Cite as Det. No. 92-316, 12 WTD 477 (1992).

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

In The Matter of the Petition For Correction of Assessment of	)	D E T E R M I N A T I O N
	)	No. 92-316
. . .	)	Lessor Registration No. . . .
	)	. . ./Audit No.

[1] RCW 82.29A.020 -- LEASEHOLD EXCISE TAX -- POSSESSION AND USE -- WHAT CONSTITUTES. A license to use public property for storage between periods when the equipment is actually used for fair events constitutes a taxable leasehold under the statute.

[2] RCW 82.29A.020 -- LEASEHOLD EXCISE TAX -- LEASES IN EFFECT FOR LONGER THAN TEN YEARS WITHOUT RENEGOTIATION. Where a lease has been in effect for more than ten years without renegotiation, the Department may examine the agreement to determine whether the rent being charged represents fair rental value for the property, using the methodology of RCW 82.29A.020(2)(b).

[3] RCW 82.29A.020 -- LEASEHOLD EXCISE TAX -- CONTRACT RENT -- CHARGES FOR UTILITIES AND SERVICES. Where flat rate is charged to all lessees for services in addition to the rental of real property and the services are a normal part of the landlord-tenant relationship under the circumstances, the additional charge is subject to leasehold excise tax.

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: . . .

NATURE OF ACTION:

Taxpayer, a county fair association, protests assessment of leasehold excise tax on its leases to users of fairgrounds property.

FACTS AND ISSUES:

Adler, A.L.J. -- Taxpayer is a fair association (. . .) which owns fairgrounds property that is subject to leasehold excise tax when rented to private users. Its records were examined for the period from January 1, 1987 through March 31, 1991, and the above-captioned assessment resulted. [Taxpayer] protests assessment of leasehold excise tax on the following transactions:

Lease 1. . . . . This is a lease for weekend use of fair property from December through March, with the lessee being permitted to store equipment in the building during the entire period. [Taxpayer] contends both that the permission to store equipment is not "possession and use" sufficient to constitute a leasehold under the statute and that the only other use is for weekends only, which is not of sufficient duration to constitute a taxable leasehold. [Taxpayer] states the lease grants use for the eight weekends only and that

> as a matter of convenience, the [Taxpayer] has allowed the lessee to leave some equipment in the building. If the [Taxpayer] had other lessees who wanted to rent the building, this equipment would have been removed.

[Taxpayer] makes the same argument with regard to leasehold excise tax assessed on the rental value of storage space [Taxpayer] permits concession operators to use for their equipment during non-fair times.

Lease 2. . . . . [This lessee] entered into a 30-year, prepaid lease calling for a rental payment of $ . . ./year. Finding the rent to be less than fair rental value, the auditor used the county assessor's valuation of the land to arrive at a rental figure of $ . . ./year and assessed tax on that amount. She found that no renegotiation under the statute had occurred. [Taxpayer] argues the rent is "an adequate amount of rent and was agreed upon through competitive bidding." Further, [Taxpayer] contends

> RCW 82.29A.020(2)(b) gives the Department authority to compute taxable rent only if none of the following three situations exist:
>
> 1. The leasehold interest has been established through competitive bidding,

> 2. The rent was set according to statutory requirements or
>
> 3. Public records demonstrate that the rent was the maximum attainable.
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> Situations 2 and 3 do not apply, but we maintain that Situation 1 is applicable. We feel that the leasehold interest has been established through competitive bidding, and that the rent amount has been negotiated in an arm's-length transaction. Even though the lease agreement was for 30 years, the [Taxpayer] has, from time to time, revisited the terms and decided that no adjustments were warranted. Since the rent is below $250, the leasehold excise tax is not applicable.

Lease 3. . . . . During off-season racing periods, [Taxpayer] rents horse barns and permits use of adjacent areas. The lease states:

> Rent: the tenant agrees to pay as rent . . . (. . .) per day per stall (which shall include leasehold tax) plus . . . (. . .) per day per stall for services which include utilities, track maintenance, barn maintenance, watchman, etc. All rental fees are payable in advance on the day of execution of the rental agreement.

[Taxpayer] agrees the . . . per day is subject to leasehold excise tax but contends the . . . daily charge for services is not. It explains the amount collected for "services" was to cover the out-of-pocket costs incurred such as contract labor; manure and trash hauling; janitorial supplies, including paper towels, soap, etc.; equipment rent for tractors and other items; equipment fuel; employee labor; employee taxes; and utilities. It continues:

> We maintain that the payment for services should not be considered as part of contract rent. The amount spent on labor and equipment for track grooming, stall cleaning and security amounted to $ . . . for the audit period. These services are required by the horsemen for the protection of their horses. The race track must be groomed each day, the stalls cleaned each day and security guards must be on duty each night to protect the horses from theft or injury. . . . These costs alone amount to $ . . . per day per stall, yet only $ . . . per day per stall was collected. Without the use of the stalls and track, none of these costs would have been incurred. Clearly these amounts

> expended . . . were for the benefit of the lessee's interest and not consideration for the leasehold interest.

DISCUSSION:

[1] The leasehold excise tax was enacted to ensure that persons using publicly-owned, tax-exempt property for private purposes were subjected to a tax similar to that which they would pay if they were the owners of the property. Because the incidence of the tax cannot be on ownership of the property, it is structured as an excise tax triggered by the private use of the property. RCW 82.29A.020 defines as a "leasehold interest"

> an interest in publicly owned real or personal property which exists by virtue of any lease, permit, license, or any other agreement, written or verbal, between the public owner of the property and a person who would not be exempt from property taxes if that person owned the property in fee, granting possession and use, to a degree less than fee simple ownership . . .

(Emphasis supplied.)

[Lease 1. Taxpayer] argues the facts and the agreement prove that no leasehold interest was created by the lease. We disagree. The agreement grants use of the premises for 24 days during the season, but the verbal or "any other agreement" between [Taxpayer] and the lessee clearly grants a taxable license to use [Taxpayer] property to store equipment during this period. That [Taxpayer] would require the removal of the equipment if another tenant became available is immaterial in showing that a taxable use is not present with this lessee. The activity is clearly taxable under the broad language of the statute, which taxes more than just traditional leases. The fact that the written agreement addresses only the 24-day rental of the property and not the informal agreement for storage cannot control taxability; the agreement merely controls the relationships between the parties thereto. It also does not negate the fact that a separate, more informal agreement exists which is taxable.

Further, it is clear the lessee occupied the property for its own personal use. That it used the property mostly for storage is immaterial, since the statute reaches any type of use of public property by a private entity. As the statute's broad language provides, a taxable leasehold interest is one involving possession and use of publicly-owned real or personal property. The terms "possession" and "use," conjunctively or singularly, are not to be so strictly construed as to demand actual and

exclusive physical occupancy of the public facility. Clearly, such strict construction would do violence to the statute itself, because it expressly includes such rights as "permits" and "licenses" within the scope of "leasehold interests." The strict concept of "possession" meaning actual, full-time physical occupancy to the exclusion of all others does not apply.

Rather, it is clear that the law intends "possession and use" to have a broader meaning than the kind of exclusive dominion and control exercised by a lessee under a traditional lease, since the legislature expressly included other types of rights and other types of agreements within its reach. For that reason, analogy to the B&O tax in this case, which taxes business income generated from granting licenses to use real estate but does not tax income generated by actually renting real estate.
As such, we find the use taxable. The auditor determined that the amount charged under the formal lease was fair for the total rental value of the lease and the informal storage arrangement and used that amount to calculate the leasehold excise tax due. She also concluded that the tax did not exceed the property tax which would be due if the lessee owned the property.

Similarly, we find that the same logic applies to the agreement permitting concessionaires to store equipment on fair property during non-fair times.

[2] On lease 2, we first disagree with [Taxpayer]'s interpretation of the statute. RCW 82.29A.020 states, in pertinent part:

> (2) "Taxable rent" shall mean contract rent as defined in subsection (a) of this subsection in all cases where the lease or agreement has been established or renegotiated through competitive bidding, or negotiated or renegotiated in accordance with statutory requirements regarding the rent payable, or negotiated or renegotiated under circumstances, established by public record, clearly showing that the contract rent was the maximum attainable by the lessor: PROVIDED, That after January 1, 1986, with respect to any lease which has been in effect for ten years or more without renegotiation, taxable rent may be established by procedures set forth in subsection (b) of this subsection. All other leasehold interests shall be subject to the determination of taxable rent under the terms of subsection (b) of this subsection.
>
> . . .

> (b) If it shall be determined by the department of revenue, upon examination of a lessee's accounts or those of a lessor of publicly owned property, that a lessee is occupying or using publicly owned property in such a manner as to create a leasehold interest and that such leasehold interest has not been established through competitive bidding, or negotiated in accordance with statutory requirements regarding the rent payable, or negotiated under circumstances, established by public record, clearly showing that the contract rent was the maximum attainable by the lessor, the department may establish a taxable rent computation for use in determining the tax payable under authority granted in this chapter based upon the following criteria: (i) Consideration shall be given to rental being paid to other lessors by lessees of similar property for similar purposes over similar periods of time; (ii) consideration shall be given to what would be considered a fair rate of return on the market value of the property leased less reasonable deductions for any restrictions on use, special operating requirements or provisions for concurrent use by the lessor, another person or the general public.

(Emphasis supplied.)

The statute, properly construed, states that all leases properly executed in one of the three acceptable ways listed in RCW 82.29A.020(2) will have the stated contract rent accepted as the taxable rent for leasehold excise tax purposes. However, even leases properly executed may be reexamined if they were in effect after January, 1986, and had not been renegotiated for ten years or more. As a result, even where a lease was negotiated under competitive bidding originally, if it has not been renegotiated for ten years or more, the Department may examine the lease and establish a fair rental value for the property under the methodology of 82.29A.020(2)(b)(i) and (ii). The section permitting such revaluation for non-renegotiated leases was included in the 1976 legislation to discourage negotiation of long-term leases which would result in avoidance of payment of a fair share of taxes during the lease's term. As RCW 82.29A.010 shows, the legislature expressly intended for all private leaseholds of public property to be taxable.

[Taxpayer] contends that periodic "revisiting" of the issue constituted renegotiation of the lease itself. We do not agree. There has been no showing that negotiations occurred after 1960 between [Taxpayer] and the lessee. It is an elementary principle of contract law that a modification must be agreed to by both

parties and cannot be done unilaterally. Tondevold v. Blaine School District, 91 Wn.2d 632, 636 (1979).

Review of a lease by one party cannot effect a modification of the lease. A renegotiation would have effected a modification of the original lease, resulting in a new agreement. No evidence has been submitted supporting the contention that [Taxpayer]'s review of the lease was anything other than a unilateral examination. [Taxpayer]'s inference was that, if [Taxpayer] felt that the property was capable of generating more income, it would have increased the rent payments. However, [Taxpayer] could not unilaterally increase the rent payable. Thus, the periodic reviews do not represent a renegotiation of the lease. Again, the auditor used the county assessor's appraised value to calculate taxable rent and ensured that the leasehold excise tax assessed was not in excess of property tax on comparable property.

[3] Lease 3 includes fees delineated as stable rental and a flat fee for various services, listed above. RCW 82.29A.020 defines "taxable" and "contract" rent:

> (2) "Taxable rent" shall mean contract rent as defined in subsection (a) of this subsection . . .
> (a) "Contract rent" shall mean the amount of consideration due as payment for a leasehold interest, including: The total of cash payments made to the lessor or to another party for the benefit of the lessor according to the requirements of the lease or agreement, including any rents paid by a sublessee; expenditures for the protection of the lessor's interest when required by the terms of the lease or agreement; and expenditures for improvements to the property to the extent that such improvements become the property of the lessor. . .

(Emphasis supplied.)

For leasehold excise tax purposes, the Department has taken a position consistent with that which has long been in WAC 458-20-205 (Rule 205) for business and occupation tax and public utility tax purposes. That rule states charges for utility services are a part of the income from rental of real estate where they are furnished as part of the landlord-tenant relationship.

However, where utility and other services are paid over and above the amount of the contract rent according to the amount of such services actually desired or received by the lessees, then we believe that the public lessor is engaged in two businesses: renting property and furnishing services. In that case, the

leasehold excise tax would not apply to the charges for services; but in the case of furnishing utilities, for example, the public lessor would be subject to the public utility tax on its income from rendering utility services. Where the public lessor is engaging in the service business of providing janitorial and guard services to the lessees, it would be subject to B&O tax on that portion of its income.

Conversely, where utility, janitorial, and other services are furnished under circumstances such that they are simply a part of the normal and routine landlord-tenant relationship, then the furnishing of such services is deemed to be a part of the rental of the real estate and the leasehold excise tax applies. Under normal circumstances, no separate charge is made for the overhead cost of these services, amounts which are simply recovered in the overall rent charged.

We find such is the case here. This is because the charges are not separately billed; they are listed and charged for as part of the rental agreement. The audit report and [Taxpayer] agree that the lessees were charged a flat rate for utilities and other services as a part of the "rent" charged under that section of the agreements. Taxpayer itself asserts that the services are required by the horsemen for the protection of their horses.

Based on the above, we find that the additional $ . . . charged for services is taxable contract rent under the statute. This is because they are part of the normal lessor-lessee relationship for this type of rental situation and are included as "rent" in the rental agreement. The $ . . . charge was calculated to assist the [Taxpayer] in recovering some of its overhead costs while still being low enough to enable it to find tenants.

DECISION AND DISPOSITION:

Taxpayer's petition is denied.

DATED this 16th day of November 1992.