



PREPROPOSAL STATEMENT OF INQUIRY

**CR-101 (October 2017)
(Implements RCW 34.05.310)**

Do **NOT** use for expedited rule making

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FILED

DATE: May 13, 2022

TIME: 9:11 AM

WSR 22-11-048

Agency: Department of Revenue

Subject of possible rule making:
WAC 458-29A-200

Statutes authorizing the agency to adopt rules on this subject:
RCW 82.32.300 and RCW 82.01.060

Reasons why rules on this subject may be needed and what they might accomplish: The 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.

Identify other federal and state agencies that regulate this subject and the process coordinating the rule with these agencies: None

Process for developing new rule (check all that apply):

- Negotiated rule making
- Pilot rule making
- Agency study

Other (describe) Parties interested in this rule making may contact the individual listed below. The public may also participate by providing written comments throughout this rule making or by giving oral testimony at the public meeting or public hearing.

Interested parties can participate in the decision to adopt the new rule and formulation of the proposed rule before publication by contacting:

Name: Ryan Becklean	(If necessary) Name:
Address: P.O. Box 47453, Olympia, WA 98504-7453	Address:
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Additional comments: Written comments may be submitted by mail or email and should be directed to Ryan Becklean using one of the contact methods above. Written and oral comments will be accepted at the Public Meeting.

Date: Wednesday, June 15, 2022

Time: 11:00 A.M.

Public Meeting Location: Telephonic/internet meeting only.

Contact Atif Aziz at AtifA@dor.wa.gov for dial-in/login information

Date: May 13, 2022	Signature: 
Name: Atif Aziz	
Title: Rules Coordinator	

WAC 458-29A-200 Leasehold excise tax—Taxable rent and contract rent. (1) **Introduction.** Ordinarily, the amount of taxable rent is the amount of contract rent paid by a lessee for a taxable leasehold interest. The law does authorize the department to establish a taxable rent different from the contract rent in certain cases. This rule explains the exclusions 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.

(2) **Contract rent exclusions.** Even when a leasehold interest is present, not all payments made to a lessor constitute taxable contract rent. For example, 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 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 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.

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 from third parties and remit them to the lessor. In those situations where:

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

(b) The amounts received by the private entity from 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 prevent 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 consideration for services provided to the public property owner or the community center which is exempt from property tax.

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, 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. 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 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, 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 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.** 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 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 provides that the rent shall be a percentage of business proceeds. The manner in which 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.** 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, the contract rent consists of the first eight percent of sales. The department will consider any portion of the contract rent that exceeds eight percent of sales as payment for the concession or other right granted by the lessor.

(4) **Expenditures for improvements.** Expenditures by the lessee for nonexcludable improvements (see WAC 458-29A-200(2)) 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 intention may be demonstrated by a contract provision granting ownership or possession and use 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. If the 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 lessee.

~~((+6))~~ (5) 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) 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 leasehold interest has not been established through competitive bidding, or negotiated in accordance with statutory requirements regarding the rent payable, or negotiated under circumstances, established by public record, clearly showing that the contract rent was the maximum attainable by the lessor, the department may establish a taxable rent computation for use in determining the tax payable under authority granted under chapter 82.29A RCW. The department shall base its computation on the following criteria:

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

(ii) Consideration shall 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 taxable rent pursuant to RCW 82.29A.020(2), and the contract rent was established in accordance with the procedures set forth in that section, but the lease is ~~((ten))~~ 10 or more years old and has not been renegotiated, the taxable rent for leasehold excise tax purposes shall 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 for purposes of determining the leasehold excise tax, subject to the provisions of RCW 82.32.050(3).

(c) 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))~~ (c) (i), (ii), or (iii) of this subsection has been in effect for ~~((ten))~~ 10 years or less without renegotiation.

(d) Where the contract rent has been established in accordance with one of the first three criteria set forth above, 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) 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 specifically referred to as rent in the sublease agreement.

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