

Cite as 3 WTD 245 (1987)

BEFORE THE INTERPRETATION AND APPEALS SECTION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition)	<u>D</u> <u>E</u> <u>T</u> <u>E</u> <u>R</u> <u>M</u> <u>I</u> <u>N</u> <u>A</u> <u>T</u> <u>I</u> <u>O</u> <u>N</u>
For Refund of)	
)	No. 87-208
)	
. . .)	Registration No. . . .
)	Petition For Refund
)	
)	

[1] **RULE 146 AND RCW 82.04.4292:** BUSINESS AND OCCUPATION TAX -- DEDUCTION -- INTEREST ON LOAN SECURED BY FIRST MORTGAGE ON NONTRANSIENT RESIDENTIAL PROPERTIES -- SECURITY INTEREST UNDER UNIFORM COMMERCIAL CODE (UCC). RCW 82.04.4292 grants a deduction to commercial lenders for interest received on loans primarily secured by first mortgages on nontransient residential properties. Law holds that a security interest under the UCC, where it is a first lien on the property, qualifies as a "first mortgage."

[2] **RCW 82.04.4292 AND ETB 460.04.146:** B&O TAX -- INTEREST INCOME -- LOAN TO DEALER -- INVENTORY OF MANUFACTURED HOMES -- LOAN TO BUYER-USER OF MANUFACTURED HOME -- RESIDENTIAL PROPERTY. Interest income from loan to dealer secured by UCC security interest on the manufactured home held in inventory of the dealer held not to be deductible from the measure of the tax. While in dealer's inventory, the manufactured home is not residential property because it is not used nor intended to be used as a residence while in inventory. Only after it is fixed in location for use as a residence by buyer/user does it become residential property. Under ETB 460.04.146, there are two types of nontransient residential property: (1) property zoned for residential use, and (2) property not so zoned but with a residence located on it.

Headnotes are provided as a convenience for the reader and are not in any way a part of the decision or in any way to be used in construing or interpreting this Determination.

TAXPAYER REPRESENTED BY: . . .

DATE OF HEARING: December 16, 1986

NATURE OF ACTION:

Petition for refund of Service business and occupation (B&O) taxes paid on the taxpayer's receipt of interest income from loans to dealers in manufactured homes and buyers of the homes where the taxpayer-lender retained a security interest in the property.

FACTS AND ISSUES:

Krebs, A.L.J. -- [The taxpayer] is a wholly owned subsidiary of . . . , a large banking institution. The taxpayer maintains an office in . . . , Washington. The taxpayer, commencing in 1984, has been engaged in financing the dealers who sell manufactured homes and financing the buyer-users of such homes. The taxpayer's receipts are solely from interest income on loans to the dealers and the buyer-users of the manufactured homes. None of the receipts relate to the actual manufacturing of the homes.

The manufactured homes are single width, double width and even larger. Single width units are self-enclosed with four walls. Double width units have three walls (one side is completely open) and are prepared for joining to one or more similar units on the open wall wide. The manufactured homes are typically delivered to the dealer's site and thereafter to the buyer's designated site. The delivery mechanism typically is removable wheels. Basically, the manufactured home is the equivalent of a mobile home. The taxpayer sometimes finances the cost of the land improvements to the buyer's homesite, that is, the improvements made to the homesite prior to the time the manufactured home is delivered. The land improvements include concrete footings, supports and/or concrete pad, sewers, telephone lines, electric lines, etc. The final assembly of the manufactured home occurs on the homesite and includes leveling, attaching double width units together at all open walls, connecting utility lines, joining roof elements, and removing wheels, if any.

A prospective buyer visits the independent manufactured home dealer, reviews the inventory and/or catalogs of manufactured homes available through that dealer and chooses a home. The buyer normally finances his purchase of that manufactured home. The taxpayer finances both the inventory of the dealer and the purchase by the retail buyer. About thirty percent of the taxpayer's income comes from financing the inventory of the dealer.

When the taxpayer finances the inventory of the dealer, it has a first mortgage lien on that manufactured home from the moment that the home arrives at the dealer's site. The taxpayer retains its first mortgage position until the ultimate purchaser completes payment for the home.

When the buyer purchases from the dealer's catalog and the taxpayer is financing the purchase, the taxpayer perfects its first mortgage lien at the time of the sale to the retail customer by fulfilling the requirements for security perfection mandated by the Uniform Commercial Code (UCC).

In order to reflect the purchase, the buyer completes an earnest money agreement which sets out the specifications and identifies, by serial number, model and other data, the manufactured home selected for purchase. The agreement shows the entire purchase price, the applicable sales tax, subtracts the amount to be paid both as earnest money and at the closing of the sale, and shows the amount to be financed. At the same time, the buyer completes a credit application which is then transmitted to the taxpayer for evaluation.

If the evaluation of the credit application is positive, the buyer completes a Retail Installment Contract-Security Agreement which specifically provides that the buyer grants to the taxpayer "a security interest under the UCC in the manufactured home." After this agreement is executed by the buyer, the taxpayer prepares a check payable to the dealer for the total net proceeds due the dealer as reflected in the underlying purchase documents. The certificate of title issued to the buyer shows the taxpayer as the legal owner with the buyer as registered owner.

The taxpayer seeks a refund of the Service B&O taxes and penalties paid for the tax periods included in 1984, 1985 and the first quarter of 1986. The taxes were paid on the taxpayer's receipt of interest income on loans made by it to the dealers and to the buyer-users of manufactured homes. The

loans were secured by UCC security interests with a first mortgage lien on the manufactured homes.

The taxpayer contends that under RCW 82.04.4292 the interest income was not taxable. RCW 82.04.4292 provides:

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.

To support its contention that UCC security interests in manufactured homes are first mortgages for purposes of RCW 82.04.4292, the taxpayer cites the unreported Pierce County Superior Court (1981) decision in Tacoma Savings & Loan Association v. The Department of Revenue, Docket No. 277826 . . . The taxpayer references also the following statutes:

RCW 62A.9-102 applies the uniform commercial code "to any transaction (regardless of its form) which is intended to create a security interest in personal property or fixtures . . .".

RCW 62A.9-103(2) states that goods covered by a certificate of title issued under a Washington statute where the certificate of title shows the security interest is considered perfection of the security interest under the Uniform Commercial Code.

RCW 62A.9-302(3)(b) states that a security interest in a manufactured home that is being held in inventory must be filed in order to perfect that security interest. RCW 62A.9-302(4) states that no separate filing is required if the notation of security interest is shown on the title of the goods. Thus, once the manufactured home has been sold to the ultimate user and a certificate of title is issued, the financing company must have its name shown as the legal owner of the property in order to have a perfected security interest.

RCW 46.12.095 requires that a security interest in a manufactured home must be noted on the certificate of title and that the notation on the certificate of title is the sole means by which the security interest is perfected.

DISCUSSION:

[1] The Superior Court in the Tacoma Savings case, supra, held that "a security interest under Article 9 of the Uniform Commercial Code comes within the definition of mortgage as that term is used under RCW 82.04.430(11)," recodified in 1980 to RCW 82.04.4292.

The exemption statute, RCW 82.04.4292, which is the focal point of our consideration, bears repeating at this time:

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 this case, the taxpayer is a financial business which derives amounts from interest received on loans primarily secured by UCC security interests with first lien (first mortgages per holding in the Tacoma Savings case). The exemption statute further requires that the first mortgage be "on nontransient residential properties" for the exemption to be granted.

In this case, about 70 percent of the taxpayer's interest income was from loans to buyer-users of the manufactured homes. Except for the possibility that a buyer-user may be renting out a manufactured home to transients, that is, for periods of occupancy of less than one month (see WAC 458-20-166), the first mortgage with respect to buyer-users was "on nontransient residential property." Accordingly, the taxpayer's interest income from the non-excepted buyer-users is exempt.

The other 30 percent of the taxpayer's interest income came from loans to the dealers who had the manufactured homes in their inventory. These loans were also secured by UCC security interests with first lien. But were they "nontransient residential properties" during the time that the manufactured homes were held for sale in the inventory of the dealer?

The meaning of "nontransient residential properties," not defined in the statutes nor regulations, may be gleaned from

ETB 460.04.146 (ETB 460), . . . , which in pertinent part states:

There are two types of nontransient residential property: (1) Properties zoned for residential use, and (2) property not so zoned but with a residence located on it.

. . .

The Department has concluded that "nontransient residential property" includes but is not limited to:

- Single family residences (one to four units)
- Apartments
- Permanent care nursing homes (occupants normally stay for more than 30 days)
- Permanent care convalescent homes (occupants normally stay for more than 30 days)
- Nontransient trailer park sites
- Construction loans for residential property including nontransient trailer park sites.

The term does not include:

- Hotels
- Motels
- Transient apartments (under 30 days)
- Churches

Neither of the above lists is meant to be exclusive.

The Department has also taken the position that property used for both residential and business purposes shall not be considered nontransient residential property if that part of the value of the property attributable to the business use exceeds 20 percent of the total value of the property.

The tenor of ETB 146 is that the property involved must be real property, not personal property, and must be used for nontransient residents.

The Superior Court in the Tacoma Savings case, supra, in pertinent part decided:

2.4 The use of the term "first mortgage" in RCW 82.04.030(11) includes personal property security interests in mobile homes as those held by the petitioner Tacoma Savings and Loan Association. (Emphasis supplied.)

The personal property security interests in mobile homes held by Tacoma Savings and Loan Association were on mobile homes acquired by buyer-users, not those held in inventory by seller-dealers.

In [a] Determination, cited by the taxpayer, the personal property security interests held by the lender in manufactured homes were on manufactured homes acquired by buyer-users, not those held in inventory by seller-dealers.

The Superior Court in the Tacoma Savings case did not expressly find the mobile homes on situs to be real property or personal property. However, we have no doubt that the Court would hold that mobile homes or manufactured homes on their homesites become real property. Property taxation statute RCW 84.04.090 in pertinent part provides:

The term "real property" for the purposes of taxation shall be held and construed to mean and include the land itself, . . . and all buildings, structures . . . of whatsoever kind thereon . . . The term real property shall also include a mobile home which has substantially lost its identity as a mobile unit by virtue of its being permanently fixed in location upon land owned or leased by the owner of the mobile home and placed on a permanent foundation (posts or blocks) with fixed pipe connections with sewer, water or other utilities. (Emphasis supplied.)

Real estate excise statute RCW 82.45.032 in pertinent part provides:

(1) "Real estate" or "real property" means real property but includes used mobile homes and used floating homes.

(2) "Used mobile home" means a mobile home which has been previously sold at retail and the immediately preceding sale has already been subjected to [retail sales] tax under chapter 82.08

RCW . . ., and which has substantially lost its identity as a mobile unit by virtue of its being fixed in location upon land . . . and placed on a foundation (posts or blocks) with fixed pipe connections with sewer, water and other utilities. (Bracketed words supplied.)

Records contained in the files of the Department of Revenue indicate that financial firms and lending institutions, in lobbying for the statutory exemption, argued before the legislature that the exemption was necessary in order to build up the depressed building market which existed in Washington State during the late 1960s. Thus, the purpose of this legislation was an attempt to stimulate land development for residential purposes by allowing a lending institution to lend its funds to such land developers and their customers and, in turn, receive interest income exempt from B&O taxation. As evidenced by ETB 460, the only interpretation of the exemption statute consistent with the legislature's intentions is to allow the deduction for interest income secured by first mortgages only on real property when "(1) . . . zoned for residential use" or "(2) . . . not so zoned but with a residence located on it." Manufactured homes in a dealer's inventory are not real property.

Without question, the manufactured home is property. It is personal property when in the inventory of the dealer. It is real property when fixed in location upon a foundation on land and has been connected to utilities. When does the manufactured home become "residential property?"

The taxpayer has furnished the definition of "residential" from Webster's Third New International Dictionary of the English Language, Unabridged as follows:

Used, serving, or designed as a residence or for occupation by residents.

[2] While the manufactured home is in the inventory of the dealer, it is not used nor does it serve as a residence, nor is it occupied by residents. The word "designed," as a verb, has the following meanings in our American Heritage Dictionary, New College Edition: "conceived, invented, contrived, and intended." While the manufactured home is in the inventory of the dealer, it cannot be conceived nor intended as a residence for occupation by residents. The manufactured home does not have the utility connections to make it habitable. The manufactured home is intended for

sale, not for residence while in the inventory of the dealer. We conclude that the manufactured home is not residential property while it is in the inventory of the dealer. Accordingly, the deduction in RCW 82.04.4292 is not available to the taxpayer with respect to interest received on loans to dealers.

The taxpayer has presented the following parallel analogy. A land developer has "stick built" (dwellings constructed from scratch on site) houses in a housing development. The houses are unsold. The houses are being held in inventory and the interest income received by a commercial lender holding the first mortgage on these dwellings is exempt from B&O tax under RCW 82.04.4292.

The taxpayer maintains that there is no substantive difference between the developer's dwellings held in inventory waiting to be sold and dwellings held on a dealer's inventory waiting to be sold.

However, the difference is that in the land developer's situation it is the real property "with a residence located on it" that has been mortgaged; see ETB 460 where such property is held to be a type of "residential property."

DECISION AND DISPOSITION:

The taxpayer's petition is granted in part and denied in part. The taxpayer is entitled to a refund of the B&O taxes paid plus penalties paid thereon for late payment with respect to interest income on loans to non-excepted buyer-users of manufactured homes. The taxpayer is not entitled to a refund of the B&O taxes paid with respect to interest income received on loans to the dealers in manufactured homes. This matter is being referred to the Department's Audit Section to compute the amount of the refund plus applicable statutory interest in accordance with the decision.

DATED this 19th day of June 1987.