Cite as Det. No. 00-196, 20 WTD 279 (2001)

BEFORE THE 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. 00-196
. . .	)	Reg. No. . . .
	)	FY. . ./Audit No. . . .

[1] RCW 82.29A.050: LEASEHOLD EXCISE TAX ("LET") -- STATUTORY LANGUAGUE – LESSOR'S LIABILITY FOR UNCOLLECTED AND UNREMITTED TAX. The public lessor's liability for payment of the LET is similar to the retailer's liability for payment of the retail sales tax. As such, the lessor, like the retailer, is liable for payment of the tax regardless of whether the lessor collected the tax from its lessee (unless the lessee failed to pay the underlying contract rent).

[2] RCW 82.29A.010: LEASEHOLD EXCISE TAX ("LET") – LEGISLATIVE INTENT – LESSOR'S LIABILITY FOR UNCOLLECTED AND UNREMITTED TAX. The intent of the LET is to provide a mechanism for lessees of publicly owned property to pay for the governmental services they receive. The imposition of liability for the LET upon the public lessor, where the public lessor fails to collect the tax from its lessee and to remit it to the Department, does not run contrary to the legislative intent.

[3] WASH. CONST. ARTICLES VII AND VIII: LEASEHOLD EXCISE TAX ("LET") – CONSTITUTIONALITY – LESSOR'S LIABILITY FOR UNCOLLECTED AND UNREMITTED TAX. The LET is an excise tax, and not a property tax. As such, holding the public lessor liable for uncollected LET does not violate Article VII of the Washington State Constitution. Holding the public lessor liable for uncollected LET does not violate Article VIII of the Washington Constitution because it does not result in the public lessor lending its credit to the private lessees.

[4] RCW 82.29A.050: LEASEHOLD EXCISE TAX ("LET") – PUBLISHED DETERMINATIONS– LESSOR'S LIABILITY FOR UNCOLLECTED AND UNREMITTED TAX. The imposition of liability for the LET upon the public

lessor, where the public lessor fails to collect the tax from its lessee and to remit it to the Department, is consistent with prior published determinations.

[5] WAC 458-29A-500; RCW 82.29A.1406, RCW 82.32.300: LEASEHOLD EXCISE TAX ("LET") – NEW RULES – LESSOR'S LIABILITY FOR UNCOLLECTED AND UNREMITTED TAX – GOOD FAITH BELIEF. WAC 458-29A-500, effective November 1, 1999, clarifies the lessor's responsibility for LET collection and remittance. Because the portions of WAC 458-29A-500 involving lessor liability are intended to simply clarify the LET statutes and not to change Department policy, these portions of the rule are retroactive. Holding the lessor liable for uncollected and unremitted LET is consistent with the new rules, unless the lessor in good faith believed the lease transaction to be exempt.

[6] WAC 458-29A-400; RCW 82.29A.130: LEASEHOLD EXCISE TAX ("LET") – EXEMPTION – ANNUAL TAXALBE RENT LESS THAN $250 PER YEAR. RCW 82.29A.130 provides an exemption for leasehold interests for which annual taxable rent is less than two hundred fifty dollars per year. However, leasehold interests held by the same lessee in contiguous properties owned by the same lessor are deemed a single leasehold interest.

[7] RCW 82.29A.020, RCW 82.29A.030: LEASEHOLD EXCISE TAX ("LET") – TAXABLE RENT – CONTRACT RENT -- RENT CREDITS GIVEN TO TENANTS --IMPROVEMENTS. Amounts a public lessor received from lessees to compensate the lessor for improvements the lessor made to the leased property and amounts the lessor credited to the lessees for improvements the lessees made to the leased property are properly included in contract rent unless certain conditions apply.

[8] WAC 458-29A-200; RCW 82.29A.020: LEASEHOLD EXCISE TAX ("LET") – TAXABLE RENT – CONTRACT RENT –RECEIPTS FROM A SEPARATE BUSINESS ACTIVITY EXCLUDED FROM CONTRACT RENT. To the extent the lessor receives consideration which is not due as payment for the leasehold interest, the amount received is not subject to the LET.

[9] WAC 458-29A-100; RCW 82.29A.0106, RCW 82.29A.020: LEASEHOLD EXCISE TAX ("LET") -- LEASEHOLD INTEREST –CONCESSION DISTINGUISHED– POSSESSION AND USE -- VENDING MACHINES. Both possession and use are required to create a leasehold interest, and the lessee must have some identifiable dominion and control over a defined area to satisfy the possession element. If the only right granted to a vending machine owner was the right to make sales on the public lessor's property, the vending machine owner merely would have received a "concession," which is not subject to LET. On the other hand, if the vending machine owner also leased

buildings or other areas subject to the actual physical control of the vending machine owner, an interest would be created that is subject to LET.

[10] RCW 82.29A.020: LEASEHOLD EXCISE TAX ("LET") – CONTRACT RENT – TAXABLE RENT – COMPETITIVE BIDDING – NEGOTIATION OR RENEGOTIATION IN ACCORDANCE WITH STATUTORY REQUIREMENTS OR UNDER CIRCUMSTANCES WHERE THE MAXIMUM RENT RECEIVED AS ESTABLISHED BY PUBLIC RECORD. Contract rent is the proper measure of the LET 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. Therefore, it is only where the contract was negotiated or renegotiated in compliance with one of the three specifically sanctioned methods that the Department is required to compute taxable rent based on contract rent. Where taxable rent is established by the Department, consideration is given to rental being paid to other lessors by lessees of similar property for similar purposes over similar periods of time and 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.

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.

NATURE OF ACTION:

A public lessor argues that the Audit Division erred in holding it liable for uncollected leasehold excise tax ("LET") because such a holding is contrary to the statutory language, contrary to legislative intent, contrary to prior published determinations, and violates the Washington Constitution. The lessor further argues that the LET rules, adopted November 1, 1999, are inapplicable to the audit period. Further, the lessor argues the Audit Division erred in including the following amounts in the assessment: Christmas tree lot payments of $200 per year, payments from lessees for improvements and rent credits the lessor gave to lessees for lessee-made improvements, payments from lessees for pro-rata utility charges, and payments from the owners of vending machines located on the lessor's property. Finally, the lessor argues that the Audit Division erred in giving future reporting instructions to certain tenants regarding the calculation of taxable rent.[1]

FACTUAL BACKGROUND, ARGUMENTS, AND ANALYSIS:

[1] Identifying details regarding the taxpayer and the assessment have been redacted pursuant to RCW 82.32.410.

C. Pree, A.L.J. – The Port of . . . (Port's) leasehold income and associated records were audited for the period of January 1, 1994, through September 30, 1997. The audit resulted in the assessment of leasehold excise tax (LET) of $. . . and interest of $. . . . The assessment totaled $. . . .

The assessment was issued because the Audit Division determined that the Port did not collect the proper amount of LET from its tenants and did not remit the tax to the Department with respect to the transactions included in the assessment.

The Port protests the assessment on a number of grounds. We will address each of the Port's arguments and the Audit Division's grounds for the assessment and set forth our analysis and conclusions with respect to each issue, below.

1. Whether the Statutory Language Supports Holding the Port Liable for Payment of Uncollected LET

As set forth above, the Audit Division issued its assessment against the Port, not against the individual lessees who leased property from the Port. The Port argues that it is merely the collector of the LET and not personally responsible for payment of the tax. Specifically, the Port argues that the statutory language does not support imposition of liability against the Port for uncollected LET.

A. Whether RCW 82.29A.030 supports the argument that the Port is not liable for the tax. The Port first cites RCW 82.29A.030(1), which imposes the LET, as follows:

> There is hereby levied and shall be collected a leasehold excise tax on the act or privilege of occupying or using publicly owned real or personal property through a leasehold interest . . . .

The Port notes that RCW 82.29A.030 imposes the LET "on the act or privilege of occupying or using publicly owned real or personal property through a leasehold interest." (Emphasis the Port's.) Thus, the Port apparently concludes that because the tax is on the lessee's privilege of occupancy, the tax is imposed on the lessee, not the Port. While we agree that the Port correctly restates the language in RCW 82.29A.030, we note that this statute addresses the incidence of the tax; it does not address who is responsible for payment of the tax. The legislature often places the description of the incidence of the tax in a separate statute from the description of who is liable for the tax. For example in RCW 82.08.020, the legislature imposes the retail sales tax, as follows: "There is levied and there shall be collected a tax on each retail sale in this state . . . ." Thus, the incidence of the retail sales tax is "retail sales." The legislature used a separate statute to set forth who is responsible for payment of the retail sales tax. See RCW 82.08.050, which will be discussed at length, below. With respect to the LET, the person responsible for the tax is addressed in RCW 82.29A.050, which will also be discussed below. In short, we find that RCW 82.29A.030 does not address the issue of whether the Port is liable for payment of uncollected LET.

B. Whether RCW 82.29A.050 supports the argument that the Port is not liable for the tax. RCW 82.29A.050 provides:

> (1) The leasehold excise taxes . . . shall be paid by the lessee to the lessor and the lessor shall collect such tax and remit the same to the department of revenue. The tax shall be payable at the same time as payments are due to the lessor for use of the property from which the leasehold interest arises . . . .

(Emphasis the Port's.) From this statutory language, the Port concludes: "Thus liability for payment of the LET is imposed by statute expressly and solely upon the lessee." We disagree. This section describes the lessor's duty to collect the tax from the lessee and to remit the collected tax. It does not address the lessor's liability when it fails to perform this duty.

The Port goes on to cite section (2) of RCW 82.29A.050:

> (2) The lessor receiving taxes payable under the provisions of this chapter shall remit the same together with a return provided by the department, to the department of revenue on or before the last day of the month following the month in which the tax is collected. . . . **The lessor shall be fully liable for collection and remittance of the tax. The amount of tax until paid by the lessee to the lessor shall constitute a debt from the lessee to the lessor. . . .Where a lessee has failed to pay to the lessor the tax imposed by this chapter and the lessor has not paid the amount of the tax to the department, the department may, in its discretion, proceed directly against the lessee for collection of the tax:** PROVIDED, That **taxes due where contract rent has not been paid shall be reported by the lessor to the department and the lessee alone shall be liable for payment of the tax to the department.**

(Bold added; underlining the Port's.) The Port continues:

> We would have no quarrel with a claim against the Port if the Port had collected the tax and then failed to remit it as required by RCW 82.29A.050(2). However, DOR interprets that section to allow DOR to assess the tax itself directly against the public lessor or the private lessee in any case where the lessor fails to collect it, except when neither rent nor LET is collected. We strongly disagree, because that is not what the statute says, even if such an interpretation would be constitutional. A very strong argument against any such implied intent is the lack of any earlier language in that section or elsewhere, making any municipal lessor liable for payment of the tax out of its own funds. If that had been the legislatur'intent, [sic] surely it could have said so in clear and direct terms as it has done in the case of retail sales taxes . . . . Where the legislature uses statutory language in one instance, and different language in another, there is a difference in legislative intent.
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> Therefore, such a strained construction would be a very fragile twig from which to suspend such a startling conclusion, especially in view of its constitutional implications.

The Port then argues:

> If the DOR's interpretation is correct, the asserted liability against the [Port] in this case would be essentially the same as the liability that is incurred by retailers who fail to collect or remit the retail sales tax that is imposed by chapter 82.08 RCW. That chapter contains a provision that is similar to RCW 82.29A.050, but clearly imposes liability upon a retailer who fails to collect the sales tax.

The Port then cited the underlined portion of RCW 82.08.050, as set forth below:

> The tax hereby imposed shall be paid by the buyer to the seller, and each seller shall collect from the buyer the full amount of the tax payable in respect to each taxable sale . . . .
>
> In case any seller fails to collect the tax herein imposed or having collected the tax, fails to pay it to the department in the manner prescribed by this chapter, whether such failure is the result of his or her own acts or the result of acts or conditions beyond his or her control, he or she shall, nevertheless, be personally liable to the state for the amount of the tax, unless the seller has taken from the buyer in good faith a properly executed resale certificate under RCW 82.04.470.
>
> The amount of tax, until paid by the buyer to the seller or to the department, shall constitute a debt from the buyer to the seller . . . .
>
> Where a buyer has failed to pay to the seller the tax imposed by this chapter and the seller has not paid the amount of the tax to the department, the department may, in its discretion, proceed directly against the buyer for collection of the tax. . . .

The Port then argues, "The legislature must be presumed to be aware of that statute. Its avoidance of similar words and phrases in RCW 82.29[A].050 cannot be presumed to have been unintentional." (Citations omitted.)

Contrary to the Port's interpretation, we do not find that the legislature avoided the use of similar words in RCW 82.08.050 and RCW 82.29A.050. In fact, we find the two statutes to be quite similar in all material respects. As set forth above, the Port's first argument is that in RCW 82.29A.050, in contrast to RCW 82.08.050, there is a "lack of . . . language . . . making any municipal lessor liable for payment of the tax out of its own funds." However, we note that the legislature used the term "fully liable" in describing the lessor's liability for remittance of the LET. We find the legislature's use of this term to be similar to its use of the term "personally liable" in the context of the sales tax. In the context of tax liability, these terms have similar meanings. According to Webster's Third New International Dictionary (1993), "fully" means:

"completely, entirely, thoroughly."[2] Thus, the legislature, by its use of the term, "fully liable" in the LET context, intended to impose "complete" liability on the lessor for the tax.

The Port points out a second distinction between the language in the retail sales tax and LET statutes:

> Significantly, RCW 82.29A.050(2) describes the liability of the lessor for only the "collection and remittance" of the tax; not for its payment . . . .[3]

(Footnote added; emphasis the Port's.) However, while we agree that the legislature did, in fact, use the term "pay" in the context of the retail sales tax and the term "remit" in the context of the LET, in this context we find there is no substantive difference between these terms. "Pay" is defined in Webster's Third New International Dictionary as "to make any agreed disposal or transfer of (money)." Similarly, Webster's Third New International Dictionary defines "remit" as "to send (money) to a person or place (as in payment of a demand, account, draft.)" Thus, under both statutes, the responsibility of the seller or lessor is to transfer or send the taxes to the Department. Further, under both statutes it is the responsibility of the seller or lessor to collect those taxes from the buyer or lessee.

In short, based upon construction of the retail sales tax and LET statutes, we find the lessor's liability for payment of the LET to be similar to the retailer's liability for payment of the retail sales tax. As such, we conclude that the lessor, like the retailer, is liable for payment of the tax regardless of whether the lessor collected the tax from its lessee (unless the lessee failed to pay the underlying contract rent).

The Port next argues:

> Note that in describing the lessor's responsibility RCW 82.29A.0505(2) uses the term "liable"; not "indebted" or ["]debt." "Liability" and "liable" are very broad legal terms, susceptible of several meanings, and generally mean "responsibility" or "responsible" . . . . Thus to the extent that the term "liable" as used in that context is ambiguous, it requires resort to rules of statutory construction for its interpretation.
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> A statute must be construed as a whole, and effect must be given to each word, phrase, clause and sentence of the statute. The legislature is presumed not to have used superfluous words. . . .
>
> Applying the above rules, the legislature's use of the word "debt" when referring to the lessee's liability, and not using that word when referring to the liability of the lessor for collection and remittance, is very significant. Correctly construed, the lessor's

[2] See, e.g., Sellen Constr. Co. v. Department of Revenue, 87 Wn.2d. 878, 883, 558 P.2d 1342 (1976)("Courts . . . resort to dictionaries to ascertain the common meaning of statutory language.").

[3] Both RCW 82.08.050 and 82.29A.050 discuss the seller's or lessor's responsibility to "collect" the respective taxes from the buyer or lessee. As such, we need not analyze this portion of the statutes.

> responsibility is for collection and remittance of the tax from the lessee; not to act as a surety.
>
> Accordingly, insofar as RCW 82.29A.050 uses the word "liable" in describing lessor's duty to collect and remit, it must be construed to mean that if the lessor refuses or neglects to collect or remit the tax, the Department may bring appropriate legal action to enforce the district's statutory obligation; e.g., by mandamus or injunction. However, the statute does not define and cannot be construed to define the lessor's obligation as that of a "debtor," or as a surety or insurer of payment by the lessee. It does not purport to require or authorize the Department to demand payment of the uncollected tax from the port district's own funds.

(Emphasis the Port's; citations omitted.) We disagree with the Port's argument that the legislature used dissimilar terms in defining the lessee's and lessor's responsibilities with the intent to relieve the lessor from liability for the tax. Webster's Third New International Dictionary defines "debt" as "Something (as money, goods, or services) owed by one person to another." "Liable" is defined as "Bound or obligated according to law or equity." Webster's Third New International Dictionary.

Thus, we find that the sentence of the statute characterizing the lessor's obligation to the Department as a liability quite clearly obligates the lessor to pay LET to the Department, regardless of whether the lessor fulfilled its duty of collecting LET from the lessee (except in cases where the lessee failed to pay the underlying contract rent). Specifically, applying the definitions set forth above, the statutory language reads: "The lessor shall be fully [completely, entirely, thoroughly] liable [obligated according to law] for collection and remittance [to send (money) to a person . . . as in payment] of the tax."

Further, we find the Port's construction of the statute violates the rules of statutory construction it cites.

First, we note the statutory language, which states, "the department may, in its discretion, proceed directly against the lessee for the collection of the tax." If the Department could not proceed directly against the lessor for the collection of the tax, there would be no reason for the legislature to include the language allowing the Department, "in its discretion," to proceed against the lessee for collection.[4]

Further, we note the provision, "taxes due where contract rent has not been paid shall be reported by the lessor to the department and the lessee alone shall be liable for payment of the tax to the department." If the lessor were not liable for the payment of taxes where it has received the

[4] We note that the legislature used precisely the same language in RCW 82.08.050, i.e., "Where a buyer has failed to pay to the seller the tax imposed by this chapter and the seller has not paid the amount of the tax to the department, the department may, in its discretion, proceed directly against the buyer for collection of the tax." It is undisputed that the Department may hold either the seller or the buyer responsible for that tax.

underlying rent, there would have been no need for the legislature to exclude the lessor from liability for payment in cases where the lessor has not received rent from the lessee.

In summary, we find the statutory language supports the Audit Division's assessment of LET against the Port.

2. Whether Holding the Port Liable for Uncollected LET is Contrary to Legislative Intent

The legislature's intent in establishing the LET is declared in RCW 82.29A.010:

> The legislature hereby recognizes that properties of . . . municipal corporations are exempted by Article 7, section 1 of the state Constitution from property tax obligations, but that private lessees of such public properties receive substantial benefits from governmental services provided by units of government.
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> The legislature further recognizes that a uniform method of taxation should apply to such leasehold interests in publicly owned property.
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> The legislature finds that lessees of publicly owned property are entitled to those same governmental services and does hereby provide for a leasehold excise tax to fairly compensate governmental units for services rendered to such lessees of publicly owned property.[5]

(Footnote added.) The Port argues:

> Nowhere in that declaration is there evidence of any anomalous intent to, in effect, assess the tax against the local government entities themselves, for whose benefit it is created, if they fail to collect it. Accordingly, DOR's interpretation runs counter to legislative intent.

We agree with the Port's argument that the intent of the LET is to provide a mechanism for lessees of publicly owned property to pay for the governmental services they receive, i.e., to "compensate governmental units for services rendered to such lessees of publicly owned property." See RCW 82.29A.010. We note that in Japan Line v. McLeod, 88 Wn.2d 93, 97, 558 P. 2d 211 (1977), the Washington Supreme Court acknowledged that the intent of the LET is to pay for government services: "The leasehold tax was clearly designed to impose a true tax for the direct support of government."

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[5] RCW 82.29A.010 and other sections of the leasehold excise tax were amended in 1999. RCW 82.29A.010(2), as amended, states:

> The legislature further finds that experience gained by lessors, lessees, and the department of revenue since enactment of the leasehold excise tax under this chapter has shed light on areas in the leasehold excise statutes that need explanation and clarification. The purpose of chapter 220, Laws of 1999 is to make those changes.

None of the 1999 amendments impacts our resolution of this case.

However, we find that imposing liability for the LET upon the public lessor, where the public lessor fails to collect the tax from its lessee and to remit it to the Department, does not run contrary to the legislative intent. First, we note that holding the public lessor liable to the Department for failure to collect and remit the tax in no way diminishes the private lessee's responsibility to the lessor for payment of the tax and in no way serves to transfer the tax burden from the person intended to be ultimately responsible for the tax, i.e., the lessee. As the legislature stated in RCW 82.29A.050, "The amount of tax until paid by the lessee to the lessor shall constitute a debt from the lessee to the lessor." Thus, as with the retail sales tax, the imposition of liability on the lessor (seller) is not intended to relieve the person intended to be responsible for the tax (the lessee in the context of the LET and the buyer in the context of the retail sales tax) from the ultimate responsibility for payment of the tax.[6]

Second, we note that while LET is generally distributed pro rata based on collections, the public lessor and the public entity that benefits from the LET are not necessarily the same entity. See RCW 82.29A.070, .090, .100. Thus, where the public lessor fails to collect and remit the tax, it may be depriving another public entity of the funds necessary to pay for services that entity provided to the private lessee.

The Port further argues:

> As further evidence of legislative intent, RCW 82.29A.060 expressly provides, in part,
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> > [T]his section shall not authorize the issuance of any levy upon any property owned by the public lessor.

We fail to see how the prohibition of a levy against the lessor's property serves to relieve the lessor for liability from the tax where it has failed to collect the tax from the lessee.

In short, we find that the Audit Division's assessment of tax against the lessor does not run contrary to legislative intent.

3. Whether Holding the Port Liable for Uncollected LET Violates Articles VII or VIII of the Washington Constitution

The Port argues:

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[6] In an affidavit filed in this matter, . . ., Accounting Customer Service Representative for the Port, states that the "possibility does not exist [to collect the taxes from tenants] in some cases because of the departure of the affected tenants, and in remaining cases recovery would be very difficult or impossible without litigation." The fact that this debt may subsequently become uncollectable or difficult to collect due to the lessee's departure does not negate the legislature's intent to hold the lessor liable where it fails to collect and remit the tax.

> [A] rule, . . . found in constitutional law, is that if there are alternative possible constructions, one or more of which would involve serious constitutional difficulties, the court without doing violence to the legislative purpose, will reject those interpretations in favor of a construction which will sustain the constitutionality of the statute. Language within a statute which is capable of both a constitutional and unconstitutional construction will be presumed to have been enacted with the constitutional interpretation intended.[7]

(Footnote added.)

A. Whether holding the Port liable for uncollected LET would violate Article VII of the Washington Constitution because it would impose a property tax on a municipal corporation. The Port argues, "RCW 82.29A.010 expressly recognizes that Washington constitution article VII section 1 exempts municipal property from taxation. For that reason the legislature created the LET in lieu of such property tax." The Port argues that the Audit Division's assessment against the Port violates article VII because "[t]he LET would become, in effect, an unconstitutional taxation of port district property." Specifically, the Port argues:

> [T]he public lessor's voluntary or enforced assumption of the lessee's tax obligation based upon the leasehold value of that property, would be equivalent to the payment or assessment of an ad valorem property tax on exempt municipal property, in violation of RCW 82.29A.60 and also in violation of article VII, section 1 of the state constitution.

In a memorandum submitted after the hearing in this matter, the Port argues:

> [O]ur supreme court . . . issued its opinion in Harbour Village Apartments et al. v. City of Mukilteo, 139 Wn.2d 604, ___ P.2d ___ (December 16, 1999). We believe that that case and two cases cited therein very clearly support our position.
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> All three of those cases dealt with the question of whether a certain charge against the owner of rental property was in reality a property tax. In all three cases the charge was held to be a property tax.
>
> In the Harbour Village case, supra, the issue was whether a "residential dwelling unit fee" charged by the City to the owner of apartments was a constitutional excise tax or an unconstitutional property tax. The charge was a flat fee based upon each rental unit. The court held, first, that the charge was a tax because its purpose was raising revenue. Second, the court held that the charge was not an excise tax because its incidence was on

[7] We note that the Port is not arguing that the statute itself is unconstitutional; we are without authority to consider such an argument. "An administrative body does not have authority to determine the constitutionality of the law it administers; only the courts have that power." Bare v. Gorton, 84 Wn.2d 380, 383, 526 P.2d 379 (1974). Rather, the Port is arguing that the Audit Division's interpretation of the statute, holding the lessor liable for payment of uncollected LET, is unconstitutional.

> the property itself; and therefore an unauthorized and unconstitutional property tax . . . . Under the court's rationale in that case, further illustrated in the two preceding cases more directly in point, the operational effect in this case would convert the tax from a lawful excise tax assessed against the lessee to a tax on the Port's rental income, and thus an unconstitutional property tax.
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> The two previous cases relied upon by the court in its opinion are more closely in point, because in those cases the tax was based upon rental income, as in the case now before this tribunal.
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> The first was Jensen v. Henneford, 185 Wash 209, 53 P.2d 607 (1936) which held, among other things, that "A tax upon rents from real estate is a tax upon the real estate itself." (185 Wash 209 at 222.)
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> The second cited case was Apartment Operators Association of Seattle, Inc., et al. v. Schumacher, et al., 56 Wn.2d 46, 351 P.2d 124 (1960). That case held, more succinctly, that under the Jensen case, supra, and others,
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> > … a tax on rental income is a tax on property, and not an excise tax. Furthermore, a tax upon rents from real estate is a tax upon the real estate itself, and is, thus, a second tax upon real estate.
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> 56 Wn.2d at 47.
>
> In both cases the court, in invalidating the tax, had rejected arguments that the tax was an excise tax because it was a tax on rental income rather than a tax on the property itself. The court in both cases had held that to be a distinction without a difference: "… a tax upon rents from real estate is a tax upon the real estate itself." *See* Harbour Village Apartments, supra, 139 Wn.2d at 608, quoting from Schumacher. [8]
>
> In conclusion, based upon the above cases, the Department of Revenue's assessments against the Port . . . for uncollected leasehold excise taxes are taxes upon the Port's property itself and therefore are unauthorized and unconstitutional.

(Footnote added.) We note that in Harbour Village, the residential dwelling unit ("RDU") fee was due regardless of whether the unit was being rented. The RDU fee was not measured by the value of the property or the amount of rent collected, but was simply an annual flat fee on each rental unit actually rented or offered for rent. 139 Wn.2d at 604. As such, the court found that

[8] The dissent in Harbour Village notes that the continued validity of Jensen and Schumacher has been questioned. See, e.g., High Tide Seafoods v. State, 106 Wn.2d 695, 700, 725 P.2d 411 (1986); Shurgard Mini-Storage v. Department of Revenue, 40 Wn. App. 721, 723 n.2, 700 P.2d 1176 (1985). Harbour Village, 139 Wn.2d at 616 n.4. We need not address this issue, as we find the LET not to be a tax on rental income, but rather a tax on the privilege of a private lessee using public property.

the incidence of the tax was "the mere ownership of that subclass of real property defined by its rental use." 139 Wn.2d at 607. The court reasoned:

> Each rental unit is directly taxed at $80.60 regardless of whether it is actually rented, the number of rental transactions associated with the property, or any other factors normally associated with ongoing business activity, including income. Nor is this RDU tax an excise on the mere privilege to conduct a rental business that is already separately taxed at the rate of $61.00 per business location. Rather the incident of this tax is on the rental property as such and a tax on rental property is no less a tax on property

Id. Thus, the court held that the RDU fee violated article VII, section 1, which prohibits non-uniform taxation of real property, and article VII, section 21, which imposes an ad valorem requirement.

In contrast, RCW 82.29A.030 imposes the LET "on the act or privilege of occupying or using publicly owned real or personal property through a leasehold interest." Thus, the incidence of the LET is the use and occupancy of public property by a private lessee through a leasehold interest. See RCW 82.29A.020. The measure of the tax is the value of that use, i.e., taxable rent. See RCW 82.29A.030. Thus, the public owner of property is not liable for the tax simply based on its ownership of the property. The public owner is liable for the tax only when it permits a private party to occupy and use its property and the public owner fails to collect the tax from its lessee and to remit it to the Department. If the property is not so occupied, no LET is due. In fact, the court in Harbour Village distinguished the type of tax at issue both here and in Black v. State, 67 Wn.2d 97, 406 P.2d 761 (1965), from the RDU fee it invalidated in that case:

> . . . Black was subjected to a $17,000 sales tax on a $425,000 ship lease payment because it was "an excise tax on the transaction of leasing tangible personal property. It is not a tax on property." *Id. At 99.* But here it is not the rental transaction which is taxed indeed there need not even be a rental transaction rather it is the fact of ownership of rental property which is taxed.

Harbour Village, 139 Wn.2d at 608. As with the sales tax at issue in Black, under the LET, there must be a "rental transaction," i.e., "occupying or using publicly owned real or personal property through a leasehold interest," for the tax to be due. As such, we find the RDU fee, and thus the holding in Harbour Village, to be readily distinguishable from the LET.

Moreover, we find that the LET does not meet the definition of a "property tax" set forth in recent case law. For example, in Covell v. Seattle, 127 Wn.2d 874, 889-91, 905 P.2d 324 (1996), the Washington Supreme Court explained the difference between a property tax and an excise tax:

> [T]he obligation to pay an excise tax is based on the voluntary action of the person taxed in performing the act or engaging in the occupation which is the subject of the tax, and

> the element of absolute and unavoidable demand, as in the case of a property tax, is lacking. . . .
> This court has distinguished a property tax from an excise tax, defining a property tax as a tax on things tangible or intangible and an excise tax as the right to use or transfer things. . . .
>
> [W]hen the tax is levied upon the exercise of only "one of the numerous rights of property," such as the right to transfer ownership the tax may be said to be indirect and so valid although not apportioned.

Further, in Black, the court explained:

> If a tax is imposed directly by the legislature without assessment, and its sum is measured by the amount of business done or the extent to which the conferred privileges have been enjoyed or exercised by the taxpayer, irrespective of the nature or value of the taxpayer's assets, it is regarded as an excise; but if the tax is computed upon a valuation of property, and assessed by assessors . . . although privileges may be included in the valuation, it is considered a property tax.

67 Wn.2d at 99. Applying the test set forth in Covell, we find that the obligation to pay the LET is based on the voluntary action of the person taxed (the lessee or the lessor where the lessor has failed to collect and remit the tax) in performing the act which is the subject of the tax (occupying and using public property). Thus, the LET is levied upon the exercise of only "one of the numerous rights of property," i.e., the right to lease the property. As such, we find that the LET qualifies as an excise tax under Covell. Further, we note that the element of absolute and unavoidable demand, as in the case of a property tax, is lacking.

Similarly, applying the test set forth in Black, we find that the LET is an excise tax because it is imposed directly by the legislature without assessment, and its sum is measured by the amount of business done, irrespective of the nature or value of the taxpayer's assets. In contrast to a property tax, the LET is not computed based upon a valuation of property, and assessed by assessors.

In summary, because we find that the LET is an excise tax, and not a property tax, we find that the Audit Division's interpretation of the statute as holding the lessor liable for uncollected LET not to be in violation of Article VII of the Washington State Constitution.

B. Whether holding the Port liable for uncollected LET would violate Article VIII of the Washington Constitution because it would force the Port to lend its credit to the private lessees. The Port argues that an interpretation "that would permit or require a port district to pay a lessee's unpaid taxes, voluntarily or otherwise, would render the statute unconstitutional" because it would result in the lending or giving of public money or credit to or in aid of a private person or entity.[9]

[9] Article VIII, section 7 provides in pertinent part:

The Port cites Washington State Highway Comm'n v. Pacific Northwest Bell Tel. Co., 59 Wn.2d 216, 367 P.2d 605 (1961), which involved the state's payment of costs of relocating utilities, which was the obligation of the private utilities. The Port also cites State ex rel. O'Connell v. P.U.D. No. 1, 79 Wn.2d 237, 484 P.2d 393 (1971). The Port explains:

> [In O'Connell], a public utility district, as a means of selling electrical equipment to its customers, took assignments of sellers' interests in conditional sales contracts from dealers who had sold the equipment covered by the contracts to the district's customers. The district thus acquired the sellers' interest in the contract and the equipment, paid to the dealers an amount equal to the balance owed after down payment, and then dealt with the customers as if the district were the contract seller. The supreme court held that to be a loan of the district's funds.

However, in Japan Line v. McLeod, 88 Wn.2d 93, 98, 558 P. 2d 211 (1977), the Washington Supreme Court explained:

> The manifest purpose of these provisions [including Article VIII, section 7] in the constitution is to prevent state funds from being used to benefit private interests where the public interest is not primarily served. State Highway Comm'n v. Pacific Northwest Bell Tel. Co., 59 Wn.2d 216, 367 P.2d 605 (1961); see, e.g., State Higher Educ. Assistance Authority v. Graham, 84 Wn.2d 813, 529 P.2d 1051 (1974) (public funds used to purchase loans made to students from commercial lenders); State ex rel. O'Connell v. Port of Seattle, 65 Wn.2d 801, 399 P.2d 623 (1965) ("promotional hosting" of shippers, businessmen and others); State ex rel. Washington Nav. Co. v. Pierce County, 184 Wash. 414, 51 P.2d 407 (1935) (state subsidy to private ferry operators); Port of Longview v. Taxpayers, 85 Wn.2d 216, 533 P.2d 128 (1974) (loaning of money or credit to finance pollution control facilities).

(Bracketed information added.) In contrast to the cases cited by the Port, holding the public lessor accountable for its failure to collect LET from its private lessee does not involve the use of state funds to benefit private interests where the public interest is not primarily served. As the Port concedes, RCW 82.29A.050 imposes the duty of collecting the LET from the private lessee on the public lessor. In holding the lessor liable for its failure to perform this duty, there is no gift or loan of money, property, or credit by the Port in aid of the private lessee, which would violate Article VIII. Instead, the Port's failure to perform its duty of collection causes the Port itself to be liable for the taxes. As RCW 82.29A.050 provides, "The lessor shall be fully liable for collection and remittance of the tax."

> No . . . municipal corporation shall hereafter give any money, or property, or loan its money, or credit to or in aid of any individual, association, company or corporation . . . .

Further, we note that upon the lessor's payment of the tax, the tax remains a debt owing from the lessee to the lessor. See RCW 82.29A.050 ("The amount of tax until paid by the lessee to the lessor shall constitute a debt from the lessee to the lessor.") Thus, the lessor's payment of the tax does not benefit a private interest because the private lessee remains fully liable to the lessor for the tax.

In summary, we find that the Audit Division's interpretation of the statute does not violate the Washington Constitution.

4. Whether Prior Published Determinations Support the Port's Position that it is Not Liable for Uncollected LET

The Port relies on several published determinations in support of its position that it is not liable for uncollected LET. The first determination, Det. No. 88-364, 6 WTD 399 (1988), involved an appeal by a lessee. The Port argues:

> In [Det. No. 88-364], the ALJ initially stated that the Department was free to pursue either the lessor or the lessee for the L.E.T[.], but then held the lessor to be exempt from liability for payment. The ALJ cited RCW 82.29A.050(2), which states that where a lessee has failed to pay to the lessor the LET and the lessor has not paid the amount of the taxto [sic] the DOR, the DOR may in its discretion proceed directly against the lessee for collection of the tax. The ALJ then went on to hold that the lessor was exempt from personal liability for the uncollected and unpaid LET.

The Port then recited the following underlined portion from Det. No. 88-364.

> **The Department is free to pursue either the lessor or the lessee for the tax in this case**. A portion of RCW 82.29A.050(2) not quoted by the taxpayer states in part: "Where a lessee has failed to pay to the lessor the tax imposed by this chapter and the lessor has not paid the amount of the tax to the department, the department may, in its discretion, proceed directly against the lessee for collection of the tax. . . ." It has done precisely that in this instance. **It is not limited to the lessor in its audit or collection efforts**. Indeed, the economic burden of the leasehold tax is the primary responsibility of the lessee, not of the lessor. The lessor, in effect, is simply a collection agent for the Department just as a merchant is an agent for the Department for the purpose of collecting sales tax. That the legislature intended the lessee to bear primary responsibility for the tax is made clear in RCW 82.29A.010. The tax was created as a substitute for the property tax which would have to be paid by somebody were the leased premises not in the ownership of a public entity.

(Bold added.) The Port goes on to argue:

> This statement [underlined above], coupled with the absence of language in RCW 82.29A.050 expressly imposing any liability on the lessor for uncollected or unpaid LET, indicates that the lessor cannot be held liable for the tax.

Contrary to the Port's assertion, we do not read Det. No. 88-364 as holding the lessor to be "exempt from liability for payment." In that determination, the Department was not addressing the lessor's liability, but was instead addressing the lessee's liability, because the lessee had been assessed the LET in that case and had appealed. We note that the determination makes it clear that "The Department is free to pursue either the lessor or the lessee for the tax," and the Department "is not limited to the lessor in its audit or collection efforts." Thus, while the lessee is primarily liable for the tax, and the tax constitutes a debt from the lessee to the lessor until paid, the lessor is nonetheless liable for its failure to collect and pay the tax. The Department is free to use its discretion in proceeding against the lessee or the lessor for payment of the tax. In this case, the Department used its discretion to proceed against the lessor.

The Port continues:

> A similar result was reached in Determination No. 89-3, 7 WTD 105 (1989). In that instance the DOR did assess LET against a public lessor for the unpaid LET of a lessee. The lessor believed the lessee (a small commuter airline) to qualify for exemption from the LET under another section of the chapter. In fact the lessee did not qualify for exemption and the DOR auditor assessed the lessor for the uncollected tax. The ALJ reversed, holding:
>
> > The incidence of the 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 upon 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.
>
> 7 WTD at 116. Thus, the ALJ held that the incidence of the tax is on the lessee. The ALJ also excused the lessor from liability because of the lessor's good faith belief that the lessee was exempt.
>
> If the statute made the lessor personally liable for the LET as the retailer is personally liable for RST, that liability would have been imposed notwithstanding the lessor's good faith belief. Therefore, this later determination reflects a departmental determination that the lessor is not personally liable under the LET statutes.

First, we disagree with the Port's statement that "If the statute made the lessor personally liable for the LET as the retailer is personally liable for RST, that liability would have been imposed notwithstanding the lessor's' good faith belief." The retail sales tax does, in fact, excuse a

seller's failure to collect the tax from a buyer where the seller has, in good faith, taken a resale certificate from the buyer.[10]

Second, we disagree with the Port's statement that the determination held the incidence of the tax to be on the lessee. The determination plainly states, "The incidence of the tax is on the use of the public property for private purposes. . . ."

Third, and more importantly, Det. No. 89-3 involved distinguishable circumstances. It involved an assessment of tax against the lessor where the lessee did not properly report and pay its public utility taxes, where payment of the public utility taxes would have exempted the transaction at issue from LET. See RCW 82.29A.130(1). In setting aside the assessment, the Department reasoned:

> 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. . . .
>
> 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

[10]RCW 82.08.050 provides:

> In case any seller fails to collect the tax herein imposed or having collected the tax, fails to pay it to the department in the manner prescribed by this chapter, whether such failure is the result of his or her own acts or the result of acts or conditions beyond his or her control, he or she shall, nevertheless, be personally liable to the state for the amount of the tax, **unless the seller has taken from the buyer in good faith a properly executed resale certificate** under RCW 82.04.470. (Emphasis added.)

> qualification of the lessee as a public utility and its subsequent reporting habits were matters between the lessee and the state.

In contrast to the above determination, as will be discussed further, below, the assessment at issue here does not involve any misrepresentations or failure on the part of the lessees to properly pay their public utility taxes or to perform other acts that would have exempted the leases from LET.

In summary, to the extent the taxes at issue are upheld in this determination, the Department may properly collect the taxes from the Port. None of the Department's published determinations supports a contrary result in this case.[11]

5. Whether the New LET Rules are Applicable to the Audit Period and, if so, Whether Holding the Port Liable for Uncollected LET is Consistent with the New Rules

WAC 458-29A-500, effective November 1, 1999, clarifies the lessor's responsibility for LET collection and remittance. The rule provides, in pertinent part, as follows:

> (2) **Lessor's responsibility to collect and remit tax.** The public lessor is responsible for collecting and remitting the leasehold excise tax from its private lessees. If the public lessor collects the leasehold excise tax but fails to remit it to the department, the public lessor is liable for the tax.
>
> (a) Where the public lessor has attempted to collect the tax, but has received neither contract rent nor leasehold excise tax from the lessee, the department will proceed directly against the lessee for payment of the tax and the lessee shall be solely liable for the tax, provided, the lessor notifies the department in writing when the lessor is unable to collect rent and/or taxes, and the amount of the leasehold excise tax arrearage is $1000 or greater. If the lessor fails to notify the department, the department may, in its discretion, look to the public lessor for payment of the tax.
>
> (b) If, upon examining all of the facts and circumstances, the department determines that the public lessor in good faith believed the lessee to be exempt from all or part of the leasehold excise tax, the department will look to the public lessor for assistance in collection of the tax due, but will not hold the public lessor personally liable for payment of such tax. To satisfy the requirement of "good faith" the public lessor must have acted with reasonable diligence and prudence to determine whether the leasehold excise tax was due from the lessee.
>
> (3) The following examples, while not exhaustive, illustrate some of the circumstances in which a public lessor may or may not be held liable for the leasehold excise tax. These examples should be used only as a general guide. The status of each situation must be determined after a review of all of the facts and circumstances.

[11] The Port also cited an unpublished determination. As the Port recognizes, unpublished determinations are not precedential. We will not further discuss this determination.

(a) Doug has been newly hired in the accounting department at City Port and is assigned the responsibility for its rental accounts. He is unaware of the leasehold excise tax laws and fails to bill new tenants for the leasehold excise tax. In this situation, City Port does not avoid possible liability for the tax. Accounting errors and lack of knowledge regarding City Port's responsibility to collect and remit the leasehold excise tax do not qualify as reasonable diligence and prudence. . . .

(c) Sonata City owns several houses on property which may be used in the future for office buildings, a fire station, or perhaps a park, depending on its future needs. The city leases the houses on six-month terms, mainly to students who attend the local college. Over the past four years that the city has rented the properties, it has not collected leasehold excise tax from the tenants, because city officials believed the property to be exempt since they planned someday to use the property for a public purpose. Following an audit, it is determined that there is no definite plan for destruction of the houses nor any funds allocated for construction of public buildings on the site. Further, the houses were not rented on a month-to-month basis. Therefore, leasehold excise tax is due. Most of the prior tenants have left the area, and there is no convenient way for the city to collect the unpaid leasehold tax. Sonata City is liable for the tax because although its managers did not believe the tax was due, the lack of knowledge regarding the city's responsibility to collect and remit the leasehold excise tax does not qualify as reasonable diligence and prudence. Sonata City had a duty to make a good faith effort to determine its obligations under the applicable leasehold excise tax statutes and rules.

A. Whether the Department abused its authority in adopting WAC 458-29A-500.

The Port states:

The Port . . . challenge[s] [WAC 458-29A-500], insofar as it holds or implies that a port district may be required to assume the lessee's obligation to pay [LET] when they are not paid by a lessee of port property. Specifically we object to WAC 458-29A-500(2)(a), (2)(b), and (3) insofar as they are based, expressly or implicitly, upon that premise. . . .

RCW 82.29A.140, granting rulemaking power to the Department of Revenue, expressly authorizes only such rules

> . . . as shall be necessary to permit its effective administration <u>including procedures for collection and remittance of taxes imposed by this chapter</u> . . . .

Thus the statute is both a grant and a limitation upon the Department's authority. In keeping with RCW 82.29A.050, the statute authorizes rules regarding the collection and remittance of funds by the lessor; it does not authorize determinations or rules requiring a port district to pay the leasehold tax out of port funds or to act as surety or guarantor of payment by a lessee.

(Emphasis the Port's.) First, as discussed at length, above, we disagree with the Port's argument that the statute does not allow the Department to collect LET from the lessor under the circumstances present here.

Second, and more importantly, the Department will not entertain general challenges to its authority to adopt rules, such as the new LET rules, in accordance with the Administrative Procedure Act; such rules have the force and effect of law unless overturned by a court of record. See RCW 82.32.300; see also, e.g., Det. No. 92-213ER, 13 WTD 108 (1993); Det. No. 88-260, 6 WTD 147 (1988); Det. No. 87-218, 3 WTD 295 (1987); Final Det. No. 86-66A, 1 WTD 55 (1986). RCW 82.32.300 provides:

> The administration of this and chapters 82.04 through 82.27[12] RCW of this title is vested in the department of revenue which shall prescribe forms and rules of procedure for the determination of the taxable status of any person, for the making of returns and for the ascertainment, assessment and collection of taxes and penalties imposed thereunder.
>
> The department of revenue shall make and publish rules and regulations, not inconsistent therewith, necessary to enforce their provisions, which shall have the same force and effect as if specifically included therein, unless declared invalid by the judgment of a court of record not appealed from.

(Footnote added.) The appropriate forums for the Port's arguments are before the state legislature and at the public hearings regarding excise tax rules. In short, the Department, as a Washington administrative agency, must presume the validity and legality of the rules "unless declared invalid by the judgment of a court of record not appealed from." RCW 82.32.300. Accordingly, for purposes of this determination, we will assume the validity of WAC 458-29A-500 and the other LET rules. (Whether these rules apply retroactively to the audit period at issue will be discussed further, below.)

B. Whether WAC 458-29A-500 applies to the audit period. The new rules have an effective date of November 1, 1999, and the Port's audit period was from January 1, 1994, through September 30, 1997. The Port asserts, "We recognize that WAC 458.29A.500 cannot be applied retroactively." However, because the portions of WAC 458-29A-500 at issue here are intended to simply clarify the LET statutes and not to change Department policy, these portions of the rule are retroactive to the audit period. See Marine Power & Equip. Co. v. Human Rts. Comm'n Hearing Tribunal, 39 Wn. App. 609, 615, 694 P.2d 697 (1985).[13] Specifically, we note that these portions of the rule are consistent with prior published determinations regarding lessor liability. Accordingly, we will apply the clarifying language to this appeal even though the activities in dispute took place before the rule's effective date.

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[12] We note that Chapter 82.29A RCW is not specifically listed in this statute. However, because the Department is responsible for the administration of Chapter 82.29A RCW , and because RCW 82.29A.060 incorporates Chapter 82.32 RCW, we find RCW 82.32.300 to be applicable to the LET.

[13] We note that the sections of the rules at issue here are consistent with prior published determinations, as will be discussed further, below.

C. Whether Holding the Port Liable for Uncollected LET is Consistent with WAC 458-29A-500. WAC 458-29A-500(2)(b) includes the exception for lessor liability for the LET where the lessor in good faith believed the lease transaction to be exempt, as was discussed in Det. No. 89-3, above. Thus, under the Rule, as under the prior published determinations, the issue is whether the Port "in good faith believed the lessee to be exempt from all or part of the leasehold excise tax." As noted in the rule above, to satisfy the requirement of "good faith," the taxpayer must have "acted with reasonable diligence and prudence to determine whether the leasehold excise tax was due from the lessee," in the transactions at issue.

As the examples to the rules indicate, "lack of knowledge regarding . . . responsibility to collect and remit leasehold excise tax [does] not qualify as reasonable diligence and prudence." Further, as the examples indicate, taxpayers have "a duty to make a good faith effort to determine [their] obligations under the applicable leasehold excise tax statutes and rules."

This is not a new standard. The legislature imposes this responsibility on taxpayers, and the Department has repeatedly applied this standard in its rules and determinations. For example, RCW 82.32A.030 provides:

> To ensure consistent application of the revenue laws, taxpayers have certain responsibilities under chapter 82.32 RCW, including, but not limited to, the responsibility to : . . .
>
> (2) Know their tax reporting obligations, and when they are uncertain about their obligations, seek instructions from the department of revenue. . . .

Further, we stated in Det. No. 98-144, 18 WTD 93 (1999):

> Taxpayer has the ultimate responsibility to know its tax reporting obligations. RCW 82.32A.030(2). With over 275,000 registered taxpayers in this state, it is not possible for the Department to educate all taxpayers concerning their tax obligations. That responsibility must lie with taxpayers. Det. No. 86-226, 1 WTD 67 (1986), Det. No. 86-278, 1 WTD 287 (1986).

See also, e.g., Det. No. 90-340, 11 WTD 81 (1990).

After the hearing in this matter, the Port filed two affidavits. The affidavit of . . ., Property Development Manager for the Port, states:

> [With respect to the items included in Schedule 2 of the assessment] where LET was not collected, the reason was that the Port . . . was following what I clearly understood and firmly believed to be the auditor's approval of the Port's existing practices in the auditor's Instructions following the previous audit period. I had been involved in those computations during the previous audit period, and assumed in good faith that insofar as

> the collection of LET was involved, the Port['s] . . . determinations in 1994 through September, 1997 were consistent with the Department's interpretation of the law and the Port's established and accepted method of computation . . . .

We will remand the issue of whether the Port had a good faith belief that the transactions were exempt to the Audit Division. We note that because WAC 458-29A-500 was adopted after the audit period, the Port did not have the opportunity to address the issue of its "reasonable diligence and prudence" with respect to each of the transactions included in the assessment. Further, it is possible that the prior audit instructions referenced in . . . 's affidavit constituted specific written instructions that are binding upon the Department for the audit period at issue; however we have insufficient information to make this determination. See RCW 82.32A.020. The Port is to provide arguments and documentation to the Audit Division regarding this issue within 60 days of the date of this decision, or within any additional time the Audit Division allows.

6. Whether the Audit Division Erred in Including Christmas Tree Lot Payments of $200 Per Year in the Assessment

The affidavit of . . . states:

> **. . . – Christmas tree lot payment. Assessment: 4 annual payments totalling $800.00.**
>
> It was and continues to be my understanding that the rental in this instance was exempt from the LET. The property involved was a small space beside a Port access road on which the "lessee" sold Christmas trees for approximately one month in each of the years in question. The "lease" payment was $200.00 each year, pursuant to separate agreements each year. Consequently, I believe that each of those payments was and is exempt from LET under RCW 82.29A.130(8) and also under the DOR's recently adopted rules[.]

See also affidavit of . . .. RCW 82.29A.130 provides:

> The following leasehold interests shall be exempt from taxes imposed pursuant to RCW 82.29A.030 and 82.29A.040:
>
> (8) All leasehold interests for which annual taxable rent is less than two hundred fifty dollars per year. For 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.

See also WAC 458-29A-400(9). It appears that the . . . lease is exempt from LET pursuant to RCW 82.29A.130(8). This issue is remanded to the Audit Division to allow the Audit Division the opportunity to confirm that . . . does not hold a leasehold interest in a contiguous property, which

would disqualify this lease from exemption. Provided no such lease exists, the Port's petition is granted with respect to this issue.

7. Whether the Audit Division Erred in Including in the Assessment Payments the Port Received from Lessees for Improvements and Rent Credits the Port Gave to Lessees for Lessee-made Improvements

In Schedule 2 of the assessment, the Audit Division assessed LET with respect to amounts the Audit Division characterized as follows:

> additional payments received from lessees for improvements made by Port to the leasehold interest property, and . . . rent credit given to lessee for improvements lessees made to Port's property. [14]

(Footnote added.) The Audit Division continued:

> The consideration received by Port was for the act or privilege of using publicly owned real property through a "leasehold interest" and is subject to the leasehold excise tax.
>
> . . . Leasehold tax is due on contract rent when contract rent meets the definition of taxable rent. There is no deduction authorized for contract rent credits given because other consideration was received by the lessor in lieu of cash payments, such as work done or improvements made by the lessee on behalf of the lessor.

. . .'s affidavit responds:

> In all three of the above listed rentals [. . .] the auditor's assessments were calculated on amounts paid or credit given for improvements.[15]

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[14]. . .'s affidavit explains the assessment relating to a single payment of $. . . received from . . . in 1997, which was included in Schedule 2:

> The reason for our failure to report the rental payment and remit the leasehold excise tax in this instance was an oversight. According to our records and my own recollection, the single amount in question included both rental and leasehold excise tax actually collected. Therefore, the tax portion normally would have been remitted. The Port will re-calculate the tax and, in consultation with the Department, I understand the Port will remit whatever tax and interest is presently owed on that rental.

Because the Port recognizes it underpaid its tax in this instance, this issue will not be addressed further.

[15] . . .'s affidavit includes similar information regarding . . ., . . .'s, and . . . In addition, this affidavit includes amounts assessed with respect to . . .'s and states:

> [T]he charges were mistakenly accounted for as the lessee's pro-rated and separately charged monthly payments for electrical service and accordingly were considered to be exempt under the Department's interpretation as I understood it, based on the previous audit. On re-examination, it appears that that those charges were for equipment rental which, we now understand, would be subject to the tax. However, I also

(Footnote added.) The LET is measured by "taxable rent." See RCW 82.29A.030. RCW 82.29A.020(2) defines taxable rent, as follows:

> "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. . . . All other leasehold interests shall be subject to the determination of taxable rent under the terms of subsection (b) of this subsection

In Schedule 2, the Audit Division determined that contract rent was the appropriate measure of taxable rent, and the Port did not disagree with this determination. "Contract rent" is defined in RCW 82.29A.020(2)(a) as follows:

> "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 . . . according to the requirements of the lease or agreement . . .; and **expenditures for improvements[16] to the property to the extent that such improvements become the property of the lessor**. . . .
>
> "Contract rent" shall not include: (i) Expenditures made by the lessee, which under the terms of the lease or agreement, are to be reimbursed by the lessor to the lessee . . .; (ii) expenditures made by the lessee for the replacement or repair of facilities due to fire or other casualty . . . .; (iv) improvements added to publicly owned property if such improvements are being taxed as personal property to any person.[17]

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would have understood that such separate charges for personal property were not taxable, in reliance on the Port's apparently approved practice.

We note that leases of personal property are subject to the LET. See RCW 82.29A.030. In the remand of this issue we are ordering, unless the Port provides arguments and documentation to the Audit Division that support its position that this amount is not subject to LET within 60 days of the date of this decision, or such additional time as the Audit Division allows, the Port's petition is denied with respect to this issue.

[16]WAC 458-29A-100 defines an improvement as follows:

> "Improvement" means a modification to real property, resulting in an actual change in the nature of the property or an increase in the value of the property. It is distinguishable from routine repair and maintenance, which are activities resulting from normal wear and tear associated with the use of property, and which do not result in a change in the nature or value of the property itself. For example, replacing worn boards in a stairway is repair and maintenance; removing the stairway and replacing it with an elevator or a ramp is an improvement.

[17] RCW 82.29A.160 provides:

> Notwithstanding any other provision of this chapter, RCW 84.36.451 and 84.40.175, improvements owned or being acquired by contract purchase or otherwise by any lessee . . . which are not defined as contract

> Any prepaid contract rent shall be considered to have been paid in the year due and not in the year actually paid with respect to prepayment for a period of more than one year. Expenditures for improvements with a useful life of more than one year which are included as part of contract rent shall be treated as prepaid contract rent and prorated over the useful life of the improvement or the remaining term of the lease or agreement if the useful life is in excess of the remaining term of the lease or agreement. . . .[18]

(Emphasis and footnotes added.)

The Audit Division assessed LET with respect to amounts the Port received from lessees to compensate the Port for improvements the Port made to the leased property and with respect to amounts the Port credited to the lessees for improvements the lessees made to the leased property. Based on the authority cited above, these amounts may have been properly included in contract rent. RCW 82.29A.020 specifically includes "expenditures for improvements to the property to the extent that such improvements become the property of the lessor" within the measure of contract rent. However, such amounts are not properly included in contract rent if: 1) the improvements do not become the property of the lessor; 2) the amounts were paid by the lessee and under the terms of the lease or agreement the amounts are to be reimbursed by the lessor to the lessee; 3) the amounts were paid by the lessee for the replacement or repair of facilities due to fire or other casualty; or 4) the amounts were spent for improvements that are being taxed as personal property to any person. Further, if the expenditures were for improvements with a useful life of more than one year, the amounts must be prorated. See RCW 82.29A.020; WAC 458-29A-500.

The Port has not specifically argued that any of these exclusions apply. However, in the affidavits the Port filed with the Appeals Division, each affiant states:

> It was my understanding that our practice conformed to Department of Revenue requirements at that time. In keeping with the previous auditors' apparent approval in the Instructions, I believed that such charges were not taxable.[19]

> rent shall be taxable to such lessee . . . under Title 84 RCW at their full true and fair value without any deduction for interests held by the lessor or others.

[18] WAC 458-29A-500(5) explains:

> Expenditures by the lessee for nonexcludable improvements . . . with a useful life of more than one year will be treated as prepaid contract rent if the expenditures were intended by the parties to be included as part of the contract rent. Such intention may be demonstrated by a contract provision granting ownership or possession and use to the public owner of the underlying property and/or by the conduct of the parties. These expenditures should be prorated over the useful life of the improvement, or over the remaining term of the lease or agreement if the useful life of the improvement exceeds that term. If the lessee vacates prior to the end of the lease without the agreement of the lessor, thereby defaulting on the lease, no additional LET is due for the term remaining pursuant to the contract between the lessor and that lessee.

[19] Although the Department is bound by specific written instructions (see RCW 82.32A.20(2)), the information provided in the affidavits is insufficient for us to determine whether the information the Port received in the prior audit rises to the level of specific written instructions.

(Footnote added.) From this statement, it is unclear whether or why the Audit Division previously permitted such amounts to be excluded from LET. This issue is remanded to the Audit Division to allow the Port the opportunity to demonstrate that the amounts with respect to these improvements were properly excluded from contract rent. The Port is to provide arguments and documentation to the Audit Division within 60 days from the date of this decision, or such additional time as the Audit Division allows. If the Port fails to provide such arguments and documents, the assessment with respect to this issue will be sustained.

8. Whether the Audit Division Erred in Including Payments from Lessees for Pro-rata Utility and Other Charges in the Assessment

In Schedule 3, the Audit Division assessed LET as follows:

> This schedule assesses leasehold excise tax on payments received for flat rate utility charges to lessees, fireline, and storm water expenses that were charged on a prorata [sic] basis to the lessees. These payments are contract rent . . . and subject to leasehold tax. There is no deduction authorized for any part of the contract rent that is allocated to or based on an expense of the lessor.
>
> The payments from lessees for charges classified as storm water are based on assessments by City of . . . against land which is covered by an impervious surface and would be assessed whether or not the property was leased. A lien would be placed against the property if an assessment was [sic] not paid. The assessment is an expense of the land owner/lessor. The payment of the storm drain assessment is for the benefit of the land owner/lessor even if paid directly by the lessee to the City.
>
> Regarding utility costs, and janitorial services or common area maintenance, the Department has taken a position for leasehold excise tax purposes consistent with that which has long been in Washington Administrative Code (WAC) 458-20-205 (Rule 205) for business and occupation tax, and public utility tax purposes. . . .
>
> Where utility, janitorial, and/or other services are furnished by the lessor under circumstances such that they are simply a part of the normal and routine landlord-tenant relationship, then the furnishing of such is deemed to be a part of the rental of the real estate and amounts charged by lessor to lessee for such supplies and/or services are subject to the leasehold excise tax.

In response, . . .'s affidavit states:

> **[Lessee] – Flat rate charge for utilities**
>
> [Lessee] was charged a flat rate of $80.00 monthly for a period of five months, at which time a meter was installed on site. Because the initial $80.00 rate was determined and billed separately, it was treated as a “pass-through” utility charge[.]

Marina Electrical – flat fees

> Approximately twelve years ago when the Port upgraded the electrical service to the docks, not all the slips were individually metered. At that time, the Port used a pro-rata equation to determine that $15.00 monthly was a reasonable amount to charge the non-metered slips.

The affidavit then goes on to explain how "Port pass-through prorated expenses" were calculated and billed on a prorata basis for stormwater to . . ., tenants within the . . . area, and a tenant in the . . . area. The affidavit further explains how other charges were calculated and billed on a prorata basis to . . . . The affidavit states, "since these charges are unidentified it is assumed they were for electric and water service."

"Contract rent" is the amount of consideration due as payment for a leasehold interest, and a leasehold interest is "an interest in publicly owned real or personal property which exists by virtue of any lease, permit, license, or any other agreement." RCW 82.29A.020. Thus, to the extent the lessor receives consideration which is not due as payment for the leasehold interest, the amount received is not properly subject to the LET. This distinction was recognized in Det. No. 92-316, 12 WTD 477 (1992). In that determination, the lessor rented out horse barns. The lease stated:

> 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.

Because the lease included the additional services as part of the rent and the lessor failed to bill the tenants separately for these additional services, we concluded these payments were subject to LET. We reasoned:

> 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. . . .
> 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.

WAC 458-29A-200(2) further clarifies the distinction between charges that are subject to LET and those that are not. The rule provides:

> [P]ayments made to or on behalf of the lessor for actual utility charges, janitorial services, security services, repairs and maintenance, and for special assessments such as storm water impact fees attributable to the lessee's space or prorated among multiple lessees, are not included in the measure of contract rent, if the actual charges are separately stated and billed to the lessee(s). "Utility charges" means charges for services provided by a public service business subject to the public utility tax under chapter 82.16 RCW, and, for the purpose of this section only, also includes water, sewer, and garbage services and cable television services . . . .
>
> For example, Dan leases retail space in a building owned by the Port of Whistler. He pays $800 per month for the space, which includes building security services. Additionally, he is assessed monthly for his pro rata share of actual janitorial and utility services provided by the Port. The Port determines Dan's share of these charges in the following manner: The average annual amount actually paid by the Port for utilities in the prior year is divided by 12. Dan's space within the building is approximately ten percent of the total space in the building, so the averaged monthly charge is multiplied by.10 (Dan's pro rata share based upon the amount of space he leases), and that amount is added to Dan's monthly statement as a line item charge for utilities, separate from the lease payment. The charges for janitorial services are treated in the same manner. In this case, Dan's payment for utilities and janitorial services are not included in the measure of contract rent. His payments for security services are included in the measure of contract rent, and subject to the leasehold excise tax, because they are not calculated and charged separately from the lease payments.

Thus, based on the authorities cited above, it is possible that the payments at issue are properly excluded from LET. If the Port can demonstrate that these charges were prorated among its tenants and that it treated these charges to its tenants as being derived from a separate business activity, both in its leases and in its statements or invoices, the payments are properly excluded from LET. Because we do not have sufficient information to determination whether the charges are properly excluded from LET, this issue is remanded to the Audit Division for further consideration in light of the authorities cited above.

Further, we note that . . .'s affidavit states:

> [I]t was my understanding that the Port of . . . practice conformed to Department of Revenue requirements. In keeping with the previous auditor instructions to the accounting

> department and with apparent Department approval, I believed in good faith that such charges were not subject to the leasehold excise tax.

From this statement, it is unclear whether or why the Audit Division previously permitted such amounts to be excluded from LET. This issue is remanded to the Audit Division to allow the Port the opportunity to demonstrate that it received specific written instructions from the Audit Division as a result of its prior audit which allowed exclusion of these payments.

The Port is to provide arguments and documentation regarding the utility charges and/or the specific written instructions to the Audit Division within 60 days from the date of this decision, or such additional time as the Audit Division allows. If the Port fails to provide such arguments and documents, the assessment with respect to this issue will be sustained.

9. Whether the Audit Division Erred in Calculating Taxable Rent to Include Vending Machine and Laundry Payments from Lessees

In Schedule 4, the Audit Division assessed LET "on the payments received from vending machine owners for the use of public property to make sales through vending machines." We note that Schedule 4 breaks down the assessment into "vending" and "laundry." Because these two items are included together in one schedule and discussed collectively as "vending machines" in the audit report, we assume the laundry facilities are coin-operated, self-service machines. In issuing the assessment, the Audit Division reasoned:

> These payments were for the act or privilege of using publicly owned real property through a "leasehold interest" . . . and are subject to the leasehold excise tax.
> As the statute expressly includes such rights as "permits" and "licenses" within the scope of "leasehold interests," the terms "possession" and "use" can not to [sic] be so strictly construed as to demand the kind of exclusion dominion and control exercised by a lessee under a traditional lease.

RCW 82.29A.010(1) defines "leasehold interest" for purposes of the LET, as follows:

> "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 . . . .

See also WAC 458-29A-200(3).

Det. No. 87-111, 3 WTD 29 (1987), addressed the issue of whether a vendor who sold food from a trailer placed at various locations on fairgrounds held an interest in the property that was subject to LET. The vendor was not confined to a particular space, but was generally free to locate his trailer wherever he was not interfering with the event in progress. We held that the vendor did not receive

a taxable leasehold interest because "the leasehold statutory scheme contemplates some kind or degree of possessory interest in addition to mere 'use' of the premises." See RCW 82.29A.020(1)(a). We reasoned:

> The vendor has something less than possession of the county's premises. He is not put in control of any real estate at the fairgrounds. He is simply given the right to sell his "food products" somewhere on the grounds. Such a right is more properly termed a "franchise" than a leasehold interest because the necessary element of possession is lacking. In the leading case on leasehold tax the Washington Supreme Court in Mac Amusement Co. v. Department of Revenue, 95 Wn.2d 963, 633 P.2d 68 (1981), quoted with approval Washington Water Power Company v. Rooney, 3 Wn.2d 642, 101 P.2d 580, 127 A.L.R. 1044 (1940), which quoted E. McQuillin Municipal Corporation § 1740 (2 ed. 1943). The court said a franchise is:
>
> > . . . the right granted by the state or a municipality to an existing corporation or to an individual to do certain things which a corporation or individual otherwise cannot do . . .
>
> Accord, Artesian Water Company v. State Department of Highways and Transportation, 330 A.2d 432 (Del. Super. Ct.), aff'd as modified; 330 A.2d 441 (Del. 1974).[20]
>
> Again, the leasehold statutory definitions contemplate some kind or degree of possessory interest in addition to mere "use" of the premises. Here, there was none. The only right granted and paid for under the oral agreement was the right to make sales on the county's property. For a leasehold interest to be found, a greater degree of dominion and control over a more defined area must be present to satisfy the possession element of the RCW 82.29A.010(1) definition.
>
> Such an interpretation is consistent with RCW 82.29A.020(2)(a) wherein "contract rent" is defined and discussed. Said statute says in part:
>
> > Where the consideration conveyed for the leasehold interest is made in combination with payment for concession[21] 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.

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[20] See also WAC 458-29A-100, which defines a "franchise" as follows:

> "Franchise" means a right granted by a public entity to a person to do certain things that the person could not otherwise do. A franchise is distinguishable from a leasehold interest even when its exercise and value is inherently dependent upon the use and possession of publicly owned property.

[21] See also WAC 458-29A-100, which defines a concession as "the right to operate a business in an area of public property."

> The conclusion to be drawn from that sentence is that concession rights are not taxable, and concession rights are all that the vendor received and paid for in the instant case.

(Footnotes added.)[22] See also WAC 458-29A-100 ("Both possession and use are required to create a leasehold interest, and the lessee must have some identifiable dominion and control over a defined area to satisfy the possession element.")

Further, we note that "possession" is defined as "the act or condition of having in or taking into one's control or holding at one's disposal; . . . actual physical control or occupancy of property by one who holds for himself and not as a servant of another without regard to his ownership and who has legal rights to assert interests in the property against all others having no better right than himself." Webster's Third New International Dictionary (1993).

The Appeals Division did not receive copies of any agreements between the Port and the vending machine owners, nor do we have sufficient facts to determine whether the vending machine owners received sufficient interest in the Port property to rise to the level of a taxable interest for LET purposes. As such, we remand this issue to the Audit Division for its determination, based on the definitions and authorities cited above, of whether a leasehold interest was created. If the only right granted under the agreements was the right to make sales on the Port's property, the vending machine owners merely would have received a "concession," which is not subject to LET. As noted above, for a leasehold interest to be found, a degree of dominion and control over a defined area must be present to satisfy the possession element. On the other hand, if the agreements include the lease of buildings or other areas subject to the actual physical control of the vending machine owners, an interest would be created that is subject to LET.

Further, we note that . . .'s affidavit states:

> [I]t was my understanding that our practice conformed to Department of Revenue requirements. In keeping with the auditor's apparent approval in the Instructions following the previous audit I believed that the payments in question, based upon period non-uniform collections of cash from the machines, were not taxable.

From this statement, it is unclear whether or why the Audit Division previously permitted such amounts to be excluded from LET. This issue is remanded to the Audit Division to allow the Port the opportunity to demonstrate that it received specific written instructions from the Audit Division as a result of its prior audit which allowed exclusion of these payments.

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[22] Contrast Det. No. 92-316, 12 WTD 477 (1992), where a fair association granted use of its premises to a tenant for 24 days between December and March and also permitted the tenant to store its equipment in fair buildings between use. We held that the tenant's use of the building for 24 days, combined with the privilege of storing its equipment in the building when the building was not in use was sufficient to create a leasehold interest for purposes of the LET.

The Port is to provide arguments and documentation regarding its vending machine agreements and/or the specific written instructions to the Audit Division within 60 days from the date of this decision, or such additional time as the Audit Division allows. If the Port fails to provide such arguments and documents, the assessment with respect to this issue will be sustained.

10. Whether the Audit Division Erred in Recalculating Taxable Rent

The audit excluded the leasehold interest of . . ., . . ., . . ., and . . . . The Audit Division noted that the leases had been in effect for ten years or more without renegotiation, and the contract rents no longer reflect taxable rent. As such, the Audit Division calculated taxable rent with respect to these leases. See RCW 82.29A.020.

With respect to the latter three tenants, the Audit Division did not adjust taxable rent for the audit periods, but gave future reporting instructions, for the period starting January 1, 1999. The Audit Division noted, "Taxable rent was established by applying the same method used during the audit period by Port for establishing contract rents." Specifically, the Audit Division took the value of the property per county assessor or the appraised value, multiplied this amount by the "Port's absorption rate factor" of 60%, then multiplied the result by the "Port's required rate of return" of 9.5%.

With respect to property leased by . . ., the Audit Division adjusted contract rent to reflect its determination of taxable rent for the audit period. The Audit Division stated:

> The contract rent did not reflect taxable rent . . . . Taxable rent was established by applying a ten percent rate of return to the value of the property as listed by the County Assessors [sic] office.

RCW 82.29A.020(2)(a) indicates that the Department must use contract rent as the measure of the LET in the following circumstances:

> . . .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. . . .

In Det. No. 96-98, 19 WTD 187 (2000), we explained:

> Therefore, it is only where the contract was negotiated or renegotiated in compliance with one of the three specifically sanctioned methods that the Department is required to compute taxable rent based on contract rent. See Det. No. 87-112, 3 WTD 39 (1987). In all other

> cases where leasehold interests are established or renegotiated, the Department is required to determine taxable rent under subsection (b).

RCW 82.29A.020(2)(b) provides:

> [T]he 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.

The Port argues that the Audit Division's determinations of taxable rents:

> . . . are unauthorized by statute and contrary to statutory law applicable to port districts. . . .[S]uch erroneous calculations would require [the Port], as lessor, to bill its tenants at rates that are erroneous and excessive, and in some cases prohibitive. The result would be contrary to the public interest because:
>
> 1. Difficulty in attracting tenants and consequential loss of tenant revenue;
> 2. Frustration of the statutory purpose of the port district expressed in chapters 53.04, 53.08 and 53.25, and other chapters.

The Port has not specifically argued that its rents were established under any of the three methods which would require the Department to use contract rent as taxable rent. Its second point, quoted above, perhaps implies that its rents were established consistent with the second method, i.e., that the rent was "negotiated in accordance with statutory requirements regarding the rent payable." In Det. No. 96-98, a port district argued that it negotiated rent pursuant to the requirements of RCW 53.08.080 and therefore had complied with the second method. RCW 53.08.080 states:

> A district may lease all lands, wharves, docks and real and personal property owned and controlled by it, for such purposes and upon such terms as the port commission deems proper. . . .

We concluded:

> While it is true that RCW 53.08.080 grants a port district the authority to set rental rates, it does not set out specific statutory procedures for determining the rent payable. Such contemplated statutory requirements normally set out procedural requirements and safeguards designed at assuring that the maximum or at least fair market rental was obtained for the use of public property. See Det. No. 87-111, 3 WTD 29 (1987). RCW 53.08.080 does not contain any such safeguards. Accordingly, we find that Taxpayer's lease does not meet the second method.

Similarly, we conclude that, if the Port is arguing that its rents were negotiated in accordance with statutory requirements regarding rent payable, based on RCW 53.08.080, that argument must fail.

The Port argues that the Audit Division's calculations "are unauthorized by statute and contrary to statutory law applicable to port districts," however, the Port does not argue specifically how the calculations are unauthorized. As set forth above, the Department is required to base taxable rent on contract rent only where the rent is negotiated or renegotiated in compliance with one of the three specifically sanctioned methods of establishing rent. The Port has not shown that its rents were so established. As such, we find that it was proper for the Audit Division to look beyond contract rent in determining taxable rent.[23]

Whether the Audit Division properly calculated taxable rent is the next issue to be considered. In Det. No. 96-98, we stated:

> The criteria contained in RCW 82.29A.020(2)(b) lists two separate factors to be considered in computing taxable rent: (1) rental paid to other lessors by lessees of similar property for similar purposes over similar periods of time (comparable rentals); and (2) a fair rate of return on the market value of the property less restrictions on use (fair rate of return). The statute also uses the term "shall," which means that the consideration of both criteria is mandatory.

See also Det. No. 98-19, 17 WTD 252 (1998); Det. No. 87-112, 3 WTD 39 (1987). The Port argues that the Audit Division's calculations of taxable rent are "excessive, and in some cases prohibitive." However, the Port does not articulate how the Audit Division erred in its calculation of taxable rent.

In calculating taxable rent, it appears that the Audit Division attempted to apply a fair rate of return analysis. There is no indication that comparable sales were considered or that information regarding comparable sales was available. If such information was not available, use of the rate of return would be acceptable. See WAC 458-29A-200 (which lists the valuation criteria in the alternative, rather than conjunctive.) If the Port has additional information it wishes the Audit Division to consider in calculating taxable rent, the Port is to supply such information to the Audit Division within 60 days of the date of this decision, or such additional time as the Audit Division allows. If the Port fails to provide such additional information, the Port's petition with respect to this issue will be denied.

DECISION AND DISPOSITION:

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[23] In Det. No. 96-98, we noted:

> RCW 82.29A.020(2)(b) provides that where the Department determines that a lease has not been established or negotiated through one of the three sanctioned methods, the Department may establish taxable rent pursuant to the designated criteria. By use of the term "may" the Legislature has allowed the Department the discretion to either accept contract rent as taxable rent or recompute taxable rent pursuant to the stated criteria.

The Port's petition is denied with respect to its argument that it is not liable for uncollected LET. The Port's petition is granted with respect to the Christmas tree lot payments, provided [the lessee] did not hold a leasehold interest in a contiguous property. The Port's petition regarding inclusion of payments from lessees for improvements and rent credits for lessee-made improvements, payments from lessees for pro-rata utility charges, and payments from the owners of vending machines located on its property are remanded to the Audit Division. The Port's petition regarding the Audit Division's future reporting instructions regarding taxable rent is remanded to the Audit Division.

Dated this 21st day of November, 2000.