

Excise Tax Advisories are interpretive statements authorized by RCW 34.05.230.

ETA 3144.2024

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## Taxability of Mortgage Escrow Receipts

### Purpose

This Excise Tax Advisory (“ETA”) provides guidance on whether funds collected and deposited in escrow accounts by mortgage lenders or servicers, for the purposes of paying insurance premiums, property taxes and other charges associated with the property on behalf of the mortgagee, constitute gross income to the mortgage lender or servicers.<sup>1</sup>

### Background

Mortgage lenders or servicers commonly establish and oversee an escrow account on behalf of the mortgage borrower. This account, sometimes stipulated by the loan agreement or required by federal regulation, is designed to manage the disbursement of funds for various expenses related to the property. These may include payments for property taxes, insurance premiums (such as homeowner’s insurance) and other charges associated with the real property (such as homeowner association dues).

### Exclusion of mortgage escrow funds from gross receipts

Washington’s business and occupation (B&O) tax is imposed on gross receipts generated from conducting business activities within the state. However, WAC 458-20-111 (Rule 111) acknowledges that not all payments received by a business necessarily constitute gross income of the business. For example, some payments received by a business are an “advance” to pay costs or fees on behalf of their client.

<sup>1</sup> An amount treated as a reimbursement under WAC 458-20-111 must be reported as a deduction on a taxpayer’s excise tax return and, therefore, will be referred to as a deduction for the purposes of this ETA.

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Rule 111 establishes a deduction from taxable income for these types of receipts, recognizing that such amounts do not constitute income directly linked to the business activities of the mortgage lender or servicer but rather represent an “advance” to pay the obligations of the mortgagee. Generally, a mortgage lender or servicer can deduct amounts it receives from a mortgagee that are placed into escrow. The subsequent sections outline the specific requirements to deduct these receipts from its gross income under Rule 111.

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**Amounts that may be deducted from gross income: Requirements of Rule 111**

A mortgage lender or servicer may deduct from its taxable gross income amounts received from a mortgagee and placed into an escrow account if **all of** the following requirements of Rule 111 are satisfied:

- (1) The payments from the mortgagee to the lender or servicer are reimbursements or advances made to pay obligations of the mortgagee;
- (2) The mortgage lender or servicer does not have liability for any of the taxes or provide any services for which payments are made; and
- (3) The mortgage lender or servicer must be acting as an agent of the mortgagee and cannot have any liability, except as agent of the mortgagee.

If any of the requirements of Rule 111 are not met, the mortgage lender or servicer may not deduct these payments.

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**Requirement 1: The mortgage lender or servicer is collecting money to pay the obligations of the mortgagee**

Amounts received by a mortgage lender or servicer from a mortgagee satisfy the first requirement of Rule 111 only if the funds are utilized to fulfill payment obligations the mortgagee has to a third party, such as a taxing authority or an insurance provider.

**Facts:**

John Homeowner (the “mortgagee”) has an obligation to pay annual property taxes to the local county. Per the mortgage agreement on the property with Big Bank (the “mortgage lender or servicer”), part of John’s monthly mortgage payment to Big Bank is held in escrow to pay John’s annual property tax assessment. Once per year, Big Bank sends the funds from the escrow account to the county for payment of John Homeowner’s property taxes.

**Result:**

Big Bank’s collection of escrow payments to cover John Homeowner’s annual property tax obligation fulfills the first requirement for deduction under Rule 111.

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**Requirement 2: The mortgage lender or servicer cannot render the services or have liability for the taxes or services provided**

The mortgage lender or servicer must not provide services directly connected to the purpose of the mortgage escrow payments received from the mortgagee.

**Facts:**

Jane Homeowner (the “mortgagee”) purchased a home with a mortgage from Big Bank (the “mortgage lender or servicer”). Jane purchased homeowner’s insurance from a third-party insurance provider. Big Bank is not a party to Jane’s homeowner’s insurance policy. As part of the mortgage agreement, Jane opted to include the homeowner’s insurance payment within the monthly mortgage payment.

Each month, Jane makes a single payment to Big Bank that covers both the mortgage and the homeowner’s insurance premium. Acting as the mortgage servicer, Big Bank collects these funds and submits the insurance payment directly to Jane’s insurance company.

**Result:**

Big Bank’s collection and remittance of Jane Homeowner’s insurance payments fulfills the second requirement for deduction under Rule 111. Big Bank neither renders the insurance services nor holds liability for the insurance beyond acting as an agent for Jane Homeowner’s payment.

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**Requirement 3: The mortgage lender or servicer can have no liability to pay the mortgagee’s obligations, except as the agent of the mortgagee**

To fulfill the third requirement of Rule 111, the mortgage lender or servicer must not assume any liability to pay the mortgagee’s obligations, except in their capacity as the agent of the mortgagee.

**Facts:**

Jane Homeowner (the “mortgagee”) purchased a home with a mortgage from Big Bank (the “mortgage lender or servicer”). Jane purchased homeowner’s insurance from a third-party insurance provider. Big Bank *is* a party to Jane’s homeowner’s insurance policy, serving as a guarantor for payment of the insurance premiums. As part of the mortgage agreement, Jane opted to include the homeowner’s insurance payment within the monthly mortgage payment.

Each month, Jane makes a single payment to Big Bank that covers both the mortgage and the homeowner’s insurance premium. Acting as the mortgage servicer, Big Bank collects these funds and submits the insurance payment directly to Jane’s insurance company.

**Result:**

Big Bank’s collection and remittance of Jane Homeowner’s insurance payments does not fulfill the third requirement for deduction under Rule 111. Big Bank’s role as a guarantor for Jane Homeowner’s insurance

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payments means Big Bank holds liability for the payments beyond merely acting as an agent for Jane Homeowner.

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