
OFF ASST 2	27,809		0.2	0.1	0.2	0.1
OFF ASST 3	29,780		2.4	1.2	0.2	0.2
REVENUE AGENT 2	47,014		3.4	1.7	2.4	2.0
REVENUE AUDITOR 3	54,505		6.0	3.0	6.0	6.0
TAX INFO SPEC 1	36,757	0.6	0.8	0.7	0.1	
TAX INFO SPEC 4	54,505	0.8	1.2	1.0	0.7	0.5
TAX POLICY SP 2	61,628		0.1	0.1		
TAX POLICY SP 3	69,756		4.9	2.5	4.0	1.0
WMS BAND 3	88,546		0.1	0.1		
Total FTE's	838,070	6.5	32.4	19.5	22.5	18.2

Part IV: Capital Budget Impact

NONE.

Part V: New Rule Making Required

Identify provisions of the measure that require the agency to adopt new administrative rules or repeal/revise existing rules.

Should this legislation become law, the Department will take the following rule actions:

(Part I)
The Department will use the standard process to amend WAC 458-20-14601, titled: "Financial institutions - Income apportionment", WAC 458-20-193, titled: "Inbound and outbound interstate sales of tangible personal property", and WAC 458-20-194, titled: "Doing business inside and outside the state". The standard process will also be used to adopt one new rule under chapter 458-20 WAC. Persons affected by this rule-making would include financial and other service businesses and businesses earning royalty income.

(Part II)
The Department will use the significant legislative process to adopt one new administrative rule under 458-20 WAC. The expedited process will be used to amend WAC 458-20-228, titled: "Returns, payments, penalties, extensions, interest, stay of collection". Persons affected by this rule-making would include tax practitioners and businesses that utilize state tax

avoidance strategies.

The Department will use the standard process to amend WAC 458-20-106, titled: "Casual or isolated sales - Business reorganizations". Persons affected by this rule-making would include businesses selling capital assets using step transactions to avoid retail sales and use taxes.

The Department will use the standard process to amend WAC 458-61A-101, titled: "Taxability of the transfer or acquisition of the controlling interest of an entity with an interest in real property located in this state". Persons affected by this rule-making would include those making transfers of real estate.

(Part III)
The Department will use the expedited process to amend WAC 458-20-146, titled: "National and state banks, mutual savings banks, savings and loan associations and other financial institutions". Persons affected by this rule-making include those businesses that receive interest from investments or loans primarily secured by first mortgages or trust deeds on nontransient residential properties.

(Part IV)
The Department will use the expedited process to amend WAC 458-20-246, titled: "Sales to or through a direct seller's representative". Persons affected by this rule-making would include businesses making sales to or through direct seller's representatives.

(Part V)
The Department will use the expedited process to amend WAC 458-20-136, titled: "Manufacturing, processing for hire, fabricating". Persons affected by this rule-making include those businesses that use meat, vegetables, or fruit in manufactured products.

(Part VI)
The Department will use the expedited process to amend WAC 458-20-210, titled: "Sales of tangible personal property for farming - Sales of agricultural products by farmers". Persons affected by this rule-making would include those farmers and those owning livestock nutrient management equipment or facilities.

(Part VII)
The Department will use the expedited process to amend WAC 458-20-105, titled: "Employees distinguished from persons engaging in business". Persons affected by this rule-making would include those individuals who are receiving compensation as a corporate director.

(Part IX)
The Department will use the standard process to amend WAC 458-20-244, titled: "Food and food ingredients ". Persons affected by this rule-making would include business selling and those purchasing candy and bottled water.

(Part XI)
The Department will use the standard process to amend WAC 458-20-104, titled: "Small business tax relief based on income of business". Persons affected by this rule-making would include businesses reporting on the service and other activities line of the tax return.

(Part XIV)

The Department will use the standard process to amend WAC 458-20 255, titled: "Carbonated beverage syrup tax". Persons affected by this rule-making would include businesses that sell carbonated beverages in the state of Washington.

(Part XV)
The Department will use the standard process to amend WAC 458-20-196, titled: "Bad debts". Persons affected by this rule-making would include financial institutions that purchase installment sales contracts and similar accounts receivable.

NO. __________

SUPREME COURT
OF THE STATE OF WASHINGTON

NO. 42514-9-II

COURT OF APPEALS
OF THE STATE OF WASHINGTON
DIVISION TWO

Cashmere Valley Bank, Appellant, vs. State of Washington Department of Revenue, Respondent.	DECLARATION OF SERVICE

I certify that on the date set forth below I served a copy of the following: *Appellant's Petition for Review* and *Declaration of Service* upon the following attorneys of record:

Heidi A. Irvin Charles Zalesky Brett Durbin Assistant Attorneys General Revenue Division P.O. Box 40123 Olympia, WA 98504-0123	_X_ U.S. Mail, postage prepaid

I declare under penalty of perjury under the laws of the State of Washington that the foregoing is true and correct.

DATED this 13th day of September, 2013, at Seattle, Washington.

Patti Saiden

PATTI SAIDEN, Legal Assistant