Cite as Det. No. 99-316R, 19 WTD 862 (2000)

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition For Reconsideration and Refund of	)	F I N A L D E T E R M I N A T I O N
	)	
	)	No. 99-316R[1]
	)	
. . .	)	Real Estate Excise Tax Assessment

[1] RULE 458-61-430; RULE 458-61-080; RCW 82.45.060: REAL ESTATE EXCISE TAX ("REET") – SALE – TRANSFER OF IMPROVEMENTS ON LEASED LAND – OWNERSHIP OF IMPROVEMENTS. Language in a lease that the improvements "shall become the property" of the lessor at the termination of the lease is an important factor in determining that the lessee owned the improvements during the lease term.

[2] RULE 458-61-430; RULE 458-61-080; RCW 82.45.060: REAL ESTATE EXCISE TAX ("REET") – SALE – TRANSFER OF IMPROVEMENTS ON LEASED LAND – OWNERSHIP OF IMPROVEMENTS. Where a lease agreement incorporates the legal description of the land and does not include any reference to improvements and does not expand the definition of "premises" to include anything other than the land, the definition of "premises" for purposes of the lease does not include the improvements.

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:

The taxpayer petitions for reconsideration of Det. No. 99-316, in which we held that a transfer of improvements on leased property is subject to the real estate excise tax. The taxpayer paid the tax and requests a refund.[2]

[1] The original determination, Det. No. 99-316, is published at 19 WTD 850 (2000).
[2] Identifying details regarding the taxpayer and the assessment have been redacted pursuant to RCW 82.32.410.

FACTS:

C. Pree, A.L.J. -- The facts were set forth in Det. No. 99-316, in pertinent part, as follows:

> The taxpayer requested a ruling from the Miscellaneous Tax Section that a proposed transfer of improvements on leased property would not be subject to the real estate excise tax ("REET"). The taxpayer appeals the Miscellaneous Tax Section's adverse ruling. Based on the Miscellaneous Tax Section's adverse ruling, the taxpayer paid the tax and now requests a refund.
>
> In 1986, the taxpayer leased a tract of commercial real estate ("the premises") under a ground lease. The taxpayer then developed the premises into a commercial site and subleased it to third parties. In its ruling request, the taxpayer recited the following terms of the ground lease as relevant to its request:
>
> 1. The Lessor conveys the possession of the Premises at the commencement of the lease free and clear of any encumbrances [2.2(b)].
> 2. The term of the lease expires 55 years after the commencement date [2.3(a)].
> 3. The Taxpayer agrees to pay all costs relating to demolition, site work, construction, landscaping and other construction costs.
> 4. The Taxpayer agrees to make lease payments to the Lessor based on a complex mix of minimum rent schedule and/or a percentage of net lease payments collected [4.2 through 4.5].
> 5. The Taxpayer agrees to use the Premises exclusively in the development and leasing of a "first class commercial" facility consistent with the terms of the <u>Ground Lease</u> [5.1]. No additional improvements may be made without the Lessor's consent.
> 6. The Taxpayer agrees to maintain at the Taxpayer's expense the premises "as a reasonable and prudent investor would. [8.1]."
> 7. If the Taxpayer fails to maintain the facilities, the Lessor may cause the necessary repairs at the expense of the Taxpayer [8.2].
> 8. At the termination of the Ground Lease, the Taxpayer must surrender the Premises to the Lessor [8.3].
> 9. At the termination date, "all existing improvements together with all the right, title and interest of Lessee in the then existing subleases shall unconditionally be and become the property solely of Lessor, and no compensation therefor shall be due or paid by Lessor to Lessee for any part thereof. . . . Lessee shall surrender to Lessor the Premises and any then existing improvements in good order, condition, and repair, reasonable wear and tear excepted, free and clear of all liens, claims and encumbrances . . . . Any then existing improvements to the Premises shall become the property of the Lessor without the payment of any consideration to the Lessee [10.1(1)].

10. The Taxpayer may not permit any liens, mortgages and encumbrances against its improvements in the Premises [11.1,3].
11. The Taxpayer may assign its interest in the Ground Lease [12.1].
12. The Taxpayer agrees to repair or restore the Premises in the event that the Premises are damaged or destroyed, subject to a right to terminate in certain instances [19.1,2,3].
13. The Lessor retains the right to subordinate the Taxpayer's interest in the Ground Lease with mortgages [20.1(a)].
14. The Lessor retains the right of first refusal and an option to purchase the Taxpayer's interest in the Ground Lease for a fair market value as determined by up to three appraisers.
15. The Taxpayer may invoke an election wherein the Lessor may either buyout the Taxpayer's leasehold interest or agree to sell the premises at fair value [23].

We note that the ground lease also provides under "basic lease provisions," after the lease term of 55 years, "OPTIONS: None." (Sec. 1.1.) Further, the lease requires the taxpayer to pay all taxes "as additional rent" (Sec. 9.1.) and to insure the improvements, with the lessor named as the insured (Sec. 14.1). Additional text in section 10.1, which was cited by the taxpayer above, provides:

> On the Termination Date . . . (i) all existing improvements . . . shall unconditionally be and become the property solely of Lessor, and no compensation therefor shall be due or paid by Lessor to Lessee for any part thereof **and this Lease shall operate as a conveyance and assignment thereof."**

(Emphasis added.)

On May 23, 1986, the parties amended the lease to provide, in part, as follows:

> Both lessor and lessee shall have the right, commencing on the first day of the twenty-fifth (25th) year of the Lease Term,[3] and continuing yearly thereafter during the remainder of the Lease Term, to elect to institute the procedure (the "Buy-Sell Procedure"). . . .
>
> [The electing party shall] state that the Electing Party will purchase the Offeree's Land Value interest (as defined below), if the Offeree is the Lessor, or the Offeree's Leasehold Value (as defined below), if the Offeree is the Lessee . . . .
>
> [T]he term "Land Value" shall mean the fair market value of the real estate (exclusive of the building and improvements then constructed on the real estate

[3] This provision was subsequently amended to read "commencing on the first day of the 326th month after the Commencement date, and continuing on the anniversary of such date thereafter during the remainder of the Lease Term."

> . . . . [T]he term "Leasehold Value" shall mean the fair market value of the Lessee's leasehold estate and shall include (i) the current fair market value of the then existing buildings on a debt free basis and (ii) recognizing all of the rights and obligations of the Lessee under the terms of this Lease . . . .
>
> The purchase price of the Land or leasehold interest shall be the Land Value or the Leasehold Value, as the case may be . . . .
> If the Offeree is the Lessee, the Offeree shall be required to accept the offer in the Notice, and the Election shall state that the Offeree accepts the Electing Party's offer to purchase the Offeree's Leasehold Value . . . .
> If the Offeree is the Lessor, then the Election shall state that:
>
> (1) The Offeree accepts the Electing Party's offer to purchase the Offeree's interest at the value determined by the appraisers . . . or
> (2) The Offeree rejects the Electing Party's offer to purchase the Offeree's interest. . . but with the obligation that the Offeree shall purchase the Electing Party's interest at the value as determined by the appraisers . . . .

In 1997, the taxpayer transferred its interests under the lease agreement to an unrelated third party for consideration. The Miscellaneous Tax Division held that this transfer was subject to REET. The Taxpayer argues that this transfer was not subject to REET.

In Det. No. 99-316, we held that the issue of whether REET applied to the taxpayer-lessee's transfer of improvements on the leased property hinged on whether the lessee owned the improvements. We further held that the taxpayer-lessee was the owner of the improvements, and, as such, the transfer of the improvements was subject to REET. In its petition for reconsideration, the taxpayer states that it "concurs with the legal analysis of Determination No. 99-316 but disagrees with the application of [the] legal analysis to the Taxpayer[']s Ground Lease." Specifically, the taxpayer states:

> The Taxpayer appears to be in agreement that all leasehold improvements made by lessees immediately become the property of the lessor unless the lease agreement provides otherwise. The Taxpayer takes exceptions in that the Determination found that:
>
> 1. the terms of the Taxpayer's Ground Lease [are] similar to the lease agreement considered in *Washington Mutual v. Dep't of Revenue,* 77 Wn. App. 669, 893 P.2d 654 (1995);
> 2. the Taxpayer's Ground Lease allowed the Lessee to retain ownership of the leasehold improvements (i.e. building, land improvements, tenant improvements) until termination of the Lease; and
> 3. the provision[s] of the Ground Lease cited by the Determination omitted language critical to understanding the intent of the provision[s].

The taxpayer's arguments with respect to each of these exceptions will be addressed in the discussion section, below.

In its original petition, the taxpayer also argued that the REET was imposed on an inflated value and that the value should be based on "the value of the improvement as stated on the county tax roles." In Det. No. 99-316, we noted that it was unclear from the information we received whether the selling price of the improvements was separately stated. We reasoned:

> If the selling price of the improvements was separately stated, then the tax is properly assessed based on the total consideration paid. See RCW 82.45.030(1), (4). On the other hand, if the selling price for the improvements was not separately stated, or "cannot be reasonably determined," RCW 82.45.030(4) mandates that the "market value assessment for the property maintained on the county property tax rolls at the time of the sale shall be used as the selling price." See WAC 458-61-430(3).

We then remanded the issue to the Miscellaneous Tax Division to allow the taxpayer the opportunity to provide information to support its argument that the selling price of the improvements cannot reasonably be determined. We noted that the taxpayer bears the burden of proving that the selling price was not equal to the total consideration paid. See RCW 82.45.030(1).

ISSUES:

1. Whether Det. No. 99-316 erred in concluding that the taxpayer owned the improvements at issue because it erroneously concluded that the terms of the taxpayer's ground lease are similar to the terms in the lease agreement considered in Washington Mutual;

2. Whether Det. No. 99-316 erred in concluding that the taxpayer owned the improvements at issue because it erroneously concluded that the taxpayer's ground lease allowed the lessee-taxpayer to retain ownership of the leasehold improvements until termination of the lease; and

3. Whether the provisions of the ground lease cited by the Determination omitted language critical to understanding the intent of the provisions. Specifically:
   a. Whether Det. No. 99-316 improperly cited the ground lease.
   b. Whether Det. No. 99-316 erroneously concluded that the buyout provisions are inconsistent with the lessor's ownership of the improvements.

DISCUSSION:

[1] In Det. No. 99-316, we concluded that the taxpayer was the owner of the improvements during the term of the lease. In doing so, we relied largely on Washington Mutual. In Det. No. 99-316, we reasoned in pertinent part as follows:

The court of appeals recently addressed the issue of whether the lessee or the lessor (a school district) owned improvements constructed on the lessor's property. Washington Mutual, 77 Wn. App. 669. In resolving the issue of who was the owner of the improvements, the court focused on the question of whether the parties intended the lessee or the lessor to be the owner. In answering this question, the court analyzed the terms of the lease. The court noted the following:

> As a contract, a lease can allocate who owns the improvements during and after the term of the lease, notwithstanding common law default rules. Cf. SSG Corp. v. Cunningham, 74 Wash. App. 708, 711, 875 P.2d 16 (1994) (modern rule is that intention of parties govern whether building constructed on leasehold is personal property of builder).

The court analyzed the parties' lease agreement to determine their intent and held:

> [B]y the plain language of the lease agreement the improvements here at issue are to remain the property of the lessee during the term of the lease and will not become the property of the lessor until the expiration or earlier termination of the lease.

77 Wn. App. at 671. Thus, the court held that the county properly imposed personal property tax on the improvements.

Similarly, the issue here is whether the lease agreement supports the taxpayer's argument that the parties intended the lessor, rather than the taxpayer, to own the improvements from the inception of the lease. As the court held in Washington Mutual, we also hold that the lessee (taxpayer) owned the improvements during the term of the lease. Thus, we find that the Miscellaneous Tax Division properly imposed REET on the taxpayer's transfer of the improvements.

The facts in Washington Mutual are similar to the facts here and support our conclusion. Both leases were long-term. In Washington Mutual, the lessee had a 99 year ground lease; in this case, the taxpayer has a 55 year ground lease. Further, both leases required the lessees to construct the improvements, subject to restrictions set by the lessor. Specifically, the Washington Mutual lease required the lessee to construct and operate office/retail space on the property. The buildings were to be constructed pursuant to a design approved by the school district, and the lessee could neither replace the improvements with improvements of lesser value nor make any changes to the plans without giving notice to the school district. In this case, the Taxpayer agreed to use the property exclusively in the development and leasing of a "first class commercial" facility; no additional improvements could be made without the lessor's consent.

In addition, in Washington Mutual, the lessee was required to restore any damaged improvements. Similarly, the taxpayer here is required to maintain at its expense the premises "as a reasonable and prudent investor would" and to repair or restore the property in the event it is damaged or destroyed. Both the taxpayer and the lessee in Washington Mutual were required to maintain insurance, naming the lessors as insured.

Perhaps most importantly, the plain language of both the lease at issue here and the lease at issue in Washington Mutual provide that the improvements shall "become" the property of the lessor at the termination or expiration of the lease. Specifically, in Washington Mutual, the lease agreement provided:

> During the term of this Lease, the Improvements constructed by Lessee . . . shall be the property of the Lessee. **At the expiration or earlier termination of this Lease, the Improvements . . . shall become the property of the lessor.**

(Emphasis added.) In this case, the lease agreement provides:

> **On the Termination Date . . . (i) all existing improvements . . . shall unconditionally be and become the property solely of Lessor**, and no compensation therefor shall be due or paid by Lessor to Lessee for any part thereof and this Lease shall operate as a conveyance and assignment thereof."

(Emphasis added.) The lessee in Washington Mutual argued that, because it already owned the right to use and occupy the land during the term of the lease, the above language should be interpreted to mean that the lessee acquired only the right to use and occupy the improvements during the term of the lease, and not the ownership of the improvements. The court disagreed. The court reasoned:

> [The lease provides] that the improvements "shall become the property" of the lessor after the lease expires or is earlier terminated. If the lessee only owns a right to use and occupy the improvements and does not own the improvements themselves, this provision is unnecessary. . . .
>
> A more harmonious interpretation of [the lease] is its plain meaning: that the lessee owns the improvements during the term of the lease and that the improvements shall become the property of the lessor at the expiration or earlier termination of the lease.

77 Wn. App. at 675. We find the court's reasoning applicable here. If the lessor were the owner of the improvements throughout the lease term, the highlighted language would be surplus. Specifically, if the lessor already owned the improvements, there would be no need to recite that the improvements "shall be and become" the property of the lessor.

1. Whether Det. No. 99-316 erred in concluding that the taxpayer owned the improvements at issue because it erroneously concluded that the terms of the

taxpayer's ground lease are similar to the terms in the lease agreement considered in Washington Mutual.

The taxpayer argues:

> While there are many comparisons between the Taxpayer's Ground Lease and the lease in Washington Mutual, the leases are absolutely not comparable in respect to the single criteria [sic] upon which this dispute rests – ownership of tenant improvements.
>
> Section 8.5 of the *Washington Mutual* lease provides: During the term of this Lease, the Improvements constructed by Lessee . . . shall be the property of Lessee. At the expiration or earlier termination of this Lease, the Improvements . . . shall become the property of the lessor.
>
> This provision was the basis for the Court ruling: "We disagree with both of the Bank's contentions. First [under] the plain language of the lease agreement the improvements here at issue are to remain the property of the lessee during the term of the lease and will not become the property of the lessor until the expiration or earlier termination of the lease."

While we agree that the lease at issue in this case does not contain the language, "the Improvements . . . shall be the property of Lessee," which was in the lease at issue in Washington Mutual, we do not find the absence of this language determinative. As explained in Det. No. 99-316, the court in Washington Mutual found the language the improvements "shall become the property" of the lessor to be determinative in its conclusion that the lessee owned the improvements during the lease term. We note that this precise language is in the lease at issue here. As such, we disagree with the taxpayer's argument that the terms in its lease are dissimilar from those in Washington Mutual.

The taxpayer further argues:

> Washington Mutual did not refute the language of the leasehold agreement nor did it suggest parole [sic] evidence that contradicted such language. The Bank merely suggested that: " . . . because the lessee already owns the right to use and occupy the land during the term of the lease, the phrase in section 8.5 of the lease stating that the improvements "shall be the property of the lessee" during the term of the lease should be interpreted to mean that the lessee acquired only the right to use and occupy the improvements during the term of the lease, and not the ownership of the improvements."

Similarly, the taxpayer here has not refuted the language in the leasehold agreement. The taxpayer's petition is denied with respect to this issue.

2. Whether Det. No. 99-316 erred in concluding that the taxpayer owned the improvements at issue because it erroneously concluded that the taxpayer's ground

> **lease allowed the lessee-taxpayer to retain ownership of the leasehold improvements until termination of the lease.**

The taxpayer argues:

> In the case under consideration, there is absolutely no equivalent language as "improvements constructed by Lessee . . . shall be the property of Lessee" – the language upon which the entire *Washington Mutual* ruling was based. In fact, the Ground Lease provided ample provisions that contradict such a conclusion.

As explained above, we disagree with the taxpayer's interpretation of the lease language. The taxpayer next argues:

> The recitals of the Ground Lease stated the intent of the Ground Lease was for the Lessee to "lease the Premises" from the Lessor: "WHEREAS, Lessee desires to lease the Premises from the Lessor and the Lessor desires to lease the Premises to Lessee; and NOW THEREFORE, for and in consideration of the rents received hereunder and the terms and conditions hereof, the Lessor hereby rents and leases to Lessee, and Lessee takes and leases from Lessor, the following described Premises . . ."
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> The "LEASED PREMISES" were described in Section 1.1 as including the buildings that were to be constructed: "A parcel of land . . . on which two (2) story buildings . . . shall be constructed."
>
> Section 8.1 requires the Lessee to "return the Premises to the Lessor" at the termination of the lease: "At the expiration or sooner termination of this Lease, Lessee shall return the Premises to Lessor in accordance with the provisions of Section 10.1 herein." The use of the term "return" indicates that the Lessor was in fact the owner [of] the Premises (inclusive of buildings).
>
> Section 21.1 uses the terms "yield and deliver . . . possession" to describe the nature of the passage of control of the Premises from Lessee to Lessor: "Lessee shall promptly yield and deliver to Lessor possession of the Premises at the expiration or prior termination of this lease." Had the parties intended to [sic] the Lessee to deliver more than possession of the Premises, the Ground Lease [would have] used different terms.
> Amendment No. 2, section 20.1 grants the lessor the right to mortgage the entire Premises – land, building and improvements – "provided that all such mortgages, deeds of trust, and other security documents shall be subject to the terms and provisions of this "Lease"". This recognizes that the Lessor is in fact the "fee simple" owner of the entire premises, but does not allow the Lessor to impair the Lessee's leasehold interest.

[2] We disagree with the taxpayer's interpretation of the term "leased premises" as including the improvements. The language the taxpayer quoted from section 1.1 simply does not support a conclusion that the taxpayer leased anything other than the land. The language supports the

conclusion that the taxpayer was leasing the land, and the taxpayer was to construct buildings on the land.

Further, we note that other provisions contradict the taxpayer's assertion that the buildings are included as part of the leased premises. We note that the first page of the ground lease provides:

> Lessor owns that certain real property as described in the legal description thereof attached hereto and made a part hereof as "Exhibit A" (which real property is hereinafter referred to as the "Premises") . . . .

Further, section 2.1 of the lease provides:

> 2.1 Definition of Premises.
>
> The Premises is legally described in Exhibit A . . . .

Exhibit A is the legal description of the land. It does not include any reference to improvements. Further, the lease agreement does not expand the definition of "premises" to include anything other than the land described in Exhibit A. Thus, we disagree with the taxpayer's assertion that the definition of "premises" for purposes of the lease includes the improvements.

The taxpayer continues:

> The Warranty Assignment of Interest Under Ground Lease is the transactional document of the transaction under this appeal. The document speaks to the assignment of the Lessee's leasehold interest but makes no reference [to] the sale or assignment of "improvements" which are owned by the Lessee. To the contrary, the Recitals provides [sic] the historical context stating that the Lessee (and its predecessors) entered into a Ground Lease "pursuant to which Lessor granted to [Lessee-Assignors] a leasehold interest in and to certain real property and the improvements, buildings, structures thereon, together with a leasehold estate in all rights, easements, and interests appurtenant thereto (collectively, the "Property") . . . ["] This recital leaves no doubt that all parties, Lessor, Lessee, predecessors, and the party acquiring the leasehold interest recognizes [sic] that the building and improvements are owned by the Lessor.

The taxpayer did not provide us with a copy of the above-referenced document. However, we note that the language quoted from this document is insufficient to overcome the clear language in the lease. The lease, not the warranty assignment of interest, is the document that sets forth the respective rights and interests of the lessee and lessor. Thus, the lease, not the warranty assignment of interest, determines who was the owner of the improvements during the lease term. The taxpayer's petition is denied with respect to this issue.

3. Whether the provisions of the ground lease cited by the Determination omitted language critical to understanding the intent of the provisions.

a. Whether Det. No. 99-316 improperly cited the ground lease.

The taxpayer argues:

> The Determination cited as the basis for its conclusion a provision in Section 10.1 but eliminated language that allowed for an incorrect interpretation. The bold face language represents the omitted language:
>
> > On the Termination Date . . . (i) all existing improvements **together with all right, title and interest of Lessee in the then existing subleases** shall unconditionally be and become the property solely of Lessor, and no compensation therefor shall be due or paid by Lessor to Lessee for any part thereof and this Lease shall operate as a conveyance and assignment thereof; . . . **Lessee shall surrender to Lessor the Premises and any then existing improvements in good order, condition and repair, reasonable wear and tear excepted, free and clear of all liens, claims and encumbrances . . .**
>
> "All existing improvements" – most of which would belong to the Lessor – "together with all the right, title, and interest of Lessee in the then existing subleases" – which would belong to the Lessee – were stated to "be" and "become" (in that order) the property of the Lessor. Or restated, all existing improvements will unconditionally "be" the property of the Lessor. All interests in the subleases will unconditionally "become" the property of the Lessor. The term "be" suggests that the Lessor already owns the Premises. The term "become" suggests a change in ownership in the sublease agreements.

We find the taxpayer's argument unpersuasive. First, we note that the date referenced at the beginning of the sentence that discusses when the improvements and subleases "shall be and become" the property of the lessor is the "Termination Date." The sentence does not provide that the improvements shall be the property of the lessor during the lease term. Thus, even assuming the word "be" relates to the improvements and "become" relates to the subleases (which we find to be a strained construction), we find that both of these transfers are intended to take place on the Termination Date.
More importantly, we note that the above provision states, with respect to "all existing improvements together with all right, title and interest of Lessee in the then existing subleases" that "this Lease shall operate as a conveyance and assignment thereof" on the termination date. Thus, we find that the lease **conveys** the improvements and **assigns** the subleases on the Termination Date. If the lessor owned the improvements throughout the term of the lease, there would be no reason for the lease to convey the improvements to the lessor on the Termination Date.

Finally, the taxpayer argues:

> According to the Ground Lease, the Lessee then surrenders the "Premises" – defined earlier as the land and the buildings and improvements constructed thereon – "and any then existing improvements" – not specifically defined but instead a "catch all" to pick up any improvements that may be added by the Lessee or a tenant. The term "catch all" was used in Washington Mutual: "However, this section contains "catch-all" language and does not refer to the ownership of the improvements."

Again, we note that we disagree with the taxpayer's interpretation of "premises" as including the improvements. Further, it is unclear how reference to the "catch-all" provision in Washington Mutual supports the taxpayer's position. The taxpayer's petition is denied as to this issue.

b. Whether Det. No. 99-316 erroneously concluded that the buyout provisions are inconsistent with the lessor's ownership of the improvements.

In Det. No. 99-316, we reasoned:

> In addition to the facts the court in Washington Mutual considered, we find the "buy-out" provisions in the taxpayer's lease to be probative of the parties' intent that the taxpayer would own the improvements during the term of the lease. Under the buy-out provisions, after a date specified in the lease, the lessor was required to respond to an offer by the taxpayer to purchase the lessor's property at "fair market value of the real estate (exclusive of the building and improvements then constructed on the real estate." The lessor was required to respond to the offer either by accepting the taxpayer's offer to purchase the land or by purchasing the improvements from the taxpayer at "the current fair market value of the then existing buildings on a debt free basis . . . recognizing all of the rights and obligations of the Lessee under the terms of this Lease." If the lessor were the owner of the improvements during the term of the lease, there would be no reason to require the lessor to purchase the improvements from the taxpayer at their "current fair market value." If the buy-out provision was intended to be a liquidated damages clause, it would seem reasonable that the lessor's payment would reflect the value of the taxpayer's use of the property for the length of time remaining in the lease, not the fair market value of the improvements.

The taxpayer argues:

> The Determination suggested that the "buy-out" provisions (Ground Lease Section 23, amended by Amendment No. 1, section 23 and Amendment No. 2, section 23) were inconsistent with the legal presumption that the Lessor is the owner of the improvements. In doing so, the Determination over simplified [sic] the buy-out provisions and failed to properly characterize such transaction.
>
> All business relationships require exit strategies. The buy-out provisions merely give the Lessee the opportunity to require the Lessor to purchase the leasehold value in its remaining occupancy interest once the Lessee has occupied the facility for 326 months

> (27 plus years). If the Lessor chooses not [to] buy-out the remainder of the leasehold interest, the Lessor must sell the entire Premises to the Lessee. The Lessor remains in full control as it has the power to require the Lessee to sell its remaining leasehold interest.
>
> In [the] event that the Lessor acquires the interest of the Lessee, the purchase price will be equal to the "Leasehold Value." [Amendment No.1, section 23.5] Leasehold value is "the fair market value of the Lessee's leasehold estate and shall include (i) the current fair market value of the then existing buildings on a debt free basis and (ii) recognizing all of the rights and obligations of the Lessee under the terms of this Lease" and (iii) "recognizing fair market value rental for leasehold as determined in Section 4.2(f), a Market Rate Adjustment shall be calculated prior to determining the leasehold value." [(iii) comes from Amendment No. 2, p. 9]. The above formula is merely a mechanical formula for the benefit of appraisers to determine the fair market value of remaining right of occupancy. Excluded from "Leasehold Value" is the value of the building and improvements beyond the remaining terms of the lease.
>
> The Determination suggested, "[i]f the Lessor were the owner of the improvements during the term of the lease, there would be no reason to require the lessor to purchase the improvements from the taxpayer at the "current fair market value"." This suggestion erroneously concluded that the Leasehold Value was equal to the fair market value of the building and improvements. The fair market value is only one component of a complex equation, subject to adjustment and reductions due to the limited remaining occupancy of the Ground Lease.

We note that the leasehold value is comprised of two major components: 1) the current fair market value of the then existing buildings on a debt free basis and 2) the lessee's rights and obligations, "recognizing fair market value rental." Thus, as we concluded in our original determination, it seems clear that the lessor is required to pay the fair market value of the buildings, plus an amount to compensate the taxpayer for early termination of its lease of the land. While the formula may be "merely a mechanical formula for the benefit of appraisers," as the taxpayer asserts, the formula does more than "determine the fair market value of remaining right of occupancy." One of its major components is the current fair market value (not merely the rental value) of the buildings. Thus, we disagree with the taxpayer's argument that Det. No. 99-316 erroneously concluded that the buyout provisions are inconsistent with the lessor's ownership of the improvements.

DECISION AND DISPOSITION:

The taxpayer's petition for refund is denied in part. We affirm our previous determination including the remand of taxpayer's petition to the Miscellaneous Tax Division with respect to the valuation issue. The taxpayer has 60 days from the date of this determination to provide such information. If the taxpayer fails to provide this information, the taxpayer's petition will be denied.

Dated this 12th day of June, 2000.