

Cite as Det No. 12-0374, 32 WTD 198 (2013)

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition for Correction of)	<u>D E T E R M I N A T I O N</u>
Assessment of)	
)	No. 12-0374
...)	
)	Registration No. . . .
)	Document No. . . . Audit No. . . .
)	
)	Docket No. . . .

[1] RULE 156; RCW 82.04.050: B&O TAX – RETAIL SALES TAX – ESCROW SERVICES – RECONVEYANCE FEES – DOCUMENT PREPARATION CHARGES. Reconveyance fees and document preparation charges received by an escrow company were subject to the retail sales tax and retailing business and occupation tax.

[2] RULE 111: ADVANCES AND REIMBURSEMENTS – ESCROW SERVICES. An escrow company could not exclude from gross income reconveyance fees and document preparation changes paid to third parties.

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.

M. Pree, A.L.J. – An escrow company that prepared documents and hired a third party to file the documents protests retail sales tax assessed on its charges for those services. Because the documents needed to be prepared and then recorded to complete the escrow, charges for those activities constituted escrow services subject to retail sales tax. We deny the petition.¹

ISSUES

1. Under WAC 458-20-156 (Rule 156), are reconveyance fees and document preparation charges taxable as escrow services?

¹ Identifying details regarding the taxpayer and the assessment have been redacted pursuant to RCW 82.32.410.

2. Are charges for reconveyance fees and document preparation performed by third parties excludable from the measure of tax as reimbursements under WAC 45-20-111?

FINDINGS OF FACT

[Taxpayer] is a licensed escrow company in Washington. The taxpayer's president is also a licensed practice officer (LPO) and drafts documents. In addition to charging its clients escrow fees, the taxpayer also charged clients for documents it prepared, courier fees from third parties who delivered the documents, and a reconveyance fee from third parties who recorded the documents. The taxpayer did not add retail sales tax to document charges, courier fees, or reconveyance fees.

The Department of Revenue (Department) investigated the taxpayer's activities for the period from January 1, 2006, through March 31, 2009. The Department's Audit Division issued two assessments. Document No. . . . assessed \$. . . in retail sales tax and \$. . . in retailing business and occupation (B&O) tax on \$. . . unreported reconveyance fees and \$. . . unreported courier fees. That assessment totaled \$. . ., including \$. . . in interest and a 5% assessment penalty of \$. . . . The taxpayer appealed that entire assessment. Document No. . . . assessed \$. . . in net taxes. That assessment totaled \$. . ., including \$. . . in interest and a 5% assessment penalty of \$. . . . Document No. . . . assessed retail sales tax and retailing B&O tax on document preparation, which the taxpayer disputes. Otherwise, the taxpayer agrees with the rest of Document No. . . .

On appeal, the taxpayer provided an explanation of the fees at issue. While the parties could prepare the documents or have their attorneys prepare them, the document preparation fees at issue were for documents prepared by the taxpayer. The taxpayer's LPOs could prepare deeds, and other forms including powers of attorney, reconveyances, mortgages, releases, satisfactions, and bills of sale. According to the taxpayer, only LPOs and attorneys were authorized to prepare these documents, and, therefore, could not be done by someone holding an escrow license only.² The taxpayer explains that it separated its escrow fees upon which it charged, collected, and remitted retail sales tax to the Department, from its other charges. Therefore, the taxpayer reasons that its document preparation fees did not constitute escrow services, and its charges to prepare these documents were not subject to retail sales tax. The documentation preparation charges were listed as a separate charge to the parties on each closing statement, and were paid from clients' funds at settlement.

In the course of closing real estate sales, the buyers and sellers signed the taxpayer's [agreement] in which the taxpayer agreed, ". . . to select, prepare, complete, correct, receive, hold, record, and deliver documents as necessary to close the transaction." The agreement provided that the taxpayer's fees were intended as compensation for the services set for in the agreement. The parties agreed to pay the taxpayer for any additional services required including any out-of-pocket costs and expenses.

² The taxpayer explained that if it only had an escrow license, it would sell escrow services and have an attorney or an LPO prepare the documents.

According to the taxpayer's escrow instructions, the taxpayer was responsible to record the documents necessary to close the transaction. The taxpayer states that it paid a reconveyance company to make sure documents were properly recorded. The reconveyance company would bill the taxpayer, who would add that charge as an additional fee paid from the client's funds at settlement.

The taxpayer now understands that its courier fees were part of its escrow services, and no longer contests the taxes assessed on courier fees.³ All the fees appeared on separate lines on the final SETTLEMENT STATEMENT (HUD-1) prepared by the taxpayer for closing. The taxpayer's escrow fee with sales tax appeared on a separate line of the HUD-1 form.

ANALYSIS

[1] Businesses engaging in retail activities must collect and remit retail sales tax on their retail sales. RCW 82.08.050. Retail sales include charges for "escrow services" under RCW 82.04.050(3)(b). We will analyze whether the amounts it charged on the closing statements for document preparation and as "reconveyance" fees should be taxed as escrow services.

Retail sales tax is measured by the "Selling price" or "sales price," which means for retail sales tax purposes:

[T]he total amount of consideration, except separately stated trade-in property of like kind, including cash, credit, property, and services, for which tangible personal property, extended warranties, or services defined as a "retail sale" under RCW 82.04.050 are sold, leased, or rented, valued in money, whether received in money or otherwise. No deduction from the total amount of consideration is allowed for the following: (i) The seller's cost of the property sold; (ii) the cost of materials used, labor or service cost, interest, losses, all costs of transportation to the seller, all taxes imposed on the seller, and any other expense of the seller; (iii) charges by the seller for any services necessary to complete the sale, other than delivery and installation charges; (iv) delivery charges; and (v) installation charges.

RCW 82.08.010(1).

Retailing B&O tax is imposed by RCW 82.04.250 on the gross proceeds of sales, multiplied by the applicable B&O tax rate. "Gross proceeds of sale" is defined in RCW 82.04.070 as:

³ The Department has held that escrow charges received by an escrow agent from buyers or sellers for third-party messenger services are subject to sales tax and retailing B&O tax. *See* Det. No. 89-237, 7 WTD 316-7 (1989). That determination cited the definition of "gross proceeds of sales" in RCW 82.04.070, and the similar definition of "selling price" in RCW 82.08.010(1)(a), and concluded that for purposes of calculating the B&O tax and the retail sales tax, respectively, delivery costs are part of the measure of the tax and must be included in the gross proceeds of sales and the selling price whatever the delivery method.

[T]he value proceeding or accruing from the sale of tangible personal property and/or for services rendered, without any deduction on account of the cost of property sold, the cost of materials used, labor costs, interest, discount paid, delivery costs, taxes, or any other expense whatsoever paid or accrued and without any deduction on account of losses

The Department adopted Rule 156 to administer the taxes for escrow businesses. Rule 156 provides in pertinent part:

The gross receipts of . . . “escrow” businesses include all service charges representing . . . a charge for . . . an escrow fee or service charge received by “escrow agents.”

Business and Occupation Tax

. . . escrow businesses are taxable under the classification retailing on gross receipts from fees or premiums charged to consumers for . . . escrow services.

Retail Sales Tax

The retail sales tax must be collected and reported by . . . escrow businesses on fees or premiums charged for such services. The retail sales tax is applicable to sales to such businesses of forms, office supplies and equipment for use in the conduct of such businesses.

Escrow services are retail sales. Gross receipts received by an escrow agent from its customers for escrow services are subject to retailing B&O tax. Escrow agents must collect and report retail sales tax on fees or premiums charged for such services. *Id.*; *See* Det. No. 91-316, 11 WTD 285 (1991); *see also* Det. No. 90-231A, 12 WTD 305 (1990) (holding that amounts received by an escrow company from activities relating to deeds of trust are subject to the retailing B&O tax and retail sales tax.).

LPOs and attorneys employed by escrow companies perform escrow services subject to retail sales tax:

(III) A certified escrow agency, owned by a principal qualified under APR 12 (the limited practice rule for limited practice officers), provides both escrow and the limited legal services allowed under APR 12 to its clients. The escrow company itemizes the services provided. APR 12(d) allows a limited practice officer to select, prepare and complete documents in a form previously approved by the board for use in closing a loan, extension of credit, sale or other transfer of real or personal property. The nature of this limited license prevents an escrow company using limited practice officers from ever engaging in legal services as a primary activity in a real estate closing. Accordingly, the escrow company will report the income from escrow and closings under the retail sales classification (see WAC 458-20-156, Abstract, title insurance, and escrow business).

(IV) The same facts as above, but the escrow company hires employees who are attorneys to provide the allowable limited legal services. The result is the same. Under RPC 5.4, an attorney is prohibited from sharing legal fees with a nonlawyer and, under RPC 5.5, cannot assist a person who is not a member of the Bar Association in the performance of an activity that constitutes the unauthorized practice of law, and under RPC 7.1 a lawyer cannot make false or misleading communications about the lawyer or the lawyer's services. Accordingly, an attorney hired by an escrow company would not be providing legal services to the escrow companies' clients except to the extent authorized for a limited practice officer. Since only limited legal services can be offered, the escrow company would continue to report all fees from both the escrow and closing services under the retail sales tax classification.

WAC 458-20-207(3)(d)(iii)(B)(III & IV) (Rule 207).

Escrow agents close real estate transactions. WAC 208-680-030 explains

"Providing escrow services" means conducting transactions, except the acts of a qualified intermediary in facilitating an exchange under section 1031 of the Internal Revenue Code, wherein any person or persons, for the purpose of effecting and closing the sale, purchase, exchange, transfer, encumbrance, or lease of real or personal property to another person or persons, delivers any written instrument, money, evidence of title to real or personal property, or other thing of value to a third person to be held by such third person until the happening of a specified event or the performance of a prescribed condition or conditions, when it is then to be delivered by such third person, in compliance with instructions under which he or she is to act, to a grantee, grantor, promisee, promisor, obligee, obligor, lessee, lessor, bailee, bailor, or any agent or employee thereof.

The escrow instructions identify the duties and responsibilities of the escrow agent in carrying out the escrow. According to the taxpayer's escrow instructions, its fees, costs and expenses were due at closing. WAC 208-680-030 defines a "completed escrow" to mean:

... a transaction in which the escrow agent has fully discharged its duties to the principal parties to the transaction. This includes, but is not limited to: Obtaining all necessary documents, obtaining required signatures, completing reconveyance or title elimination, and disbursing funds to the principal parties to the transaction, the agents to the transaction, and to third parties to the transaction as agreed by the principal parties in the escrow instructions or on the settlement form (such as HUD-1 or HUD-1A).

The taxpayer, as an escrow company, was required to obtain the necessary documents to close escrow. In some cases, the taxpayer prepared them to fulfill this requirement. Its documentation preparation activities constituted escrow services because the documents were necessary to close the transaction. Similarly, the taxpayer was responsible to record the documents to complete the reconveyance. Under WAC 208-680-030, completed documents and reconveyance activities are

necessary to complete escrow. We conclude those activities constituted escrow services subject to retail sales tax.

[2] While the taxpayer may glean from its instructions that its charges for reconveyance were merely reimbursements, the taxpayer's charges for those services were not excludable from its measure of tax as reimbursements. WAC 458-20-111 (Rule 111) provides authority to exclude certain "reimbursements" from tax. Rule 111 defines "advance" and "reimbursement" and excludes from the measure of tax money received (pass-through payments) by a taxpayer as a reimbursement of an advance in accordance with the regular and usual custom of the business. In *Walthew, Warner, Keefe, Arron, Costello & Thompson v. Dep't of Revenue*, 103 Wn.2d 183, 188, 691 P.2d 559 (1984) the Washington Supreme Court affirmed that amounts merely "passing through" a business in its capacity as an agent for the client are not taxable.

. . . Excise Tax Advisory (ETA) 3100.2009 states:

In order to exclude these payments from the measure of tax, the Washington State Supreme Court has ruled that two conditions must be met. The taxpayer must first establish that it received the funds as the agent of the customer or client. If this first condition is satisfied, the taxpayer must also establish that its use of the funds to pay a third party is solely as an agent of the customer or client. *City of Tacoma v. William Rogers Co.*, 149 Wn.2d 169, 60 P.3d 79 (2002).

[The Court reiterated these requirements more recently in *Washington Imaging Services, LLC v. Dep't of Revenue*, 171 Wn.2d 548, 561-63, 252 P.3d 885 (2011).] Therefore, in order for taxpayers to legally take the Rule 111 exclusion, they must first establish that they had an agency relationship with their customers and that they had acted solely in an agency capacity when paying the third-party service providers.

In Det. No. 89-237, 7 WTD 316-7 (1989), the Department held that the Rule 111 exclusion did not apply because the taxpayer in that case was not acting solely as an agent for another party, even though it had contracted with the messenger service for the services rendered. The taxpayer was liable for the disputed third-party reconveyance services it contracted for in order to provide its escrow services. It was not acting solely as an agent for the buyers or sellers. The same is true here. Consequently, the Rule 111 exclusion does not apply in the present matter.⁴

⁴ By contrast, the Department has recognized that escrow agents are not liable, other than as an agent, for third-party fees charged to their customers for title insurance, credit reports, and appraisals. Escrow agents can exclude deposits for these customer expenses deposited in the escrow agents' trust accounts. Det. No. 92-073, 12 WTD 131 (1992); Det. No. 94-092, 14 WTD 251 (1994). These amounts are required by law to be held in trust and never accrue to the benefit of the escrow agent. The escrow agent is not permitted to expend such funds for any purpose other than specific third-party costs or refunds to the customers. *Id.*

Also, the Department has adopted Excise Tax Advisory 3095.2009, which explains that loan application deposits are payments made to a lending institution by a person applying for a mortgage loan. They are used by the lending institution to purchase third party services for the applicant that are necessary for the institution to evaluate the loan application. The services purchased with these funds typically include an appraisal of the subject property, a credit

DECISION AND DISPOSITION

The taxpayer's petition is denied.

Dated this 27th day of December 2012.

report, and a title report. In some cases, they may also be used for inspection fees (pest, septic tank, etc.). Several conditions must exist for a loan application deposit to be considered as an advance that is not included in the definition of "gross income of the business" (RCW 82.04.080). If all of the conditions are present, loan application deposits received by lending institutions should not be reported as gross income subject to the B&O tax. Taxpayers must keep sufficient records to substantiate the existence of each of the conditions listed.