Cite as Det. No. 14-0126, 34 WTD 278 (2015)

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

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| 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. 14-0126 |
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| | ) | Registration No. . . . |
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| | ) | Registration No. . . . |

[1] RULE 118: B&O TAX – MALL – RENT – PROMOTIONAL DUES. Payments designated as "promotional dues" dues in a Mall's lease agreement were rent not subject to B&O tax. *Accord* Det. No. 91-163, 11 WTD 203 (1991).

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.

M. Pree, A.L.J. – Two shopping malls protest business and occupation (B&O) tax assessed on promotional dues that they collected from their retailers. . . . Because the payments booked as promotional dues were exempt from B&O tax as derived from the rental of real property, we grant the petition [. . .] .[1]

## ISSUES

1. Under WAC 458-20-118 (Rule 118), were portions of lease payments booked as promotional dues exempt from B&O tax?

2. . . .

## FINDINGS OF FACT

[Taxpayers] own and operate two shopping malls in Washington. The malls realized income from rent and other fees pursuant to their lease agreements with mall tenants. Our principal issue pertains to the taxability of charges to the tenants that the malls labeled "promotional dues."

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

The Department of Revenue (Department) reviewed the taxpayers' books and records for the period from January 1, 2005, through June 30, 2008. As a result of the examination, the Department's Audit Division issued assessments against each of the malls. Document No. . . . totaled $. . . against [Taxpayer A]. [Taxpayer A] appealed $. . . of that assessment, which it attributes to denial of a credit for service business and occupation (B&O) tax on amounts it received for promotional dues. [Taxpayer A] does not appeal the balance of that assessment.

Document No. . . . totaled $. . . against [Taxpayer B]. [Taxpayer B] appealed $. . . of that assessment, which it attributes to denial of a credit for service B&O tax on amounts received for promotional dues, and the assessment of use tax and/or deferred sales tax on the equipment acquired through a third party, . . . . [Taxpayer B] does not appeal the balance of that assessment.

The malls provided a copy of a lease agreement, which they state was representative of the leases from which they book [as] promotion[al] dues. The agreement required the tenants to pay the taxpayer rent based upon a minimum amount computed from the square footage of the space occupied by the tenant plus a percentage of the tenant's sales. In addition, the agreement required the tenants to pay an "operating cost charge" plus a proportionate share of taxes.

The agreement also required tenants to pay as "promotional dues" the greater of an amount computed by multiplying the squared footage of the leased space by an amount (e.g. $1.50/square foot) or a fixed sum ($1,000) increased by a percentage (e.g. 4%) each year under the lease. Under the agreement, the malls could determine how they would use the funds for professional advertising and promotional services to benefit all their tenants. The malls did not directly engage in advertising. They hired third parties for the advertising service. The malls booked these amounts as promotional dues, and the Audit Division assessed B&O tax on the promotional dues account under the service and other activities classification.

The malls note that, under the lease agreement, the failure of a tenant to pay any amount due to be a default, which results in a breach of the lease and possible eviction of the tenant. Another provision of the lease deemed all amounts due from the tenant to be "rent." The malls reason that because the promotional dues were deemed rent (as were taxes and the operating cost charge), and linked to default and eviction, that the dues should be considered as payment for the real estate and, therefore, exempt from B&O tax.

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## ANALYSIS

Washington imposes the B&O tax on every person for the act or privilege of engaging in business activities in Washington. RCW 82.04.220. The tax is measured by applying particular rates against the value of products, gross proceeds of sales, or gross income of the business as the case may be. RCW 82.04.220. The tax rate or rates applicable to a particular taxpayer depend on the type of activity or activities in which the taxpayer engages, absent an available exemption.

Rule 118 exempts from the B&O tax amounts "derived from" the lease or rental of real estate. . . . The exemption does not extend, for example, to "amounts derived from engaging in any business wherein a mere license to use or enjoy real property is granted." Rule 118(1).

In Washington, the rules of construction that apply to contracts also apply to leases. *Seattle-First Nat'l Bank v. Westlake Park Assocs*., 42 Wn. App. 269, 272, 711 P.2d 361 (1985). "The goal of contract interpretation is to carry out the intent of the parties as manifested, if possible, by the parties' own contract language." *Hearst Commc'ns, Inc. v. Seattle Times Co*., 154 Wn.2d a493, 504, 115 P.3d 262 (2005). The words that the parties use are given "their ordinary, usual, and popular meaning unless the entirety of the agreement clearly demonstrates a contrary intent." *Id*. at 504. In this case, the parties deemed all amounts due under the contract, including promotional dues, to be rent. . . . Accordingly, we must still consider whether those amounts are "derived from" the lease of real property, such that the amounts are exempt from B&O tax under Rule 118.

Rules of statutory construction also apply to administrative rules and regulations. *State v. Burke*, 92 Wn.2d 474, 478, 598 P.2d 395 (1979). If an administrative rule or regulation is clear on its face, its meaning is to be derived from the plain language of the provision alone. *Cannon v. Dep't of Licensing*, 147 Wn.2d 41, 56, 50 P.3d 627 (2002). We look no further than the plain language of a facially unambiguous administrative regulation. *Cockle v. Dep't of Labor & Indus.*, 142 Wn.2d 801, 807, 16 P.3d 583 (2001).

In general, the term "rent" is the consideration paid for the use, enjoyment, possession, or occupation of property; in a broader sense, it is the compensation or fee paid, usually periodically, for the use of any rental property, land, buildings, etc. 49 Am. Jur. 2d Landlord and Tenant § 546 (2014). It is the means by which landlords make a profit on their property. *Id*. However, rent may be distinguished from such miscellaneous charges as unreasonable wear and tear penalties, late charges, and security deposits. *Id.*; *see also* Det. No. 09-0213, 29 WTD 75, 78 (2010)(where we upheld an assessment of B&O tax on income from late fees charged to tenants because they were "not taken or received for the lease or rental of real estate"). Certain additional charges, e.g., for utilities that are "a part of the normal and customary landlord-tenant relationship" may also not be subject to B&O tax. *See* WAC 458-20-205.

In this case, the malls enter into agreements with their tenants whereby they both lease space to some tenants and provide licenses to use space to other tenants. At issue here are the "promotional dues" that the taxpayers charge their tenants in the lease agreements and whether those dues are [payments for] the lease of space, thereby making them exempt from tax under Rule 118.

. . . In other words, the promotional fees must be received from tenants as part of the normal and customary mall rent and not be, for example, a miscellaneous or financial charge.

Clauses in mall lease agreements requiring tenants to pay mall owners promotional fees are common. The IRS recognizes that under I.R.C. § 856(d)(1)(B), rents from real estate include charges for services customarily furnished or rendered in connection with the rental of real property, whether or not such charges are separately stated. Treas. Reg. Section § 1.856-4(b)(1) provides that services provided to tenants of a particular building will be considered customary if, in the geographic market in which the building is located, tenants in buildings that are of a similar class are customarily provided with the service. The IRS recognizes that promotional dues for promotional services a mall provided to the tenant are considered customary for mall rentals. *See* I.R.S. P.L.R. 9536013, 06/08/1995. We [recognize] the same . . .[here], that the

promotional dues are a customary part of the landlord-tenant relationship for rental of space at the mall.

We reached a similar conclusion in Det. No. 91-163, 11 WTD 203 (1991). In that determination, the rent charged by a landlord of a shopping mall included a percentage of gross sales, which amounts were to be used by the landlord for advertising or promotional purposes. The landlord considered the proceeds as amounts derived from the rental of real estate, exempt under Rule 118. Tax was assessed on the proceeds under the service B&O tax classification. We found that the "advertising" charge was "merely a label . . . not a charge for advertising, but rent. . . ." 11 WTD at 206. In sum, the payments in that case were tax exempt because they were derived from the rental of real estate. *Id.*

In the present case, we conclude that the amounts paid, however designated, only allow the mall tenants to occupy the space. There was no entitlement to advertising or other services. [Thus, the promotional dues did not represent payments by the tenants for advertising.] Under such circumstances, as is customary in that particular industry, the lease payments were derived from the rental of real estate, and, therefore, not subject to B&O tax in accordance with Rule 118.

. . .

## DECISION AND DISPOSITION

We grant [Taxpayers] petition in part. B&O tax on promotional dues required under mall leases taxed in accordance with Rule 118 as derived from rent will be removed from the assessment.
Dated this 3rd day of April 2014.