Cite as Det. No. 92-073, 12 WTD 131 (1993).

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

In the Matter of the Petition For Correction of Assessment of	)	D E T E R M I N A T I O N
	)	No. 92-073
. . .	)	Registration No. . . .
	)	. . ./Audit No. . . .

[1] RULE 111: B&O TAX -- ESCROW AGENTS -- ADVANCES AND REIMBURSEMENTS -- LOAN COSTS. Escrow agent not liable other than as agent for third-party fees charged to clients for title insurance, credit reports, and appraisals to process mortgages. The escrow agent could exclude deposits for these client expenses deposited in its trust account.

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: . . .

NATURE OF ACTION:

A mortgage broker that is also an escrow agent appeals the assessment of service B&O tax on advances deposited in its escrow account to pay for title insurance, credit reports and appraisals.

FACTS AND ISSUES:

Pree, A.L.J. -- The taxpayer is an escrow agent and mortgage broker. It does not lend money directly but arranges loans for other lenders. It maintains a trust account where customer funds are deposited to pay expenses that the customers have agreed to pay.

The taxpayer was audited for the period from January 1, 1986 through March 31, 1990. The auditor included the customer's payments to the taxpayer's trust account for the various third party services required to obtain mortgages, assessing service and other activities business and occupation tax plus interest. The taxpayer contests the entire amount.
A customer seeking to qualify for a loan would sign an agreement appointing the taxpayer as the escrow agent.[1] The taxpayer did not retain or service any of the mortgages/deeds of trusts that it assisted the customers in obtaining. It provided the customer an estimate of the fees and charges that it arranged and required the customer to pay the fees in advance. The fees were deposited in its trust account. They were not included in the taxpayer's measure of business and occupation tax.

The auditor contends that the funds paid by the borrowers to the trust account were taxable income to the taxpayer. The taxpayer states that it was not liable for the expenses paid with these funds. It contends that these funds should not be included in its measure of tax under WAC 458-20-111 (Rule 111).

After the hearing, the taxpayer provided a statement from a title insurance company that it did not consider the taxpayer liable for its fees. In the event a transaction cancelled, the title insurance company said that it would not pursue the taxpayer for its fees. The taxpayer also indicated that the appraisal firm that did most of the appraisal work for the taxpayer's customers would bill the customers in care of the taxpayer rather than considering the taxpayer directly liable for the appraisal fees.

DISCUSSION:

RCW 82.04.220 imposes business and occupation tax on the gross income of a business. RCW 82.04.080 defines "gross income of the business" as the value proceeding or accruing by reason of the transaction of the business engaged in. Rule 111 excludes advances and reimbursements from income. It applies only when the customer or client alone is liable for the payment of the fees or costs and when the taxpayer making the payment has no

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[1] Typically the agreement is contained on the standard Puget Sound Multiple Listing Association Form No. 21 - Residential Real Estate Purchase and Sale Agreement and Form No. 22A - Financing Addendum to Purchase and Sale Agreement.

personal liability therefor, either primarily or secondarily, other than as agent for the customer or client.

The taxpayer states that it is not liable other than as an agent for the fees incurred on behalf of its customers. This was corroborated by the letter it provided from one of the title insurance companies stating that if the customers did not pay for the preliminary title report, the title company did not hold the taxpayer responsible for payment.
Most of the income in question constituted advances from the taxpayer's customers to the account. After receiving the advance and depositing it the escrow account, the taxpayer would order title insurance, credit reports, and an appraisal. The taxpayer would pay those fees from the escrow account. As a certified escrow agent, the taxpayer was required to keep a separate escrow fund account under RCW 18.44.070. That statute provides that the escrow fund account be kept, "separate and apart and segregated from the agent's own funds". The statute prohibits it from disbursing funds from that account unless there had been a deposit directly relating to the account which was equal to or greater than the disbursement.

The taxpayer used the account only to hold other peoples' money forwarded to it. After completing a transaction, the taxpayer received its fee from the escrow account by writing a check to itself pursuant to the escrow agreement and instructions. See WAC 308-128E-011(12)(a).

WAC 308-128E-011 is the Department of Licensing's regulation governing the administration of funds in escrow accounts. It prohibits the escrow agent from using such funds for the benefit of the agent. Subsection (8) provides that the reconciled trust account(s) must equal at all times the outstanding trust liability to clients. Subsection (14)(a) prohibits the use of the account for items not pertaining to a specific escrow transaction or escrow collection account.

Probably the regulation language that is most relevant to this determination regarding the nature of these deposits is contained in WAC 308-128E-011(14)(d), which prohibits disbursements from the account:

> In payment of a fee owed to any employee of an agent or in payment of any business expense of the agent. Payment of fees to employees of an agent or of any business expense of the agent shall be paid from the regular business account of the agent; . . .

We find that funds deposited in this account are not the taxpayer's receipts. It is clear that the taxpayer cannot use

the account for its expenses. The taxpayer is not liable for the expenses paid from this account other than as agent for the customer or client.

The restriction contained in WAC 308-128E-011(14)(d) is similar to the restriction in the Washington Code of Professional Responsibility for attorney trust accounts and client expenses. See Christensen, O'Connor, Garrison & Havelka v. Department of Rev., 97 Wn.2d 764 (1982) and Walthew v. Department of Rev., 103 Wn.2d 183 (1984). In Christensen, the court held that client reimbursements were exempt from gross income under Rule 111. The parties had stipulated that third-party providers understood that they were working for named clients. In Walthew, the court allowed exclusion, finding that the third-party costs were the obligation of the client and at most, the attorney assumed the liability "only as agent" of the client. The same analysis should apply to escrow agents.

It is necessary to distinguish this from prior department determinations (Det. No. 89-461, 11 WTD 21 (1989) and Det. No. 90-95, 9 WTD 189 (1990)) for charges by banks for similar expenses related to mortgages. In those determinations, the banks were found to be liable for the third-party expenses. Other than bare assertions, no evidence had been provided to establish that the banks were acting as agents. There is no indication that escrow accounts subject to the limitations of RCW 18.44.070 were used.

In this case, the taxpayer has provided third-party evidence that it was not liable for the third-party services. The banks were liable for the expenses. As an escrow agent, the taxpayer was legally prohibited from using the escrow account for its own business expenses. There is no indication in the bank determinations that the banks had a similar legal prohibition.

DECISION AND DISPOSITION:

The taxpayer's petition is granted. Amounts deposited in the escrow account were not includable in the taxpayer's measure of tax.

DATED this 23rd day of March 1992.