

BEFORE THE APPEALS DIVISION  
DEPARTMENT OF REVENUE  
STATE OF WASHINGTON

|   |   |                                  |
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| 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. 99-018                       |
|   | ) |                                  |
| ...   | ) | Registration No. . . .           |
|   | ) | FY. . . Audit No. . . .          |
|   | ) |                                  |
|   | ) |                                  |

- [1] RULE 156; RCW 82.04.050; ETA 288: BUSINESS AND OCCUPATION TAX – RECONVEYANCE FEES PAID TO TRUSTEE. The receipt of a reconveyance fee by a trustee under a deed of trust is subject to the business and occupation tax under the service and other activities classification. This rule applies whether the trustee was the original named trustee or is a substituted trustee.
- [2] MISCELLANEOUS: USE OF TEST PERIODS. The use of test periods by the Audit Division to determine tax liability is a commonly and widely accepted audit method. The errors found during the test period are presumed to have occurred during the entire audit period. After the completion of the audit, taxpayer's correction of an error does not affect the projection of errors during the remaining portion of the audit period.
- [3] RULE 156; RCW 82.04.050; ETA 288: RETAIL SALES TAX – RECONVEYANCE FEES PAID TO A TITLE INSURANCE OR ESCROW COMPANY. When a title insurance company or escrow company receives reconveyance fees it was not entitled to receive because it was not the named trustee, the receipt of those fees is subject to the retail sales tax and retailing business and occupation tax.<sup>1</sup>

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.

NATURE OF ACTION:

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<sup>1</sup> Nonprecedential portions of this determination have been deleted.

A title insurance company protests . . . the reclassification of certain reconveyance fees from service and other activities to retailing.<sup>2</sup>

#### FACTS:

Coffman, A.L.J. -- The taxpayer is a title insurance company. The Audit Division of the Department of Revenue (Department) reviewed the taxpayer's books and records for the period January 1, 1993 through March 31, 1997. As a result of that review, the Department issued the above-referenced tax assessment. The Department assessed B&O tax under the retailing, service and other activities, and financial business classifications. Additionally, the Department assessed retail sales tax and use tax. The taxpayer has paid the Department an amount it believes equals the uncontested portion of the tax assessment. The taxpayer contests two portions of the tax assessment.

#### **1. Reconveyance fees.**

Among the taxpayer's business activities is providing escrow services, including filing the reconveyance of deeds of trust when the underlying note has been satisfied. The Audit Division states<sup>3</sup>:

Amounts received by a title insurance company 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. See Det. No. 90-231A, 12 WTD 305 (1990).

The taxpayer reported its income from reconveyances under the service and other activities B&O tax classification.

The Audit Division and the taxpayer jointly selected July 1997 as a test period to determine if the taxpayer had properly reported its income from reconveyance fees. During that period the taxpayer received reconveyance fees from 164 transactions. In 159 of those transactions, the taxpayer was the original named trustee, so the Audit Division accepted the taxpayer's treatment of its income from these 159 transactions.

However, the Audit Division found that the other five reconveyances involved deeds of trust where the taxpayer was not the named trustee. Therefore, the Audit Division concluded the receipts should have been reported as retail sales. Based on this conclusion and using the percentage of errors found during the test period, the Audit Division determined the portion of

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<sup>2</sup> Identifying details regarding the taxpayer and the assessment have been redacted pursuant to RCW 82.32.410.

<sup>3</sup> Auditor's Detail of Differences and Instructions to Taxpayer included in the audit report provided to the taxpayer.

the taxpayer's reconveyance income that should have been reported under the retailing B&O tax classification and retail sales tax.<sup>4</sup>

The taxpayer has submitted for our review a copy of the resignation and appointment of successor trustee for one of the five disputed reconveyances. Further, as the taxpayer states<sup>5</sup>:

It turns out in the other four instances that the taxpayer should not have gotten the fee, as it was not trustee. Corrective documents are being prepared, and the fee remitted to the proper trustee. Thus we have only one transaction in question, the other four not generating revenue for the taxpayer.

...

#### ISSUES:

1. What is the proper B&O tax classification for income received for reconveying deeds of trust by a successor trustee?
2. ...

#### DISCUSSION:

1. Reconveyance Fees.

RCW 82.04.050(3)(b) states:

(3) The term "sale at retail" or "retail sale" shall include the sale of or charge made for personal, business, or professional services including amounts designated as interest, rents, fees, admission, and other service emoluments however designated, received by persons engaging in the following business activities:

(b) Abstract, title insurance, and escrow services;

[1] Excise Tax Advisory 288.04.156 (ETA 288) states:

The 1965 legislature enacted the "Trust Deed Act" which provides an alternative to the ordinary real estate mortgage method of financing sales of real property. The act provides that title, abstract, escrow businesses or attorneys may be appointed trustees of the Trust Deed. The taxpayer, a title insurance company, questioned whether fees received for services performed as a trustee under the act should be subjected to the Retail Sales Tax

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<sup>4</sup> In so doing, the Audit Division gave the taxpayer credit for the service and other activities B&O tax paid on the portion being reclassified.

<sup>5</sup> Letter, dated October 19, 1998, from taxpayer's attorney.

because this is not the type of service the legislature contemplated when it established title insurance as a service subject to Sales Tax.

The Tax Commission ruled that such trustee fees were not subject to Sales Tax. It also recognized that the trustee performed no real service until such an event as reconveyance or foreclosure occurred. The Commission held that such services performed pursuant to a Deed of Trust are entirely unrelated to title insurance business. However, fees earned as a trustee of a Deed of Trust are taxable under the "Service and Other Activities" classification of the Business and Occupation Tax.

The Department confirmed this treatment in Det. No. 90-231A, 12 WTD 305 (1992). We find that there is no valid distinction between the original named trustee on a deed of trust and a substituted trustee. Therefore, the taxpayer's receipt of a reconveyance fee for the one deed of trust where it was a substituted trustee was subject to the B&O tax under the service and other activities classification.

[2] However, this does not dispose of the issue. The taxpayer acknowledges that during the test period it received four reconveyance fees it had not earned. The use of test periods is an acceptable auditing technique. We said in Det. No. 87-354, 4 WTD 293 (1987),

The use of test period projections is a common and widely accepted auditing method. Auditors are instructed to seek the taxpayer's concurrence in determining an equitable basis upon which a representative test period can be selected. From that test period, tax liability is projected over the entire audit period. Considering the time and inconvenience involved in separately revealing every transaction, it is usually in the best interest of both the Department and the taxpayer to use the test period method.

The taxpayer stated it will correct the errors occurring during the test period. However, the test period results create a presumption that the taxpayer erroneously received reconveyance fees during the remaining portion of the audit period. Because we must presume the erroneous receipt of reconveyance fees, it is necessary to properly characterize those fees.

[3] The taxpayer's receipt of the improper reconveyance fees was a result of its title insurance and escrow business activities. As such, they are subject to retail sales tax per RCW 82.04.050(3)(b). The exception for trustee's reconveyance fees is precisely that. Exceptions are strictly construed. Budget Rent-A-Car, Inc. v. Department of Rev., 81 Wn.2d 171, 500 P.2d 764 (1972). We conclude the Audit Division properly used the test period. The Audit Division will recalculate the percentage of reconveyance fees subject to retail sales by removing the one fee where the taxpayer was the substituted trustee from the test period sample.

After recalculating the measure of the retail sales tax and adjustments to service and other activities credit, the Audit Division shall reduce the measure of the retail sales tax by the amount the taxpayer demonstrates was remitted to the actual trustees. Additionally, the Audit Division

will provide the taxpayer a credit for the service and other activities B&O tax paid on reconveyance fees remitted to the actual trustees.

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DECISION AND DISPOSITION:

The taxpayer's petition is granted in part and denied in part. The file is remanded to the Audit Division for the purpose of issuing a post assessment adjustment consistent with this determination.

Dated this 29<sup>th</sup> day of January 1999.