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Loan Application Deposits

This excise tax advisory clarifies when loan application deposits may be excluded from the measure of the business and occupation (B&O) tax as an advance under WAC 458-20-111. The specific facts and circumstances surrounding each situation must be carefully examined to determine if the loan application deposits are true advances.

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 report, and a title report. In some cases they may also be used for inspection fees (pest, septic tank, etc.).

All of the following 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.

1. The receipt of loan application deposits must be in accordance with the regular and usual custom and practice in the industry.
2. The taxpayer has a signed, written, acknowledgment from the loan applicant at the time of loan application, whereby the loan applicant agrees to be solely liable for payment of the third party services. This acknowledgment must indicate an agreement between the lending institution and the borrower that the lending institution agrees to act solely as the borrower's agent for payment purposes only to third party providers.
3. The taxpayer segregates the loan application deposits from the general cash accounts maintained by the taxpayer, and does not expend any loan application deposit receipts for the general purposes of the institution. The taxpayer must maintain ledger accounts for each applicant, which clearly designates funds by name, and document receipts, requests for payment by service providers, and disbursements, for each such applicant.

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4. The services acquired with the deposits are ones that the taxpayer does not or cannot provide. If the taxpayer performs any of the services itself, then the amount of the deposit collected for that service shall not qualify as an advance
5. The taxpayer must notify the third party service providers in writing of the fact that:
 - a) as a condition of the loan application process the applicant agrees to be solely liable for payment of the third party services; and
 - b) the taxpayer will not be secondarily liable for payment so long as the taxpayer, acting as agent for the applicant for payment purposes only, has collected funds from the applicant either in advance of, or simultaneous to, ordering services and in fact delivers such funds to the service provider upon request for payment.

It is not necessary for notification to be made each time a service is requested. Notification may take the form of:

- a) a blanket agreement, such as a master service agreement, signed by the taxpayer and the service provider (typically for credit report and title report services), which governs the relationship between the taxpayer and the service provider over the term of the agreement;
- b) letters of engagement sent to the service providers requesting a service to be performed (typically used for appraisal services); or
- c) other means of formal notification.

6. The service providers must acknowledge their understanding and acceptance of the contents of the notification by the lending institution. Acknowledgment may take the form of signing a blanket agreement, such as a master service agreement or other agreements between the lending institution and the service provider or, in the case of letters of engagement, having received formal notification via such correspondence, agreeing to its conditions by actually performing the service requested. Acknowledgment does not have to occur prior to performance of each service requested.

7. The taxpayer either receives payment prior to or simultaneous with its request for services on behalf of the applicant.

8. Requests for payment by service providers must itemize the charge for each loan applicant. The taxpayer shall keep sufficient records to demonstrate that the actual requests for payment by service providers are equal to the actual payments made.

9. If the amount of the initial loan application deposit is insufficient to cover the cost of any service, additional funds come from the loan applicant unless such deficiency is de minimus. De minimus amounts are typically so small that the cost of pursuing collection is greater than the amount of the deficiency.

10. If the amount of the loan application deposit is greater than the payments made for services, any balance shall be returned or otherwise credited to the loan applicant unless the applicant agrees otherwise. If the parties agree, and the excess is not material but is de minimus, the excess need not be returned to the applicant. De minimus amounts are typically amounts which are so small that the cost of processing a refund or issuing a credit is greater than the excess balance.

11. The actual practice of the loan applicant, the lending institution, and the service provider must match the documentation.

12. The loan applicant must be entitled to a copy of the purchased report or service upon request unless federal or state law or regulatory authorities restrict the taxpayer from complying with such request.
