

No. 80544-0

**SUPREME COURT  
OF THE STATE OF WASHINGTON**

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**HOMESTREET, INC., HOMESTREET CAPITAL  
CORPORATION, AND HOMESTREET BANK,**

*Petitioners*

v.

**STATE OF WASHINGTON, DEPARTMENT OF REVENUE,**

*Respondent*

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**SUPPLEMENTAL BRIEF OF PETITIONERS**

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## **I. ASSIGNMENTS OF ERROR**

1. The Court of Appeals, Division II, erred by failing to apply RCW 82.04.4292 according to its plain meaning.
2. The Court of Appeals, Division II, erred by treating a portion of the plain language of RCW 82.04.4292 as mere surplusage.

## **II. ISSUES PRESENTED FOR REVIEW**

1. Whether an unambiguous tax statute must be applied to undisputed facts according to its plain language and without resort to rules of construction?
2. Whether an unambiguous tax statute may be construed to have a different meaning by treating a portion of the plain language as mere surplusage?

## **III. STATEMENT OF THE CASE**

### **A. HomeStreet's Residential Mortgage Lending Business**

HomeStreet, like most residential mortgage lenders, sells or securitizes some or all of its rights associated with loans it originates. CP 160. This case involves mortgage loans in which HomeStreet has retained a portion of the original loan known as a retained servicing asset.

When a loan is securitized or sold on a "servicing retained" basis, the original asset representing the full bundle of rights in the loan is split into two parts. CP 50. HomeStreet realizes a gain or loss on the sale of the portion of the asset that is sold, and HomeStreet keeps the retained

servicing asset on its books. CP 193-194. The retained asset entitles HomeStreet to a portion of each borrower's interest payment on the mortgage loan, with the purchaser or investor receiving the borrower's payment of principal and another portion of the interest. CP 161, 197-198, 511, 616. HomeStreet determines the amount of interest that it retains by selecting which loans to securitize or sell and setting the amount of interest to be paid to the investor. CP 220-221, 511.

HomeStreet's retained servicing asset, which the Department of Revenue's own expert conceded is an asset derived from the original loan asset, is subject to interest rate risk, risk of prepayment, and risk of default. CP 48-49, 193-194. As when HomeStreet retains an entire loan, HomeStreet's income from the retained servicing asset is derived exclusively from interest payments on the underlying loan. If the borrower does not pay the interest to HomeStreet, HomeStreet does not receive any revenue. CP 162, 509, 616. Not only does HomeStreet not receive any revenue unless the borrower makes interest payments, HomeStreet is obligated to make timely payments to investors from its own funds in the event the borrower fails to pay. *See, e.g.*, CP 579-580 (Ginnie Mae MBS Guide, Ch. 1, pp. 1-12, 1-13).

**B. Prior Taxation of HomeStreet and Other Residential Mortgage Lenders**

Prior to 1970 financial institutions were generally not subject to B&O tax. CP 762. In 1970 the Legislature extended the B&O tax to financial institutions, but excluded "amounts derived from interest

received on investments or loans primarily secured by first mortgages or trust deeds on nontransient residential properties." 1970 Wash. Laws, Ch. 65, § 5 (creating the residential mortgage deduction now codified at RCW 82.04.4292); 1970 Wash. Laws, Ex. Sess., Ch. 101, § 2 (repealing the B&O tax exemption for financial institutions). The Legislature adopted RCW 82.04.4292 over the objections of the DOR, which claimed that the deduction would be too expensive and was not necessary to foster residential mortgage lending. CP 789-791 (DOR's Memorandum to Senator Mike McCormick, dated February 2, 1970).

For nearly 30 years, the DOR agreed with HomeStreet and other residential mortgage lenders that amounts retained by lenders from borrowers' payments of interest on residential first mortgages that were securitized or sold with servicing rights retained were deductible under RCW 82.04.4292. The DOR issued a formal determination to HomeStreet confirming this treatment in 1992. CP 147-157. The DOR issued similar determinations to other residential mortgage lenders. *See, e.g.*, CP 114-130, 132-142. In addition to issuing numerous determinations consistently ruling that the statute applies to amounts retained by lenders from borrowers' interest payments on mortgage loans that were securitized or sold on a servicing retained basis, the DOR choose to publish and designate one such determination as binding departmental precedent pursuant to RCW 82.32.410. CP 58-73.

The current case stems from the DOR's decision in 1999 to reverse its position and deny the deduction for retained interest to HomeStreet and other financial institutions.<sup>1</sup> CP 106.

#### IV. ARGUMENT

##### A. The Statute Must Be Applied According to Its Plain Language.

RCW 82.04.4292 provides a B&O tax deduction for "amounts derived from interest" on residential first mortgage loans. It is well-settled that:

The meaning of a statute is a question of law that is reviewed de novo. The Court's fundamental objective in determining what a statute means is to ascertain and carry out the Legislature's intent. *If the statute's meaning is plain on its face, then courts must give effect to its plain meaning* as an expression of what the Legislature intended. A statute that is clear on its face is *not* subject to judicial construction.

*State v. J.M.*, 144 Wn.2d 472, 480, 28 P.3d 720 (2001) (emphasis added) (internal citations omitted). Division II paid lip service to these principles by noting them in passing, but failed to apply them. *See* Slip Op. at 11.

This Court has made clear that a statute is ambiguous only if it is susceptible to two or more reasonable interpretations. *Agrilink v.*

*Department of Revenue*, 153 Wn.2d 392, 396, 103 P.3d 1226 (2005).

Neither Division II nor the DOR have suggested that RCW 82.04.4292 is

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<sup>1</sup> As noted in the Petition for Review, Washington Mutual Bank and Seattle Mortgage Co. each have lawsuits pending in Thurston County Superior Court challenging the DOR's change of interpretation of RCW 82.04.4292. Pet. for Rev. at 6-7.

ambiguous or offered any alternative interpretation of the statutory language "amounts derived from interest," let alone a reasonable one. There is no dispute that "derived" means "received from [a] specified source." Slip Op. at 14 (quoting Black's Law Dictionary 444 (6th ed. 1990). *See also* Webster's Third New International Dictionary 608 (1981) (defining "derive" as "to take or receive esp. from a source.") and American Heritage College Dictionary 375 (3rd ed. 1997) (defining "derive" as "to obtain or receive from a source.")

Considering the plain language of the statute, Division II's opinion acknowledges that the income at issue "is, in the broadest sense, 'derived from interest' because HomeStreet deducts it directly from the interest stream the loans generate." Slip Op. at 15. Having determined that the revenue at issue was derived from interest, Division II should have ended its analysis and ruled in HomeStreet's favor.

However, rather than applying the plain language, Division II's opinion recites three pages of principles of construction before concluding that HomeStreet's request to apply the statute according to its plain language "ignores the requirement that we construe tax deduction statutes narrowly." Slip. Op. at 15-16. There is neither a need nor a legal basis to resort to construction where the statutory language is plain and unambiguous. "Where statutory language is plain and unambiguous courts will not construe the statute but will glean the legislative intent from the words of the statute itself, regardless of contrary interpretation by an administrative agency." *Agrilink*, 153 Wn.2d at 396.

**B. The Statute Must Be Applied Without Deleting Language as Mere Surplusage.**

Division II's opinion appears to accept the DOR argument that "amounts derived from" is meaningless surplusage and that the deduction is "better understood as referring to persons receiving 'interest.'" RP 28; Resp. Br. at 12; Slip Op. 1-2 (holding that HomeStreet "no longer received interest" and was, therefore, not entitled to the B&O tax deduction). There is no basis in the statute or case law for manufacturing ambiguity by deleting language from an unambiguous statute. To the contrary, "[s]tatutes are to be construed, wherever possible, so that no clause, sentence or word shall be superfluous, void, or insignificant." *United Parcel Service, Inc. v. Department of Revenue*, 102 Wn.2d 355, 361, 687 P.2d 186 (1984). Furthermore, courts cannot rewrite or delete the plain language of an unambiguous statute. *State v. Roggenkamp*, 153 Wn.2d 614, 632, 106 P.3d 196 (2005).

As noted above, neither Division II nor the DOR have suggested that the phrase "amounts derived from interest" is ambiguous or has a reasonable alternative meaning. Accordingly, Division II should have limited its analysis to the question of whether the revenue at issue was "derived from interest"—a question Division II answered affirmatively and that is supported by the undisputed facts. Slip Op. at 15.

**C. The Revenue at Issue Is "Derived from Interest."**

There is no reasonable dispute that the revenue at issue in this case is "derived from interest." Division II's opinion acknowledged that the income at issue in this case "is, in the broadest sense, 'derived from

interest' because HomeStreet deducts it directly from the interest stream the loans generate." Slip Op. at 15. The *DOR's own expert* testified that when HomeStreet securitizes its loans or sells them with servicing rights retained, HomeStreet has retained an asset that was part of the original mortgage loan. CP 50 (Baldwin Dep. Transcript at 136-137). The DOR's expert further testified that HomeStreet's retained interest is derived from interest on the underlying loan: "*It is paid from interest. It's embedded as a part of it [the original mortgage loan].*" *Id.* (emphasis added).

The record is also clear that HomeStreet's *only* source of revenue is the borrower's interest payment. If a borrower fails to make an interest payment to HomeStreet, HomeStreet does *not* receive any revenue or compensation.<sup>2</sup> CP 509, 616. HomeStreet may recover its unpaid interest on delinquent loans by foreclosing on the borrower's mortgage in the same manner as if it owned the whole loan. CP 509. The amounts at issue in this case are "amounts derived from interest" under the plain meaning of the phrase and the undisputed facts.

**D. Division II's Opinion Appears to Be Based upon Improper Factual Inferences Drawn in Application of an Erroneous Interpretation of the Statute.**

As noted above, rather than applying the plain language of the statute to the undisputed facts, Division II accepted the DOR's argument

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<sup>2</sup> Division II's opinion characterizes the retained interest as merely being a convenient mechanism for investors to pay HomeStreet for servicing loans. Slip Op. 15. However, HomeStreet's co-owners or investors are never liable to HomeStreet for a servicing or other fee. CP 509. If a borrower fails to pay interest to HomeStreet on a loan, HomeStreet receives no revenue and must attempt to collect its unpaid interest just like a whole loan that HomeStreet retains in its portfolio. CP 509.

that the deduction should apply only to "interest" (improperly deleting the words "amounts derived from" from the statute). From that faulty legal premise, Division II opines that HomeStreet's revenue is not "interest" based on factual inferences that are contrary to the record and the principle that, in reviewing a summary judgment motion, all facts should be reviewed in a light most favorable to HomeStreet, the non-moving party. *Korslund v. Dyncorp Tri-Cities Services, Inc.*, 156 Wn.2d 168, 177, 125 P.3d 119 (2005).

Although Division II's opinion acknowledges that the revenue at issue is derived from interest, Division II suggests that it is not "interest" because HomeStreet is "allowed to keep or 'retain' part of the interest stream ... in exchange for servicing the loans." Slip Op. 15. The opinion dismissively concludes that "the only reason it is entitled to income is its *contractual relationship* with the purchaser." *Id.* (emphasis in original). Of course, "contractual relationships" were the mechanism by which HomeStreet originated the whole loan asset in the first place and, quite necessarily, were the mechanism by which HomeStreet split the whole loan asset into two assets—retaining one and selling the other. Investors did not "allow" HomeStreet to keep part of the interest. Rather, as the DOR's expert testified, HomeStreet retained part of the original mortgage loan asset when it securitized its loans or sold them with servicing rights retained. CP 50 (Baldwin Dep. Transcript at 136-137).

Division II's opinion also mistakenly infers that HomeStreet's securitization of loans or sale of loans on a servicing retained basis "severs

the relationship between HomeStreet and the borrower." Slip Op. at 15. To the contrary, HomeStreet maintains its direct relationship the borrower after a loan is securitized. As noted above, when HomeStreet securitizes its loans or sells them with servicing rights retained, HomeStreet remains a creditor by retaining a part of the original mortgage loan. CP 50 (Baldwin Dep. Transcript at 136-137). HomeStreet also remains the legal mortgagee in the Washington real property records. CP 493, 509. Borrowers continue to make all loan payments to HomeStreet. CP 161. HomeStreet processes the borrower's mortgage payments and administers the loan in the same manner that it administers whole loans that HomeStreet keeps in its portfolio. CP 161. Borrowers are generally unaware that anyone other than HomeStreet has an interest in their loan because it has no impact on how borrowers interact with HomeStreet in connection with repayment. CP 161. If a borrower defaults, HomeStreet attempts to collect from the borrower, if necessary by foreclosing on the mortgage for itself and the other owners. CP 509.

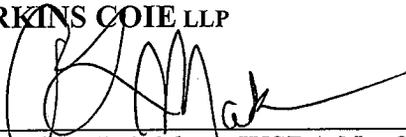
## V. CONCLUSION

Division II's opinion extends B&O taxation to activity and revenue that has never been subject to B&O tax and that the Legislature explicitly excluded when extending the B&O tax to financial institutions more than thirty-five years ago. This significant expansion of the B&O tax is not supported by the application of the plain language of RCW 82.04.4292 to the undisputed facts of this case. Accordingly, HomeStreet respectfully

requests that this Court reverse the decision of the Court of Appeals and remand for entry of summary judgment in favor of HomeStreet.

DATED: June 20, 2007

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**DECLARATION OF SERVICE**

I, Jessica Flesner, state and declare as follows:

I am a citizen of the United States and over 18 years of age and not a party to this action. I caused a true and correct copy of Supplemental Brief of Petitioners to be served by legal messenger on this day to:

Donald F. Cofer  
Assistant Attorney General  
Attorney General's Office  
Revenue Division  
7141 Cleanwater Drive SW  
Tumwater, Washington

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

Executed this 20th day of June, 2008, at Seattle, Washington.

  
Jessica Flesner

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