Cite as 9 WTD 189 (1990)

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. 90-95
. . .	)	Registration No. . . .
	)	. . . /Audit No. . . .

[1] RULE 111: B&O TAX -- ADVANCES AND REIMBURSEMENTS -- FEES AND COSTS. Fees and costs charged to customers of a bank for processing loan applications (costs for credit reports, title insurance, property appraisals, etc.) are not excludable under Rule 111 when the bank itself is liable for the payment of the costs. Accord: Christensen v. Department of Revenue, 97 Wn.2d 764 (1982)

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 CONFERENCE: July 20, 1989
September 14, 1989

NATURE OF ACTION:

Taxpayer protests the assessment of tax on amounts it received for appraisal, title insurance, and other fees.

FACTS AND ISSUES:

Hesselholt, A.L.J. -- Taxpayer bank was purchased by [X] Bank, who merged it with [Y] Bank. The Department of Revenue audited taxpayer's books for the period July 1, 1985 through April 30, 1988. An assessment was issued in the amount of $.

. . , which included taxes and interest. Taxpayer protests part of that assessment.

Taxpayer initially protested the tax assessed on obligations of municipal corporations or political subdivision. This amount will be adjusted in accordance with the holding of Det. 89-370, 7 WTD __, 1989.

Taxpayer also protested tax assessed on amounts it charged to loan customers for appraisals, credit reports, title insurance, and recording and filing fees. Taxpayer alleges that these amounts are non-taxable reimbursements, under WAC 458-20-111 and Christensen v. Department of Rev., 97 Wn.2d 764 (1982).

Taxpayer states that it

> is in the business of making loans and is not in the business of providing appraisal, credit report, title insurance or recording services. The taxpayer merely serves as an agent in procuring such services as an incident to its business. Upon the origination of a loan, the taxpayer accepts separate deposits for the items referred to above. Deposits are placed in a separate clearing account until payment is actually made. Recording and filing advancements are not directly receiving by the taxpayer but rather represent adjustments to the debtor's loan amount.
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> The Department should realize that the taxpayer assumes his agency role with respect to these advances only to fulfill regulatory requirements and to perform agency functions that the borrower either cannot perform or cannot perform expeditiously. The advances are at no time the property of the taxpayer and, therefore, do not constitute the taxpayer's gross receipts. The taxpayer is separately compensated for his agency services and in no way do the advances represent compensation to the taxpayer.

The Audit Division explains the items as follows:

> When a customer applies for a loan the bank [taxpayer] requests a credit report from a credit bureau, an appraisal from an appraiser, and a title

> insurance report on property. The respective service providers bill the bank. The bank passes along the charge to its customer. Once the loan is approved the bank records itself as lienholder on the property involved and files other regulatory documentation. The fees charged the bank for such recording are passed on to the bank's customer as recording/filing fees.

Taxpayer also requested, if its petition was denied on this issue, a ruling regarding whether having the service providers bill in the customer's names would qualify it as an agent for such fees.

DISCUSSION:

RCW 82.04.290 imposes a tax upon the persons engaged in business activities other than or in addition to those for which a specific rate is provided elsewhere in chapter 82.04 RCW. Such persons are taxable upon the gross income of the business, defined at RCW 82.04.080 as follows:

> "Gross income of the business" means the value proceeding or accruing by reason of the transaction of the business engaged in and includes gross proceeds of sales, compensation for the rendition of services, gains realized from trading in stocks, bonds, or other evidences of indebtedness, interest, discount, rents, royalties, fees, commissions, dividends, and other emoluments however designated, all without any deduction on account of the cost of tangible property sold, the cost of materials used, labor costs, interest, discount, delivery costs, taxes, or any other expense whatsoever paid or accrued and without any deduction on account of losses.

(Emphasis added.)

Thus, unless taxpayer can prove that the amounts are "advances" under WAC 458-20-111 (Rule 111), they are subject to tax. Rule 111 does not, strictly speaking, provide an exemption or deduction from the business and occupation tax. Instead, Rule 111 merely recognizes that "advances" and "reimbursements", as defined therein, may be excluded from the measure of the tax because they did not fall within the definition of "gross income of the business."

In Christensen, the court recognized that certain costs which were ostensibly incurred by attorneys in rendering legal services were actually the direct costs of their clients. Consequently, the court held that amounts received by attorneys with which to pay these costs were excludable from the measure of their business and occupation tax pursuant to WAC 458-20-111.

The Christensen court identified requirements for excludability under WAC 458-20-111 as follows:

1. The repayments received by the taxpayer must be reimbursements or advances made as part of the regular and usual custom of the taxpayer's business or profession.

2. The payments made by the taxpayer to associate firms must be for services that the taxpayer does not or cannot render.
3. The taxpayer must not be liable for paying the associate firms except as an agent of the client.

Christensen and the Department stipulated that the first two requirements had been satisfied; the sole dispute involved the third requirement. As to this issue, the parties stipulated that the associate firms understood that they were working for the named client with respect to the work performed. The Department argued that Christensen was nevertheless personally liable for payment to the associate firms. The court found otherwise, based on its interpretation of the general agency rule stated in Restatement (Second) of Agency ¶ 79 comment a. at 200:

> a. Whether or not the agent is authorized to employ agents of the principal depends upon the manifestations of the principal in light of the circumstances, including the usages of the business and of the parties inter se. The agents so employed are the agents of the principal and not of the employing agent, who is not responsible to them for their compensation unless he so manifests, and is no more responsible for their conduct to third persons or to the principal than he is for the conduct of other agents of the principal, unless he is negligent in their selection. (Emphasis the court's.)

The Christensen case involved "reimbursements" for money already expended by that taxpayer in payment of costs or fees for its clients. In the present case, the taxpayer normally receives money from its customers prior to paying its outside service providers; such payments are "advances." In our view, the holding and rationale of the Christensen decision apply equally to both "advances" and "reimbursements."

[1] Applying the foregoing Christensen requirements for excludability to the facts of this case, we find that the first two have been satisfied. The evidence reveals that the taxpayer obtains from its clients funds with which to pay third party providers which assist the taxpayer in processing loan applications. This has been the regular and usual custom of the taxpayer's business over the course of many years.

As in the Christensen case, however, the issue here is whether the taxpayer is liable in its own behalf for payment to the outside providers. Here there is no evidence offered to indicate that the outside providers recognized that they were to be paid only from funds received from the taxpayer's customer, or that the taxpayer would not be liable to them for compensation if such funds were not received for any reason.

There is likewise no evidence to indicate that either the taxpayer's customers or providers recognized the taxpayer to be dealing with those providers merely as an agent for those customers.

Taxpayer has not argued that it is not liable for payment to the providers of the service; it has argued only that

> the customer understands that a third party will perform the service as evidenced by the deposit. In fact, the customer assumes the risk by making an additional payment if the service costs more than the deposit and enjoys the benefit of a refund if the service costs less than anticipated.

Accordingly, we must conclude that the third element required by Christensen has not been met and that the tax was properly due under the rationale of that case.

Taxpayer has also requested a ruling as to whether billing fees and costs in the name of the customer would satisfy the Rule 111 requirements for agency.

As pointed out in the case of Rho Company, Inc. v. Department of Rev., 113 Wn.2d 561, 573 (1989) ". . . the standard definition of agency should be used in analyzing Rule 111. . . " The court went on to point out that to fit within the exclusion, Rho's liability for the payments had to be solely that of an agent. Here, for taxpayer to fit within that requirement, it must be clear that it has no liability to pay for the fees--that the fees are the sole liability of the customers of taxpayer. Any indication that the provider looks to the bank for payment would defeat that claim.

DECISION AND DISPOSITION:

Taxpayer's petition is denied in part and granted in part. The Audit Division shall issue a new assessment, to be due on the date stated therein.

DATED this 26th day of February 1990.