Cite as Det. No. 21-0039, 42 WTD 019 (2023)

BEFORE THE ADMINISTRATIVE REVIEW AND HEARINGS 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. 21-0039
	)	
. . .	)	Registration No. . . .
	)	

[1] WAC 458-20-179; RCW 82.16.020: PUBLIC UTILITY TAX (PUT) – TAXATION OF UTILITY PAYMENTS MADE BY THIRD PARTIES. Revenue from utilities paid by long-term tenants is not subject to the public utility tax because it is not part of, or incidental to, Taxpayer's municipal entity or port business, or any other public service business.

[2] WAC 458-20-118; WAC 458-20-205; RCW 82.04.220: BUSINESS AND OCCUPATION (B&O) TAX. Revenue from utility payments made by a third-party tenant to its port landlord are part of the normal and customary landlord-tenant relationship and are exempt from B&O tax.

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 THE CASE

Gabriella Herkert, T.R.O. – A port district municipal corporation engaged in renting real property to tenants on long-term leases protests the classification of certain revenue streams. The port argues that amounts received from tenants to pay for certain utilities provided by third parties are not subject to either the PUT or the B&O tax. The taxpayer's petition is granted.[1]

ISSUES

1. Are amounts the port received from tenants for utilities provided by third parties subject to PUT under RCW 82.16.020 and WAC 458-20-179?

2. Is revenue the port received from tenants for utilities provided by third parties exempt from B&O tax as additional rent from real property under WAC 458-20-118 or WAC 458-20-205?

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

FINDINGS OF FACT

. . . (Taxpayer) is a municipal corporation operating an independent seaport in . . . Washington. . . . Taxpayer rents certain commercial facilities, including office and warehouse space. Tenants sign lease agreements that include billing for their share of utility costs. Monthly, Taxpayer summarizes expenses paid for water, solid waste, sewer, power, and other utilities. Taxpayer allocates expenses to tenants. In some cases, Taxpayer allocates expenses by lessee square footage and, in other cases, by the number of lessee's employees. At some facilities, Taxpayer allocates actual expenses using submeters. Taxpayer bills lessees' utility charges on monthly invoices with the base rent due under their lease. Taxpayer paid tax under the water distribution and power charges classifications of the PUT on these separately stated utility charges.

Taxpayer filed a request for refund with the Department of Revenue for PUT previously paid on separately stated billed utility charges in the amount of $. . . for the tax period January 1, 2010, through August 31, 2016. In its request for refund, Taxpayer asserted that the utility charges were either exempt as advances and reimbursements[2] or, in the alternative, were exempt as additional long-term rent under the leases for both PUT and B&O tax purposes. Taxpayer's request for refund was denied. Taxpayer timely requested review of that denial.

As part of its request for review, Taxpayer provided long-term rental agreements with . . . [several tenants]. The rental agreements provided by Taxpayer represent all transactions included in its request for refund. The contracts include a standard provision for utilities. The provision reads:

> Utilities: Lessee shall be liable for, and shall pay during the term of this Lease, all charges for all utility services furnished to the Premises, including, but not limited to, light, heat, electricity, gas, water, sewerage, storm sewer, storm water, waste water, janitorial services, and garbage disposal. If the Premises are part of a building or are part of any larger premises to which any utility services are furnished on a consolidated or joint basis, Lessee shall pay Lessee's pro rata share of the cost of any such utility services. Lessee's pro rata share of any such services may be computed by Lessor on any reasonable basis, and separate metering or other exact segregation of cost shall not be required. All charges for utility installation shall be paid by Lessee.

ANALYSIS

1. Public Utility Tax

PUT is imposed for the act or privilege of engaging within this state in any of the public service or transportation businesses listed in RCW 82.16.020. The parties agree that Taxpayer is a business which may be subject to PUT due to the nature of its business.[3]

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[2] During its hearing, Taxpayer conceded Audit's position that the separately stated utility amounts were not advances and reimbursements under WAC 458-20-111. Consequently, we do not consider that argument.

[3] [We do not address whether Taxpayer properly collected and remitted leasehold excise tax (LET), as that was not an issue raised in the audit. We note that the lease of public property is generally subject to LET. RCW 82.29A.030(1); *but see* WAC 458-29A-200(2) ("payments made to or on behalf of the lessor for actual utility charges, janitorial

The tax is computed by multiplying the "gross income of the business" by the rate specific to the particular type of business being taxed. RCW 82.16.020(1). The term "gross income" for the purposes of PUT means:

> "Gross income" means the value proceeding or accruing from the performance of the particular public service or transportation business involved, **including operations incidental thereto**, but without any deduction on account of the cost of the commodity furnished or sold, the cost of materials used, labor costs, interest, discount, delivery costs, taxes, or any other expense whatsoever paid or accrued and without any deduction on account of losses.

RCW 82.16.010(3) (emphasis added).

Thus, to be subject to PUT, the gross income must be derived from the performance of the public service or transportation business at issue, or operations incidental thereto. *See* Det. No. 00-080, 20 WTD 204 (2001); *King County Water Dist. No. 68 v. Tax Comm'n*, 58 Wn.2d 282, 285-86, 362 P.2d 244 (1961); *City of Kennewick v. State*, 67 Wn.2d 589, 593-94, 409 P.2d 138 (1965).

WAC 458-20-179(104)(a) reiterates that amounts derived from services that are incidental to a public utility activity are subject to PUT. The term "incidental" is not defined in chapter 82.16 RCW. When a statutory term is not defined, it is given its plain, ordinary meaning. *Garrison v. Wash. State Nursing Bd.*, 87 Wn.2d 195, 196, 550 P.2d 7 (1976). A term's ordinary meaning may be ascertained from its dictionary definition. *Id.* "Incidental" means "subordinate to something of greater importance; having a minor role." *Black's Law Dictionary* 879 (10th ed. 2014). WAC 458-20-179(104)(a) lists several activities that are incidental to a public utility activity but does not include either long-term rental income or amounts charged to tenants for utility costs provided by third parties in connection with those long-term lease agreements. Because the rule is silent as to long-term leases, we must decide whether amounts charged to long-term tenants for utilities provided by third parties qualifies as performance of the transportation, utility, or public service businesses, or operations incidental thereto, under RCW 82.16.010(3).

Taxpayer claims its revenue from renting real property, including amounts charged for utilities provided by third parties, is not subject to PUT. We agree.

We first look at the leasing activities. Taxpayer's leasing activities are not subject to PUT because it is not a public service business in this context. The leasing activities are not "subject to control by the state;" related to powers of eminent domain; "declared by the legislature to be of a public service nature;" or any of the other activities designated as a public service business ("airplane transportation, boom, dock, ferry, pipe line, toll bridge, toll logging road, water transportation and wharf businesses."). RCW 82.16.010(7)(a). Therefore, to be subject to PUT, it must be incidental to other public service business activities, such as operating the port. Leasing real property is not necessary to the transportation or public service activities provided by Taxpayer in its role as either a municipal corporation or a port.

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services, security services, repairs and maintenance, and for special assessments such as stormwater 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).")]

Furthermore, the rebilling of utilities provided by third parties to its long-term tenants is not incidental to Taxpayer's business as a municipal corporation or port. Taxpayer does not generate, produce, or distribute electrical or other utilities to the tenants subject to its long-term leases. Those utilities are provided by third parties. Taxpayer merely measures the costs of utilities employed by long-term tenants, rebills those costs to its tenants, and does not charge tenants a greater amount than the charges made by the third-party utility providers. In *King County Water*, the Washington Supreme Court noted "[t]he phrase 'including operations incidental thereto' is governed by the specific words 'performance of the business' . . . ." 58 Wn.2d at 286. "Incidental" means having a minor role. *Black's Law Dictionary* 879 (10th ed. 2014). The port's business activities center around its providing transportation access for . . . commercial goods entering the state every year. In doing so, the port has expanded its geographic area over time. The land upon which the port offers transportation access includes numerous facilities that allow for the movement and storage of goods coming into the port. Utility charges associated with the numerous locations that the port offers for rent for transportation and storage play no role and have no effect on Taxpayer's performance as a port. The utility charges are related to Taxpayer's business of leasing space to third parties, which, as we described above, is not a transportation, utility, or public service activity. There is no evidence that those charges have any relationship to the PUT-taxable activities that Taxpayer conducts at its port. Accordingly, we conclude that Taxpayer's revenue from utilities paid by long-term tenants was not subject to PUT because it was not part of, or incidental to, Taxpayer's municipal entity or port business, or any other public service business.

2. Business and Occupation Tax

The B&O tax is imposed for the privilege of engaging in business in Washington. RCW 82.04.220. The term "business" includes "all activities engaged in with the object of gain, benefit, or advantage to the taxpayer or another person or class, directly or indirectly." RCW 82.04.140. The measure of the tax is the gross proceeds of sales, value proceeding or accruing, or gross income of the business. RCW 82.04.220.

Because Taxpayer's income from utilities charged to long-term tenants is not subject to PUT, Taxpayer's revenue is generally subject to the B&O tax, unless an exemption applies. *City of Kennewick*, 67 Wn.2d at 593-94. Taxpayer asserts its income from utilities provided by third parties and paid for by long-term tenants is exempt from B&O tax under WAC 458-20-118 or WAC 458-20-205, which exempt amounts received from the rental of real estate from B&O tax.

"Amounts derived from the sale and rental of real estate are exempt from taxation under the business and occupation tax." WAC 458-20-118(1). WAC 458-20-118(2) describes the lease or rental of real estate as follows:

> 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.

There is no dispute that the leases here convey an estate or interest in real property and tenants paid the utility charges under the terms of the leases. The dispute lies in whether the utility charges are "amounts derived from the sale and rental of real estate" between the "landlord and tenant." *Id*. We have previously articulated what qualifies as "amounts derived from the sale and rental of real estate" between a landlord and tenant:

> In general, the term "rent" is the consideration paid for the use, enjoyment, possession, or occupation of property; in a broader sense, it is the compensation or fee paid, usually periodically, for the use of any rental property, land, buildings, etc. 49 Am. Jur. 2d *Landlord and Tenant* § 546 (2014). It is the means by which landlords make a profit on their property. *Id*. However, rent may be distinguished from such miscellaneous charges as unreasonable wear and tear penalties, late charges, and security deposits. *Id.*; *see also* Det. No. 09-0213, 29 WTD 75, 78 (2010) (where we upheld an assessment of B&O tax on income from late fees charged to tenants because they were "not taken or received for the lease or rental of real estate"). Certain additional charges, e.g., for utilities that are "a part of the normal and customary landlord-tenant relationship," may also not be subject to B&O tax.

Det. No. 14-0126, 34 WTD 278 (2015).

While WAC 458-20-118 provides general guidance as to what is included in amounts derived from the rental of real estate, WAC 458-20-205 specifically addresses utilities. WAC 458-20-205 reads:

> When building companies, apartment house owners or other real estate owners or lessors furnish utility services such as heat and electrical energy to their own tenants of office buildings, apartment houses and storerooms under circumstances indicating it is a part of the normal and customary landlord-tenant relationship and the charge made therefor is the cost of this utility service to the owner or lessor prorated among his tenants based upon the use or consumption of such services, the income derived therefrom is construed to be incidental to and a part of gross income from the renting or leasing of real estate and not subject to the provisions of the business and occupation tax . . . .

WAC 458-20-205.[4]

[4] The express inclusion of property expense items, such as taxes and insurance, in a commercial lease is commonly referred to as a "net" lease. *See* 49 Am. Jur. 2d *Landlord and Tenant* § 716; 51 Durand H. Van Doren, *Some Suggestions for the Drafting of Long Term Net and Percentage Leases*, Colum. L. Rev. 186 (1951); s*ee also* WAC 458-20-211(7) (for an example of "net lease" in the tangible personal property context). A common lease in commercial rentals, a "net" type lease, which may also be denominated a "net-net" or "net-net-net lease," typically requires a lessee to pay a monthly lump sum for rental, in addition to holding the lessee responsible for all other costs and expenses arising from the property, including taxes and insurance. 49 Am. Jur. 2d *Landlord and Tenant* § 716. Black's Law Dictionary defines a "net lease" as "a lease in which the lessee pays rent plus property expenses (such as taxes and insurance)." *Black's Law Dictionary* 908 (8th ed. 2004). The *Washington Real Property Deskbook* defines a "triple net" lease as one in which the tenant pays all expenses (property taxes and insurance), maintenance, and utilities. 2 Wash. State Bar Ass'n, *Washington Real Property Deskbook Series: Real Estate Essentials* § 18.1(2), at 18–5 (4th ed. 2009). *See also Viking Bank v. Firgrove Commons 3, LLC*, 183 Wn. App. 706, 714, 334 P. 3d 116 (2014) (discussing what triple net leases are).

Here, the utility charges are additional expenses commonly contemplated in commercial leasing. We find that the tenants are receiving nothing beyond their absolute right of control and occupancy during the term of the lease or rental agreement. As such, we hold that utility amounts are part of the normal and customary landlord-tenant relationship and are exempt from B&O tax.[5]

DECISION AND DISPOSITION

Taxpayer's petition is granted.

Dated this 23rd day of February 2021.

[5] Having determined that the utility charges are not subject to either PUT or B&O tax, Taxpayer's argument that it should be entitled to a PUT deduction for services jointly furnished is rendered moot.