Cite as Det. No. 03-0118, 23 WTD 218 (2004)

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition For Refund of	)	D E T E R M I N A T I O N
	)	
	)	No. 03-0118
. . .	)	
	)	Registration No. . . .
	)	
	)	Petition for Refund
	)	Docket No. . . .
	)	

[1] RULE 118: BUSINESS AND OCCUPATION TAX – EXEMPTION –LEASES –LICENSES TO USE -- DESIGNATION OF SPACE. An agreement which does not convey a designated area of real property for the tenant's control or dominion will not be considered a lease exempt from B&O tax.

[2] RULE 118: BUSINESS AND OCCUPATION TAX – EXEMPTION –LEASES –LICENSES TO USE – HOW NAMED. What the parties may call their relationship does not necessarily control. An agreement that conveys an interest in a certain designated area of real property with the exclusive right to control and occupy the conveyed premises during the term of the agreement may be considered a lease even if the parties term the agreement a license.

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.

Mahan, A.L.J. – Lessor of warehouse space in . . . , Washington seeks a refund of business and occupation (B&O) tax that it paid on income from the use of the space by another party. Based on the evidence submitted, the taxpayer's petition is granted in part and denied in part.[1]

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

ISSUE

Did the use of the . . . warehouse space involve the rental of real property (not subject to B&O tax) or the license to use real property (subject to B&O tax)?

FACTS

The taxpayer operated distribution warehouses in various areas, including [city A] and [city B], Washington. It leased these warehouses from third parties. In its operations, the taxpayer provided warehousing services for some of its customers. One of the taxpayer's customers, . . . (the Tenant), used a portion or all of the [city B] facility in providing services for one of its customers, . . . , (the Retailer). The Tenant also used space in other buildings operated by the taxpayer.

The taxpayer entered into a . . . Agreement with the Tenant that covered joint operations in the various facilities, including the [city B] facility. The agreement generally addressed freight handling services provided by the taxpayer to the Tenant. An Addendum to Appendix I of this agreement, dated January 26, 1998, involved a "Use Agreement" for the [city B] facility.

Under the terms of this Use Agreement, the taxpayer agreed to provide warehouse and office space to the Tenant on a month-to-month basis. The "space will be utilized by [the Tenant] in furtherance of [the Tenant's] business relationship with [the Retailer], and that the total square footage of the space may vary from month to month as required by the Tenant and agreed by the parties." The agreement provided a square foot charge for the warehouse space and a square foot charge for the office space. The Tenant also agreed to pay a pro rata share of janitorial and fencing costs and a special lighting expense for a maximum of 60 months. The agreement provided for termination upon three months written notice.

Although the Use Agreement did not reserve any defined space for the Tenant's use, the facility had a cyclone fence (with a locked gate and alarm) that sectioned off the portion of the facility being used by the Tenant. The Tenant had a separate entry for employees and its own warehouse bays for loading and unloading trucks. As stated in a Declaration of the Tenant's Distribution Services Manager, the Tenant "had its own security system and its own entry doors. [The Tenant] also controlled the light and heat in the space it rented. [The taxpayer] employees and representatives did not have access to [the Tenant's] space without its permission and assistance."

For the period from February 1998 through December 1999, invoices show the taxpayer received monthly payments from the Tenant ranging from a low of $ . . . to a high of $ . . . . The variation in monthly payments resulted from the amount of space used, the additional use of an office, tenant improvements, and the Tenant's share of management's expenses.

In 2000, the Tenant began using the entire [city B] warehouse facility. The use was based on a new oral agreement between the parties. As stated in the Declaration:

> In January 2000, [the Tenant] took possession of the entire Facility and negotiated a new 'triple net' rate structure with [the taxpayer] in which [the Tenant] paid directly for all of the utilities and security for the Facility, as well as payment to [the Taxpayer] for rent, lighting and office improvements, and operating expenses (CAM charges.) Some of the tenants on the [taxpayer's] side of the facility remained until May 2000. [The Tenant] sublet or charged [the taxpayer] back for the space used by [the taxpayer] and others from January through May 2000.

On . . . , 2001, the taxpayer filed for protection under Chapter 11 of the Bankruptcy Code, 11 U.S.C. § 1101, *et seq.* As part of the plan of reorganization, the [city A] operation was sold. The taxpayer continued to lease the [city B] facility. In its Disclosure Statement, the taxpayer described its arrangement with the Tenant as being pursuant to an "oral agreement" and that, after filing the bankruptcy, it entered into negotiations for a Revocable License Agreement (dated October, 2001), which was approved by the Bankruptcy Court.

Although the Revocable License Agreement expressly provides that "This agreement creates only a revocable license, and is not a lease nor does it create a leasehold estate or any interest in real property," it specifically provides that "[The Tenant] shall have exclusive access to the Licensed Area."[2] The agreement further provides for termination upon twelve months written notice. Unlike the earlier addendum for the use of an undefined variable space, the Revocable License Agreement had a copy of the floor plan attached and specifically referred to a license to use of . . . square feet of space, as identified in the floor plan. Other than the increase from three to twelve months for a notice of termination, we find this agreement consistent with the prior oral agreement for the warehouse space when the Tenant began using the entire warehouse space in January 2000.

The taxpayer's agreement with its landlord required the landlord's approval of any sublease. The landlord approved the Revocable License Agreement. Although the taxpayer was unable to find any authorization for the original Use Agreement, it provided a copy of a Landlord Waiver and Consent, dated October 5, 2000, with respect to the Tenant's installation of freight handling equipment. The Tenant is referred to as a "subtenant" that "entered into a sublease with" the taxpayer for the [city B] property.

While in bankruptcy, the taxpayer applied for a refund of B&O tax previously paid on income from operation of various warehouse spaces for 1997 through 2001. The Department of Revenue (Department) granted a partial refund with respect to the [city A] facility, due to the existence of a written sublease for a portion of the property. It denied the refund request as it applied to the [city B] facility. The taxpayer timely sought review as to the Tenant's use of the

[2] According to the taxpayer, the Tenant requested the agreement be called a license "to satisfy its own internal business policy mandates" concerning leases and how it accounts for them.

[city B] facility for the February 1998 through June 2001 period. At issue is approximately $ . . . , plus interest.

ANALYSIS

The taxpayer contends the income from occupancy of the warehouse is exempt under RCW 82.04.390 and WAC 458-20-118 (Rule 118). . . . Rule 118 . . . states that amounts from the sale of "real estate" are exempt from B&O tax. It further identifies income from the rental of real estate as being subject to the exemption. Rule 118 further distinguishes between the rental of real estate and licenses to use real property, with the latter not subject to the exemption.

In relevant part, Rule 118 provides as follows:

> (2) Lease or rental of real estate. A lease or rental of real property conveys an estate or interest in a certain designated area of real property with an exclusive right in the lessee of continuous possession against the world, including the owner, and grants to the lessee the absolute right of control and occupancy during the term of the lease or rental agreement. An agreement will not be construed as a lease of real estate unless a relationship of "landlord and tenant" is created thereby. It is presumed that the sale of lodging by a hotel, motel, tourist court, etc., for a continuous period of thirty days or more is a rental of real estate. It is further presumed that all rentals of mini-storage facilities, apartments and leased departments constitute rentals of real estate. The rental of a boat moorage slip or an airplane hangar/tie down site is presumed to be a rental of real estate only if a specific space, slip, or site is assigned and the rental is for a period of thirty days or longer.
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> (3) License to use real estate. A license grants merely a right to use the real property of another but does not confer exclusive control or dominion over the same. Usually, where the grant conveys only a license to use, the owner controls such things as lighting, heating, cleaning, repairing, and opening and closing the premises.

(Emphasis added.)

The rule is consistent with the common law. *Lacey Nursing Ctr. v. Department of Rev.*, 103 Wn. App. 169, 183, 11 P.3d 839 (2000) *rev. denied*, 144 Wn.2d 1008, 29 P.3d 719 (2001) (citing William B. Stoebuck, 17 *Washington Practice: Real Estate: Property Law* § 6.18, at 319 and § 6.3, at 295 (1995)).

[1] If exclusive possession or control of the premises, or a portion thereof, is granted, even though the use is restricted by reservations, the instrument will be considered to be a lease and not a license. *McKennon v. Anderson*, 49 Wn.2d 55, 59, 298 P.2d 492 (1956). The relationship of a landlord and tenant is a question of fact, and a lease may be found even if the parties choose to call it something else. *Barnett v. Lincoln*, 152 Wash. 613, 619, 299 P. 392 (1931). In *Barnett*,

the court found the parties created a lease, despite the designation of the assignment of warehouse space as a "privilege." *Id.* at 621.

In the present case, the original Use Agreement between the parties clearly does not meet Rule 118's requirements for a lease. The agreement merely provides for the variable use of warehouse space for a set price per square foot. It did not designate an area of real property for the tenant's exclusive use. The amount and location of warehouse space for use by the tenant was subject to change. Such use would be under a license, not a lease.

[2] But it is equally clear that the relationship between the parties changed over time. In January 2000, the tenant began to occupy or control the entire warehouse space under an oral agreement with the taxpayer. That oral agreement was later reduced to a written Revocable License Agreement. Although that agreement was termed a "license," it appears to convey an interest in a certain designated area of real property with an exclusive right in the sublessee of continuous possession and the absolute right to control and occupy the premises during the term of the agreement. Other evidence (the landlord's consent to a sublease) and testimony also support a conclusion that a lessee-sublessee or landlord tenant relationship developed between the taxpayer and the Tenant. Accordingly, we conclude that the income received from the tenant for the [city B] property after 1999 was exempt from B&O tax under Rule 118 . . . . But we sustain the Department's denial of a refund for 1998 and 1999.

DECISION AND DISPOSITION:

The taxpayer's petition is granted in part and denied in part.

Dated this 17th day of April 2003.