AUDITOR’S DETAIL OF DIFFERENCES
AND INSTRUCTIONS TO TAXPAYER

Olympic Peninsula Title Co Inc

Registration Number 600 440 548

Your records have been audited for the period of January 1, 2011 through June 30, 2015.

Objective and Methodology

The objective of this audit is to verify that your Washington State business activities and transactions were properly reported on your excise tax returns. The Department of Revenue (Department) administers a number of tax programs that have their own application or tax return. This report is qualified to the extent that the Department reserves the right to verify any other liability within the statute of limitations period.

The audit was conducted at your business office and the Department of Revenue Port Angeles field office.

Various procedures were used to reach conclusions regarding your compliance with reporting requirements. The conclusions reached were based on the auditor’s understanding of records provided, explanations furnished, and other observations made.

Business Activities

Your business activities in Washington State during the audit period included operating a title & escrow company. You have offices in Sequim and Port Angeles, Washington.

References

The instructions in this report may address the application of the Revised Code of Washington (RCW), the Washington Administrative Code (WAC), the Washington Tax Decisions (WTD), the Excise Tax Advisories (ETA), and all other stated references. All authoritative references are available at the Department’s website at dor.wa.gov.

The following abbreviations may also be used in this report: business and occupation (B&O) tax, public utility tax (PUT), Multiple Activities Tax Credit (MATC), Small Business Tax Credit (SBC), and Regional Transit Authority (RTA) Washington Tax Determination (WTD).

Specific Written Instructions

These instructions constitute “specific written instructions” within the meaning of RCW 82.32.090. Failure to follow the instructions may subject the taxpayer to an additional 10 percent negligence penalty.

Schedule 1 – Summary of Tax Adjustments by Classification

This schedule summarizes the tax difference as calculated on supporting Schedule 2.

Schedule 2A - Service & Other Activities Tax Adjustment on Income Reconciliation Differences

Schedule 2B - Retailing B&O Tax Adjustment on Income Reconciliation Differences

Schedule 2C - Retail Sales Tax Adjustment on Income Reconciliation Differences - Port Angeles

Schedule 2D - Retail Sales Tax Adjustment on Income Reconciliation Differences – Sequim

Gross Income

RCW 82.04.070 defines gross proceeds of sales as:

“the value proceeding or accruing from the sale of tangible personal property, digital goods, digital codes, digital automated services, and/or for other services rendered without any deduction on account of the cost of property sold, the cost of materials used, labor costs, interest, discounts paid, delivery costs, taxes, or any other expenses whatsoever paid or accrued and without any deduction on account of losses.”

Gross Proceeds Subject to Tax

Chapter 82.04 RCW imposes B&O tax upon the “gross proceeds of sales” and/or “gross income of the business” for the act or privilege of engaging in all activities, either directly or indirectly, within Washington State with the object of gain, benefit, or advantage to the taxpayer. These activities include, but are not limited to, wholesaling, service, and retailing. Wholesaling is defined by RCW 82.04.060 to mean any sale of tangible personal property to persons who are not consumers; that is, sales for resale. Service is defined by RCW 82.04.290 as any business activities engaged in other than or in addition to those specifically enumerated in Chapter 82.04 RCW. A retail sale is defined by RCW 82.04.050 as a sale to the ultimate consumer. In general, all sales of goods or services to persons in Washington are subject to the B&O tax.

Selling Price

RCW 82.08.010 and WAC 458‑20‑107 explains the term “selling price” as the consideration given, whether money, credits, rights, or other property except trade-in property of like kind, without any deduction on account of the cost of tangible personal property sold, the cost of materials used, labor costs, interest, discount, and delivery costs.

When the seller advertises the price as including the retail sales tax, a tax in gross deduction is allowed.

*Title and Escrow Companies*

WAC 458-20-156 states:

The gross receipts of "abstract," "title insurance" and "escrow" businesses include all service charges representing an abstract fee, a charge for a title insurance fee or premium, or an escrow fee or service charge received by "escrow agents."

The term "escrow" means any transaction 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 is to act, to a grantee, grantor, promisee, promisor, obligee, obligor, lessee, lessor, bailee, bailor, or any agent or employee thereof.

"Escrow agent" means any sole proprietorship, firm, association, partnership, or corporation engaged in the business of performing for compensation the duties of the third person referred to in the foregoing definition.

Abstract, title insurance and escrow businesses are taxable under the classification retailing on gross receipts from fees or premiums charged to consumers for abstract, title insurance or escrow services.

The gross income from collection contracts which do not involve an escrow as above defined is subject to tax under the classification service and other activities.

The retail sales tax must be collected and reported by abstract, title insurance and 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.

Amounts received by an escrow company from activities relating to deeds of trust are generally subject to retailing and retail sales taxes. They are subject to the service and other activities classification if they are fees derived from services rendered when the company is named as trustee on the deed of trust.

RCW 18.44.011 defines “Escrow” to include the collection and processing of payments and the performance of related services by a third party on seller-financed loans secured by a lien on real or personal property but excludes vessel transfers.

Services Typically Part of Escrow Services

Outlined in the publication, *Consumer’s Guide to Title Insurance and Escrow Services,* published in cooperation by the Washington State Office of the Insurance Commissioner and the Washington State Department of Financial Institutions, is the following information:

The Cost of Escrow Services

“You should know that escrow fees are not regulated by the State. Some escrow agents will offer a low escrow fee, but charge you other incidental fees related to the transaction, which increases the total escrow fee. Other incidental costs may include:

* Wire transfer fees
* Tracking or reconveyance fees (a reconveyance fee is what title insurers charge you to cover the cost of removing your current lender’s lien from your property title when you refinance)
* Trustee fees
* Electronic document fees
* Courier fees
* Fax fees
* Copying fees
* Trust accounting fees

The escrow agent should provide you the total fee amount he or she will charge you so you can compare prices or fees effectively.”

Advances & Reimbursements

RCW 82.04.070 and RCW 82.04.080 define “gross proceeds of sale” and “gross income of business.” These amounts are the basis for computing the B&O tax. The definitions of these terms found in the law provide no deduction for costs of doing business, such as the cost of property sold, cost of materials used, labor costs, interest, delivery costs, or any other expense whatsoever paid or accrued and without any deduction on account of losses. Regardless of whether itemized expenses billed to customers are actual or marked up, such amounts are considered part of gross income and subject to tax.

The words “advance” and “reimbursement,” as defined in WAC 458‑20‑111, apply only when the customer or client alone is liable for the payment of fees or costs. Advances and reimbursements may be excluded from taxable amounts only when they meet all of the following conditions:

* They are a customary reimbursement for an advance made to procure a service for the client.
* They are for services that the taxpayer does not and cannot render.
* The taxpayer is not liable for the payment except as an agent for the client.

Rule 111 allows reimbursements to be excluded from gross income 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 personal liability therefore, either primarily or secondarily, other than as agent for the customer or client.” Rule 111 has been interpreted as requiring that the taxpayer prove that the advance in question was made pursuant to an agency relationship, and prove that the taxpayer's liability to pay the advance constituted solely agent liability.

Account Descriptions and Related Issues

**Advance Funds Account – by Location – Workpaper A2**

This account is listed in your chart of accounts as an “Other Current Asset” balance sheet account. You record entries here for *Recording Fees* and *Excise Tax*. Audit has removed the *Excise Tax* entries as not subject to tax. The billing for both fees is based on the amounts charged you by the County Assessor’s office at the time of document recording.

* *Recording Fees*

The recording fees detailed in the Advance Funds account are payments to the local county assessor’s office for recording original documents such as a Deed or Deed of Trust. It is typical that this function is part of the escrow services provided.

The Washington State Escrow Agent Registration Act defines recording fees as “the fees for recording the various documents involved in the transaction are usually charged to the party who benefits from the recording. For example, the fees for recording the deed and the new mortgage or deed of trust are debits to the buyer; the fee for recording a satisfaction of the old mortgage is a debit to the seller.”

You have stated that you pay the assessor’s office at the time you take the documents to be recorded and then recoup that amount at closing. You do not charge sales tax on these transactions and do not report them with gross income.

Audit views recording fees as necessary to the escrow service provided and should be included in reported as income Retailing and Retail Sales tax.

\*Recording Fees meet all 3 tests cited und WAC 458-20-111 Rule 111. We collect the funds from our clients and pay the Auditor from our account as a convenience to the Auditor and to avoid a large number of documents being refused for recording by the Auditor because the client sent the incorrect amount for the document in question. Recording fees vary widely from county to county and can also vary day to day in a specific county depending on who is working at the counter and how they determine the fee due for a given document. By advancing funds and billing the client after recording we can assure that time sensitive documents get recorded in a timely fashion. We could cut a separate check to the Auditor for each recording fee from each specific escrow and instruct clients who are only having us record documents to make a check out to the Auditor for the recording fee and take all of these checks over to the county with the documents, thus avoiding any of the recording fees ever running through our General Account and showing up in our bookkeeping records but the County prefers to run a daily tab of all documents recorded by our office and receive one check to close out the tab at the end of the day. The only way for us to meet this request is to deposit recording fees into our account and then pass them through to the Auditor.

* *Excise Tax Fees (Not subject to tax)*

It is typical that the recording process at Clallam County includes two separate line-item charges in the amount of five dollars each per transaction. Both are discussed below. You enter this combined payment in the Advance Funds account identified as excise tax fees. You do not charge sales tax on these amounts, nor do you include them in gross income. You do not consider these as reportable income and have treated them as advance and reimbursements.

Related information from your Real Estate Excise Tax Affidavit includes the following line items:

**State Technology Fee:** A $5.00 Electronic Technology Fee is due on all transactions. (RCW 82.45.180).

**Affidavit Processing Fee:** A minimum of $5.00 shall be collected in the form of tax and processing fee. A processing fee is due on all transactions where no tax is due and on all taxable transactions where the tax due is less than $5.00. (RCW 82.45.180).

***Contract Collections Account by Location – Workpaper A3***

This account is listed as an income account. You engage in acting as an intermediary for contract collections on behalf of a third-party. You currently charge sales tax on the one-time establishment fee when the contract account is setup. You then charge an annual fee for services on which you do not charge sales tax.

As detailed above, the gross income from collection contracts which do not involve an escrow as above defined is subject to tax under the classification service and other activities.

The account list of all contract collection entries for the audit period was sent to you for review and response whether or not the particular contract was part of an escrow account. Those entries to which you answered “No” were used for this adjustment to the Service & Other Activities tax classification. All entries to which you answered “Yes” have been included in the Retailing & Retail Sales tax classification adjustments.

\* In looking at Workpaper A3, it appears that Audit believes that the service we are providing is to be taxed differently based on who sent the Contract Collection Agreement to OPT’s contract collection department. The service provided to the consumer is identical regardless of whether the parties signed the Contract Collection Agreement in the OPT escrow department, at the office of an outside Escrow service provider or in their home, therefore I don’t understand the difference in taxation on the work.

***Escrow Fees Accounts by Location – Workpaper A4***

Escrow fees are recorded in income accounts based on the office location of the transaction. Per company information you provided, the following excerpt is taken:

“The basic escrow charge includes costs incurred and services performed for document preparation for the primary transaction, U.S. mail, wire transfers, reconveyance tracking, receipt of digital documents by email, notary services, coordination with section 1031 facilitator companies, use of OPT central (transaction management site), paper and/or digital copies, IRS 1099-S reporting, and signing appointments conducted by our personnel at remote locations with the county.”

Workpaper A4 lists all entries for escrow fees charged to your clients. This list is sorted by Sequim and Port Angeles locations.

***Miscellaneous Accounts by Location – Workpaper A5***

Miscellaneous charges are recorded in these income accounts based on the office location of the transaction. These transactions include cancellation fees and miscellaneous other endorsement fees on which sales tax was charged.

Included in these accounts are other non-taxable charges for which there is very little transaction detail but are understood to be E-doc fees. The E-doc fee is a line-item charge for printing the electronic escrow/closing documents.

* *Miscellaneous – Port Angeles*

Entries in this account for the Port Angeles office include cancellation fees, endorsement updates, and various other document services – all of which you are charging retail sales tax on.

You also record E-doc fees of $25.00 per transaction. Your accounting records show these transactions as “Non-taxable Sales” and they have not been reported with gross income.

* *Miscellaneous – Sequim*

This account for the Sequim location was used in 2011 to record E-doc fees of $25.00 per transaction. Your accounting records show these transactions as “Non-taxable Sales” and they have not been reported with gross income.

The document preparation fee is received by you directly for services rendered. It is not received for a “third-party provider service.”

The E-doc fee represents a document preparation charge and is considered part of the escrow services that are subject to Retailing B&O and Retail Sales tax.

\*The E-doc Fee is a standard charge in our industry to help defray the cost of printing out loan packages that typically run at 100+ pages and can be several hundred pages, should we be charging sales tax on the fee?

***Service Accounts by Location – Workpaper A6***

Entries in these income accounts include E-doc fees and reconveyance fees. Your accounting records show both transactions as “Non-taxable Sales” and they have not been reported with gross income.

* *Service Account – Port Angeles*

The entries in the Port Angeles location account include E-doc fees of $25.00 per transaction in addition to reconveyance fees of varying amounts.

* *Service Account - Sequim*

The entries in the Sequim location account are almost exclusively E-doc fees of $25.00 per transaction.

E-doc fees are discussed above under Workpaper 5.

Under WAC 208-680-030, reconveyance activities and document preparation are necessary to close the transactions.

Reconveyance fees are defined as amounts received by an escrow company at full payment of loan to reconvey title to the buyer.

Per Det. No 99-018, 18 WTD 372 (1999), “amounts received by a title insurance or escrow company from activities relating to deeds of trust are generally subject to retailing and retail sales taxes. They are subject to the service and other activities classification if they are fees derived from services rendered when the company is named as trustee on the deed of trust.”

\*We only provide Reconveyance services for deeds of trust on which we are the named trustee and we report the portion of the fee we collect for processing the reconveyance under the service and other activities classification on our Excise Tax report every month. A portion of the fee collected is for the recording fee and we don’t report that as we are just passing it through our account and on to the Auditor.

***Title Insurance Accounts by Location – Workpaper A7***

Gross proceeds from the sale of title insurance are recorded in these income accounts by office location. You charge sales tax by office location.

Reference discussion under Workpaper 11 for allowable deductions for payments made to principal.

***Postage – Prod Account by Location – Workpaper A8***

This account is a Cost of Goods Sold account in your financial statements. Entries show as Sales Receipts made out to either office location. Your accounting records show these transactions as “Non-taxable Sales” and they have not been reported with gross income.

The charge for postage is typical to most transactions and shows up in the accounting details, if applicable, for individual sale numbers.

The discussion by the administrative law judge as noted in 5 WTD 49 (1988) regarding delivery costs includes, “charges for delivery services, however provided, must be included as part of the “gross proceeds of sales” or “selling price,’ notwithstanding the fact that these delivery services may be provided by the U.S. Post Office, United Parcel Service, or a commercial freight company.”

RCW 82.04.070, RCW 82.04.080, and WAC 458‑20‑110 explain that amounts charged to customers for freight and delivery costs are part of the “gross proceeds of sale” and “gross income of the business.” Such charges are to be reported under the same classification used for the reporting of the sale of the goods. Sales for resale are to be reported under the Wholesaling tax classification. Sales to consumers are to be reported under both the Retailing and Retail Sales tax classifications.

At closing there may be a charge for a messenger or delivery service (postage) which is separately stated as cost to be paid from the buyer’s or seller’s funds.

As an escrow company, you would contact the delivery company, which is typically FedEx, and make the necessary arrangements for the delivery of escrow or other related documents. You are also responsible for the payments to the delivery business. This transaction does not constitute an advance and reimbursement situation, as you are primarily or secondarily liable for the payment to the delivery company for its services.

\*Based on this, it appears that I should be including the Fed-Ex charges as part of the escrow fee and charging sales tax on it since the Audit says we are supposed to remit tax at the Retail Sales rate on the postage fees we collect.

 ***Refunds Account – Workpaper A9***

Refunds are recorded as credits in this income account in amounts you have reimbursed to the payor for a variety of reasons. If sales tax was charged in the initial billing, your records show you correctly included this amount in your refund.

Workpaper A9 details the transactions eligible for refund against gross income.

WAC 458‑20‑108 states that the seller may deduct an amount equal to the selling price from gross proceeds of sales in computing tax liability if both of the following conditions are met:

* The purchaser returns the property purchased and the entire selling price is refunded or credited to the purchaser.
* The seller has previously included the sale in the gross amounts reported on the excise tax returns.

A deduction is allowed under the Retail Sales tax classification if the amount of retail sales tax previously collected has been refunded by the seller to the buyer.

If the property purchased is not returned within the guaranty period as established by contract or by customs of the trade, or if the full selling price is not refunded or credited to the purchaser, a presumption is raised that the property returned is not returned goods but is an exchange or repurchase by the vendor.

Due to the minimal difference between Wholesaling and Retailing B&O tax rates, .00484 and .00471, respectively, reconciled refund amounts have been applied to the Retailing and Retail Sales tax classifications only.

***Bad Debt Account – Workpaper A10***

You have periodic bad debt entries that include sales tax. It was determined that most of the entries were for the Port Angeles office, therefore, the Port Angeles location code was used for the bad debt reconciliation.

WAC 458‑20‑196 states that a taxpayer who maintains accounting records on an accrual basis may deduct the amount of bad debts sustained. The deduction will be allowed only with respect to transactions upon which the tax has been previously paid and the deductible amount has not previously been deducted or credited.

Taxpayers are not eligible for the bad debt deduction unless they are eligible for the federal bad debt deduction allowed under Section 166 of the Internal Revenue Code. Bad debts do not include the following:

* Amounts due on property that remains in the possession of the seller until the full purchase price is paid.
* Expenses incurred in attempting to collect debt.
* Retail sales or use taxes payable to a seller.
* Repossessed property.

Bad debt deductions must be taken during the tax reporting period during which bad debts were recorded as uncollectible. Local retail sales tax credit should be computed at the rate in effect at the time of the sale. It should be noted that if the original sale included nontaxable elements such as retail sales tax, finance charges, license fees, cash back to purchaser, and the like, a proportionate adjustment must be made in calculating the deduction.

Recoveries of bad debts previously deducted must be included in gross income reported for the taxable period in which received. Fees paid to collection agencies cannot be deducted from the recovered bad debts.

***Agency Commission Account – Workpaper A11***

Part of your escrow services includes the sale of title insurance as discussed above in Workpaper A7. In conversation, you acknowledged that you are an Underwritten Title Company, or UTC.

You record payments made to various title insurance underwriters for their providing the title insurance. In the case of *First American Title Insurance Co. v. Department of Revenue,* the court held that the UTC collected premiums from insureds, retaining a portion of the premiums for title search services, and remitted the remainder to First American Title for fees related to the insurance policy itself.

Workpaper 11 details the payments made to various insurance companies. You are credited for the amounts paid.

Closing Comments

The adjustments were discussed with Maureen Pfaff, Chief Financial Officer, on October 20, 2015.

If there are any questions regarding these adjustments or if additional information is needed, contact either Bob Carter, Revenue Auditor, telephone number (360) 417-9905; or John Rapp, Field Audit Manager, telephone number (360) 594-4850. Copies of all authoritative references cited in this report may be downloaded from the Department’s website at dor.wa.gov.

RCW 82.32.050 imposes interest on the tax due before any payments are made. Full payment of the tax and interest must be made by the due date to avoid additional interest and penalties. The penalty imposed can be up to 15 percent of the tax due if the payment is not made by the due date.

For procedures to file a petition for appeal, refer to the “File and Pay Taxes” section on the Department’s website.

You must file an appeal (or an extension) within 30 days of the date the assessment was issued in order for the appeal to be received timely. If filed timely, the assessment does not have to be paid while awaiting review. Interest will accrue on any unpaid amount.

When an appeal is not filed or postmarked on time, you must first pay the assessment and then file an appeal seeking a refund within the statute of limitations. Additional information is contained in WAC 458‑20‑100 and [WAC 458‑20‑229](http://apps.leg.wa.gov/WAC/default.aspx?cite=458-20-229).

If the tax returns you filed for reporting periods after the end of the assessment period of June 2015 are inconsistent with the instructions in this report, it is your responsibility to file amended returns for those periods.

Department of Revenue, Audit Division