

In the Matter of the Petition ) D E T E R M I N A T I O N  
For Correction of Assessment of )  
) No. 88-464  
  
)  
    . . . ) Registration No. . . .  
                  ) LEASEHOLD EXCISE TAX  
                  ) Assessment No. . . .

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 petitions for correction of assessment of leasehold excise tax on the grounds that the contested portion assesses tax on payments made to the lessor for repairs or improvements to a road located outside the leased property.

Johnson, A.L.J. -- Taxpayer does business as a ski resort and leases land from the U. S. Forest Service. As a part of the lease agreement, taxpayer is to perform some routine maintenance on a road serving, but not in the boundaries of, the leased property. Additionally, taxpayer is required to make deposits to the Forest Service for road repairs and maintenance which require use of heavier equipment. The contract specifies that the rate shall be 10 cents per skier, which is agreed to be the cost of the work. Throughout the

contract, the language recites that the amounts are based on a scale intended to make each user pay its commensurate share of the burden its type of use places on the road.

Taxpayer contends that the auditor should not have assessed tax on these amounts because

you do not appear to have taken into account the next sentence [of RCW 82.29A.020(2)(a)]: "When the consideration conveyed for the leasehold interest is made in combination with payments for concession or other rights granted by the lessor, only that portion of such payment which represents consideration for the leasehold interest shall be part of contract rent."

[The auditor's] recitation in the audit notice is flawed when she states that we are improving the Forest Service's [road]. We receive the road in "X" condition as the season begins. Skier and other public usage cause ruts and displacement of gravel. Natural weather conditions cause rocks and dirt to slough and slide into the ditches and road bed. All this takes the road to a "Y" condition. The purpose of the payments we make is to return the road to the "X" condition in the Spring . . . NOT improve beyond "X."

We do not believe it was the intent of the Washington State legislature to tax payments for items or services beyond the physical limits of the leasehold. Otherwise, it would have mentioned them in the statute. Silence in this case enures [sic] to the benefit of the taxpayer, NOT the Department of Revenue.

The contract states:

The Permittee shall bear the expense, by making deposits to the Forest Service, for all other road maintenance (except for emergency maintenance) which cannot practicably be accomplished by a motor patrol equipped with a front end blade, or comparable equipment, and by the use of hand tools.

When payments are required, the rate will be \$0.10/skier which is agreed to be the cost of such

work; the deposits or payments to be made at such times and in such amounts as requested by the Forest Supervisor revised upward or downward on September 1 on each year hereafter based on estimated costs and uses anticipated.

Improvements. Cost of improvements on the [road] necessitated by permittee's use and requested by him shall be borne by the permittee. Permittee shall submit plans and specifications to the Forest Service for approval. Improvements as used above are items other than maintenance (including surface rock replacement) which adds value to the road. . .

#### DISCUSSION:

[1] RCW 82.29A requires that rental property owned by tax-exempt entities should be subject to leasehold excise tax when leased to private parties for private uses, because "private lessees of such public properties receive substantial benefits from governmental services provided by units of government." RCW 82.29A.010. The intent of the statute is to ensure that property owned by tax-exempt entities bears its fair share of the cost of governmental services when rented to a lessee who would be subject to property taxes if he were the owner of the rented property.

The leasehold excise tax is not intended merely to tax the lease payment between the lessor and lessee but is a tax "on the act or privilege of occupying or using publicly owned real or personal property through a leasehold interest. . ." RCW 82.29A.030. Pursuant to RCW 82.29A.020, the tax is levied on the contract rent, which is defined as

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. Where the consideration conveyed for the leasehold interest is made in combination with payment for concession or other rights granted by

the lessor, only that portion of such payment which represents consideration for the leasehold interest shall be part of contract rent.

Taxpayer's reliance on the last sentence of the above paragraph is misplaced. Although use of the road for which contributions to maintenance are required could be considered "other rights" outside the lease by virtue of the fact that the road is located outside the boundaries of the leased property, use of the road is necessary to the lessee.

It is apparent that any right granted by a public lessor which is not in itself integral to or necessary for completeness of the lease proper and for which cash payment is required from the lessee is not subject to leasehold tax even when payment is tendered in combination with contract rent. However, for the payments to be deductible from the amount subjected to the leasehold excise tax, the "concession or other rights" must be

- (1) A grant of a right controlled by the lessor to the lessee;
- (2) A right with its own discernible value; AND
- (3) A right which is clearly divisible from the leasehold property and its use.

Taxpayer's permitting agreement with the Forest Service grants it use of a defined section of real property along with a nonexclusive right to ingress and egress shared by others. The nonexclusive right is obviously necessary and goes hand in hand with the lessee's leasehold interest. We conclude that the use of the road relates to the leasehold interest just as in the case of a commercial lease where the lessor has several tenants in the same building who use common areas outside their leased office spaces and whose rents include charges for maintenance and upkeep on those common areas based on each tenant's use. As such, the expenses associated with use of the road are an integral part of the leasehold, are includable in determining the total of payments made to the lessor for use of the property and are taxable under the provisions of the leasehold excise tax laws. As a result, expenditures which would be taxable within the leased property will be taxable on the road which the lessor permits taxpayer and its customers to use for access to the ski resort. The contract states that expenditures for improvements to the property will be borne by the taxpayer and will be subject to the lessor's

approval. All such expenditures, which permanently change or increase the value of the road, are taxable for leasehold excise tax purposes.

The auditor also assessed leasehold tax on the expenditures to be made by the lessee for road restoration caused by wear and tear to the road during the ski season, concluding that, where the expenditures for road maintenance are required by the lease agreement, they were part of the total consideration due as payment for the leasehold interest.

The department has ruled on prior occasions that costs for repairs or maintenance do not constitute expenditures for "improvements to the property." As a result, such amounts are not a part of "contract rent." A distinction is made between costs for maintenance and repairs which are made to preserve the property in its original condition and those made for improvements which permanently change and increase the value of the property.

In the present case, the lease agreement requires that the lessee maintain the premises in good condition and bear the expense of repairs and maintenance made necessary by its use. We do not believe that the fact that a fixed fee figure for the maintenance costs is agreed upon in the lease or the fact that the costs incurred could be substantial necessarily mean that the payments were more than routine maintenance costs. We believe that even minimal maintenance costs would be substantial for road repairs. The facts indicate that the maintenance expenditures are for work which must be performed annually; as such, we agree that the expenditures constitute charges to maintain rather than to improve the property.

A second reason that the department has ruled, on prior occasions, that maintenance expenditures are not taxable for leasehold excise tax purposes is that they will not necessarily result in a higher assessed value of the property. The 1986 amendment to 82.29A.020, which limits the leasehold excise tax to what the ad valorem property tax would be if the parcel were in private ownership requires consistent treatment of such expenses. If expenditures for routine maintenance performed on private property would not result in enhanced value and increased property taxes, then maintenance expenditures made by a private lessor of public property should not be subject to the leasehold excise tax.

DECISION AND DISPOSITION:

Taxpayer's petition is granted in part and denied in part. Any portion of [the] Assessment No. . . . which was based on the maintenance expenditures required by the lease agreement will be deleted. Any portion of the assessment which was based on improvement expenditures will be upheld. The file will be referred to the Audit Division for a determination of the amount of leasehold excise tax due and payable, and an amended assessment bearing a due date for payment will be issued.

DATED this 9th day of December 1988.