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Cite as Det. No. 22-0133, Annual WTD Page (Year)

BEFORE THE ADMINISTRATIVE REVIEW AND HEARINGS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition for Correction of Assessment of . . .	))))))	D E T E R M I N A T I O N No. 22-0133 Registration No. . . .

[1] WAC 458-20-118; RCW 82.04.290; RCW 82.04.390: SERVICE B&O TAX – EXEMPTION FOR AMOUNTS DERIVED FROM REAL ESTATE – LEASE VERSUS MERE LICENSE TO USE REAL ESTATE – EXCLUSIVE USE – COMPUTER DATA CENTER – COLOCATION. A data center's contract that provided exclusive use of specified areas in the facility constituted a lease of real estate, the income from which was not subject to B&O tax. The data center's contract that granted non-exclusive use of certain colocation space was a mere license to use, the income from which was subject to B&O tax.

[2] WAC 458-20-19402; RCW 82.04.460, RCW 82.04.462: SERVICE B&O TAX – MERE LICENSE TO USE REAL ESTATE – ATTRIBUTION OF APPORTIONABLE INCOME – LOCATION WHERE BENEFIT RECEIVED. Income derived from the mere licensing of real property located in Washington State should be attributed to the location of the property because that is where the benefit of the service is received.

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.

LaMarche, T.R.O. – A data center owner disputes the assessment of business and occupation tax (B&O) on gross income it received from its provision of data center space to certain customers, arguing that the income is derived from the rental of real property and is therefore exempt from B&O tax. We grant the petition in part and deny it in part, and remand the matter to the audit division for adjustments.[1]

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

ISSUES

1. Under RCW 82.04.290(2)(b), RCW 82.04.390, and WAC 458-20-118, does the taxpayer's provision of space in its data center to its customers constitute a mere license to use real property, subject to service and other activities B&O tax, or the rental or lease of real property, which is exempt from B&O tax?

2. Under RCW 82.04.460, RCW 82.04.462, and WAC 458-20-19402, if the income is taxable under the service and other activities B&O tax classification, how should it be attributed?

FINDINGS OF FACT

. . . (Taxpayer) is an out-of-state company that owns a data center in Washington (Data Center) and derives income from providing space within the Data Center to its customers. Customers bring in their own equipment and Taxpayer charges certain fees, which we will discuss in more detail below. Most customers contract for the use of spaces located in certain rooms within a single floor of the Data Center, while one customer contracts for the use of large parts of two complete floors. At issue here is whether Taxpayer is renting real estate to its customers, which is exempt from B&O tax, or is only licensing use of its facility, which is subject to B&O tax.

The Department of Revenue's Audit Division (Audit) audited Taxpayer's business activities for the period of January 1, 2015, through March 31, 2019. Audit found that Taxpayer had not reported on its excise tax returns the income it earned from providing space to its customers in the Data Center. Taxpayer claimed that the income was from the rental or lease of real property and was therefore exempt from B&O tax. Audit reviewed contracts provided by Taxpayer and concluded they constituted mere licenses to use real property, rather than rentals of real estate. On that basis, Audit treated the income from those and substantially similar contracts as being subject to service and other activities B&O tax.

The Department issued a Notice of Balance Due, . . . , on May 13, 2021, totaling $. . . .[2] The assessment consisted of $. . . in service and other activities B&O tax; $. . . in retail sales tax; $. . . in retailing B&O tax; $. . . in penalties; and $. . . in interest. Taxpayer did not pay the assessment but timely filed a petition for review.

During the audit, Taxpayer provided copies of contracts that Audit used as the basis for the assessment. We have chosen two contracts as being representative of Taxpayer's activities because they have language substantially similar to contracts Taxpayer has with its other data center customers. The first agreement is made between Taxpayer and . . . (Customer A), and the second is made between Taxpayer and . . . (Customer B). Because the Customer A Contract is some 28 pages and the Customer B Contract is 109 pages, we cannot reproduce them in full here, but will address those provisions most relevant to our discussion.

Customer A Contract

[2] All figures are rounded unless otherwise noted. Total in Notice of Balance Due is . . . less than assessed amounts as shown in audit workpapers due to rounding in audit.

Taxpayer and Customer A entered into a contract on March 28, 2017, with monthly payments over an initial 36-month term (Customer A Contract) and automatic one-year annual renewals. The contract refers to the arrangement as a "License Agreement," and the parties as "Licensor" and "Licensee." We will use these latter terms for the purposes of this facts section, with the understanding that they are not intended to be conclusory with regard to whether the agreement is a mere license to use real property, or a lease or rental of real property. That determination will be made in our later legal analysis and discussion.

Under Section 2 of the Customer A Contract, Taxpayer grants a license to Customer A to use the licensed premises to install, maintain, operate, replace, and remove Customer A's telecommunication equipment within the licensed premises. "Licensed Premises" is comprised of three elements: (1) the "Equipment Space;" (2) the conduit Taxpayer provides from the property line to the data center; and (3) the conduit Taxpayer installs in the building from the exterior to the Equipment Space. *See* Customer A Contract, Section 1(k), at 2. "Equipment Space" is defined to mean the colocation[3] space located in either of the building's two meet-me rooms (Meet-Me rooms).[4] Customer A Contract, Section 1(g), at 1.

The Customer A Contract also grants a "non-exclusive license to provide Telecommunications services to Tenants of the Building and to such parties desiring to connect to any such Tenant." Customer A Contract, Section 2, at 3 (emphasis added). Customer A Contract, Exhibit A, more particularly describes the Equipment Space as two racks[5] in a Meet-Me room and two power circuits, which Taxpayer agrees to install.

The contract specifies: "Licensee acknowledges that it will share the Meet-Me-Rooms with other telecommunications services providers on a non-exclusive basis." Customer A Contract, Section 1(g), at 1 (emphasis added).

Customer A Contract, Section 1(g), describes Taxpayer's services, which include providing use of the rack space, power, and cross-connections between the customer and other occupants of the

[3] "Colocation" services generally consist of the provision of space in data center facilities for the purpose of providing power, cooling, and physical security for the server, storage, and networking equipment of customers. *See* definition of "colocation" provided in TechTarget, Essential Guide, *Building a disaster recovery architecture with cloud and colocation*, Don Brancato and Davis S. Jones, posted by Margaret Rouse, August 2015, https://whatis.techtarget.com/definition/colocation-colo (last accessed May 9, 2022).

[4] A meet-me room or MMR is described as:

> [A] secure place where customers can connect to one or more carriers. This area enables cable companies, ISPs, and other providers to cross-connect with tenants in the data center. An MMR contains cabinets and racks with carriers' hardware that allows quick and reliable data transfer. MMRs physically connect hundreds of different companies and ISPs located in the same facility. This peering process is what makes the internet exchange possible.

Phoenixnap, *What is a Meet-Me Room? Why They are Critical in a Data Center*, June 5, 2019, Goran Jevtic, https://phoenixnap.com/blog/what-is-a-meet-me-room (last accessed May 9, 2022).

[5] Data center racks are described as "a type of framework that is usually made from steel and houses your servers, cables, and other equipment. Your servers can fit neatly into the framework, helping to keep them organized and off the floor." TRG Datacenters, *What is a data center rack?*, August 20, 2021, https://www.trgdatacenters.com/what-is-a-data-center-rack/#:~:text=A%20data%20center%20rack%20is,Airflow (last accessed May 9, 2022).

Data Center. Taxpayer selects and installs the racks, and retains title to all installed racks. *See* Customer A Contract, Exhibit D. Taxpayer also agrees to keep the facility within certain temperature and humidity ranges, with certain penalties imposed on Taxpayer if Taxpayer fails to maintain these parameters, or if Taxpayer otherwise causes certain disruptions. *See* Customer A Contract Section 1(m) and Exhibit E.

Section 13 addresses building security and indicates that Taxpayer requires that the building and Meet-Me rooms are locked at all times and are not open to the general public. Taxpayer provides security in the form of limited access to the building and the Meet-Me rooms.

Section 4 addresses permitted uses and states that Taxpayer "may, at . . . [Taxpayer's] discretion authorize others, including without limitation, Tenants and other licensees of the Building to use portions of the Meet-Me Rooms and other common areas of the Building . . . ." Customer A Contract A, Section 4(a), at 5 (emphasis added).

Section 5 and Exhibit D indicate that Customer A pays monthly charges for the use of electricity based on amperage used in addition to the monthly charge for use of the Meet-Me room, and there is no indication in the contract that Customer A pays for other types of utilities or building operation and maintenance costs.

Section 7 indicates that Customer A must install the conduits from the property line of the Data Center using a professional engineering firm or consultant approved by Taxpayer, and Taxpayer has the right to monitor all of Customer A's installation, operation, and maintenance of its telecommunications equipment within its Licensed Premises.

Section 16 of the contract indicates that Taxpayer has the right to relocate Customer A's telecommunications equipment to other areas of the building at Taxpayer's own discretion, with a minimum of 180 days prior notice.

Section 18 indicates that unauthorized persons working under or through Customer A with "insufficient expertise or experience" are not allowed to enter the property, Data Center, the Meet-Me rooms, or the Equipment Space, or to maintain or operate its telecommunications equipment. Customer A Contract, Section 18, at 10.

Section 19 gives Taxpayer the right to enter immediately during any emergency, or at all other times with a 10-day notice.

Customer B Contract

Taxpayer and Customer B entered into a contract on April 30, 2015, for use of designated space at the Data Center (Customer B Contract). The parties are named "Landlord" and "Tenant" in the contract, which is entitled "Lease Agreement." We will use these terms for purposes of this facts section, with the understanding that they are not intended to be conclusory with regard to whether the agreement is a lease or rental of real property, or a mere license to use real property. That determination will be made in our later legal analysis and discussion.

Taxpayer indicates that approximately 90% of its revenue comes from Customer B.[6] The Customer B Contract indicates that Customer B is leasing certain designated premises (" [Leased] Premises") and designated electrical conduits for a term of 15 years, with the option of renewing for as long as three additional consecutive 60-month extensions, for a total of 30 years. The [Leased] Premises include two suites . . . on the first floor of the Data Center and . . . on the second floor. The specified area in the contract is set forth in floor plans attached to the contract as Exhibit B-1.

For no additional charge, Customer B has use of common areas, including Meet-Me rooms in the Data Center, which, for purposes of calculating Customer B's share of utility and other building costs, amounts to approximately 3,000 square feet.

Section 2.4 states that Customer B may use up to two full-size dedicated racks in the Meet-Me rooms at no cost to Customer B. Unlike the Customer A Contract, where Customer A pays for Meet-Me rack space, Customer B does not pay for the space, so the primary purpose of the Customer B Contract [seemingly] is not to simply obtain the use of rack space in a Meet-Me room.

Under Section 2.5, entitled "Covenant of Quiet Enjoyment," the agreement states that Taxpayer covenants to Customer B the "right to quiet enjoyment," and that Taxpayer or any other person claiming superior title "shall not disturb Customer B's possession of the Premises or use of the Designated Conduits during the term of the lease." Customer B Contract, Section 2.5, at 8 (emphasis added).

Section 5.1 states that Customer B's permitted use is for computer data center purposes only, including installing, replacing, operating, maintaining and using computer, switch, transmission, and communication equipment, and connecting to other occupants.

Section 5.3 addresses Meet-Me rooms. Unlike its [Leased] Premises, Customer B does not have exclusive rights to use the Meet-Me rooms Taxpayer provides at no charge, and all connections or other facilities of Customer B within the Meet-Me rooms are governed and controlled by Taxpayer, subject to the terms of the contract.

Sections 6.3 and 6.4 provide that Customer B must pay for all electricity it consumes in the [Leased] Premises and pay a share of the operating costs of the Data Center, which include all costs paid for or incurred by Taxpayer in connection with the maintenance, operation, management, or repair of the Data Center building or its related facilities. Customer B has the right to audit Taxpayer's books and records related to operating costs.

Section 7.2 indicates that Taxpayer must operate a security desk at the Data Center's main entrance with at least one staff member per shift on duty 24 hours per day, seven days per week. Taxpayer is required to install and operate a key card system to control access to the Data Center, and upon request install and maintain control card readers and biometric scanners on all access points into Customer B's [Leased] Premises. Taxpayer also agrees to provide security lighting, and monitor and record closed circuit television (CCTV). The contract also allows Customer B the right to

[6] Taxpayer has a separate contract with Customer B for use of the third floor, and it is not clear whether this income is included in the 90% figure.

install additional CCTV devices in its [Leased] Premises. Taxpayer "reserves the right, . . . , to install and implement additional measures to control access and provide security" for the Data Center as Taxpayer "deems necessary in its unfettered, sole, and absolute discretion," so long as it does not interfere with Customer B's business in, or access to, the [Leased] Premises. Customer B Contract, Section 7.2.3(4), at 14.

Under Section 7.2., all tenants of the building, including Customer B, must provide a master list to Taxpayer of employees, contractors, and customers' representatives who work at the Data Center, and an access badge is provided to each individual on Taxpayer's master list. Entry is limited to those individuals, except those escorted by a person on the list with escorting authority. Landlord must provide locks on the doors into the [Leased] Premises, and Customer B is allowed to place any additional locks on doors into or within the [Leased] Premises with prior consent from Taxpayer.

Under Section 8.2, Customer B is responsible for maintaining the [Leased] Premises in good repair, regularly removing trash, and maintaining, repairing, and replacing all parts and components that exclusively serve the [Leased] Premises. Taxpayer may provide these services and bill Customer B. Section 8.2, and Exhibit L. Section 8.4 grants Customer B the right to audit and review Taxpayer's performance of the tasks and agreed services in Section 8.1 and 8.2.

Under Section 13.2, Customer B has the right to sublease its [Leased] Premises or assign the lease to affiliates of Customer B. Customer B and its customers, licensees, or colocators, also have the right to install certain equipment owned or leased by Customer B or its permitted licensees in Customer B's racks in the building and Meet-Me rooms, and in parts of the rooftop area Customer B is allowed to use, in order to interconnect between the parties.

Customer B Contract, Exhibit I, lists 29 "common-sense" rules and regulations. Among these, Customer B and its related parties may not possess or use weapons of any kind, may not keep animals or lodge in the facility, and may not smoke within the building or within 50 feet outside of the building. Customer B cannot solicit business, distribute food, or install blinds, curtains or other window coverings without the approval of Taxpayer.

Audit made a field visit to the Data Center during the audit, and the auditor observed that the servers for customers like Customer A were kept on racks in colocation cages.[7] Although the cages themselves could be locked, the areas where they were kept were Meet-Me rooms, which all licensees shared. The auditor said Taxpayer told her security personnel walked through the facility from time to time, and that all of Taxpayer's customers were required to keep lights on all the time for security purposes.

[7] A "colocation cage," is generally a server space located within a data center or similar facility that is surrounded by mesh walls, which is accessed through a locking door. *See* Newark Wire Works, Inc., *Data Center Cages / Colocation Cages,* https://newarkwireworks.com/products/colocation-cages/ (last accessed May 12, 2022).

ANALYSIS

1. Rental or lease of real property vs. mere license to use real property

In Washington, "there is levied and collected from every person that has a substantial nexus with this state a tax for the act or privilege of engaging in business activities." RCW 84.04.220(1). The B&O tax measure is "the application of rates against value of products, gross proceeds of sales, or gross income of the business, as the case may be." *Id.*

By enacting Washington's B&O tax system, the legislature intended to impose the B&O tax on virtually all business activities carried on within the state. *Time Oil Co. v. State,* 79 Wn.2d 143, 146, 483 P.2d 628 (1971). Further, the B&O tax system was meant to "leave practically no business and commerce free of . . . tax." *Budget Rent-A-Car of Washington-Oregon Inc. v. Dep't of Revenue,* 81 Wn.2d 171, 175, 500 P.2d 764 (1972).

Income from any business activity that is not expressly classified in chapter 82.04 RCW is taxed under the service and other activities B&O tax classification. RCW 82.04.290(2). RCW 82.04.290(2)(a) is a "catch all" provision that imposes a certain B&O tax rate "upon every person engaging within this state in any business activity other than or in addition to an activity taxed explicitly under another section in . . . [chapter 82.04 RCW]."

RCW 82.04.390 exempts from B&O tax amounts derived from the sale of real estate. WAC 458-20-118 (Rule 118) implements this exemption, stating that amounts "derived from" the lease or rental of real estate are exempt from B&O tax. Rule 118(2).[8]

Rule 118(1) goes on to state:

> However, there is no exemption of amounts derived from engaging in any business wherein a mere license to use or enjoy real property is granted. Amounts derived from the granting of a license to use real property are taxable under the service B&O tax classification unless otherwise taxed under another classification by specific statute . . . .

Thus, if the income Taxpayer receives from its provision of Data Center space to its customers is from the mere license to use real property and not from the rental or lease of real property, the income is subject to service and other activities B&O tax. RCW 82.04.390; RCW 82.04.290(2); Rule 118.

Rule 118 distinguishes between a lease or rental of real estate and a license to use real estate, and provides in pertinent part:

> **Lease or rental of real estate.** A lease or rental of real property conveys an estate or interest in a certain designated area of real property with an exclusive right in

[8] "The taxpayer bears the burden of proving its receipts are from the exempt rental of real estate, rather than from a service B&O taxable license . . . ." Det. No. 04-0023E, 23 WTD 206, 210 (2004). "Exemptions to a tax law must be narrowly construed." *Budget Rent-A-Car, Inc,* 81 Wn.2d 171, 174-75. "Taxation is the rule and exemption is the exception." *Id.* at 174 (citations omitted).

> the lessee of continuous possession against the world, including the owner, and grants to the lessee the absolute right of control and occupancy during the term of the lease or rental agreement. An agreement will not be construed as a lease of real estate unless a relationship of "landlord and tenant" is created thereby. . . .

Rule 118(2) (emphasis in original).[9]

In contrast to a lease or rental of real estate, Rule 118(3) defines a license to use real estate as one that:

> [G]rants merely a right to use the real property of another but does not confer exclusive control or dominion over the same. Usually, where the grant conveys only a license to use, the owner controls such things as lighting, heating, cleaning, repairing, and opening and closing the premises.

Washington courts have recognized that exclusivity is a central element in differentiating between a lease or rental of real estate and a mere license to use real estate. *See Barnett v. Lincoln*, 162 Wash. 613, 618, 299 P. 392 (1931) ("A lease is a contract for the exclusive possession of lands or tenements for some certain number of years or other determinate period, and a contract for such exclusive possession is a lease although there may be certain reservations or a restriction of the purpose for which the possession may be used, and although it may be described as a license."); *McKennon v. Anderson*, 49 Wn.2d 55, 57-59, 298 P.2d 492 (1956) (exclusive possession of part of a barn); *Lamken v. Miller*, 181 Wash. 544, 44 P.2d 190 (1935) (contract covering food and sundry stands at racetrack created a lease); *City of Bellevue v. Jacke*, 96 Wn. App. 209, 212-13, 978 P.2d 1116 (1999) (sole tenant has exclusive right of possession of leased premises for duration of the leasehold); *City of Tacoma v. Smith*, 50 Wn. App. 717, 721-23, 750 P.2d 647 (1988) (rental of reassignable boat slips constituted leases, not mere licenses to use). *See also*, *Regan v. City of Seattle*, 76 Wn.2d 501, 504, 458 P.2d 12 (1969) ("The critical question in determining the existence of . . . [a landlord-tenant] relationship is whether exclusive control of the premises has passed to the tenant.") and *Conway v. Time Oil Co*. 34 Wn.2d 884, 210 P.2d 1012 (1949) (written paint and facilities agreement related to a service station constituted a license agreement, not a lease).

Thus, the question of whether an agreement contemplates a mere license to use real estate, as opposed to a lease or rental of real estate, generally turns on the level of exclusive possession and control the grantee has under the agreement. *See* Det. No. 92-297, 12 WTD 461 (1992) (Whether the legal relationship between two parties is a landlord-tenant or a licensor-licensee relationship is determined by the definitions of those terms in the statute and rule, and by the weight of the evidence.)

Customer A Contract

[9] We have previously addressed the landlord–tenant relationship. As we note in Det. No. 06-0122, 26 WTD 69 (2007):

> The lease of real estate involves the creation of a landlord–tenant relationship. Rule 118(2). "The essence of the [landlord–tenant] relationship is that one person who has an estate in land gives another person permissive possession of the land at will or for a period of time . . . ." 17 Wash. Pract., *Real Estate: Property Law* § 6.2.

Here, Customer A was explicitly granted a "non-exclusive license to provide Telecommunications services to Tenants of the Building and to such parties desiring to connect to any such Tenant." Customer A Contract, Section 2, at 3 (emphasis added). The contract also explicitly states: "Licensee acknowledges that it will share the Meet-Me-Rooms with other telecommunications services providers on a non-exclusive basis." Customer A Contract, Section 1(g), at 1 (emphasis added).

Customer A does not pay for utilities, except for electricity based on its amperage, and there is no indication in the agreement that Customer A generally pays for other types of utilities or building operation and maintenance costs. *See* Rule 118(3). If Customer A wishes to install conduits in its [L]icensed premises, it must use an engineering firm or other consultant approved by Taxpayer. Taxpayer has the right to disallow entry of persons with "insufficient expertise or experience" from entering the property, Data Center, the Meet-Me rooms, or the Equipment Space, to maintain or operate Customer A's telecommunications equipment. Customer A Contract, Section 18, at 10.

Taxpayer has the right to monitor all of Customer A's installation, operation, and maintenance of its telecommunications equipment within its Licensed Premises. Taxpayer also retains the right to relocate Customer A's equipment at Taxpayer's own discretion, and is free to authorize others, without limitation, including tenants and other licensees of the Data Center, to use portions of the Meet-Me rooms in which Customer A's equipment is located.

We find the foregoing factors indicate that Customer A does not have the level of exclusive possession and control to indicate it is renting or leasing Taxpayer's real property. Instead, Customer A has limited control and non-exclusive rights to use the colocation rack space and conduits in Taxpayer's real estate, which are properly classifiable as a mere license to use. *See* Det. No. 14-0260, 34 WTD 467 (2015) (addresses control and exclusivity as they pertain to a shoe company's use of licensed space in locations within a store). *See also* 19 WTD 618 and 41 WTD 37 (both address colocation services; see footnote 3). Accordingly, as to the Customer A Contract and those that convey similar limited rights, we deny the petition.

Customer B Contract

Customer B, as opposed to Customer A, is contracting for the use of designated areas set forth in floor plans, which include two suites in which to keep its servers, associated equipment and conduits, and areas for use by its employees. In contrast to Customer A, Customer B receives use of the colocation space and conduits in the Meet-Me rooms free of charge, whereas those services are specifically what Customer A contracts for. Therefore, the contracts are for two different kinds of services.

The Customer B Contract is a 15-year contract and, with extensions, can be increased up to 30 years. It provides for the use of two suites, each of which takes up most of an entire floor of the Data Center. The suites are separate from the Meet-Me rooms, and are partitioned off from the rest of the facility with their own locking doors.

Section 2.5, entitled "Covenant of Quiet Enjoyment," states that Taxpayer covenants to Customer B the "right to quiet enjoyment," and that Taxpayer or any other person claiming superior title "shall not disturb [Customer B]'s possession of the Premises or use of the Designated Conduits

during the term of the lease." Customer B Contract, Section 2.5, at 8 (emphasis added). Taxpayer does not have the right to relocate Customer B, as it can with Customer A. The foregoing factors indicate Taxpayer has exclusive possession and control over its [Leased] Premises.

Customer B pays all of its share of utilities and costs of operating the facility. Customer B has the right to audit Taxpayer's records regarding utility and building charges, and has the right to sublease its [Leased] Premises to its affiliates. Customer B's right to sublease, its payment of its own utilities, and its right to audit Taxpayer also indicate a substantially greater degree of possession and control than a mere license to use.

Audit asserts that there are restrictions on Customer B's use of the facility that mean the agreement is a mere license to use real property. For example, Customer B must use the [Leased] Premises only for data center purposes and all personnel must be authorized to enter the facility, and must go through security. There are additional "common-sense" restrictions. For instance, Customer B may not possess or use weapons of any kind, may not keep animals, may not lodge in the facility, or smoke within the building or within 50 feet outside of the building. Also, Customer B cannot solicit business, distribute food, or install blinds, curtains or other window coverings without the approval of Taxpayer.

However, a finding of a landlord-tenant relationship does not require there to be *no* restrictions, and we do not find the restrictions in Customer Contract B meet the level of interference in Customer B's quiet enjoyment to substantially affect its rights to exclusive possession and control of its [Leased] Premises. Indeed, Washington courts have held that some reservations or restrictions by a lessor do not destroy the character of the contractual arrangement as a lease. *See, e.g., Tacoma v. Smith*, 50 Wn. App. 717, at 721 (use of boat moorage); *Barnett v. Lincoln*, 162 Wash. at 618 (use of port property); and *McKennon v. Anderson*, 49 Wn.2d at 57-59 (lease of barn).

Rule 118(3) indicates that "[u]sually, where the grant conveys only a license to use, the owner controls such things as lighting, heating, cleaning, repairing, and opening and closing the premises." Here, Taxpayer provides lighting, heating, and air conditioning, but these utilities are expressly controlled by its contract with Customer B, where Taxpayer is required to provide electricity and control heat and humidity within certain parameters or be subject to penalties, which indicates that Taxpayer is not in sole control of those services. Unlike a license to use, Customer B provides its own cleaning and repairing services, and all authorized persons have key cards or other access to its [Leased] Premises at all times. Further, Customer B must pay for its utilities and operating costs.

The Department has found landlord-tenant relationships in other circumstances where tenants had certain restrictions. For instance, in 12 WTD 461 we found that rental of space in a cold storage warehouse was not a mere license, because it was a "certain designated area" (the entire warehouse), the tenants operated the warehouse, and they could enter and leave at will, although the taxpayer controlled utilities. In Det. No. 96-173, 18 WTD 1 (1999), we found that lessees of space at antique malls had a landlord-tenant relationship with the taxpayers because the lessees received a "designated area" enclosed by walls (on three sides) with a "particular number of square feet." Lessees' contracts did not expressly state that they had exclusive control over the premises; the taxpayers' employees were generally the ones who accessed and sold the merchandise; and the

taxpayers had control over heating, lighting, and the opening and closing of the mall. However, we found these did not substantively interrupt possession and control by the lessees.[10]

In Det. No. 01-015, 23 WTD 121 (2004), the issue was whether a county coroner's office's use of space in a morgue was pursuant to a mere license to use or was instead a rental of real property. Although the taxpayer controlled all utilities, maintenance, and cleaning, the county coroner's office could access the space 24 hours a day, seven days a week, and on that basis we found the agreement constituted a lease of real property.

In Det. No. 03-0118, 23 WTD 218 (2004), which involved a warehouse, we found that the agreement, entitled a "Revocable License Agreement," was a lease for real property even though it expressly provided that "[t]his agreement creates only a revocable license, and is not a lease nor does it create a leasehold estate or any interest in real property." The factors in support of this finding were that the tenant controlled access to its leased premises, the agreement stated that the tenant was granted "exclusive access" to the premises, and the agreement had a floor plan attached showing the leased area. Also, the tenant had the right to sublease with the taxpayer's approval. *See also* Det. No. 15-0276, 35 WTD 419 (2016) (swap meet's use of indoor space a taxable license to use); 26 WTD 69 (use of offices within a business suite was rental of real property); Det. No. 92-213ER, 13 WTD 108 (1993) (restrictions on exhibitors to use space in a trade show and terms less than 30 days were indicia of a mere license to use).

Based on the foregoing, we find Customer B has the level of exclusive possession and control needed to establish a landlord-tenant relationship with Taxpayer, and that this finding falls within the parameters that the Department and Washington courts have previously adopted when determining whether an agreement is a rental of real property or mere license to use real property.

Accordingly, we grant the petition as to the Customer B Contract, and other contracts Taxpayer may have that convey the right to use specific designated areas in the Data Center with the same level of exclusivity and control granted to the tenant as in the Customer B Contract.

2. Attribution of apportionable income

Taxpayer asserts that if the Department concludes income Taxpayer receives from its customers is apportionable income derived from licensing space in the Data Center, that income should be apportioned outside Washington to the location of the customers' end subscribers. As we have indicated above, income from contracts like the Customer Contract A are taxable proceeds from a mere license to use real property.

"Apportionable income" is defined as "gross income of the business generated from engaging in apportionable activities." RCW 82.04.460(4)(a). "Apportionable activities" include those under RCW 82.04.290(2). RCW 82.04.460(4)(a)(vi). As we concluded above, Taxpayer's activities with regard to the licensing of the Data Center to its customers fall under RCW 82.04.290(2).

[10] We note that in 18 WTD 1 we applied both Rule 118 and WAC 458-20-200 (Rule 200). Rule 200 addresses leased departments, and applies the same principles found in Rule 118 and RCW 82.04.050(2)(f): 1) whether the grantee is granted exclusive possession and control of the space; 2) whether the term is for a time certain greater than 30 days; and 3) whether parties are required to notify each other in the event of termination of the occupancy.

RCW 82.04.460(1) addresses apportionable income taxable in Washington and other states, and provides:

> Except as otherwise provided in this section, any person earning apportionable income taxable under this chapter and also taxable in another state must, for the purpose of computing tax liability under this chapter, apportion to this state, in accordance with RCW 82.04.462, that portion of the person's apportionable income derived from business activities performed within this state.

RCW 82.04.460(1) (emphasis provided).

We also note that WAC 458-20-19402 (Rule 19402), the Department's administrative rule that addresses single factor receipts apportionment, states that "**[i]f the taxpayer's service relates to real property, then the benefit is received where the real property is located**." Rule 19402(303)(a) (emphasis in original).

Here, Taxpayer earns its income from licensing space in its Data Center facility, which is real property located in Washington State. This income is not taxable in another state, therefore, RCW 82.04.460(1) does not apply. Accordingly, the licensing income is not apportionable outside of Washington and we deny the petition as to this issue.

DECISION AND DISPOSITION

Taxpayer's petition is denied in part with regard to contracts substantially similar to those of Customer A, and granted in part with regard to contracts substantially similar to those of Customer B. We remand this matter to Audit (Operating Division) for adjustment consistent with this determination.

Dated this 3rd day of August, 2022.