Cite as Det. No. 13-0207, 33 WTD 554 (2014)

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition for Refund and Correction of Future Reporting Instructions of	)	D E T E R M I N A T I O N
	)	No. 13-0207
. . .	)	Registration No. . . .

[1] RCW 82.29A.030, 82.29A.120: LEASEHOLD EXCISE TAX CREDIT. For purposes of determining the leasehold excise tax credit on the rental of two buildings on a single tax parcel, the hypothetical property tax is calculated by using a *pro rata* portion of the aggregate value of the entire parcel, rather than the individual appraised values of the two buildings.

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.

Sohng, A.L.J. – Public hospital district protests future reporting instructions and denial of refund request on the grounds that the Department of Revenue (the "Department") improperly calculated its leasehold excise tax credit under RCW 82.29A.120. The petition is denied.[1]

ISSUE

Did the Department properly calculate a public hospital district's leasehold excise tax credit under RCW 82.29A.120, when the hospital leases out a portion of its medical facility to private tenants?

FINDINGS OF FACT

[Taxpayer] is a public hospital district that operates as . . . a medical facility comprising more than 1,000,000 square feet in . . . Washington. The facility at issue here consists of six separate buildings, including the main hospital, surgical center, outpatient clinics, laboratories, office space, and parking garages. All six buildings occupy the same property tax parcel number . . . [2] Taxpayer leases space in two of its buildings, [Building A] and [Building B] (collectively, the

[1] Identifying details regarding the taxpayer and the assessment have been redacted pursuant to RCW 82.32.410.
[2] In 2009, Taxpayer added another building, the . . . [pavilion], to its medical facility. This pavilion is located on its own tax parcel adjacent to the parcel at issue here.

"Leased Premises"), to private physician practices. Taxpayer does not lease out the entire buildings, but rather, only portions of them. [Building A] and [Building B] contain areas that are not part of the Leased Premises, such as conference rooms and board rooms that are used exclusively by Taxpayer.

[Building A] and [Building B] are adjacent to the main hospital facility. The Leased Premises consist primarily of physicians' offices and examination rooms. The leases include access to common areas in [Building A] and [Building B], as well as parking privileges, but do not include admitting privileges at the hospital. The leases do not provide tenants with access to any other part of Taxpayer's campus other than the Leased Premises and the parking spaces. Taxpayer explains that while most physician-tenants do have admitting privileges at the hospital itself, such privileges are negotiated independently, rather than as part of the lease.

The . . . County Assessor's Office conducts an annual appraisal of Taxpayer's property to determine its assessed value for property tax purposes. As part of this process, the assessor appraises each building of the facility separately. The appraised value of the individual buildings is for improvements only and does not include the underlying land, which is appraised separately. During the years at issue, the appraised values for [Building A] and [Building B] were substantially lower than those of the main hospital buildings (excluding the parking garage). The appraised values for [Building A], [Building B], the underlying land, and the entire parcel (including land and improvements) during the Refund Period were as follows:

YEAR	**[BUILDING A]** (improvements)	**[BUILDING B]** (improvements)	**LAND** (for entire parcel)	**TOTAL PARCEL VALUE** (land + improvements)
2008	$. . .	$. . .	$. . .	$. . .
2009	$. . .	$. . .	$. . .	$. . .
2010	$. . .	$. . .	$. . .	$. . .
2011	$. . .	$. . .	$. . .	$. . .

Taxpayer is organized as a municipal corporation under Chapter 70.44 RCW and is exempt from property tax under RCW 84.36.010. However, Taxpayer reports leasehold excise tax on the Leased Premises. On June 9, 2011, the Special Programs Division ("Special Programs") requested Taxpayer's taxable rent calculations on which its quarterly leasehold excise tax returns were based. During this process, Taxpayer submitted amended leasehold excise tax returns and revised taxable rent calculations for the period Quarter 3, 2008, through Quarter 2, 2011 (the "Refund Period"), requesting a refund in the amount of $. . . . Taxpayer's revised taxable rent calculations were based on the individual values of [Building A] and [Building B] stated above, as well as a proportionate share of the land value.

The Special Programs Division rejected Taxpayer's calculations and denied the refund request. In adjusting the taxable rent calculations submitted by Taxpayer, the Property Tax Division assisted the Special Programs Division in determining the hypothetical property tax computation for purposes of determining the amount of leasehold excise tax credit allowed under RCW 82.29A.120 during the Refund Period.

On April 11, 2012, Special Programs issued future reporting instructions on how to compute the leasehold excise tax credit for future periods. The future instructions stated:

> The calculation provided . . . in the future reporting instructions has been worked in collaboration with the Department's Property Tax Division. This calculation abides by Washington property tax law. The Special Programs Division and the Property Tax Division are in agreement that this is a valid calculation to use when factoring the leasehold excise tax liability.
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> Using the . . . County Assessor's market values and levy rates for each tax year, we estimate the liability "as if" property were subject to property tax as follows:

Tax Year	Assessor Value	Levy Rate per $1,000	Hypothetical Property Tax
2008	$. . .	8.4903	$. . .
2009	$. . .	7.8307	$. . .
2010	$. . .	9.1486	$. . .
2011	$. . .	9.6626	$. . .

* * *

Tax Year	Leased Area	Total Office, Hospital Area	Percent Leased	Property Tax Proportion
2008	. . .	. . .	. . . .%	$. . .
2009	. . .	. . .	. . . .%	$. . .
2010	. . .	. . .	. . . .%	$. . .
2011	. . .	. . .	. . . .%	$. . .

The amounts in the column entitled Assessor Value represent the value of the entire tax parcel, including the underlying land, as determined by the . . . County Assessor's Office. Special Programs determines the hypothetical property tax attributable to the Leased Premises by multiplying the amounts in the Hypothetical Property Tax column by the amounts under the Percent Leased column. Taxpayer challenges the denial of the refund request and the future instructions on the grounds that the hypothetical property tax attributable to the Leased Premises should be calculated solely on the appraised values of [Building A], [Building B], and the pro rata portion of the underlying land. In other words, Taxpayer argues that the individual building values (plus their pro rata share of the underlying land), as determined by the . . . County Assessor, must be multiplied by the levy rate per $1,000 to arrive at the hypothetical property tax for the Leased Premises, rather than calculating hypothetical property tax by multiplying the value of the entire parcel by the levy rate per $1,000 and then multiplying it by the Percent Leased amount, as Special Programs has done.

ANALYSIS

Leasehold excise tax (or "LET") is imposed on the act or privilege of occupying or using publicly owned real or personal property through a "leasehold interest" at a rate of [12.84]% of taxable rent. RCW 82.29A.030(1)(a); [RCW 82.29A.040].[3] "Leasehold interest" is defined as:

> [A]n interest in publicly owned real or personal property which exists by virtue of any lease, permit, license, or any other agreement, written or verbal, between the public owner of the property and a person who would not be exempt from property taxes if that person owned the property in fee, granting possession and use, to a degree less than fee simple ownership . . . .

[RCW 82.29A.020(1)(a)]. The purpose of the tax is set forth in RCW 82.29A.010:

> (1)(a) The legislature hereby recognizes that properties of the state of Washington, counties, school districts, and other municipal corporations are exempted by Article 7, section 1 of the state Constitution from property tax obligations, but that private lessees of such public properties receive substantial benefits from governmental services provided by units of government.
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> (c) The legislature finds that lessees of publicly owned property or community centers are entitled to those same governmental services and does hereby provide for a leasehold excise tax to fairly compensate governmental units for services rendered to such lessees of publicly owned property or community centers . . . .

The leasehold excise tax is intended to "defray some of the governmental expense of maintaining areas from which private lessees benefit." *MAC Amusement Co. v. Dep't of Revenue,* 95 Wn.2d 963, 971, 633 P.2d 68 (1981). Had the private lessees owned the Leased Premises, they would have paid property tax, which would have helped to pay for the government services they receive.

The leasehold excise tax is based on the amount of "taxable rent" paid or deemed payable by a lessee for a taxable leasehold interest. RCW 82.29A.020, 030. Generally, where the terms of the lease have been negotiated through a competitive bidding process or circumstances that clearly demonstrate that the rent being charged is "the maximum attainable by the lessor," the taxable rent is equal to the contract rent (*i.e.*, the total consideration paid by the lessee to the lessor for the leasehold interest). RCW 82.29A.020(2)(a),(c). In this case, Taxpayer received contract rent for the Leased Premises. Nevertheless, under RCW 82.29A.120, if the amount of leasehold excise tax calculated on taxable rent exceeds the amount of property tax that that would be due if the property was privately owned by the lessee (*i.e.* the hypothetical property tax), a credit equal

[3] The lessor generally collects LET from the lessee and remits it to the Department. RCW 82.29A.050(1).

to the difference between the leasehold excise tax and the hypothetical property tax is applicable. RCW 82.29A.120 states:

> After computation of the taxes imposed pursuant to RCW 82.29A.030 . . . (1) . . . there shall be allowed a credit against the tax as otherwise computed equal to the amount, if any, that such tax exceeds the property tax that would apply to such leased property . . . if it were privately owned by the lessee . . . .

RCW 82.29A.120(1).[4] In essence, a taxpayer pays the lesser of the leasehold excise tax or the hypothetical property tax. WAC 458-29A-600(4) explains, "Because the leasehold excise tax is intended only to equalize treatment between private property owners and lessees of public entities, the amount of leasehold excise tax should not exceed the amount of property tax that would be due if the leased property was privately owned." Computation of the leasehold excise tax credit first requires a calculation of the hypothetical property tax. However, neither the statute nor the administrative rules provide any specific guidance on how to calculate the hypothetical property tax for purposes of the leasehold excise tax credit.

Taxpayer and Special Programs disagree on how to calculate the hypothetical property tax for the Leased Premises. Special Programs' computation multiplies the value of the entire parcel (including land and common areas, such as parking garages, lobbies, and elevators) by the county's levy rate per $1,000 to arrive at Hypothetical Property Tax for the entire parcel. Special Programs then multiples that Hypothetical Property Tax by the percentage leased to arrive at the proportionate share of the Hypothetical Property Tax attributed to the Leased Premises. Expressed algebraically, Special Programs' method would be:

> *Value of entire parcel x Levy Rate per $1,000 x Percent Leased = Hypothetical property tax for Leased Premises.*

Taxpayer's method starts with the appraised value of the Leased Premises, which Taxpayer argues is more accurate because it recognizes that those buildings are substantially less valuable, on a square-foot basis, than the other buildings. Taxpayer's method uses the proportionate value of the tenant-occupied portion of the Leased Premises, plus the pro rata share of the land value, rather than the average value (per square foot) of the entire parcel. Expressed algebraically, Taxpayer's method would be:

> *(Pro rata value of Leased Premises + Pro rata land value) x Levy Rate per $1,000 = Hypothetical property tax for Leased Premises*

In support of its method, Special Programs relies on Excise Tax Advisory No. 3113.2009 ("ETA 3113") and *University Village Ltd. Partners v. King County*, 106 Wn. App. 321, 23 P.3d 1090 (2001), for the proposition that property tax is based on the value of the entire property. ETA

[4] Effective July 28, 2013, the leasehold excise tax credit allowed under RCW 82.29A.120(1) is repealed. Laws of 2013, ch. 235, §3.

3113, entitled "Computing Leasehold Excise Tax at Public Marinas," was issued on February 2, 2009 and provides, in pertinent part:

> Some confusion may exist over the proper calculation of LET for permanent moorage slips at public marinas. In many instances, LET calculated only on the contract rent paid for moorage may result in the tenant paying LET in excess of the amount of property tax that would have been due if the property were privately owned. In order to determine the proper measure of the LET for these facilities, it is necessary first to determine what the comparable property tax would be for the slips if they were privately owned. If the LET based upon contract rent exceeds the comparable property tax, the measure of the LET can be based upon the calculation of comparable property tax for the moorage slip. (RCW 82.29A.120). <u>While separate appraisals for each slip would provide the most accurate basis for determining LET liability, separate appraisals are generally not administratively feasible</u>. This advisory provides public marinas with an acceptable formula to compute the amount of LET the marinas as lessors are required to collect from lessees. This formula uses a square footage formula in conjunction with rental rates in calculating the LET due. This ETA does not indicate a change in the Department's position.

ETA 3113 at 1 (emphasis added).

The ETA provides an example of valuing the hypothetical property tax of leased boat slips at a public marina. In the example, the marina provided both permanent moorage (more than 30 days) and guest moorage (30 days or less). Generally, leasehold excise tax is due only on permanent moorage. RCW 82.29A.130(9). The ETA's calculation started with the assessed value of the *entire marina* and divided it by the total rentable area (including guest moorage) to arrive at a value per square foot, which was then multiplied by the square footage of the permanent moorage area to arrive at the value of the permanent moorage area, as follows:

Total Public Marina area (measured in square footage)	600,000 sf
Total rentable area	225,000 sf
Total permanent moorage area	150,000 sf
Total guest moorage area	75,000 sf

<u>Computing value per square foot:</u>

Total assessed value / Total rentable area = Value per square foot

$4,000,000 / 225,000 = $17.78

<u>Computing value of permanent moorage area:</u>

Total permanent moorage area X Value per square foot = Value of permanent moorage area

150,000 X $17.78 = $2,667,000

Id. at 1-2. In determining the value of various individual slips, the ETA example multiplies the value of the permanent moorage area by the relative share of the permanent moorage value (based on the slip's relative proportion to total rental income), as follows:

Relative share of perm. moorage value X value of all perm. moorage = Slip value		
32' covered slip	0.31% X $2,667,000	= $ 8,267.70
50' open slip	0.38% X $2,667,000	= $10,134.60
28' side tie slip	0.20% X $2,667,000	= $ 5,334.00

Id. The individual slip values are then multiplied by the levy rate per $1,000 to arrive at the hypothetical property tax attributable to each slip. *Id*. at 3. Both Special Programs and Taxpayer argue that their respective method of determining the leasehold excise tax credit is consistent with ETA 3113. Special Programs states, "Allocating the LET by leased area compared to total area is also consistent with our Excise Tax Advisory 3113.2009, Computing Leasehold Excise Tax at Public Marinas."[5] Taxpayer, on the other hand, emphasizes the following language of ETA 3113: "While separate appraisals of each slip would provide the most accurate basis for determining LET liability, separate appraisals are generally not administratively feasible." *Id*. at 1. Taxpayer argues that because it is "administratively feasible" to appraise each building separately, Special Programs' method of computing the LET credit based on the value of the entire parcel is contrary to legislative intent and the Department's own guidance.

Because the appraisals at issue here are of the individual buildings only and not the value of the underlying land or of Taxpayer's use of common areas (such as parking spaces), we do not find that it would be "administratively feasible" to determine such values. Moreover, we assume that the term "appraisal" as used in the quoted language of the ETA includes the value of both the improvements *and* land attributable to individual boat slips. Here, the appraisals of [Building A] and [Building B] conducted by the . . . County Assessor's Office, on which Taxpayer's method relies, did not include the corresponding land values. Thus, we do not read the quoted phrase from ETA 3113 to mandate the Department to use individual building-level appraisals that do not include the value of the underlying land or of the private lessees' common area usage.

The Department issued ETA 3113 for specific application to public boat marinas, not for universal application in substantially different contexts in which LET is due. We conclude that RCW 82.29A.120, not the quoted ETA language on which Taxpayer relies, is controlling here. RCW 82.29A.120(1) provides a credit if the LET exceeds "property tax that would apply to such leased property." For property tax purposes, the assessed value of property subject to tax is "the aggregate valuation of the property subject to taxation." RCW 84.04.030. Here, the individual values of [Building A] and [Building B], which do not account for the underlying land or common area usage, cannot be the basis on which the hypothetical property tax would apply because it is not the "aggregate valuation" of the property, as required by RCW 84.04.030.

Special Programs also relies on the *University Village* case, *supra*. In that case, the taxpayer was a shopping mall that claimed that the county's failure to value the land portion of its real property the same as the land portion of two neighboring parcels violated the uniform taxation clause of the Washington State Constitution. *Id*. at 324. The taxpayer did not dispute the total assessed value of the real property—only the land portion. *Id*. The court held that there was no

[5] Special Programs' Response to Appeal Petition, dated June 13, 2012, at 4.

constitutional violation because land is only one component of a property's total value, which the taxpayer did not dispute. *Id.* The court stated:

> [T]he statutory definitions of taxes, assessments, and property indicate that assessment ratio relates to total property value, not solely to a component of it. Under RCW 84.04, the term "tax" is defined as the imposition of "burdens upon real property in proportion to the value thereof." [RCW 84.04.100.] Real property, for tax purposes, is defined as "the land itself . . . *and* all buildings, structures or improvement, or other fixtures of whatsoever kind thereon. . . ." [RCW 84.04.090 (emphasis added).] Assessed value is the "aggregate valuation of the property subject to taxation . . .." [RCW 84.04.030.] These definitions reflect that taxes are imposed on property as a whole, not on individual parts of it.

University Village, 106 Wn. App. at 325-26 (footnotes omitted)(emphasis added). The court emphasized that property tax is imposed on the *entire* property, and not the individual components that comprise it. Applying the holding of *University Village* to the instant case results in a hypothetical property tax that is calculated first on the value of the *entire* parcel, which is then multiplied by the levy rate per $1,000 and the occupancy percentage of the Leased Premises to arrive at the hypothetical property tax attributable the Leased Premises. By multiplying the value of the individual buildings of the Leased Premises by the levy rate per $1,000, Taxpayer's method fails to consider the value of the entire property and is contrary to *University Village* case. Given the court's mandate that property tax be based on the whole, not its parts, we uphold the method employed by Special Programs in determining Taxpayer's hypothetical property tax for the Leased Premises. The petition is denied.

DECISION AND DISPOSITION

We deny the petition for refund and correction of future reporting instructions.

Dated this 9th day of July 2013.