

WSR 23-10-027

PROPOSED RULES

DEPARTMENT OF REVENUE

[Filed April 26, 2023, 11:46 a.m.]

Original Notice.

Preproposal statement of inquiry was filed as WSR 22-11-048.

Title of Rule and Other Identifying Information: WAC 458-29A-200
Leasehold excise tax—Taxable rent and contract rent.

Hearing Location(s): On June 6, 2023, at 10:00 a.m. This meeting will be conducted over the internet/telephone. Please contact Cathy Holder at CathyH@dor.wa.gov for login/dial-in information.

Date of Intended Adoption: June 16, 2023.

Submit Written Comments to: Ryan Becklean, P.O. Box 47453, Olympia, WA 98504-7453, email RyanBe@dor.wa.gov, fax 360-534-1606, 360-534-1576, by June 9, 2023.

Assistance for Persons with Disabilities: Contact Julie King, phone 360-704-5733, TTY 800-833-6384.

Purpose of the Proposal and Its Anticipated Effects, Including Any Changes in Existing Rules: The department of revenue (department) intends to modify WAC 458-29A-200 to clarify the amount of contract rent subject to leasehold excise tax when the rent includes payment for both the leasehold interest as well as a concession or other right. The department has also made changes to enhance the readability of the rule.

Reasons Supporting Proposal: Businesses will find that the updates to the rule will assist taxpayers with the calculation and reporting of leasehold excise tax.

Statutory Authority for Adoption: RCW 82.01.060, 82.32.300.

Statute Being Implemented: RCW 82.29A.020, 82.29A.030.

Rule is not necessitated by federal law, federal or state court decision.

Agency Comments or Recommendations, if any, as to Statutory Language, Implementation, Enforcement, and Fiscal Matters: None.

Name of Proponent: Department of revenue, governmental.

Name of Agency Personnel Responsible for Drafting: Ryan Becklean, 6400 Linderson Way S.W., Tumwater, WA, 360-534-1576; Implementation and Enforcement: Heidi Geathers, 6400 Linderson Way S.W., Tumwater, WA, 360-534-1615.

A school district fiscal impact statement is not required under RCW 28A.305.135.

A cost-benefit analysis is not required under RCW 34.05.328. This rule is not a significant legislative rule as defined by RCW 34.05.328.

Scope of exemption for rule proposal from Regulatory Fairness Act requirements:

Is not exempt.

The proposed rule does not impose more-than-minor costs on businesses. Following is a summary of the agency's analysis showing how costs were calculated. The proposed rule does not impose more-than-minor costs on businesses, as it does not propose any new requirements not already provided for in statute. The proposed rule does not impose fees, filing requirements, or recordkeeping guidelines that are not already established in statute.

April 26, 2023
Atif Aziz
Rules Coordinator

OTS-3794.2

AMENDATORY SECTION (Amending WSR 10-18-034, filed 8/25/10, effective 9/25/10)

WAC 458-29A-200 Leasehold excise tax—Taxable rent and contract rent. (1) **Introduction.** The leasehold excise tax is imposed on the act or privilege of occupying or using publicly owned, or specified privately owned, real or personal property through a leasehold interest at a rate of 12 percent of taxable rent. RCW 82.29A.030. Ordinarily, the amount of taxable rent is the amount of contract rent paid by a private lessee for a taxable leasehold interest. RCW 82.29A.020. The law does authorize the department to establish a taxable rent different from the contract rent in certain cases. RCW 82.29A.020. This rule explains the ((exclusions)) deduction of certain moneys and other property received by or on behalf of a lessor from the measure of contract rent. It also explains the conditions under which the department is authorized to establish a taxable rent different from the contract rent. Examples found in this rule identify 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) **Contract rent ((exclusions)) deductions.** ((Even when a leasehold interest is present, not all)) Certain payments, as described in this subsection, made to a lessor will not constitute taxable contract rent. ((For example,))

(a) **Utility and other charges.** 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 stormwater impact fees attributable to the private 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 private 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.

(b) **Amounts collected for third parties.** In some circumstances a private lessee that is occupying or using public property or property of a community center, which is exempt from property tax, may collect ((fees)) amounts from third parties and remit them to the lessor. ((In those situations where:

(a) ~~The fee structure, rate, or amount~~)) These amounts are not included in the contract rent under this chapter under the following conditions:

(i) The amount (e.g., fee structure or rate) collected by the private party is established by or subject to the review and approval of the lessor or other public entity; and

((b)) (ii) The amounts received by the private entity from the third parties are remitted entirely to the public lessor or credited to the account of the lessor((, those amounts are not considered part of the contract rent under this chapter, provided that)).

Nothing in this section ((shall preclude or)) prevents the imposition of tax, as appropriate, under any other chapter of Title 82 RCW on any amounts retained by or paid to the private entity as considera-

tion for services provided to the public property owner or the community center, which is exempt from property tax.

(c) **Private lessee expenditures.** Contract rent does not include certain private lessee expenditures. These deductions are as follows:

(i) Expenditures made by the private lessee for which the lease agreement requires the lessor to reimburse the private lessee;

(ii) Expenditures made by the private lessee for improvements and protection if the lease or agreement requires the improved property to be open to the general public (e.g., a public boat launch) and prohibits the lessee from enjoying any profit directly from the lease;

(iii) Expenditures made by the private lessee to replace or repair the facilities due to fire or other catastrophic events including payments:

- For insurance to reimburse losses;
- To a public or private entity to protect the property from damage or loss; or
- To a public or private entity for alterations or additions made necessary by an action of government which occurred after the date the lease agreement was executed.

(d) **Improvements taxed as personal property.** Contract rent does not include private lessee improvements added to public property or property of a community center, which is exempt from property tax, if the improvements are taxed as any person's personal property. See subsection (4) of this section for the treatment of improvements not taxed to another person that have a useful life over one year.

(e) **Limitation on deductions.** Notwithstanding the provisions of this subsection, if ((such)) deductions are determined by the department to reduce the amount of contract rent to a level below market value, the department may establish a taxable rent in accordance with subsection (6) of this section.

((For example,)) **Example 1:**

Facts:

• 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. The building security services are not separately stated and billed to Dan.

• 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)) 10 percent of the total space in the building, so the ((averaged)) average 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,))

Result:

• 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 stated and billed from the lease payments.

((Contract rent also does not include:

(a) Expenditures made by the lessee for which the lease agreement requires the lessor to reimburse the lessee;

~~(b) Expenditures made by the lessee for improvements and protection if the lease or agreement requires the improved property to be open to the general public (e.g., a public boat launch) and prohibits the lessee from enjoying any profit directly from the lease;~~

~~(c) Expenditures made by the lessee to replace or repair the facilities due to fire or other catastrophic event including, but not necessarily limited to, payments:~~

~~(i) For insurance to reimburse losses;~~

~~(ii) To a public or private entity to protect the property from damage or loss; or~~

~~(iii) To a public or private entity for alterations or additions made necessary by an action of government which occurred after the date the lease agreement was executed.~~

~~(d) Improvements added to public property or property of a community center which is exempt from property tax if the improvements are taxed as any person's personal property.)~~

(3) Special circumstances.

(a) Combined payments including payments for concession, franchise, or other rights. When the payment for a leasehold interest is made in combination with payment for concession, franchise or other rights granted by the lessor, only that part of the payment which represents consideration for the leasehold interest is considered part of the contract rent. For example, if the payment made by the private lessee to the lessor exceeds the fair market rental value for comparable property with similar use, the excess is generally attributable to payment for a concession or other right.

~~((4))~~ **(b) Lease payments based on a percentage of sales.** The measure of contract rent subject to the leasehold excise tax may be based upon a lease ~~((which))~~ that provides that the rent shall be a percentage of business proceeds. The ~~((manner in which))~~ way the rent is calculated does not, in itself, determine the character of the underlying right or interest for which the payment is made.

~~((5))~~ **(c) Concession arrangements for retail sales.** If the rent is based in whole or in part on a percentage of sales and includes payment for the leasehold interest as well as a concession or other right granted by the lessor, there is a rebuttable presumption that the contract rent consists of the first eight percent of sales plus any prepaid rent or minimum rent required under the lease. The department will consider any portion of the contract rent that exceeds that figure as payment for the concession or other right granted by the lessor. If either party to a lease agreement believe the fair market value differs from presumed amount, they may submit documentation to the department demonstrating the fair market rental value for comparable property with similar use. The department will consider this documentation when determining the value of the leasehold interest.

Example 2:

Facts:

• John leases retail space on a Washington state ferry. John pays \$500 per month for the space plus 10 percent of his gross sales.

Result:

• The department will consider contract rent to be \$500 plus 8 percent of John's sales.

(4) Expenditures for improvements treated as contract rent. Expenditures by the private lessee for nonexcludable improvements (see WAC 458-29A-200(2) regarding excludable improvements) with a useful life of more than one year will be treated as prepaid contract rent if the expenditures were intended by the parties to be included as part

of the contract rent. (~~Such~~) This intention may be demonstrated by conduct of the parties or a contract provision granting ownership or possession and use of the improvement to the public owner of the underlying property or the community center, which is exempt from property tax, that owns the underlying property (~~and/or by the conduct of the parties~~). These expenditures should be prorated over the useful life of the improvement, or over the remaining term of the lease or agreement if the useful life of the improvement exceeds that term.

(5) **Default by private lessee.** If the private lessee vacates prior to the end of the lease without the agreement of the lessor, thereby defaulting on the lease, no additional LET is due for the term remaining pursuant to the contract between the lessor and that private lessee.

(6) **Department's authority to establish taxable rent.** RCW 82.29A.020(2) authorizes the department to establish a "taxable rent" that is different from contract rent in some situations.

(a) **When the department may establish taxable rent.** The department may establish a taxable rent that is different from the contract rent if the department determines that (~~a lessee has a leasehold interest in publicly owned property or property of a community center which is exempt from property tax and that such~~) the leasehold interest has not:

(i) Been established through competitive bidding(~~(τ)~~); or

(ii) Negotiated in accordance with statutory requirements regarding the rent payable(~~(τ)~~); or

(iii) Negotiated under circumstances, established by public record, clearly showing that the contract rent was the maximum attainable by the lessor(~~(τ the department may establish a taxable rent computation for use in determining the tax payable under authority granted under)~~). Chapter 82.29A RCW.

(b) **Criteria for computing taxable rent.** The department (~~(shall)~~) must base its computation on the following criteria:

(i) Consideration (~~(shall)~~) must be given to rent being paid to other lessors by private lessees of similar property for similar purposes over similar periods of time; or

(ii) Consideration (~~(shall)~~) must 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.

(~~(b) If the department establishes~~) (c) **Special rule for leases 10 or more years old.** If a lease is 10 or more years old and has not been renegotiated, taxable rent established pursuant to RCW

82.29A.020(2) (~~(τ and the contract rent was established in accordance with)~~) and the procedures (~~(set forth)~~) in that section, (~~(but the lease is ten or more years old and has not been renegotiated, the taxable rent for leasehold excise tax purposes shall)~~) must be prospective only. However, if upon examination, the department determines that the contract rent was not set in accordance with the statutory provisions of RCW 82.29A.020(2) and the rent is below fair market rate, the department may (and in most instances, will) apply the taxable rental rate (~~(retroactively)~~) to prior periods for purposes of determining the leasehold excise tax, subject to the provisions of RCW 82.32.050(~~(τ)~~).

(~~(e)~~) (d) **When the department will not establish taxable rent.** The department will not establish taxable rent if one of the following four situations apply:

(i) The leasehold interest has been established or renegotiated through competitive bidding;

(ii) The rent was set or renegotiated according to statutory requirements;

(iii) Public records demonstrate that the rent was the maximum attainable; or

(iv) A lease properly established or renegotiated in compliance with ~~(6) ((e))~~ (d) (i), (ii), or (iii) of this subsection has been in effect for ~~((ten))~~ 10 years or less without renegotiation.

~~((d))~~ (e) Where the contract rent has been established in accordance with one of the first three criteria ~~((set forth above))~~ provided in (a) of this subsection, and the lease agreement has not been in effect for ~~((ten))~~ 10 years or more, or has been properly renegotiated within the past ~~((ten))~~ 10 years, the taxable rent is deemed to be the stated contract rent.

~~((e))~~ (f) Hanford reservation subleases. If land on the Hanford reservation is subleased to a private or public entity by the state of Washington, "taxable rent" means only the annual cash rental payment made by the sublessee to the ~~((state and))~~ department of ecology as specifically referred to as rent in the sublease agreement between the parties and does not include any other fees, assessments, or charges imposed on or collected by such sublessee irrespective of whether the sublessee pays or collects such other fees, assessments, or charges as specified in the sublease agreement. RCW 82.29A.020.

[Statutory Authority: RCW 82.29A.140. WSR 10-18-034, § 458-29A-200, filed 8/25/10, effective 9/25/10; WSR 99-20-053, § 458-29A-200, filed 10/1/99, effective 11/1/99.]