WAC 458-20-XXX Sales and use tax deferral – conversion of underutilized commercial property into affordable housing.

(1) **Introduction.** Chapter 82.XX RCW establishes a limited sales and use tax deferral program. The purpose of the program is to encourage the conversion of underutilized commercial property to multifamily housing units in targeted urban areas to increase affordable housing.

(a) **Deferral program.** This deferral program allows the legislative authorities of cities under Chapter XX RCW to authorize a sales and use tax deferral for an investment project within the city if that legislative authority finds that there are significant areas of underutilized commercial property and a lack of affordable housing within that city.

(b) **Administration.** This rule provides guidance regarding how the department will determine whether and to what extent an applicant qualifies for a state and local sales and use tax deferral under chapters 82.08, 82.12, 82.14, and 82.104 RCW on each eligible investment project. The department may not accept applications for deferral after June 30, 2034.

(d) **Examples.** Examples found in this rule identify a number of facts and then state a conclusion. These examples should be used only as a general guide. The tax results of other situations must be determined after a review of all facts and circumstances.

(2) **Definitions.** For the purposes of this rule, the following definitions will apply.

(a) **"Affordable housing"** means:

(i) Homeownership housing intended for owner occupancy to low-income households whose monthly housing costs, including utilities other than telephone, do not exceed 30 percent of the household's monthly income;

(ii) **"Rental housing"** for low-income households whose monthly housing costs, including utilities other than telephone, do not exceed 30 percent of the household's monthly income.

(b) **"Applicant"** means an owner of commercial property.

(c) **"City"** means any city or town, including a code city.

(d) **"Conditional recipient"** means an owner of commercial property granted a conditional certificate of program approval under Chapter XX RCW, which includes any successor owner of the property.

(e)(i) **"Eligible investment project"** means an investment project that is located in a city and receiving a conditional certificate of program approval.

(ii) To qualify as an "eligible investment project" under this program, the property in question must be an "underutilized commercial property."

(f) **"Governing authority"** means the local legislative authority of a city having jurisdiction over the property for which a deferral may be granted under this chapter.

(g) **"Household"** means a single person, family, or unrelated persons living together.

(h)(i) **"Initiation of construction"** means the date that a building permit is issued under the building code adopted under RCW 19.27.031 for construction of the qualified building if the underlying ownership of the building vests exclusively with the person receiving the economic benefit of the deferral.

(ii) "Initiation of construction" does not include soil testing, site clearing and grading, site preparation, or any other related activities that are initiated before the issuance of a building permit for the construction of the foundation of the building.

(iii) If the investment project is a phased project, "initiation of construction" applies separately to each phase.

(i) **"Investment project"** means an investment in multifamily housing, including labor, services, and materials incorporated in the planning, installation, and construction of the project. "Investment project" includes investment in related facilities such as playgrounds and sidewalks as well as facilities used for business use for mixed-use development.

(j) **"Low-income household"** means a single person, family, or unrelated persons living together whose adjusted income is at or below 80 percent of the median family income adjusted for family size, for the county, city, or metropolitan statistical area, where the project is located, as reported by the United States department of housing and urban development.

(k) **"Multifamily housing"** means a building or a group of buildings having four or more dwelling units not designed or used as transient accommodations and not including hotels and motels. Multifamily units may result from rehabilitation or conversion of vacant, underutilized, or substandard buildings to multifamily housing.

(l) **"Owner"** means the property owner of record.

(m)(i) **"Underutilized commercial property"** means an entire property, or portion thereof, currently used or intended to be used by a business for retailing or office-related or administrative activities. If the property is used partly for a qualifying use and partly for other purposes, the applicable tax deferral must be determined by apportionment of the costs of construction under this rule.

(ii) Areas of the property that are outside of the building or structure defined as an "underutilized commercial property" may qualify only if they are used for retailing, office-related, or administrative activities.

(iii) The department presumes that vacant land does not qualify. However, the department will consider evidence from a conditional recipient regarding their intent to use the property for a qualifying use. This evidence must demonstrate some material action to begin construction of space to be used for retailing, office-related, or administrative activities.

(3) **What types of property may be classified as "underutilized commercial property" eligible for the sales and use tax deferral program?**

(a) An "underutilized commercial property" must currently be used for or "intended to be used" for one or more of the following "qualifying uses": retailing activities, office-related activities, or administrative activities.

(i) "Retailing activities" means the selling, leasing, or renting of products to the ultimate customer consumption. "Retailing" for the purposes of this rule is not limited to the activities that are taxable under RCW 82.04.250 and RCW 82.08.020.

(ii) "Office-related activities" means the supplying of a service or a space that is used by professional, clerical, or administrative staff to conduct business. Such activities may include the building space used for meeting rooms, copy rooms, reception areas, office libraries, storage rooms, or call centers.

(iii) "Administrative activities" means the managing or operating of a business. Such activities may include use of the space for human resource activities, accounting, legal, sales and marketing, or executive management activities.

(b)(i) "Intended to be used" means that the property is expected to be used for "qualifying uses," i.e., retailing, office-related and administrative activities, at the time of application to the city for conditional approval. For an applicant to establish that a property is intended to be used for a "qualifying use," the applicant must include adequate substantiation with their application to the department that shows this intent. Adequate substantiation may include, but is not necessarily limited to, the following: marketing materials, leasing agreements, sales agreements, promotional materials, or similar documents showing the intended use of the property is for a "qualifying use."

(ii) For property with existing structures and property already under commercial development, the department will review the substantiation provided to determine that it adequately shows the property’s intent and will generally consider this element to be met unless there is clear, objective evidence that the intended use changed or that the applicant misrepresented the intended use.

(iii) Property previously used for nonqualifying activities will generally not qualify. However, the department will consider evidence from a conditional recipient that their intent has since been to use the property for a qualifying use. This evidence must demonstrate some material action to improve or change property use to the new intended qualifying use and that there is no nonqualifying use.

Example 1: Underutilized commercial property currently used for retailing, office-related, or administrative activities.

Facts: Applicant currently leases commercial property to a tenant that uses the entire property for their daycare center business. The property has several play areas and learning rooms for the children, but there is a section of the property that contains a break area for the teachers and an office area for the support staff. The applicant’s lease with the tenant establishes that the property will be used for this purpose.

Result: Applicant’s property qualifies as underutilized commercial property as the applicant has provided adequate substantiation that the entire property is being used for a “qualifying use.” Daycare activities qualify as “retailing activities” as it involves the sale of services to an ultimate consumer. The tenant uses the remaining areas of the property to conduct or manage their daycare business, so these other areas also qualify as the space is being used for "office-related" or "administrative" activities.

Example 2: Underutilized commercial property intended to be used for office-related activities.

Facts: Applicant's commercial property is currently vacant but has previously leased the entire property to other businesses for use as office space. Applicant's marketing materials for the property promote the property as containing numerous offices, meeting areas, storage rooms, and a call center.

Result: Applicant's property qualifies as underutilized commercial property as the applicant has provided adequate substantiation that the entire property is intended to be used for "office-related activities."

Example 3: Underutilized commercial property under construction to be used for office-related activities and administrative activities.

Facts: Applicant is in the process of constructing a commercial property. While construction is not complete, original blueprints and marketing materials used for promotion purposes demonstrate that the property is entirely comprised of meeting rooms, space for cubicles and offices, a mail room, and a reception area.

Result: Applicant's property qualifies as underutilized commercial property as the applicant has provided adequate substantiation that the entire property is intended to be used for "office-related activities" and "administrative activities."

Example 4: Vacant land marketed as being usable for retailing activities.

Facts: Applicant owns a vacant lot and plans to sell the entire property to a developer. The marketing and promotional materials for the vacant lot provide that the site may be used for retailing, office-related, or administrative activities.

Result: Applicant's property does not qualify as underutilized commercial property because it is a vacant lot. The marketing and promotional materials do not adequately substantiate the intent that the property will be used for one of the enumerated "qualifying uses."

(4) **Application to the department is required.** After receiving a conditional certificate from the local jurisdiction, but before the initiation of the construction of the investment project, recipients of a conditional certificate must submit an initial application to the department.

(a) **How does a conditional recipient obtain an application?** Application forms may be obtained from the department's website at dor.wa.gov, or by contacting the department at 360-534-1443. Applications approved by the department under chapter 82.XX RCW are not confidential and are subject to disclosure.

(b) **What information does an application to the department need to include?** Applicants must include the following information and materials with their application to the department:

(i) A copy of the conditional certificate of approval issued by the local jurisdiction,

(ii) Estimated construction costs (both qualifying and non-qualifying),

(iii) Time schedules for completion and operation,

(iv) Estimate of the square footage of the investment property that is currently used or intended to be used for a "qualifying use" prior to conversion to multifamily housing,

(v) Estimated or actual square footage of the investment property,

(vi) Waiver of the 4-year limitation under RCW 82.32.100 by the conditional recipient, and

(vii) Any additional information that is needed for the department's review.

(c) **What if the project involves multiple qualified buildings?** For an investment project that involves multiple buildings, a conditional recipient must submit a separate application before the initiation of construction for each building.

(d) **When will a conditional recipient receive a response from the department?** If the application is complete, the department has 60 days to approve or deny the submitted application.

(e) **What happens if the conditional recipient's application is approved?** If approved, the department will issue a tax deferral certificate and notify the conditional recipient of the types of documentation that the conditional recipient must retain to substantiate the amount of sales and use tax actually deferred.

(f) **What happens if the conditional recipient's application is denied?** If denied, a conditional recipient may seek review of the department’s denial of their tax deferral application through the department’s informal administrative review process within 30 days from the date of the denial notice. See WAC 458-20-100.

(5) **What happens after the department approves the conditional recipient’s application?** The department will issue a sales and use tax deferral certificate for state and local sales and use taxes due under chapters 82.08, 82.12, 82.14, and 82.104 RCW for each eligible investment project. The department will state on the certificate the estimated amount of qualifying taxable purchases the conditional recipient is eligible to receive.

(6) **How should a tax deferral certificate be used?** A tax deferral certificate issued under this program is only valid during active construction of a qualified investment project and expires the day the local jurisdiction issues a certificate of occupancy for the investment project for which a deferral certificate was issued. Conditional recipient may only use the deferral certificate to defer sales and use taxes due on eligible investment projects.

(7) **When is apportionment of underutilized commercial properties appropriate?** A deferral of sales or use tax under this program is only allowable for underutilized commercial properties that are currently used or are intended to be used for a “qualifying use.” If a portion of the investment property is not used, or intended to be used, for retailing, office-related, or administrative activities, that portion does not qualify for tax deferral treatment and the underutilized commercial property must be apportioned accordingly.

(a) **How does the department apportion qualifying and non-qualifying underutilized commercial property?** The apportionment method used depends on the status of the eligible investment project.

(i) **Deferral estimate:** The department will first use the estimated figures in the conditional recipient's application to the department to provide a preliminary estimate of the amount of sales and use tax that may be deferred. The department will use the ratio of the square footage of the portion of the building that the applicant reports is used for a "qualifying use" in the following apportionment formula:

Step 1. Calculate percentage of building that may be eligible.

$$\frac{\text{Square feet of investment property with qualifying use}}{\text{Total square feet of investment property}} = \text{Percent of investment property eligible for deferral}$$

Step 2. Calculate the estimated costs eligible for deferral.

$$\begin{array}{rr} & \text{Percent of investment property eligible for deferral} \\ \times & \text{Estimated total costs} \\ \hline & \text{Estimated eligible costs} \end{array}$$

Step 3. Estimate the amount eligible for deferral.

$$\begin{array}{rr} & \text{Estimated eligible costs} \\ \times & \text{Tax Rate} \\ \hline & \text{Estimated amount eligible for deferral} \end{array}$$

(ii) **Final deferred tax amount:** The department will calculate the final deferred tax amount using the conditional recipient's actual construction costs for eligible purposes (multifamily housing) in the investment project. The department will determine the actual costs eligible for deferral by touring the operationally complete investment project and auditing the conditional recipient’s records. The final deferral figure will supersede the department’s preliminary deferral estimate.

Example 5: Apportionment of qualifying and nonqualifying activities.

Facts: Applicant receives a conditional certificate of program approval for a church. The church space also includes an area where staff conduct various tasks such as accounting, organizing community events, and other administrative activities. Of the total 5,000 square feet of space, the area where the administrative activities occur is 1,000 square feet. Applicant estimates that project will cost about $1,000,000 and the combined sales/use tax rate at this location is 9%.

Result: The 1,000 square feet of space used for office-related and administrative activities are used for a “qualifying use,” but the remaining 4,000 square feet are not because space used for religious services is not used for retailing, office-related, or administrative activities. In approving the application, the department will estimate the amount of sales and use tax that may be deferred as follows:

Step 1. Calculate percentage of building that may be eligible.

$$\frac{\text{1,000 sq ft of investment property with qualifying use}}{\text{5,000 total sq ft of investment property}} = \text{20\% of investment property is eligible for deferral}$$

Step 2. Calculate the estimated costs eligible for deferral.

.20 (Qualifying percentage of investment property)
X $1,000,000 (Estimated total cost)

$200,000 (Estimated eligible costs)

Step 3. Estimate the amount of tax eligible for deferral.

$200,000 (Estimated eligible costs)

X .09 (Tax rate of investment property location)

$18,000 (Estimated tax eligible for deferral)

Therefore, the applicant may be eligible to receive up to $200,000 in qualifying purchases.

Example 6: Apportionment of adjacent property.

Facts: Applicant applies for a conditional certificate of program approval for an existing building that includes an associated parking lot located on an adjacent parcel. The existing building is a commercial building that is currently being used as a grocery store. Applicant plans to convert the existing store into multifamily housing units and build new multifamily housing units on the adjacent parking lot. Applicant reaches out to the department to clarify how the project will be apportioned.

Result: [TBD – POINT OF DISCUSSION IN PUBLIC MTG]

(b) **When will the department certify the final amount of sales and use taxes that qualify for deferral?** Within 30 days after the local jurisdiction issues the conditional recipient with a certificate of occupancy for the eligible investment project, the conditional recipient must notify the department that the eligible investment project is operationally complete. Upon receiving such notification, the department will certify the project and determine the final amount of sales and use taxes that qualify for deferral. As a part of the certification process, the department will independently verify the areas of the property that qualify for deferral and qualifying purchases.

(c) **What happens if the department determines that purchases are not eligible for deferral?** The conditional recipient is required to pay the sales and use tax on purchases made for the project and the department is required to assess interest, but not penalties, on nonqualifying amounts. Conditional recipients who are denied the tax deferral may pursue informal administrative review of the department's decision as provided in WAC 458-20-100.

(7) **What types of projects are eligible for deferral?**

(a) **Are mixed-use projects eligible for deferral?** Yes. Local jurisdictions may approve certain mixed-use projects (i.e., projects that have both a commercial and residential component). However, these projects may only have the commercial activity on the ground floor of the building and the remainder of the building must be used for multifamily housing units. "Ground floor" means the building floor that is level with the street. **[POINT OF DISCUSSION IN PUBLIC MTG]**

Example 6: Related facilities in mixed-use development projects.

Facts: Applicant applies for a conditional certificate of program approval for an existing mixed-use building. The ground floor of the building currently has several shops and a daycare facility while the remainder of the building is used entirely for office-related activities. The day care facility has a fenced outdoor playground for the children, which the applicant plans to renovate as a part of the conversion project. Applicant reaches out to the department to clarify whether purchases for the outdoor playground may qualify for deferral.

Result: Assuming that this investment property is otherwise qualifying, purchases for the outdoor playground qualify for tax deferral. This is because the term "investment project" also includes investment in related facilities. In this case, the outdoor playground would be related to the daycare facility located within the building and any renovation costs for the outdoor playground would be deferrable.

(b) **Are additions eligible for deferral?** The eligibility of an addition will depend on the facts and circumstances at issue, but the existing investment project for which an addition is being considered must qualify for the deferral. If an applicant is unsure whether their project qualifies for the deferral, they may contact the department at 360-534-1443, or email DORdeferrals@dor.wa.gov.

Example 7: Addition to previously renovated commercial building.

Facts: Applicant applies for a conditional certificate of program approval for a renovated commercial building that previously qualified for tax deferral under this program. The building, previously used for office-related activities, is now fully comprised of several multifamily housing units. However, the applicant would like to expand the current building to add additional units. Applicant reaches out to the department to clarify whether purchases for an addition to this property may qualify for deferral.

Results: Purchases for an addition to this property do not qualify for deferral. This is because the property is no longer used or intended to be used for a "qualifying use" as it has been fully converted to multifamily housing units. As such, this building no longer can qualify as an underutilized commercial property for the purposes of tax deferral under this program.

(c) **Are existing buildings that are demolished to build new multifamily housing eligible for deferral? [TBD – POINT OF DISCUSSION IN PUBLIC MTG]**

(8) **What are the processes for an investment project?** An applicant must provide the department with the estimated cost of the investment project at the time the application is made. Following approval of the application and issuance of a tax deferral certificate, a certificate holder must notify the department, in writing, when the value of the investment project reaches the estimated cost as stated on the tax deferral certificate.

(a) **What should a certificate holder do if its investment project reaches the estimated costs but the project is not yet operationally complete?** If an investment project has reached its estimated costs and the project is not operationally complete, the certificate holder may request an amended certificate stating a revised amount on which the deferral taxes are requested along with an explanation for the increase in estimated costs. Requests must be mailed or emailed to the department at DORdeferrals@dor.wa.gov.

(b) **What should a certificate holder do if its investment project reaches the completion date but the project is not yet operationally complete?** If an investment project has reached the completion date and the project is not operationally complete, the certificate holder may request from the city an amended certificate stating a revised completion date along with an explanation for the new completion date.

City approved extensions must be mailed or emailed to the department prior to the expiration date on the deferral certificate.

(c) **What should a certificate holder do when its investment project is operationally complete?** Within 30 days after the local jurisdiction issues the conditional recipient with a certificate of occupancy for the eligible investment project, the conditional recipient must notify the department in writing that the eligible investment project is operationally complete. The project is operationally complete once it can be used for its intended purpose as described in the application. The department will certify the qualifying areas and costs and the date when the project became operationally complete. It is important to remember that annual tax performance report reporting requirements begin the year following the operationally complete date, even though the audit certification may not be complete.

(9) **Is a recipient of a tax deferral required to submit annual tax performance report?** RCW 82.32.534 requires each recipient of a tax deferral to complete an annual tax performance report by May 31st following the year in which the project is operationally complete, and each year thereafter for 10 years, regardless of whether the department has audited the project. For more information on the requirements to file annual tax performance reports refer to WAC 458-20-267.

(10) **What happens if the conditional recipient is no longer in compliance with the requirements of this program?** If the conditional recipient is no longer in compliance with program requirements after

the department has issued a sales and use tax deferral certificate and the conditional recipient has received a certificate of occupancy, all deferred sales and use taxes are immediately due and payable. Interest will be assessed retroactively to the date of deferral.

(11) **How long does a conditional recipient need to stay in compliance to not pay back deferred taxes?** The conditional recipient of a deferral of taxes under this chapter must file a complete annual tax performance report (ATPR) with the department pursuant to RCW 82.32.534 beginning the year the certificate of occupancy is issued and each tax year thereafter for 10 years. The ATPR is due May 31 the year after the tax year the incentive was taken. For example, if the certificate of occupancy is issued July 31, 2024, then the first ATPR is due May 31, 2025. The reports need to be submitted for tax years 2024-2034.

(12) **Is debt extinguishable because of insolvency or sale?** Insolvency or other failure of the conditional recipient does not extinguish the debt for deferred taxes nor will the sale, exchange, or other disposition of the conditional recipient's business extinguish the debt for the deferred taxes.

(13) **Does transfer of ownership terminate tax deferral?** Transfer of ownership does not terminate the deferral. The deferral is transferred, subject to the successor meeting the eligibility requirements of chapter 82.XX RCW. The transferor of an eligible property must notify the department of the transfer and must provide all information necessary for the department to transfer the deferral. If the transferor fails to notify the department, then all deferred

sales and use taxes are immediately due and payable with interest, which will be calculated retroactively back to the date of the deferral. Any person who becomes a successor to such investment project is liable for the full amount of any unpaid, deferred taxes under the same terms and conditions as the original recipient of the deferral. For additional information on successorship or quitting business refer to WAC 458-20-216.

(14) **Can a conditional applicant also apply for other tax exemptions for multifamily housing?** Yes. The owner of an underutilized commercial property may also apply for the multiple-unit housing property tax exemption program under chapter 84.14 RCW. Applicants who are receiving a property tax exemption under chanter 84.14 RCW should note that the amount of affordable housing units required for eligibility under this program is in addition to the affordability conditions in chapter 84.14 RCW.