Cite as Det. No. 20-0107, 41 WTD 142 (2022)

BEFORE THE ADMINISTRATIVE REVIEW AND HEARINGS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition for Correction of Tax Ruling of	)	D E T E R M I N A T I O N
	)	No. 20-0107
. . .	)	Registration No. . . .

RCW 82.29A.030: LEASEHOLD EXCISE TAX – ASSUMED LEASES. A public entity that purchases a building with existing tenants, and assumes the existing leases that do not address LET, is subject to LET under RCW 82.29A.030.

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.

Sattelberg, T.R.O. – A port district protests the Department's tax ruling dated October 30, 2019. The port argues that the Department's Taxpayer Information and Education ("TI&E") section erroneously concluded that the port would be responsible for leasehold excise tax ("LET") on leases it will assume when it purchases a building with existing tenants. We deny the petition.[1]

ISSUE

Whether a port district will be subject to LET under RCW 82.29A.030 on leases it will assume when it purchases a building with existing tenants.

FINDINGS OF FACT

. . . ("Taxpayer") is a port district formed under Washington's Title 53 RCW. . . . . In addition to owning real properties [within Washington] and elsewhere in . . . County, Taxpayer occasionally acquires additional real properties.

On October 18, 2019, Taxpayer wrote to the Department's TI&E section with the following scenario:

> [We are] in the process of purchasing a building from a private corporation. The corporation has several long-term leases in place with private individuals/businesses, who will remain in the building after the purchase. There are several leases that do not have cancellation clauses. The leases are currently

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

> written with no building expenses being passed through, all utilities, insurance and real estate taxes are paid and absorbed by the building owner. As a government entity, we charge current tenants in the building we own . . . % leasehold tax on the rents that are collected. These purchased leases do not have an allowance for collecting leasehold taxes.

TI&E tax ruling dated October 30, 2019. Taxpayer then went on to ask TI&E if an exemption or exclusion from LET applied in these circumstances, since the to-be acquired leases did not have a mechanism for paying or collecting LET. On October 30, 2019, TI&E issued Taxpayer a tax ruling stating:

> It does not appear that there is an exemption or exclusion from the tax, for the situation you have described.
>
> Any use of public property is subject to leasehold excise tax in which the user of the property would be subject to real or personal property tax if they owned the property outright. While the law allows some specific exemptions (RCW 82.29A), there are no exemptions based on the facts you have provided.

TI&E tax ruling dated October 30, 2019.

Taxpayer timely sought review of the tax ruling. Taxpayer argues that the circumstances here create an exclusion from LET because there is no "leasehold interest," as statutorily defined, nor is Taxpayer a "lessor," as defined by regulation. Taxpayer further argues that, if imposed here, the LET would be tantamount to an impermissible property tax.

In support of its petition, Taxpayer explains that the leases it plans to acquire provide that the landlord is responsible for real property taxes on the premises and that the tenant is responsible for any personal property taxes. Taxpayer explains that the rent section of the leases do not address any payment of LET, nor does any other part of the leases.

ANALYSIS

LET is imposed for the "act or privilege of occupying or using publicly owned . . . real or personal property through a leasehold interest . . . ." RCW 82.29A.030(1). The private entity, or lessee, is responsible for payment of LET to the public entity, or lessor. RCW 82.29A.050(1). The public entity is responsible to collect LET and remit it to the Department. *Id*.

A. Leasehold Interest and Lessor

"Leasehold interest" is defined as:

> . . . *an interest in publicly owned . . . real* or personal *property which exists by virtue of any lease*, permit, license, or any other agreement, written or verbal, *between the 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 . . . .

RCW 82.29A.020(1)(a) (emphasis added).

Taxpayer argues that there is no "leasehold interest" here because the lease is not between Taxpayer, "the owner of the property," and the private entities, "persons who would not be exempt from property taxes if that person owned the property in fee." In support of its argument, Taxpayer cites to *In re K-Fabricators, Inc.*, 135 B.R. 654 (1992), a decision from the United States Bankruptcy Court, Western District of Washington. We first note that federal authority is not controlling when interpreting state statutes. *Bravo v. Dolsen Companies*, 125 Wn.2d 745, 753, 888 P.2d 147 (1995). However, federal authority, such as the opinion of a bankruptcy court, can be persuasive. *Id*.; *see also Green River Community College, District No. 10 v. Higher Education Personnel Board*, 107 Wn.2d 427, 730 P.2d 653 (1986) ("While not controlling, decisions under the NLRA are persuasive in construing state labor acts which appear to be based on or are similar to the federal act."); *Inland Empire Distribution Systems, Inc. v. Utilities and Transportation Commission*, 112 Wn.2d 278, 770 P.2d 624 (1989) ("While ICC interpretations of federal statutes similar to state statutes are persuasive authority, they are not controlling").

In *K-Fabricators,* a private owner of real property leased the real property to a private tenant. *K-Fabricators*, 135 B.R. at 656. During the course of the lease, the Port of Tacoma purchased the real property. *Id*. The tenant failed to pay rent or LET, and later filed for bankruptcy. *Id*. The Port of Tacoma pursued its interest in bankruptcy court by claiming it was owed a debt for the unpaid rent and LET. *Id*. The bankruptcy court held that the tenant was liable to the Port for the rental of the property, but did not owe any LET. *Id*. at 658-659. In reaching this conclusion, the bankruptcy court reasoned:

> There is no taxable "leasehold interest" in the present case: [the tenant] negotiated with private landlords, rather than a public owner. The essential statutory predicate, an agreement with a public owner, is missing. This analysis is buttressed by the purpose section of the leasehold excise tax chapter, RCW 82.29A.010, in which the Legislature recognized that, notwithstanding Washington's constitutional exemption of publicly-owned property from property taxes, private leases of such properties receive substantial [property tax-funded] benefits from local units of government.

Id. at 658. The court went on to add:

> There has been no showing of any increase in government services provided to [the tenant] as a result of the Port's acquisition of the property; if the (presumably fair) compensation governmental entities previously received from the [prior owners] ceased upon the Port's purchase, [the tenant] is not responsible, and it ought not be charged equitably with any consequences.

Id.[2]

K-Fabricators was decided in 1992. The court, in that case, focused on a prior agreement with the prior landlord and misconstrued how the LET applies. Here, Taxpayer clearly has an agreement to lease property to a private tenant, which is covered by the definition of "leasehold interest" in RCW 82.29A.020(1)(a), regardless of whether the prior lease was with a private landlord.

To further explain the definition of "leasehold interest," the Department promulgated WAC 458-29A-100(2)(g), which includes the following in the definition of "leasehold interest:"

> (i) Regardless of what term is used to label an agreement providing for the use and possession of public property or property of a community center which is exempt from property tax by a private party, *it is necessary to look to the actual substantive arrangement between the parties in order to determine whether a leasehold interest has been created*.
>
> (ii) *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*. The defined area does not have to be specified in the agreement but can be determined by the practice of the parties. This requirement distinguishes a taxable leasehold interest from a mere franchise, license, or permit.

(Emphasis added.)

We have previously addressed the "possession and use" element in Det. No. 18-0016, 37 WTD 231 (2018). In 37 WTD 231, a municipal corporation contested the Department's assessment of LET on fees the municipality received from issuing street obstruction permits. 37 WTD at 232. We held that the Department properly assessed the LET because the permits granted "the right to possess and use a defined portion of the public right of way." 37 WTD at 233. By looking at the "actual substantive arrangement between the parties," we found that the possession and use elements were met, and so a leasehold interest existed.

So, in determining whether a leasehold interest has been created under RCW 82.29A.020(1)(a) and WAC 458-29A-100(2)(g), we examine the actual substantive arrangement between the parties. The arrangement of the parties here is that the public party, Taxpayer, will own a commercial office building. Private tenants will lease space under a lease negotiated between the tenants and the prior private owner, and those leases will continue to be effective after Taxpayer acquires the real property. This arrangement will grant exclusive dominion and control to the private tenants under the terms of the assumed leases. By looking at the "actual substantive arrangement between the parties" here, we find that the possession and use elements will be met, and so a leasehold interest will exist.

Taxpayer argues that *K-Fabricators* controls and dictates the result that no leasehold interest exists. We disagree. First, as explained above, *K-Fabricators* is a federal bankruptcy court opinion

[2] The court also indicated that: "Even if the analysis in this part is incorrect, and the leasehold tax is payable in such circumstances, the value of the property to the estate would be reduced by the amount of any tax due." *Id*. at 658-659.

and federal court opinions provide persuasive authority, at most. Second, however, we do not find the *K-Fabricators* opinion persuasive. While the court cites to the definition of leasehold interest in RCW 82.29A.020(1)(a) (". . . which exists by virtue of any lease, permit, license, or any other agreement, written or verbal, between the owner of the property and a person who would not be exempt from property taxes if that person owned the property in fee . . ."), the analysis is superficial and does not assist us in reaching a conclusion. After stating that K-Fabricators negotiated with private landlords, the court concludes that "[t]he essential statutory predicate, an agreement with a public owner, is missing." *Id.* at 658. The court fails to analyze what was the legal effect of the lease assumption, perhaps because of the particular facts regarding the assumption in that case.[3] In Washington, the assignee to a contract stands in the shoes of the assignor. *Northwest Business Finance, LLC v. Able Contractor, Inc.*, 196 Wn. App. 569, 575, 383 P.3d 1074 (2016) (citing *Kendrick v. Davis*, 75 Wn.2d 456, 463, 452 P.2d 222 (1969)). Thus, while Taxpayer here will not be the named party on the leases, it will be standing in the shoes of the named party, the prior lessor, and will therefore have an agreement with the lessees, the private tenants. This is why we find *K-Fabricators* unpersuasive.

Having found that the "actual substantive arrangement of the parties" is one of a leasehold as it meets both the possession and use elements, we hold that a "leasehold interest" is present. We also note that *Crystal Mountain, Inc. v. Dep't of Revenue*, 173 Wn. App. 925, 295 P.3d 1216 (2013), supports this conclusion. In *Crystal Mountain*, a corporation operated a ski resort on federal land under a special use permit from the United States Forest Service. *Id.* at 928. Crystal Mountain paid LET for years 2002 through 2006, and sought a refund of the LET paid. *Id.* at 930. Crystal Mountain argued that the special use permit did not create a taxable "leasehold interest" under RCW 82.29A.020 because it did not grant Crystal Mountain a right of possession. *Id*. at 931. The Washington Court of Appeals rejected this argument, holding that the LET statute "treats possession and occupancy as interchangeable concepts." *Id*. at 931. The Court of Appeals found Crystal Mountain's permit terms sufficient to meet "possession and use" under RCW 82.29A.020(1). *Id*. at 936.

Taxpayer also argues that it does not meet the definition of "lessor" in WAC 458-29A-100(2)(i) because it did not grant the leasehold interests. "Lessor" is defined as "an entity exempt from property tax obligations pursuant to Article 7, section 1 of the state Constitution . . . that grants a leasehold interest in public property . . . to a private person or entity." WAC 458-29A-100(2)(i). As we held above, there is a "leasehold interest" here through the "actual substantive arrangement of the parties." Taxpayer has not granted this leasehold interest by being a party to the leases themselves, but will grant a leasehold interest as successor to the leases. Thus, it qualifies as a "lessor" under WAC 458-29A-100(2)(i).

B. Tax on Public Property

Taxpayer argues that the imposition of LET by the Department in these circumstances amounts to an unconstitutional property tax, as discussed in *Washington Public Ports Ass'n v. Dep't of Revenue*, 148 Wn.2d 637, 62 P.3d 462 (2003). In *Washington Public Ports*, the state's trade

[3] The Bankruptcy Court had noted in its facts that the "record does not disclose any consent to the assignment by K-Fabricators" and "the lease was never assumed by the Trustee," although it doesn't appear to rely on these [statements] in its analysis. *Id*. at 656.

association for ports sued the Department after the Department promulgated regulations regarding LET. *Washington Public Ports*, 62 P.3d at 464. One of the regulations, WAC 458-29A-500, held ports liable for unpaid or uncollected LET in certain circumstances. The Washington Public Ports Association ("WPPA") argued that WAC 458-29A-500 was beyond the Department's statutory authority and also amounted to an unconstitutional property tax. *Id*.

In denying WPPA's statutory authority argument, the Washington Supreme Court noted that the underlying statute at issue, RCW 82.29A.050, states that the public lessor is "*fully liable* for collection *and* remittance" of LET. *Id*. at 467 (emphasis in original). The Supreme Court went on to note that RCW 82.29A.050(2) states that "'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.'" *Id*. (emphasis in original). The Supreme Court stated "[t]his language clearly demonstrates that the public lessor is held liable for uncollected LET." *Id*. After looking at the dictionary definitions of "full" and "liable," the Supreme Court stated " . . . we find that the public lessor is entirely, i.e. fully, responsible for the collection and remittance of the LET – even if the LET is uncollected." *Id*.

In denying WPPA's unconstitutional property tax argument, the Washington Supreme Court drew a distinction between LET and other taxes that the Supreme Court had previously held amounted to property taxes. In making this distinction, the Supreme Court held that "LET cannot be considered a property tax that is directly imposed on the ports." *Id*. at 468. Instead, the Supreme Court held that "LET is indeed an excise tax." *Id*. at 469. The Supreme Court further concluded that "[t]he public lessor is liable for the amount of the LET only when it permits a private lessee to occupy and use its property by way of a lease, and fails to collect the tax from the private lessee and remit the same to DOR." *Id*.

Here, Taxpayer argues that the imposition of LET is akin to an unconstitutional property tax because Taxpayer has no discretion to permit, deny, or alter the terms of the lease that it assumed. Even if Taxpayer is unable to collect LET from its tenant under the terms of the lease it assumed, there is nothing in the law that prevents rent collected from the terms of the lease from being subject to LET. We also disagree that the imposition of the LET to the taxable rents from these tenants amounts to an unconstitutional property tax. As the Washington Supreme Court held in *Washington Public Ports*, "[t]he public lessor is liable for the amount of the LET only when it permits a private lessee to occupy and use its property by way of *a lease*, and fails to collect the tax from the private lessee and remit the same to DOR." *Id*. (emphasis added). That situation described by the Supreme Court is precisely what we have here: a private entity is occupying what is now public property by way of a lease, and the public lessor is failing to collect the LET. As *Washington Public Ports* instructs, "the public lessor is entirely, i.e., fully, responsible for the collection and remittance of the LET – even if the LET is uncollected." *Id*. at 467. Thus, under *Washington Public Ports,* we hold that this is not an unconstitutional property tax, but a properly imposed excise tax.

C. Exemption or Exclusion

Taxation is the rule and exemption is the exception. *Spokane City v. Spokane*, 169 Wash. 355, 358, 13 P.2d 1084 (1932) ("Where there is an exception, the intention to make one should be expressed in unambiguous terms."); *Budget Rent-A-Car, Inc. v. Dep't of Revenue*, 81 Wn.2d 171, 174-175, 500 P.2d 764 (1972). Because "taxation is the rule and exemption is the exception," a tax applies unless the Legislature has expressed clear intent to provide an exemption. *Grays Harbor Energy, LLC v. Grays Harbor Cty*., 175 Wn. App. 578, 584, 307 P.3d 754 (2013) (citing *Tracfone Wireless, Inc. v. Dep't of Revenue,* 170 Wn.2d 273, 296-97, 242 P.3d 810 (2010)).

The statutory exemptions from LET can be found in RCW 82.29A.125 through RCW 82.29A.138. None of those exemptions address the situation present here. Likewise, WAC 458-29A-400 addresses the exemptions from LET in regulatory form, and none of the exemptions listed in that rule apply here either. Without an articulated exemption or exclusion, LET applies. *See Grays Harbor Energy,* 175 Wn. App. at 584. As we are unable to find an applicable exemption or exclusion, we hold that TI&E correctly ruled that LET applies to Taxpayer in this situation. Accordingly, we deny Taxpayer's petition.

DECISION AND DISPOSITION

We affirm TI&E's tax ruling dated October 30, 2019.

Dated this 2nd day of April 2020.