

Cite as Det. No. 03-0280, 23 WTD 323 (2004)

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition For Refund of)	<u>D E T E R M I N A T I O N</u>
)	
)	No. 03-0280
...)	
)	Registration No. . . .
)	. . . /Audit No. . . .
)	Docket No. . . .

WAC 458-29A-200; RCW 82.29A.020: LEASEHOLD EXCISE TAX (“LET”) – TAXABLE RENT – CONTRACT RENT – SEPARATELY STATED AND BILLED UTILITY CHARGES. Payments a lessee makes to a lessor for actual utility charges are not included in the measure of the contract rent for purposes of LET, if the actual charges are separately stated and billed to the lessee. This exclusion applies even when the lessor bills the lessee an amount less than the amount the public service business charges the lessor for the utility service.

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.

Prusia, A.L.J. – A public lessor that separately states and bills its lessee a flat amount for utility charges by public service businesses for utility service to the leased premises, in an amount that is intentionally less than the actual charges to the lessor by the public service companies, requests refund of Leasehold Excise Tax (LET) assessed and paid on revenue from the lessee’s payment of those separate charges. We conclude the revenue was excludable from the measure of the LET under WAC 458-29A-200, and grant the petition for refund.¹

ISSUE

If a public lessor separately bills its lessee a flat utility fee for utility charges by public service businesses for service to the premises, does the fact that the lessor’s fee is less than the actual utility charges by the public service companies disqualify the lessee’s payments from exclusion from the measure of the LET under WAC 458-29A-200?

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

FINDINGS OF FACT

Taxpayer is a public port district that is a municipal corporation incorporated under provisions of RCW 53.04.060. It operates an airport.

Taxpayer leases restaurant space at the airport, under a written lease agreement. Its lessee since 1996 has been [Lessee]. The [Lessee's] lease agreements provide for the payment by lessee of a rental fee, leasehold excise tax, and a separate utility fee. The utility fee is a flat monthly amount for utility usage, and is reviewed and subject to adjustment each year. Taxpayer delivers a monthly billing statement to the lessee wherein the utility fee is separately stated from the rental fee.

The utility service providers are . . . , both of which are public service businesses regulated by the Washington Utilities and Transportation Commission and subject to the Public Utility Tax (PUT). Those providers bill Taxpayer for utility service provided to the [Lessee's] restaurant, and Taxpayer pays 100% of the amounts billed. Taxpayer's payments to the utility providers include PUT. The flat monthly utility fee Taxpayer charges this lessee has always been below the average combined monthly utility billings from the two utility service providers.

Taxpayer has based the amount of this lessee's flat monthly utility fee on two factors: the average monthly amount the utility providers billed during the past year, and Taxpayer's estimation of how much utility expense the lessee can and will bear. Taxpayer has had two or three previous tenants since acquiring the restaurant . . . , and they all failed. The building was empty for about a year and a half before the [Lessee] leased it. It is important to Taxpayer that the restaurant be open, because the restaurant attracts private air traffic to the airport, which increases the airport's revenue from fuel sales and fees. When it was trying to attract a new tenant to the empty building, Taxpayer decided to set the future lessee's utility costs at a level that would create an incentive to prospective operators and increase the chances of a successful operation. Taxpayer has continued the practice, revisiting yearly the question of how much to charge the tenant for utilities.

Taxpayer has charged and collected Leasehold Excise Tax (LET) on its rental charges to the [Lessee], but has not charged or collected LET on its fees for utilities. Taxpayer has paid Business and Occupation (B&O) tax on its revenue from utility fees charged the lessee.

The Special Programs Unit ("Special Programs") of the Audit Division of the Department of Revenue ("DOR") examined the books and records of Taxpayer for the period January 1, 1999 through June 30, 2002. On December 4, 2002, Special Programs issued audit assessment number . . . against Taxpayer. The assessment assessed LET on utility fees Taxpayer charged and collected from the [Lessee], in the amount of \$. . . , LET in the amount of \$. . . on other unreported contract rent, and interest in the total amount of \$ Taxpayer paid the assessment in full, and requests refund of LET assessed and paid on the [Lessee] utility fee revenue, and related interest.

ANALYSIS

Properties of the State of Washington, counties, school districts, and other municipal corporations are exempted from property tax obligations by Article 7, section 1 of the state constitution. Chapter 82.29A RCW establishes a Leasehold Excise Tax (LET) on the act or privilege of occupying or using publicly owned real or personal property through a leasehold interest. The intent of the chapter is to ensure that lessees of property owned by public entities bear their fair share of the cost of governmental services when the property is rented to a lessee who would be subject to property taxes if the lessee were the owner of the property. WAC 458-29A-100. The lessor is liable for collection and remittance of the LET. RCW 82.29A.050.

The LET imposed is a specified percentage of the taxable rent. RCW 82.29A.030. "Taxable rent" generally means "contract rent," which RCW 82.29A.020(2)(a) defines as "the amount of consideration due as payment for a leasehold interest." WAC 458-29A-200 further interprets the terms "taxable rent" and "contract rent." WAC 458-29A-200(2) addresses when utility charges are and are not considered part of "contract rent." It states, in pertinent part:

Even when a leasehold interest is present, not all payments made to a lessor constitute taxable contract rent. For example, payments made to or on behalf of the lessor for actual utility charges, janitorial services, security services, repairs and maintenance, and for special assessments such as storm water 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). "Utility charges" means charges for services provided by a public service business subject to the public utility tax under chapter 82.16 RCW, and, for the purpose of this section only, also includes water, sewer, and garbage services and cable television services.

* * *

For example, Dan leases retail space in a building owned by the Port of Whistler. He pays \$800 per month for the space, which includes building security services. Additionally, he is assessed monthly for his pro rata share of actual janitorial and utility services provided by the Port. The Port determines Dan's share of these charges in the following manner: The average annual amount actually paid by the Port for utilities in the prior year is divided by 12. Dan's space within the building is approximately ten percent of the total space in the building, so the averaged monthly charge is multiplied by .10 (Dan's pro rata share based upon the amount of space he leases), and that amount is added to Dan's monthly statement as a line item charge for utilities, separate from the lease payment. The charges for janitorial services are treated in the same manner. In this case, Dan's payment for utilities and janitorial services are not included in the measure of contract rent. His payments for security services are included in the measure of contract rent, and subject to

the leasehold excise tax, because they are not calculated and charged separately from the lease payments.

Special Programs gave the following reason for including the [Lessee's] utility payments in the measure of the LET (in “contract rent”): “These utility charges are based on amounts which do not reflect the actual utility costs incurred by the lessee. Since these payments are not based on actual costs, they are to be included in contract rent.”²

Taxpayer contends that it separately billed “actual” utility charges to the lessee, and therefore the utility fees it received were not subject to LET. Taxpayer cites an unpublished Department determination as controlling on this question.

Without considering or relying in any way upon the unpublished determination Taxpayer cites,³ we conclude that the utility fee revenues Taxpayer received from the [Lessee] qualified for exclusion from the measure of the LET, under WAC 458-29A-200(2).

WAC 458-29A-200(2) explains that payments to the lessor may be excluded if they are payments **for** actual utility charges. “Utility charges” means charges for services **by** public service businesses If a lessor can demonstrate that the separately-stated and billed utility charge is for actual utility charges by public service businesses to the lessor for utility service to the leased premises, and not for something else, the lessee’s payments to the lessor may be excluded. The rule provides an example of how a lessor who has a recent historical record of actual utility company charges may calculate an excludable monthly charge to the lessee. In the present case, Taxpayer has established that it received actual utility charges from two public service companies, and the monthly utility fee it charged its lessee was **for** those actual utility charges, and not for any other cost or charge. The method Taxpayer used to determine the charge is substantially the same as the method described in the rule’s example. Taxpayer’s situation differs from the example in that it has only one tenant and does not attempt to recover 100% of past average actual utility charges from its current lessee, but we do not see those differences as affecting the excludability of the lessee payments.

Special Programs apparently interprets WAC 458-29A-200(2) as requiring that the utility charges the lessor separately states and bills must be the exact amount the public service providers billed for the utility services, in order for any of the lessee’s utility payment to be excluded from the measure of the LET. That interpretation adds a requirement that is inconsistent with the example in the rule. In the example, the lessor sets the current utility charge to its lessees based on its recent past history of actual utility charges. The current charge to the lessees is unlikely to exactly correspond to the current actual utility charges by the public service companies, yet is fully excludable. We do not interpret WAC 458-29A-200(2) as limiting

² Auditor’s Detail of Differences and Instructions to Taxpayer” dated November 4, 2002.

³ Neither a taxpayer nor DOR can rely upon, nor can DOR comment upon, an unpublished determination in a tax dispute in which the current taxpayer was not a party. Such determinations have no precedential value. *Det. No. 99-298*, 20 WTD 197 (2001); *see also* RCW 82.32.410.

exclusion of lessee payments to situations where the lessee payments are in the exact amount of the public service company billings for the service.

A determination, Det. No. 00-196, 20 WTD 279 (2001), briefly addressed the issue of the excludability of utility charges to lessees, and analyzed excludability of such charges in terms of whether the lessor treated the charges as being derived from a separate business activity. That analysis was dictum, and we do not believe the approach is appropriate in the case of charges for utility service. WAC 458-29A-200(2) limits the utility charges that are excludable to charges for services provided by a public service business A lessor cannot treat its utility charges as derived from a separate business activity unless the lessor is such a public service company. A lessor that only maintains the utility systems inside its building would not fit the definition of a public service business. A lessor such as Taxpayer, that is not a public service business . . . , simply cannot be engaged in a separate business activity of providing utility services for purposes of WAC 458-29A-200(2).

In sum, the utility fee revenues Taxpayer received from the [Lessee] qualified for exclusion from the measure of the LET, under WAC 458-29A-200(2). They were payments for actual utility charges for services by public service businesses Accordingly, Taxpayer's petition for refund will be granted.

DECISION AND DISPOSITION

Taxpayer's petition for refund of LET paid on revenue from utility charges it collected from the [Lessee], and related audit interest paid, is granted. The file is remanded to the Special Programs Unit for adjustment and refund consistent with this determination.

Dated this 18th day of September, 2003.