

Cite as 9 WTD 095 (1990)

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

In the Matter of the Petition)	<u>D</u> <u>E</u> <u>T</u> <u>E</u> <u>R</u> <u>M</u> <u>I</u> <u>N</u> <u>A</u> <u>T</u> <u>I</u> <u>O</u> <u>N</u>
For Correction of Assessment of)	
)	No.90-60
)	
. . .)	Registration No. . . .
)	. . . /Audit No. . . .
)	

[1] RCW 82.29A.020 and LEASEHOLD EXCISE TAX: LIABILITY FOR PAYMENT OF TAX -- SUBLESSEE OF PRIVATE LESSEE OF PUBLIC LAND. Lessees of public property for private uses are subject to leasehold excise tax. Where the lessee subleases the property to another private entity, the lessee remains the proper taxpayer for leasehold excise tax purposes, whether or not the lessee recovers the amount of the tax from the sublessee in the form of increased rent payments.

[2] RCW 82.29A.020 and LEASEHOLD EXCISE TAX: CONTRACT RENT -- AGREEMENTS BETWEEN PARTIES NOT BINDING ON STATE. The incidence of the leasehold tax is on the private use. Arrangements between the public lessor and lessees or sublessees to forgive or reduce rent are not binding upon the State in determining whether a taxable leasehold exists.

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: . . .

DATE OF TELEPHONE CONFERENCE: December 6, 1989

NATURE OF ACTION:

Taxpayer petitions for correction of assessment of leasehold excise tax on its rental of a theatre site on the grounds that

it is a sublessor of the proper taxpayer or, alternatively, that either no contract rent was paid or the fair rental value of the property is zero.

FACTS AND ISSUES:

Johnson, A.L.J. -- Taxpayer is an association formed to operate a theatre. It is a private association which was denied tax-exempt non-profit status by the Washington Board of Tax Appeals. Docket No. 27705 (1983).

Taxpayer-association was formed by and leases the property from another private entity (hereinafter referred to as "lessee"). The lessee leases a large tract of land, including the theatre premises, from a tax-exempt public entity (hereinafter referred to as "lessor"). The lessee subleases various portions of the property for retail, office, parking and other uses to private sublessors.

Taxpayer was assessed leasehold excise tax for the years 1985-1988 and January-March, 1989.

Taxpayer argues that the lessee is the proper taxpayer in this case and that its status as sublessee to the private party-lessee does not elevate it to the status of lessee. It also opines that leasehold excise tax on the lessee's entire tract, including the theatre, was paid during the period.

Additionally, taxpayer contends no leasehold excise tax is due either because no "contract rent" was paid during the audit period or because the fair rental value of the theatre was zero.

DISCUSSION:

[1] Taxpayer's argument, supported by the attorney representing the lessor, is that it is not the proper taxpayer. It is not a party to the lease between the lessor and lessee, and it has no independent lessee relationship with the public lessor. As such, it contends there is a private entity between the public lessor and the private sublessee on whom the tax liability should fall. We agree with the taxpayer.

On March 9, 1987, a King County Superior Court ruled that the personal property of tenants in a large tract should be taxed to the sublessees instead of to the lessor. The judge found that, although the normal valuation procedure might be to

assess the personal property tax against the lessee, where there are multiple sublessees in numerous types of businesses, "the interest of the tenants is sufficient to assess the tax against these tenants." Unigard Mutual Insurance Company, et al., v. King Co., Case No. 82-2-08763-7 (1987). A similar result does not occur in the application of the leasehold excise tax, however.

The incidence of the leasehold excise tax is on the private use of publicly-owned property. Where a lessee is also a tax-exempt entity, the tax will apply against a private sublessee, even though no contractual arrangement exists between the sublessee and the public lessor. This accomplishes the legislative purpose of assessing leasehold excise tax against "a person who would not be exempt from property taxes if that person owned the property in fee." RCW 82.29A.020(1) and RCW 82.29A.130.

Here, the lessee is a taxable private entity and is the proper party against whom the leasehold tax should be asserted. It is not unnoticed that the sublessee will, presumably, bear the ultimate burden of the tax, particularly where its lease currently assigns personal property tax and liability for future taxes to the sublessee. However, on these technical grounds, taxpayer's petition is granted.

[2] Alternatively, taxpayer contends that no leasehold excise tax should be due because either the contract charged no "contract rent" for the audit period or the rent was forgiven by either the lessee or lessor in an effort to provide incentive for the theatre association to continue the unprofitable operation. Because this argument is likely to be made by the lessee since the association is not the proper taxpayer, it is being addressed in this Determination.

RCW 82.29A.020(2) and RCW 82.29A.020(2)(b) provide that

"Taxable rent" shall mean contract rent. . .in all cases where the lease or agreement has been established or renegotiated through competitive bidding, or negotiated or renegotiated in accordance with statutory requirements regarding the rent payable, or negotiated or renegotiated under circumstances, established by public record, clearly showing that the contract rent was the maximum attainable by the lessor. . .All other leasehold interests shall be subject to the determination of

taxable rent under the terms of subsection (b) of this subsection.

. . . .

the department may establish a taxable rent computation for use in determining the tax payable under authority granted in this chapter based upon the following criteria: (i) Consideration shall be given to rental being paid to other lessors by lessees of similar property for similar purposes over similar periods of time; (ii) consideration shall be given to what would be considered a fair rate of return on the market value of the property leased less reasonable deductions for any restrictions on use, special operating requirements or provisions for concurrent use by the lessor, another person or the general public.

In this case, the private lessee made a business decision to provide incentives to the sublessee to compensate for the predicted unprofitability of the theatre during its early years of operation. This decision to forgive all or part of the rent was made independently or with the concurrence of the public lessor. Such a decision, however, does not bind the state.

The express intent of the tax is to ensure that private users of tax-exempt public property pay a tax similar to that which they would pay if they owned the property in fee. Because the private use occurs regardless of whether the enterprise is profitable, the state is not obligated to waive leasehold excise tax if one or more of the parties involved agree to accept a financial arrangement which does not reflect a fair rental value for the property. For this reason, the department correctly compared the contract terms and the rent paid during the audit period and found that leasehold excise tax had not been paid on the fair rental value of the property.

Beginning in July, 1988, an amount in addition to the base monthly rental for the leasehold was to be due in the form of a percentage if a stated income level was reached by the tenant. That level has not been reached, and the audit report states that the base monthly rental required by the agreement was used for asserting leasehold excise tax.

The responsibility to pay the tax on all items properly qualifying as "taxable rent" under RCW 82.29A.020 will rest on

either the lessee or, less directly, on the sublessee. Consequently, the alternative argument based on profitability will not prevail regardless of the identity of the petitioner arguing it.

DECISION AND DISPOSITION:

Taxpayer's petition is granted with regard to its argument that it is not the proper taxpayer to whom the assessment of leasehold excise tax should be issued. The assessment against this taxpayer will be cancelled. Taxpayer's argument that a business decision between the parties to forgive or reduce rent should control its liability for payment of leasehold excise tax is denied.

DATED this 8th day of February 1990.