

Cite as 11 WTD 203 (1991).

BEFORE THE INTERPRETATION AND APPEALS DIVISION  
DEPARTMENT OF REVENUE  
STATE OF WASHINGTON

In the Matter of the Petition )	<u>D E T E R M I N A T I O N</u>
For Correction of Assessment)	
of )	No. 91-163
)	
. . . )	Registration No. . . .
)	. . . /Audit No. . . .
)	
)	

[1] RULE 118 -- B&O TAX -- RENTAL -- ADVERTISING.  
Shopping mall rental receipts are not bifurcated for  
advertising charge if the receipts received as  
"advertising" are rent.

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 HEARING: June 4, 1991

NATURE OF ACTION:

The taxpayer was audited for the period from January 1, 1986  
through December 31, 1989. Tax Assessment No. . . . was  
issued [in May of 1990] with a total deficiency due and  
assessed of \$ . . . . The taxpayer paid all but \$ . . .  
service business and occupation tax which remains contested.  
The assessment was adjusted [in January of 1991] allowing a  
credit based on a revised use tax computation leaving  
adjusting the balance due to \$ . . . .

FACTS AND ISSUES:

Pree, A.L.J. -- The taxpayer owns a shopping mall which it rents to retailers. A typical provision in its agreements with lessees provides:

Lessee shall pay as additional rent, together with a monthly percentage rent to be paid on or before the 15th day of each month of the term, a sum equal to one percent (1%) of all gross sales for the preceding month. Such sum shall be used by Lessor [taxpayer] exclusively for such advertising and promotion of [shopping center] and the businesses of its tenants as Lessor may from time to time deem necessary or desirable.

This provision was included in most of the leases. Some of the larger tenants that drafted their own leases may have varied the language and their rates<sup>1</sup> may have been different. They did pay lower rent as well. Some short term, seasonal retailers or customer service outlets (such as gift wrappers) may not have had any advertising provision at all. However, it was a required, standard, nonnegotiable clause in most of the leases.

The taxpayer's advertising expenditures significantly exceeded what it collected as the 1% charge.<sup>2</sup> Most of the payments were to newspapers, radio stations, and other third parties. The only internal charge on its account for this expense was the salary of the advertising coordinator who arranged the promotions and advertising.

The taxpayer considered the proceeds from the "additional rent" as amounts derived from the rental of real estate, exempt under WAC 458-20-118 (Rule 118). The auditor considered the proceeds to be for advertising, subject to the service business and occupation tax.

#### DISCUSSION:

WAC 458-20-118 (Rule 118) provides in part:

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<sup>1</sup> Also referred to as "anchor" tenants, they are generally given preferential rates since they draw business for other stores. They will also advertise on their own.

<sup>2</sup> According to the taxpayer in 1989 and 1990, approximately \$635,000 was paid for advertising, while only \$250,000 was collected from its lessees to offset the expense.

(1) Amounts derived from the sale and rental of real estate are exempt from taxation under the business and occupation tax.

\* \* \* \* \*

(3)(a) Persons who are involved in more than one kind of business activity are required to segregate their income and report under the appropriate tax classification based on the nature of the specific activity (see RCW 82.04.440).

WAC 458-20-224 (Rule 224) provides in part:

(1) Chapter 82.04 RCW imposes a tax upon every person for the privilege of engaging in business in this state.

\* \* \* \* \*

(2) Persons engaged in any business activity, other than or in addition to those for which a specific rate is provided in the statute, are taxable under a classification known as service and other business activities, and so designated upon return forms. In general, it includes persons rendering professional or personal services to persons (as distinguished from services rendered to personal property of persons) such as accountants, aerial surveyors and map makers, agents, ambulances, appraisers, architects, assayers, attorneys, automobile brokers, barbers, baseball clubs, beauty shop owners, brokers, chemists, chiropractors, collection agents, community television antenna owners, court reporters, dentists, detectives, employment agents, engineers, financiers, funeral directors, refuse collectors, hospital owners, janitors, kennel operators, laboratory operators, landscape architects, lawyers, loan agents, music teachers, oculists, orchestra or band leaders contracting to provide musical services, osteopathic physicians, physicians, real estate agents, school bus operators, school operators, sewer services other than collection, stenographers, warehouse operators who are not subject to other specific statutory tax classifications, teachers, theater

operators, undertakers, veterinarians, and numerous other persons.

\* \* \* \* \*

(4) Business and occupation tax. Persons engaged in any business activity, other than or in addition to those for which a specific rate is provided in chapter 82.04 RCW, are taxable under the service and other business activities classification upon gross income from such business.

The taxpayer has a single contract with the lessees which cannot be bifurcated. If the lessees do not pay the advertising charge, they are in breach of the entire contract and the taxpayer can terminate the entire contract. The taxpayer's remedy is not limited to ceasing to provide advertising services. Likewise, the taxpayer only provided advertising for tenants. We must determine the predominant nature of the contract to determine the business and occupation tax classification of the receipts received under its terms. We must also determine if it is a separate service, severable from the contract.

The amounts paid are not directly related to the advertising services performed. The advertising services are for the entire mall and not specific tenants. The advertising performed was incidental to the rental of the premises and not separate or severable from the contract.

We find that the nature of the taxpayer's contract is the rental of real estate, exempt from business and occupation tax. The taxpayer does very little advertising. The advertising is incidental to rent. The taxpayer relies on third parties to provide advertising services which are an expense of its primary business, the rental of real estate. It is the owner and manager of real estate, not an advertiser. The charge for advertising is merely a label, incidental to rent. It is not a charge for advertising, but rent, exempt from business and occupation tax.

#### DECISION AND DISPOSITION:

The tax assessment will be adjusted by the audit division removing the \$ . . . business and occupation tax assessment on the rental proceeds and refunding to the taxpayer any excess tax paid plus extension interest.

DATED this 17th day of June 1991.