Cite as 1 WTD 261 (1986)

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

In the Matter of the Petition) F I N A L
For Correction of Assessment and) D E T E R M I N A T I O N
Refund of)
) No. 86-39A
)
. . .) Registration No. . . .
) Leasehold Tax Assessment
) . . .
) (. . .)

[1] LEASEHOLD EXCISE TAX - EXPENDITURES FOR IMPROVEMENTS - BALLOON PAYMENTS. A balloon payment representing expenditures for improvements to leased public property, accelerated because of early lease termination, is subject to leasehold excise tax under RCW 82.29A.030 as consideration for occupying and using public property.

[2] LEASEHOLD EXCISE TAX - EXPENDITURES FOR IMPROVEMENTS - PREPAID CONTRACT RENT - PRORATION. RCW 82.29A.020(2)(a) provides a mechanism for reporting leasehold tax upon expenditures for improvements as a method of tax payment only; failure to properly employ this reporting mechanism does not excuse tax liability on such expenditures when actually made.

[3] LEASEHOLD EXCISE AND TAX - NATURE OF TAX - COMPENSATION FOR GOVERNMENTAL SERVICES - PROPERTY TAX COMPARED.
RCW 82.29A.010 expressly provides legislative intent that leasehold excise tax is imposed to compensate for governmental services. Economic parity between

leasehold tax and real property tax burdens is not intended or contemplated.

[4] LEASEHOLD EXCISE TAX - EXPENDITURES FOR IMPROVEMENTS - INTEREST EXPENSE. Interest expenses incurred in financing improvements to leased public property constitute consideration for other rights or concessions and are not part of the consideration for leasehold interest includable in the leasehold tax measure. MAC Amusement Company v. State, 95 Wn.2d 963 (1981).

These 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.

TAXPAYER REPRESENTED BY: . . .
. . .
. . .
. . .

HEARING CONDUCTED BY: Matthew J. Coyle, Acting Director
Gary O'Neil, Assistant Director
Edward L. Faker, Senior Administrative Law Judge

DATE AND PLACE OF HEARING: June 6, 1986; Olympia, Washington

NATURE OF ACTION:

Leasehold excise tax was assessed measured by the total of expenditures for improvements to publicly owned property leased by the taxpayer, as lessee, from the Port of Seattle. The taxpayer appealed the assessment pursuant to RCW 82.32.160.

Also, the taxpayer reported and paid leasehold excise tax, measured in part by its interest expense in financing the leasehold improvements. The taxpayer sought refund of the tax pursuant to RCW 82.32.170.

Determination No. 86-39 was issued by the Department on January 29, 1986 after original appeal hearings conducted in Seattle, Washington on August 23 and October 11, 1985. The Determination sustained the additional tax and interest assessment and denied the taxpayer's refund request. The taxpayer has appealed the findings and conclusions of that Determination to the Director.

FACTS AND ISSUES:

Faker, Sr. A.L.J.--The facts of this matter are not in dispute. Those facts, together with the audit and tax assessment details are fully reported in the FACTS portion of Determination 86-39 and will not be restated here, except as necessary for perspective of the issues presented.

There are two distinct issues on appeal.

Issue No. 1

Was a balloon payment which represented the cost of leasehold improvements made by the taxpayer/lessee properly included within the taxable contract rent measure for leasehold excise tax under RCW 82.29A.020?

Issue No. 2

Were the interest expenses incurred in financing the leasehold improvements properly included as expenditures for those improvements and correctly reported for leasehold excise tax?

TAXPAYER'S EXCEPTIONS:

The taxpayer asserts that under the operative facts controlling its lease arrangement with the Port, the taxpayer was to make certain named improvements to the leased Port property, with ownership of such improvements passing to the Port. These improvements, and others similarly negotiated, were in addition to the agreed periodic rent payments. The original lease agreement was effective on January 1, 1977 for a five-year term and it included five successive option periods of five years each. The improvements, which incurred total expenditures in excess of 2.7 million dollars, were amortized on a 30-year payment schedule as part of the lease, with the Port financing their cost at ten percent interest. An accelerated, lump sum payment of the unpaid balance, less interest, was to be made if the lease was terminated early. In fact, the lease was terminated early and the lump sum payment was made. The Department's auditors concluded that this payment constituted part of contract rent for leasehold excise tax purposes, resulting in the assessment at issue here.

Issue No. 1

The taxpayer asserts that the Department's conclusion, as sustained by Determination 86-39, was incorrect for several related reasons. At the June 6, 1986 hearing the taxpayer reiterated its arguments placed at the original hearings and requested a more analytical, rather than conclusory, response from the Department.

The taxpayer argues that RCW 82.29A.020 establishes two independent criteria for the imposition of leasehold excise tax. First, there must be the payment of "contract rent" as defined by the statute. Secondly, that contract rent must be paid in return for the act or privilege of occupying or using publicly owned property. The taxpayer asserts that the second criterion is missing in this case. That is, the lump sum payment amounted to a lease termination payment which was due because the taxpayer would no longer use or occupy the property. Because the payment was not made for "use or occupancy" of the property, it did not constitute "taxable rent" under the statute. The taxpayer relies upon the decision in MAC Amusement Company v. State Department of Revenue, 95 Wn.2d 963 (1981) as standing for the proposition that not all payments made by a lessee are in consideration of the right of occupancy. The Court ruled that payments for "other rights granted by the lessor," as contemplated by RCW 82.29A.020(2) (a), are not for use or occupancy and are not subject to leasehold excise tax. Here, according to the taxpayer, the option to terminate the lease and pay the accelerated balloon payment was precisely such an "other right."

At the hearing the taxpayer also argued that the leasehold excise tax must somehow directly relate to and compensate for nonpayment of ad valorem, real property tax on publicly owned property which is leased and commercially used. However, in this case, the lump sum lease termination payment was more in the nature of liquidated damages which simply compensated the Port for out-of- pocket expenses. The loan for financing of the improvements by the Port was actually separate and independent from any value of using public property. Therefore, its accelerated repayment was not in consideration of occupying the leasehold and a tax upon this amount does not actually compensate for property tax. The taxpayer implies that there should be some economic parity between the amount of leasehold excise tax due and the amount of real property tax which would be owing if the property were privately owned.

Regarding the technical workings of the tax law, the taxpayer asserts that chapter 82.29A. RCW expressly treats expenditures for improvements to the public leasehold as "prepaid contract rent" which is to be prorated over the useful life of the improvement or the remaining term of the lease, whichever first occurs. The taxpayer stresses that the Department has consistently ruled that "options to renew" in a lease agreement are not to be considered when calculating the lease term. Thus, the lease term in this case is only five years from its execution date, without regard to the five optional renewal periods. If the expenditures for improvements were properly prorated over the true lease term of five years, then the expenditures for improvements should have been prorated only over that period because it was less than the useful life of the improvements. However, that five year-period, from January 1, 1977 through December 31, 1981, is beyond the statute of limitations for tax assessment. Conversely, if the Department changes its position and does consider the option periods for purposes of prorating the expenditures for improvements, this would be a marked departure from past rulings. Also, if this approach is taken, it attributes the expenditures for improvements to future periods during which the leasehold property is actually used or occupied. In this case, however, the lease was voluntarily terminated early and the property was not occupied for the option periods of the lease. Thus, the future prorated parts of the expenditures for improvements cannot be taxed as "rent." The taxpayer submitted a supplemental memorandum on August 29, 1986 which explains these contentions in greater detail, in pertinent parts, as follows:

> The tax statute provides two criteria for the imposition of the leasehold excise tax. First, a payment to a lessor must satisfy the definition of "contract rent" which is set forth in the statute. Second, the payment must be for the act or privilege of occupying or using publicly owned property.
>
> The first criterion is provided by RCW 82.29A.020(2), which is solely a definitional section, defining "contract rent" to mean the consideration due as payment for a leasehold interest, including, among other things, expenditures for improvements to the property to the extent that such improvements become the property of the lessor. That section goes on, however, to provide that expenditures for such improvements shall be classified as a special category of contract rent, denominated as "prepaid contract rent", as follows:

> 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.

The second criterion is provided by RCW 82.29A.130, which is the provision imposing the tax upon the act or privilege of occupying or using publicly owned property. The statutory framework implicitly recognizes that a payment may fall within the statutory definition of "contract rent", but may nevertheless <u>not</u> constitute a payment for the act or privilege of occupying or using publicly owned property.

. . .

A. Lease Term

In the case of a lease with an option, the question presents itself as to whether or not the option period should be included as part of the "remaining term of the lease" within the meaning of the statute. Subsequent to the commencement of this audit, Mr. Jarvinen supplied the taxpayer with excerpts of several unpublished decisions which indicate that the Department has uniformly ruled that options which have not been exercised are merely continuing offers which should not be included in the calculation of the remaining lease term. Copies of pertinent pages of two of those excerpts are annexed to this memorandum as Attachments 2 and 3.

This interpretation requires that the cost of the improvements be amortized, and the leasehold excise tax thereon paid, over the original five year term of the lease, which in this case expired in December of 1981. Under this interpretation, the amount of expenditures to be prorated would have been measured by the original capital outlay of the taxpayer. That sum was subsequently reimbursed by the lessor in the nature of a permanent financing. The ensuing payments made to the lessor would be no more relevant to the calculation of the tax, despite the fact that they are expressly included in the lease, than they would be if they were made to an independent third party. By the same theory, the interest component of those payments would, of course, have no bearing upon the excise tax. The end result would be a leasehold excise tax in each of the first five years upon 1/5 of the cost of the improvements, and zero tax thereafter for the next 25 years, during which time, as originally contemplated, the tenant would remain in possession and the amortization payments would continue to be made monthly. In no event would the balloon payment made by the lessee upon termination have any impact whatever upon this result.

If indeed this is the proper application of the statute, the taxpayer has underpaid its leasehold excise tax liability for the first five years of the lease, and has overpaid its liability for subsequent years. (The attached rulings are unpublished, and hence the taxpayer was unaware that its reporting position did not comport with the Department's position.) However, as the matter presently stands, the years for which an underpayment occurred are now closed by statute, and although the subsequent years are open, the only refund which the taxpayer has sought for those years has been for the leasehold excise tax which was paid in respect of the interest component of the monthly amortization payments.

. . .

The option that presents itself, of course, is to treat option periods in a lease agreement as part of the lease "term", in appropriate cases. It is often necessary to estimate, in advance, the actual length of time that the tenant will retain a possessory interest in improvements. Such estimates are required for legal, financial and tax purposes, among others. Under Section 178 of the Internal Revenue Code, for instance, for purposes of depreciation it is presumed that an option will be exercised if the remaining lease term is less than 60% of the useful life of a new improvement unless it can be shown that is is more probable the lease will not be continued. Thus, the technical legal property interests of the landlord and tenant as evidenced by the lease and related lease documents will be probative, but will count only as one item of evidence of the amount of time it can reasonably be expected that the tenant will, in fact, retain possession. If economic reality suggests that the tenant, in all likelihood, will exercise a lease option, then the option period will be included in the "lease term", even prior to its exercise. Obviously, this requires a level of factual inquiry which goes beyond the literal language of the lease, but the benefit is the assurance of a result that is more likely to comport with economic reality. The cost, of course, is that which is ordinarily associated with the application of a standard that is somewhat more subjective.

In this case, for example, where the economic life of the improvements that were financed by the tenant far exceed the original lease term, the "reasonable probability" standard of Code Section 178 would require that the "term" for tax purposes include the lease option periods.

By virtue of the fact that the Administrative Law Judge concluded that any tax at all was payable in respect of the improvements beyond the original lease term, it is evident that he has departed from the position that the Department has steadfastly maintained since the inception of the leasehold excise tax.

But either alternative is nothing more that a means of determining the period over which the improvement costs will be prorated. This choice says nothing about the treatment of a lump sum payment upon a termination prior to the expiration of the "term", regardless as to which alternative is selected to measure that term. A determination of the proper treatment of such a payment requires an interpretation of the statutory language which provides that such improvement costs be treated as "prepaid contract rent and prorated over...the remaining [lease] term."

B. Premature Termination

At the outset it is certain that the manner in which a tenant finances the improvements will have no bearing upon the proration required by this language. The improvement costs are tallied, the term is determined, and through simple arithmetic, an annual allocation of "prepaid contract rent" is calculated. By definition, this exercise will be performed on the assumption that the lease term, by whatever means measured, will not subsequently be truncated. Whether a tenant pays cash for improvements or finances his costs, whether he pays in even installments or with a balloon payment at the end, whether the debt schedule is less than, equal to or in excess of either the useful life of the improvement or the lease term, and whether the financing is through the lessor or a third party, is utterly irrelevant in the application of the statute to determine the prorated "rent".

But once the annual "rent" is determined, what treatment should apply when the term by which it was determined is prematurely terminated? Plainly, the fact that a lump sum payment is made to the lessor at that point can have no relevance. That payment is the result of nothing more than a trigger in a financing arrangement. If the financing itself did not figure in the prorated payments, surely the unexpected balloon payment can not. There is no more statutory authority for such a result than there would be for taxing a similar payment to a third party lender.

The real question, therefore, is, will the prorated payments which are assigned by statute to later years in the lease "term" be accelerated into the last year of the tenant's possession? The Administrative Law Judge determined that they would be, but this is just a conclusory opinion for which, conspicuously, no statutory authority is cited, because, in fact, none exists. In fact, a contrary result is mandated by the statute.

At the time the improvements are completed, the prorated costs are treated, by definition, as "<u>prepaid</u> contract rent", each payment relating specifically to a given year in the lease "term". If the tenant leaves early, nothing in the statute alters the characterization of those prepayments, or

> their relationship to subsequent years. It would require a rather tortured construction of the statute to find authority for the notion that the prepaid rent should be treated instead as rent for the last year of the tenant's possession. Rather, what has happened is the tenant has suffered an economic loss by having paid in advance for a benefit it reasonably expected to, but it now knows will not, enjoy. This presents the textbook case where a payment will satisfy the definition of "contract rent", but will not constitute a "payment for the act or privilege of occupying or using publicly owned property", as required by RCW 82.29A.130. By force of the statute itself, those prepayments relate to later years. Not only will the tenant not occupy or use the property in those years, but the lessor will be free to lease the property to another. Consequently, the prepayments are properly characterized as a forfeiture by the tenant, to which no tax liability will attach.

The taxpayer's memorandum also extensively deals with two so-called "policy considerations." First, it is asserted that if the expenditures for improvements are prorated over future periods and not deemed to be attributable to any period of actual use or occupancy by the taxpayer, there is no real risk of revenue loss to the state. This is because the value of the property is improved and it will bring higher rental payments in the future, which translates to higher leasehold tax payment. Secondly, if there is any risk of revenue loss, it should not be borne by the taxpayer. The taxpayer asserts that to tax it on the lump sum payment as well as taxing any new tenant's occupancy would result in doubly taxing the leasehold interest. It is the Port which realizes the benefit of both the improved property as well as the opportunity for higher rental income. The taxpayer stresses that the state and the Port are both governmental agencies and that it is inappropriate for one such agency to require a third party tenant to indemnify against any possible revenue loss to another such agency which has, in fact, realized a potential revenue gain.

The taxpayer's memorandum concludes:

> If the Department intends to abide by its previously decided precedents concerning the exclusion of option periods in calculating the lease term, then the decision of the Administrative Law Judge must be

> reversed, as no excise tax whatever in respect of the improvements in question was payable beyond December 31, 1981.
>
> If the Department elects to overrule its previous precedent and adopt a more flexible approach, it must then adopt criteria for the inclusion of any period beyond the original lease term, and it must then decide whether or not the lease agreement in question meets those criteria. Should the Department conclude that, in fact, the cost of the improvements by the tenant in this case should be prorated beyond the original lease term, the tax on those prorated costs should be calculated, but the taxes paid in respect of the interest component of the tenant's financing arrangement with the lessor must be refunded.
>
> Finally, if the proper period for amortizing the cost of any of the improvements extends beyond the date the lease was prematurely terminated, the prepayments allocable to subsequent years must be treated as beyond the scope of the leasehold excise tax.

Issue No. 2

The taxpayer asserts that the interest payments made to the Port on its loan financing the improvements are clearly not in consideration of the use or occupancy of the property. These payments are even more clearly made in return for other rights and benefits conferred by the Port, to wit: the Port's forbearance to collect on the loan principal. The interest payments were no part of taxable contract rent, even if the actual expenditures for the improvements constituted such rent. In other words, under the law, contract rent includes the cost of the improvements, not the cost of financing them. The interest on the loan was payment for "other rights" under the Court's statutory construction in MAC Amusement, supra. Obviously, had the taxpayer procured independent bank financing of the loan, the interest payments made to the bank would not be considered part of the expenditures for the actual improvements. The taxpayer paid tax on the interest amounts in error, it asserts, simply because they were part of the total of payments being made to the Port. The taxpayer's petition to the Director addresses this point as follows:

> RCW 82.29A.020(a) provides that:

> "Contract rent" shall mean the amount of consideration due as payment for a leasehold interest . . .

Thus, a determination must be made as to whether interest payments are consideration for the leasehold interest. Judge . . . failed to address this point. Pursuant to Judge . . . 's methodology, Black's Law Dictionary defines "leasehold" as "An estate in realty held under a lease; an estate for a fixed number of years." The interest payments are not consideration for an estate in realty, but are consideration for the forbearance of the payment of money.

Judge . . . found it significant that a default in the payment of interest would constitute a default in the lease. This is merely a security arrangement. Such arrangements are often seen in the purchase and sale of a business where the seller subleases the real property and sells the assets on a promissory note. The fact that a default on the promissory note also constitutes a default on the sublease does not mean that the payments on the promissory note are consideration for the sublease. The seller has merely put itself in a position of greater security.

Our argument presented in Paragraph A2. regarding "other rights granted by the lessor" is applicable here as well. The payment of interest pursuant to money loaned by a lessor falls directly under RCW 82.29A.020(a) as follows:

> Where the consideration conveyed for the leasehold interest is made in combination with payment for concession or <u>other rights granted by the lessor</u>, only that portion of such payment which represents consideration for the leasehold interest shall be part of contract rent. (emphasis added)

Again, the <u>MAC Amusement</u> case makes it clear that the courts will not treat all payments to a lessor as contract rent.

DISCUSSION:

Issue No. 1

[1] The taxpayer has painted the issue before us here with a broad brush, in an attempt to show that its expenditures for improvements fall outside the scope and intent of RCW 82.29A.020 which defines the leasehold tax measures. This wide range of contentions somewhat clouds the real issue. The bottom line question continues to be whether the expenditures for improvements, however and to whomever paid, constituted taxable contract rent within the clear and unambiguous provisions of the statute. We are convinced that they did. Determination 86-39 is not cursory in its treatment of this question. Merely because it does not expressly respond to each and every compound and complex argument posited by the taxpayer does not mean that it does not directly and thoroughly deal with the dispositive question. The record and testimony clearly evidence that the taxpayer agreed to pay a set rental amount and to make specific improvements to Port property in return for the use and occupancy of that property. Title to all of the improvements vested immediately in the Port. There is no denial of these facts. In such cases the law is clear that taxable contract rent includes both the direct rent payments and the costs of improvements to the leasehold made by the lessee.

RCW 82.29A.020(2) provides in pertinent part that "taxable rent" shall mean contract rent as further defined in subsection (a) of the statute. Subsection (a) defines "contract rent" to mean the amount of consideration due as payment for a leasehold interest, including ". . .expenditures for improvements to the property to the extent that such improvements become the property of the lessor." Subsequently in subsection (a) of the statute it is provided that expenditures for improvements with a useful life of more than one year shall be treated as prepaid contract rent and prorated over the remaining term of the lease or the full useful life of the improvements, whichever is less. This is the substance and clear meaning of the statutory language.

In the present case the taxpayer agreed to pay money and make improvements in return for use of the Port property. The parties both contemplated and intended that the taxpayer should pay for the improvements in full whether it occupied the property for five years only, or for the full 30 years by exercising its renewal options. Payment of the costs of improvement were not made as consideration for early termination of the lease. Had there been no improvements at all there would have been no charge for early lease termination. The lump sum payment was not made when it was <u>in order</u> to terminate the lease but rather <u>because</u> the lease was terminated early. In fact, under the terms of the lease agreement, this payment would have been due in full even if the taxpayer had not voluntarily terminated the lease early, but if the Port had done so under section (5)(a) of the lease agreement. Under the law the expenditures for improvements constitute taxable contract rent regardless of how they are made, i.e., all at once or from rental period to rental period. Clearly the taxpayer recognized this because it paid leasehold excise tax on the prorated payments of both principal and interest during the periods of its occupancy of the Port property. The taxpayer admits that the periodic amortized payments representing the expenditures for improvements constituted part of "contract rent" under the law, but somehow inexplicably distinguishes these parts of the payment from the lump sum final payment. The statutory law simply provides a mechanism for amortizing these expenditures so that the practical economic burden upon the lessee is decreased. The lessee can pay tax upon the cost of the improvements over the course of time. Nonetheless, the improvements have been made at the expense of the lessee. That expenditure is in lieu of additional consideration for the rental of the property. The lessee makes a lower actual rental payment because it also has to make improvements. This obligation was clearly within the contemplation and intent of the parties at the time the lease was executed. The taxpayer knew of these additional lease expenses and negotiated and contracted to incur them, whether the lease ran for five years or 30 years. If the taxpayer exercised its option not to renew, it would have the full balance of expenditures for improvements to pay at that time. The agreement expressly called for this payment. Thus, the expenditure was part of the consideration for occupying the property, whether for five years or any period thereafter. Under the terms of the statute this payment was properly included as taxable contract rent. We reject the taxpayer's conclusion that payments may constitute "contract rent" under the statutory definition and yet not constitute consideration for use or occupancy of the property. Such a proposition is self contradictory.

[2] Regarding the taxpayer's position that the expenditures for improvements must be treated as prepaid contract rent and be prorated only over the contracted term of the lease, we agree that this is the proper methodology for reporting the

expenditures for tax purposes. Also, as the taxpayer asserts, it has been the consistent position of the Department that the term of the lease must be determined without reference to any options to renew. Thus, in this case, had the taxpayer and the Port properly prorated the improvement expenditures over the lease term as allowed under RCW 82.29A.020, the taxpayer would have paid leasehold excise tax upon these amounts by 1981. However, the failure of the taxpayer to properly employ the statutory mechanism does not excuse the tax liability attendant to the actual payment of the improvement expenditures. The law clearly imposes the leasehold excise tax upon the full contract rent. There is nothing in the law which excuses that liability based upon the method of payments agreed to by the lessee and lessor. The payment was actually received during the audit period in question here, which was within the statutory period for assessment of taxes. We are not persuaded by the taxpayer's ingenious arguments that the tax liability attendant to this payment must be excused because the tax could have been reported or assessed earlier, during a period which is now protected by the statute of limitations. In conclusion on this point, even if the expenditures are treated as prepaid contract rent prorated over the remaining term of the lease, that term expired when the taxpayer voluntarily terminated its leasehold interest. The law contemplates that the tax measured by improvement expenditures is due no later than that time. Conversely, nowhere does the law contemplate that any portion of the expenditures for improvements to the leased property should go untaxed. The overriding consideration is that the taxpayer paid the lump sum payment for improvements during its period of occupancy and was bound to do so under the lease agreement by reason of that occupancy.

We are cognizant of the ruling in MAC Amusement, supra, but find it to be inapposite here. Most importantly, we find nothing in the lease agreement or the record of this case which establishes that the lump sum payment was made in return for any lease termination right. The "voluntary termination" provision of the lease was clearly independent of anything related to leasehold improvements or the making of improvement expenditures. As noted earlier, either the taxpayer or the Port could voluntarily terminate the lease with six months' written notice. No charge or fee is exacted for this privilege. Clearly, even under the Court's rationale in MAC Amusement, the requirement in a lease for the making of improvements and paying the expenses thereof, which the statute expressly includes as part of "contract rent," cannot be a payment for "other rights," other than the very occupancy and use of the property for which contract rent is charged. Determination 86-39 properly responds to the contention based upon this case law ruling.

[3] We disagree that with taxpayer's contention that some economic parity is intended, under the law, between leasehold excise tax due and ad valorem property tax which would be due on the leased property if it were privately owned. RCW 82.29A.010 expressly reveals legislative intent concerning the purpose of the leasehold excise tax. It is to "fairly compensate governmental units for services rendered to such lessees of publicly owned property." Obviously, the value of those services and the commercial benefits derived from exclusive use and occupancy of public Port property may far outweigh and outvalue real property tax land valuations. The tax measure for leasehold excise tax is predicated upon the legally negotiated "contract rent" agreed between the lessor and lessee. It may have no relationship whatever with ad valorem tax valuations. This is generally the case with respect to Port property with its natural waterborne commerce access characteristics. As the Court clearly recognized in MAC Amusement, access to the stream of commerce is a taxable right. Moreover, the tax rates imposed for the leasehold tax and property tax are not the same or even remotely calculated to derive comparable tax revenue. It is clearly the "substantial benefits from governmental services," including access to the stream of commerce in this case, which are being compensated by leasehold excise tax, not the achievement of economic parity with unrealized property tax revenues. In this same vein, we fail to perceive how the payment of improvement expenditures, which the taxpayer was contractually obligated to make under any circumstances, can be likened with liquidated damages. There is simply no evidence or authority for this novel contention.

Concerning the Department's established position that lease terms are to be determined without regard to any unexercised options to renew, the prior Determinations referenced by the taxpayer were rulings which dealt exclusively with express terms of specific public property leases different from the taxpayer's here. Clearly, each case will be controlled by the lease agreement which pertains in that case. The excise tax laws operate upon what actually transpires between the parties rather than speculations about what could have taken place. Regardless of how the expenditures for improvements could be prorated if the taxpayer had exercised its full renewal options, it is clear that the contract rent which was actually paid, including the improvement expenditures, was due and was paid in full during the actual period of occupancy in this case. The Department's determinations dealing with wholly different factual situations and wholly different lease provisions in other cases are not controlling. Those rulings were rendered for the purpose of applying the leasehold excise tax laws in cases of ongoing public property leases where the prorating mechanism for tax reporting was in doubt. They are factually and substantively distinguishable from the taxpayer's early terminated lease in this case.

We fully respect the taxpayer's concern for so-called policy considerations. However, the Department of Revenue is without discretion or authority to ignore the clear and unambiguous language of the law in favor of alleged public policy concerns to which the law does not speak. Such elements as the risk of revenue loss and the competing interests of respective governmental agencies, while high sounding, merit no weight in applying the express provisions of statutory law to clearly defined factual and contractual transactions. The fairness of tax laws, both with respect to their economic impact and their accord with claimed public policy suggestions, are matters exclusively for legislative concern. As the tax administering agency, the Department's concern must be the uniformity and consistency of those tax law applications, not their potential for deriving tax revenues or the relative advantages or disadvantages which result to governmental agencies or taxpayers.

Conclusion

As the taxpayer requested, the foregoing explanations are a more analytical response to its positions rather than conclusory applications of the technical statutory provisions. Nonetheless, after a review of the entire record and testimony, we must sustain the findings and conclusions of Determination 86-39 on this issue and deny the taxpayer's petition for correction.

Issue No. 2

We agree with the taxpayer's analysis of the MAC Amusement decision as recognizing that not all payments made to a lessor constitute taxable contract rent. The Department has so ruled in many instances, depending upon the facts of individual cases and the specific transactional dealings of the parties. Payments to pubic lessors which have been determined to be in return for "other rights and concessions" under the statute have included insurance premiums insuring the lessee's interests; fees for preferential use of a pier; maintenance reimbursements for minor upkeep and repair; extermination charges; pest and rodent control charges; and metered utility payments, among others. However, the question whether interest payments to finance expenditures for improvements are made in return for "other rights" granted by the lessor is a matter of first impression. Clearly, under the statutory law and the MAC Amusement decision, if these interest payments are in return for rights other than the use and occupancy of the property, the amounts are not part of the leasehold tax measure.

[4] After fully reviewing the entire interest issue we conclude that these interest payments were made as consideration for "other rights" granted by the Port, to wit; forbearance of the payment of money. It occurs to us that the actual expenditures for improvements "to the extent" that they became the property of the Port could not include the interest expense of financing the loan. No part of the interest expenditure inhered in the improved property and to no extent did the interest inure to the Port's benefit through the improvements. The common and ordinary meaning of the term "expenditures for improvements" is the amount spent to make the improvements. It does not include amounts spent for the use of money or for forbearance to collect the amount spent to make the improvements. Moreover, the interest expense in this case is clearly distinguishable from the lump sum improvements payment. As to the former, the Port granted "other rights" and benefits in return for the payment. As to the latter, the Port granted only the right to occupy and use the public property. Additionally, it is clear that the actual expenditure for improvements would be precisely the same whether or not the taxpayer had to secure financing.

We recognize that Determination 86-39 concluded that the interest expense was consideration for the leasehold interest because of express recitations in the lease. The lease also provided that default on the prorated payments, including interest, could default the lease and give the Port the right to terminate the taxpayer's occupancy. We do not agree that these factors are dispositive. The same conditions prevailed in the MAC Amusement case. Nonpayment of the monopoly rights portion of the consideration by MAC Amusement Company could also have defaulted the lease agreement. Such payments were, generally, part of the "rent" under the agreement. The Court ruled, nonetheless, that such payments were not within the statutory leasehold tax measure.

Finally, we have determined that the taxpayer "expensed" the interest payments for its accounting and tax reporting purposes rather than capitalizing and depreciating those expenditures. It has never treated the interest costs as part of its expenditure for improvements.

For all of the foregoing reasons we agree that the interest portion of the prorated payments for improvements should not have been reported for leasehold tax. The tax paid measured by such interest amounts will be calculated and credited against the taxpayer's outstanding tax assessment on the lump sum payment.

Conclusion

The taxpayer's petition on this issue is sustained. Interest expense for financing leasehold property improvements are not taxable expenditures for such improvements under RCW 82.29A.020.

DECISION AND DISPOSITION:

The taxpayer's petition is sustained in part and denied in part. Tax Assessment No. . . . will be amended as provided earlier herein. The amended assessment will be due for payment on the date to be shown thereon.

DATED this 24th day of October 1986.