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

In the Matter of the Petition For Correction of No. 89-3	D E T E R M I N A T I O N Assessment of
. . .	Registration No. . . . Tax Assessment No. . . . Registration No. . . . Document Nos. . . .
Lessees:	 . . . .

[1] **LEASEHOLD EXCISE TAX:** POSSESSION AND USE. Lease granting use of parking spaces does not create a separate grant of concession or other rights taxable in addition to the stated contract rent where the lease agreement is intended to grant the lessee possession and use of counter space within the airport and parking spaces on the airport grounds for storage of automobiles and where no charge is made to any other airport patrons for parking on the premises.

[2] **LEASEHOLD EXCISE TAX:** MULTIPLE LEASES -- SAME LESSEE -- CONTIGUOUS PROPERTIES. Multiple leases by the same lessee of public land from the same lessor will be not considered a single lease for leasehold excise tax purposes unless they are in closer proximity than merely within the boundaries of one piece of property. CASES CITED: Strenge v. Clarke, 89 Wn.2d 23, 29, 569 P.2d 60 (1977); Puyallup v. Pacific N.W. Bell Tel. Co., 98 Wn.2d 443, 448, 656 P.2d 1035 (1982); State v. Superior Court for

Chehalis County, 57 Wash. 71, 76, 106 P.2d 481 (1910).

[3] **LEASEHOLD EXCISE TAX:** FACTORS CONSTITUTING. Agreement permitting annual cutting of hay for a fixed fee creates a leasehold interest in the property on which the hay is grown and is not taxable as a "product" lease under RCW 82.29A.020(2)(a) where the consideration paid is a fixed fee which is not based on the price of the product harvested.

[4] **LEASEHOLD EXCISE TAX:** QUALIFICATION OF LESSEE FOR EXEMPTION -- DUTY OF LESSOR TO INVESTIGATE. For leasehold excise tax purposes, a lessor is entitled to rely on its investigation which showed lessee to be registered with department of revenue. RCW 82.29A.130 cannot be read to impose a duty on the lessor to review the books of a lessee to determine whether lessee is or remains in compliance with the laws governing its registration.

[5] **LEASEHOLD EXCISE TAX:** CREATION OF LEASEHOLD INTEREST -- CONSIDERATION. Letter of credit given to guarantee partial payment of architectural fees in the event that the grantor chooses not to enter into a lease agreement at a future date is not consideration paid for a leasehold interest where no lease is in existence at the time of the payment.

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.

PETITIONER REPRESENTED BY: . . . . . .

DATE OF TELEPHONE CONFERENCE: July 20, 1988

NATURE OF ACTION:

Petitioner, hereinafter referred to as the port, is a public entity not subject to Washington State property tax; it protests assessment of leasehold excise tax on its leases of property to private parties.

FACTS AND ISSUES:

Johnson, A.L.J. and Dressel, A.L.J. -- The port is a public entity which operates the port authority for a city. In this capacity, it manages the city's airport and waterfront port areas. The Department of Revenue (Department) examined the books and records of the lessor. The purpose of the audit was to ascertain whether the proper leasehold excise tax had been collected and/or remitted by the lessor to the Department pursuant to the provisions of chapter 82.29A RCW. The audit resulted in an assessment against the port, as lessor, and against some of the lessees. The port is appealing several portions of the assessment, which involve a number of lessees. The issues are fewer in number than are the lessees, and this Determination will be organized by issue type.

> [1] Assessment of additional tax due on parking spaces leased to car rental agencies operating at the airport.

The auditor determined that a grant of use of a specified number of parking spaces to each car rental agency leasing counter space in the airport represented a taxable leasehold interest for which no consideration was paid under the lease. Pursuant to 82.29A.020(2)(b), the auditor established a taxable rent computation for the parking spaces and asserted tax thereon. The port protests the additional assessment, stating that the lease should be viewed as one transaction granting rental of counter space and a certain number of stalls, not as two separate rentals. The pertinent portion of each agreement lists the rental amount for floor and counter space and a concession amount to be paid in addition to the flat rental amount. The next paragraph states

> 4. LICENSEE'S PARKING SPACES: LICENSOR shall provide to LICENSEE, ten (10) parking spaces in the airport parking lot. Location of such parking spaces shall be determined by the Director of Aviation and may be changed as the Director of Aviation determines necessary or desirable. LICENSOR shall have the right to charge, if desired, for the use of these spaces.

The port's petition contends that

> [t]he intent of the lease was to include parking spaces with space in the terminal building. No charge is made for any parking space used by anyone at the airport. There may be a time when we would

> charge for parking spaces. When that is instituted, the auto rental agents will be charged. Until that time we do not believe the Leasehold Auditor should usurp the Port Commission authority to set rates for rental.
>
> [2] Assessment of tax based on a finding that multiple leases to single lessees are of contiguous property and should each be regarded as a single lease.

The port has entered into lease agreements with numerous lessees. The leases include

> one to a fish company, which holds leases to three separate fish-storage lockers in one building. The building has two sides: one locker is on one side of the building; the remaining lockers, which are separated by two other storage lockers, are on the other side. The two rows of lockers are separated by an inside walkway.
>
> a lease to a flying club of hangar space, subject to the leasehold excise tax, and a separate lease for ramp space, not subject to the tax. The port states that the rented hangar is located in the center of the hangar building, that the closest ramp space is "at least 200 feet from the nearest corner of the hangar" and that the rented ramp is ten spots away from the ramp which is nearest a corner of the hangar. In addition to the considerable distance separating them, the ramp space is separated from the hangar by several other lessees' rented ramp spaces. "Ramp" space is, essentially, outdoor tie-down parking for airplanes on the airport grounds. Such parking is often used by airplane operators on a transient basis or by owners on a more permanent basis where hangar space is either unavailable for undesirable for some reason.
>
> leases to sellers of boats in which one lease is for the rental of retail space in a port building and another lease is of boat-display spaces in the waterfront parking area. In all cases, the display spaces are separated by a driveway and some parking spaces; some of the display spaces are located "some distance" from the building space leased.

> a yacht club's lease of land for its building and a separate lease of a parking space for its commodore. The parking space is separated by a driving lane from the building.

The auditor, pursuant to RCW 82.29A.130(8), assessed tax in cases where a single lessee held multiple leases of different areas of port property. In most cases, one or more of the multiple leases, viewed singly, called for annual rental payments which were less than the minimum annual amount on which leasehold excise tax can be imposed. Viewing the multiple leases as a single lease qualified all for imposition of the tax.

The port contends that the auditor's use of the word "contiguous" as a basis for such assessment is too broad. The auditor relied on Black's Law Dictionary, which includes "in close proximity; near, though not in contact; and bounded or traversed by" as criteria for a finding that properties are contiguous. The port urges a more narrow interpretation: actually touching, having a common boundary (Barron's Real Estate Guides, Dictionary of Real Estate Terms); in close proximity, adjoining or abutting, near any point of contact (Complete Guide to Washington Real Estate Practice, Revised 2nd Edition); adjoining (Manual for Real Estate Brokers and Salesmen, compiled by the Bureau of Professional Services Division of Real Estate). Additionally, the port states that

> I gained my opinion of the word "contiguous" when I received a May 11, 1976, Department of Revenue Common Questions and Answers pamphlet. In it I read:
>
> Q. We lease two separate units to the same lessee at less than $250 yearly each.
>
> A. Both are exempt unless the properties are contiguous. If the properties **adjoin one another** they are to be treated as one lease. (Emphasis theirs.)

> [3] Assessment of leasehold excise tax on lease payments for purported product lease.

The port entered into a lease which it identified as a "product lease." The port agreed to grant the lessee a leasehold interest in a portion of the airport property for a limited term with conditions attached: the lessee was to cut

the hay and re-fertilize the land in conformance with the lease's specific terms, with the general benefit to the lessor of a reduced fire hazard thereon; and the lessee was not to interfere with the aviation use of the property. The right to cut hay on the airport grounds once a year for three years. The consideration received by the port was $1,000 per year for this privilege. The lessee conducted no other activity on the grounds.

The port contends that the lease should be taxed as a product lease which was transacted in this manner because

> [i]n the past, we have had trouble determining how many bales of hay were removed from the property. We, therefore, made it easier for ourselves by establishing a flat rate for the hay.

The port collected leasehold excise tax at the lower rate permitted by the statute for product leases.

The auditor asserted additional tax against the lease on the grounds that it did not meet the definition of a "product lease" under RCW 82.29A.020.

> [4] Assessment of tax against the land of the tax-exempt lessor where the lessee did not properly report and pay its public utility taxes, which would have exempted the lessee from leasehold excise tax.

The port protests assessment of leasehold excise tax where its former lessee, a small commuter airline serving the port's city and the San Juan Islands, properly registered with the Department but failed to properly comply with the public utility tax classification's reporting requirements. As a result, the lessee was not assessed tax under the Public Utility tax statutes, RCW 82.16.

The port's petition states that

> [u]ntil the audit, we were not aware what proof we needed in order to establish [the lessee] as a Public Utility. We did contact [an agent of the department] and were advised that Island Airlines was registered as a Public Utility, having registration [number]. We were not aware of further requirements of RCW 82.29A.130 in order to be recognized as a Public Utility for exemption from Leasehold tax.

In a February 3, 1988, letter following the audit, the supervisor of the Leasehold Excise Audit Unit informed the taxpayer that the lessee had not complied with its reporting requirements and that

> [t]his incident [of leasehold excise tax] upon your properties is taxable until such time that this taxpayer can show where he is being properly assessed for this use and occupancy. (Brackets supplied.)

> [5] Assessment of tax on portion of architect's fees guaranteed to the port by its eventual lessee.

The port sought to develop a restaurant on its waterfront property but wanted a guarantee that an interested party would either follow through on the development and become the eventual lessee or would bear part of the cost incurred by the port in getting a prospective project to the bidding stage.

The port entered into an agreement on August 19, 1986 with a private party whereby the private party agreed to obtain a $15,000 letter of credit at a local bank in trust for the port as security. The purpose of the arrangement was to reimburse the port for one-half of the cost of architect's fees up to the stated amount; in the event that the costs exceeded the stated amount, the private party agreed to pay half of the excess. The project went ahead as planned, and the letter of credit was returned to the private party.

The agreement provides in pertinent part that

> [s]hould the Second Party not enter into a lease with the Port of the designed and constructed facility and shall pay its share of the design fees, the Second Party shall be entitled to a copy of the plans and specifications provided by the Architect.

> [t]he Second Party shall have the right in its sole discretion to elect not to enter into a lease with the Port. (Emphasis supplied.)

In its petition materials, the port supplied a letter dated August 17, 1987. In that letter, the port stated that

> [the private party] has entered into a lease with the Port. . .for a new restaurant facility. . .
>
> Therefore, the Port, as beneficiary, does hereby release all interest in that Letter of Credit dated August 28, 1986.

DISCUSSION:

RCW 82.29A states that rental property owned by tax-exempt entities is 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.

RCW 82.29A.020 defines the arrangements which are subject to leasehold excise tax under this chapter:

> "Leasehold interest" shall mean 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.)

[1] The port contests the assessment of leasehold excise tax on an established value for the parking spaces assigned to the car rental agencies operating on its airport grounds. It strenuously argues that, although the spaces were provided for in a separate paragraph of the lease agreement and although it reserved the right to charge additional rent for the spaces at some future date, the spaces are not a second, separate leasehold from the overall transaction.

We agree with the port. It is clear from the information submitted by the port that it is customary at this airport to charge a flat rental fee for the use of counter and floor space within the airport building and for the use of parking stalls on the airport grounds to facilitate the agencies' rental operations. The stalls are necessary to the efficient

operation of the rental businesses. The department has previously considered other, similar leases by public entities on the issue of taxability of the concession rights associated with car rental operations. In those cases, the customary leases were for counter, floor and parking spaces, included in one rental price. We believe that, for an airport of this type, the customary leasehold interest to be created was for the floor, counter and parking spaces as a whole.

We are not persuaded that the language in the lease addressing future, higher payments for the leasehold interest in the event that the port decides to start charging users for parking at the airport justifies setting a value for such parking at the present time. To do so treats non-lessee parking customers differently from the rental businesses in this case. We believe, instead, that the port's purpose is to provide notice to its lessees that future circumstances, such as increased costs or a market which would support pay parking in that area, might result in a change in the costs which the lessee can expect to pay as a part of its lease. We are further persuaded that this is the proper interpretation of such leases by the fact that there is currently no parking charge to any users of the airport.

The port's petition with respect to this issue is granted. The portion of the assessment treating the parking spaces of the various car rental agencies as a separate, taxable leasehold interest will be deleted.

[2] The leasehold excise tax statutes contain an exemption for leases on which the annual rental payments are less than $250 per year. RCW 82.29A.130(8) further states, however, that

> [f]or purposes of this subsection leasehold interests held by the same lessee in contiguous properties owned by the same lessor shall be deemed a single leasehold interest.

The words of a statute, unless otherwise defined, should be given their usual and ordinary, everyday meaning. Strenge v. Clarke, 89 Wn.2d 23, 29, 569 P.2d 60 (1977). If a tax statute is ambiguous the statute must be construed most strongly against the taxing authority. Puyallup v. Pacific N.W. Bell Tel. Co., 98 Wn.2d 443, 448, 656 P.2d 1035 (1982).

In this case, the statute does not define "contiguous." The court cases require that the word be given its ordinary

meaning. The auditor and the port urge differing definitions of "contiguous;" the port supports its definition with a 1976 informational department publication requiring that the properties in question adjoin one another to be considered contiguous. We believe that the auditor's reliance on a broad definition of contiguous as "near" or "in close proximity to" as the basis of taxability is misplaced.

In State v. Superior Court for Chehalis County, 57 Wash. 71, 76, 106 P.2d 481 (1910), the Court of Appeals stated that lands considered to be contiguous in a flooding case need not be actually "next to" or "touching" the river which overflowed. But the court did require some link between the river and lands for which recovery was sought:

> [l]ands not bordering upon the river nor forming its banks, but subject to damage by its overflow, are as much entitled to protection from damage caused by overflow as is the land next to and forming the bank of the river.

We believe that the court's intent is that, for "next to" to qualify as contiguous, there must be some additional link besides mere proximity to another piece of property. Further, we find that, because the courts require ambiguities to be construed against the taxing body, a broad interpretation of "next to" or "in close proximity to" should not be used to permit a grouping of multiple leases into a single lease where no real link other than identity of the lessee exists. Finally, a study of the House and Senate records of this statute made from the legislative reports surrounding its enactment and of the state-archived notebooks containing comments by house, senate and gubernatorial staffs showed no discussion whatever of an intent on the part of those involved to broaden the meaning of "contiguous," or, more particularly, "near" or "in close proximity to" to permit a consolidation of leases where no connection between the allegedly-separate properties exists. Where the division is merely an access road or an inside walkway, a claim that the properties are contiguous will not be defeated, because the necessity of a road or a walkway does not sufficiently separate the properties.

Additionally, although an argument could be made that leases to a singular lessee for properties which are either put to similar use or which facilitate sales, as is the case with the boat display spaces used by the boat retailers, there is no language in the statute suggesting that the type of use to

which the property is put could be the basis of a link justifying a finding of contiguousness; there is also no such comment in any of the house, senate or gubernatorial reports. Absent more of a link between the leased properties, we are unwilling and without authority to construe a statute which is not, on its face, ambiguous in order to find that the multiple leases are one for leasehold excise tax purposes.

We find, consequently, that the lease to the yacht club of a parking space for its commodore is not sufficiently separate from the yacht club where the separation is caused by an access road.

Where the boat retailers lease retail space in the port's building and display space in the lot across from the building and where the retail space and the lot are only separated by an access road or driveway, such properties shall be considered contiguous and the leases will be considered to be a single lease. Where the display spaces are separated from the building by more than an access road, such as other lessees' rented spaces, we find that proximity sufficient to support a finding that the properties are contiguous is lacking. We are aware that this interpretation could result in differing treatment of leases to similarly-situated boat retailers. However, the problem here is one of competition between the statute's intent and definition of its terms. We believe that the intent of the statute, to tax separate leases for contiguous properties as one leasehold, requires the result that those near the building be considered contiguous.

We find that the storage lockers are not sufficiently separated from each other to defeat the contention that they are contiguous. The port has stated that there is a walkway between the rows; consequently, there is direct access between them. The case is directly analogous to that of the parking spaces separated from the yacht club or the boat retailers' offices by nothing more than an access road.

We find that the distance between the hangar and the ramp space is sufficient to render the leases ones of non-contiguous properties to the same lessee. The division between the two spaces is, by the port's account, considerable; such a contention is not disputed in the auditor's report. Additionally, other lessees' ramps or hangars separate the contested leases' hangar and ramp, unlike the case of the fish lockers, the commodore's parking or the boat display spaces separated only by a driveway or access road. The ramp and hangar spaces are similar to the boat-

display spaces which are separated by distance and by the rented spaces of other users from the retailing space. This finding is made on the narrow, uncontested facts presented in this appeal. This determination should not be construed to suggest that rental of a ramp and rental of hangar space in the closest possible proximity at this airport to the same lessee should not result in consolidation of the leases.

[3] As with the rule requiring strict construction of a statute granting an exemption, a statute granting special treatment must also be strictly construed. In order to qualify for special treatment under RCW 82.29A.020, a lease must meet the specific definition provided in that statute. The statute provides that

> "Product lease" as used in this chapter shall mean a lease of property for use in the production of agricultural or marine products to the extent that such lease provides for the contract rent to be paid by the delivery of a stated percentage of the production of such agricultural or marine products to the credit of the lessor or the payment to the lessor of a stated percentage of the proceeds from the sale of such products.

In this case, the port granted its lessee the right to use a portion of its land, subject to certain conditions on such use. Both parties intended that the lessee would remove hay from the property. In consideration for use of the property, the lessee was to pay a flat fee of $1,000 per year. The port's reasons for using a flat fee in determining the value of that right are immaterial. We are without authority to look beyond the plain, clear language of the lease in an effort to turn it into a product lease for leasehold excise tax purposes where such language was not supplied in the lease by either party.

The port's petition is denied with regard to this portion of the assessment.

[4] The intent of the leasehold excise tax is to require that private users of public property pay their share of the cost of government services to that property just a private landowner would be required to do. RCW 82.20.050(2) states that

> [t]he lessor shall be fully liable for collection and remittance of the tax. The full amount of the

> tax until paid by the lessee to the lessor shall constitute a debt from the lessee to the lessor.

Lessors are required by law to collect the leasehold excise tax from their lessees unless relieved of that duty. The port believed that it was relieved of the duty to collect tax by the fact that its lessee was exempt from a duty to pay the tax because of its liability for reporting and paying its taxes under the public utility statutes.

RCW 82.29A.130 states that

> [t]he following leasehold interests shall be exempt from taxes imposed pursuant to RCW 82.29A.030 and 82.29A.040:
>
> (1) All leasehold interests constituting a part of the operating properties of any public utility which is assessed and taxed as a public utility pursuant to chapter 84.12 RCW.

A check with the Department's registration section confirmed the information in taxpayer's petition. The lessee was registered with the Department of Revenue. To qualify for reporting under the public utility statutes, an airline must operate as more than a small charter airline. In this case, the airline in question clearly stated that it was serving the port's county as well as the San Juan Islands.

The leasehold excise tax statutes are intentionally stringent in an effort to require that land used for private purposes pay its fair share of the cost of services just as do private landowners. Additionally, the statutes strongly impose a duty on the lessor to force compliance on the lessee. This is not an unreasonable requirement, because the lessor benefits from the rents received from leases of its tax-exempt property and from its overall tax-exempt status. Further, the statute operates to encourage results which correspond to the practice whereby private landlords charge rent which covers their property-tax costs, thereby recovering the amount of their taxes from their lessees.

However, there is no language in RCW 82.29A.130 which requires that a lessor investigate a lessee's tax-exempt status to the point which seems to be suggested by the audit in question. The lessor determined that the small commuter airline was registered as a public utility; we will not impose upon this lessor the duty to monitor the lessee's books in order to

ensure that this lessee was reporting and paying its taxes in the proper manner. The qualification of the lessee as a public utility and its subsequent reporting habits were matters between the lessee and the state.

The incidence of tax is on the use of the public property for private purposes; it is not on the public lessor, nor is it on the public lands. An assessment against the public lessor through such public lands which forces a standard on the public lessor that "the incidence upon your properties is taxable until such time that this taxpayer can show where he is being properly assessed for this use and occupancy" is improper. As a result, the port's petition will be upheld with regard to this portion of the assessment.

[5] The leasehold excise tax statutes permit taxation of leasehold interests, which are defined in RCW 82.29A.020 as

> 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. . .

In this case, although the grantor of the letter of credit eventually became the port's lessee, we are unable to find that a lease agreement existed at the time that the letter of credit was granted. The substance of the transactions was that the port sought to develop a restaurant, which it would eventually lease out. That lease of any eventually-completed restaurant would be subject to leasehold excise tax. In order to protect itself from costs incurred prior to the construction phase of the project in the event that it was unable to lease the project, the port required that a prospective lessee grant the port a letter of credit to guarantee payment of a portion of the contemplated fees. The grantor of the letter of credit was under no obligation whatever to enter into a lease for the restaurant. Although loss of its $15,000 would be an incentive to follow through and eventually enter into a lease, the escape clauses still clearly provide the private party with the opportunity to avoid any future leasing arrangement. Nothing in the agreement indicates that a written or verbal lease agreement was in effect at the time of the payment. Indeed, there was, at the time of the granting of the letter of credit, no

property to be leased. The agreement was for guarantee of payment of fees. There was never, prior to the execution of the 1987 lease, an interest in real or personal property conveyed by the port. The actual lease was not transacted between the parties until the following year.

As a result, although the grantor of the letter of credit contemplated becoming the port's lessee at the time of the arrangement, and although the security arrangement was intended to be mutually beneficial to both contracting parties, we are unwilling to use hindsight once the lease was transacted and once a leasehold interest was created to bootstrap the prior agreement into the subsequent lease and subject it to leasehold excise tax. We find that, at the time of the first agreement, no interest in the port's property was granted to the private party. As a result, the $15,000 letter of credit amount is not taxable under the leasehold excise tax statutes.

The port's petition with regard to this portion of the assessment is granted.

DECISION AND DISPOSITION:

The port's petition is granted in part and denied in part. With respect to issues 1, 4 and 5, the petition is granted. With respect to issue 2, the petition is partially granted and remanded to the Leasehold Audit Section for a determination of which of the leases in question were actually contiguous as defined in this Determination. With respect to issue 3, the petition is denied, because the lease does not qualify as a product lease. The file will be remanded to the Leasehold Audit Section, which will issue revised assessments consistent with the findings of this Determination and which will bear a new due date.

DATED this 5th day of January 1989.