Cite as Det. No. 15-0276, 35 WTD 419 (2016)

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition for Refund of Assessment of	)	D E T E R M I N A T I O N
	)	No. 15-0276
. . .	)	Registration No. . . .

[1] RULE 118: B&O TAX – LICENSE TO USE REAL PROPERTY - TEST. The test to determine whether an occupant has a lease rather than a license to use is whether the occupant is granted the rights of exclusive possession and control over the property. Taxpayer did not grant exclusive control to the occupant and thus is found to have sold a license to use real estate subject to service and other activities B&O tax.

[2] RCW 82.32.020: ESTOPPEL. Based on written tax reporting instructions contained in the narrative of a prior audit the Department is precluded from collecting the tax found due.

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.

Lewis, A.L.J. – Taxpayer appeals the assessment of service and other activities business and occupation ("B&O") tax on income derived from the rental of indoor space in a building where a swap meet is held. We conclude that the income is derived from granting a B&O taxable license to use realty and not a B&O exempt rental of real estate. While we sustain the future reporting instructions on a prospective basis, we grant Taxpayer's request for cancellation of the assessment based on erroneous previous written reporting instructions contained in a prior audit report.[1]

ISSUES:

1. Under the provisions of WAC 458-20-118 ("Rule 118"), is the income Taxpayer receives from the rental of indoor space in a building with a license to use subject to service and other B&O tax, or the rental of real estate exempt from payment of B&O tax?

2. If the tax is found due, is the Department [precluded] from collecting the tax based on prior written reporting instructions contained in a prior audit report, under the provisions of RCW 82.32A.020?

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

FINDINGS OF FACT:

Taxpayer's business activities within Washington during the audit period included operating a swap meet. Taxpayer derives income from renting outdoor space, table space, and indoor space to vendors from which the vendors sell their own products or services. Taxpayer also charges individuals a nominal amount to enter the swap meet.

The Department of Revenue (Department) first audited Taxpayer's business records for the period January 1, 2006 through March 31, 2010. Subsequently, during January 2011, the Department issued a $ . . . assessment of which $ . . . was service and other business activities B&O tax assessed on unreported income. The audit narrative explained:

> Your business activities include renting space to vendors on a full time and part time basis. The spaces are approximately 8' X 10'. Some of the rented spaces are outside. Indoor spaces are rented by the month only. The indoor spaces are considered to be rental of real estate and not subject to B&O tax; however the utility reimbursements that are included in this income account are subject to tax. The utility reimbursement represents approximately 4 percent of the income generated from indoor space rentals. Therefore, only 96 percent of the income in this account is exempt. The 4 percent was calculated as follows:
> $ . . . per month/per space
> $ . . . utility reimbursement fee
> Total; due from vendor is $ . . .
> $ . . . divided by $ . . . equals 4 percent
>
> Other taxable sources of income include commissions from arcade machines and ATM machines and the admission that you charge the public to enter the swap meet.
>
> A reconciliation has been made of income taxable under the Service and Other Activities tax classification through a comparison of the amounts recorded in the business records with the amounts reported. The taxable differences identified on this schedule were the result of misunderstanding your tax reporting obligation. (Emphasis added.)

Most recently, the Department audited Taxpayer's business records for the period April 1, 2010 through March 31, 2014. Subsequently, the Department issued two assessments. Taxpayer did not protest a $ . . . assessment.[2] However, Taxpayer did protest a $ . . . assessment.[3] The contested tax arose from the Department's assessment of service and other B&O tax on unreported income derived from the rental of inside space to vendors. Taxpayer protested the tax assessed on income derived from the rental of indoor rental of space because it was in conflict with the tax reporting instructions contained in the prior audit report.

[2] The $ . . . assessment consisted of $ . . . tax, $ . . . interest, and $ . . . assessment payment (Document No. . . . /Audit No. . . .).
[3] The $ . . . assessment consisted of $ . . . tax, $ . . . interest, and $ . . . assessment penalty (Document No. . . . /Audit No. . . .).

The Department's Audit Division (Audit) determined the income received was derived from the B&O taxable license to use realty rather than the B&O tax exempt rental of real estate. In making that decision, Audit relied on certain provisions contained in the written rental agreement ("Agreement") between Taxpayer and its tenants. Pertinent sections of the Agreement include:[4]

> [Taxpayer], hereby grants permission to the undersigned, to temporarily store his/her property at . . . , WA, subject to the following terms and conditions:
>
> 1. The permission herein granted is temporary, on a month to month basis (the months in which you paid for). Permission may be revoked at any time upon serving the undersigned with a three (3) day written notice.
>
> . . .
>
> 5. Hours of Operation: Tue-Fri, Sellers hours are 9:00a-6:00p; Sat&Sun, Sellers hours are 8:00a-6:00p. Business hours are: Tue-Fri 10:00a-6:00p; Sat&Sun, 9:00a-9:00p. We ask that you are in your booths and opened by the time we open for business. If there is an emergency situation that you absolutely cannot be in your booth during business hours please notify the office.
>
> 6. [Taxpayer] is a place of business so we ask that you please keep the foul language to yourselves. Please keep children within the boundaries of your space. Children are not allowed to wander freely throughout the building.
>
> . . .
>
> 8. Please stay within the boundaries of your space. Do not protrude out into the walk ways; we need to keep these clear and safe for our customers. Please keep your booth clean at all times, do not leave leftover food, crumbs, or drinks of any kind with your booth. . . .
>
> . . .
>
> 12. Tarps and Booth covers. When securing your booth at night please make sure that your tarps are tucked under your merchandise. This way when the janitor is cleaning he may do so without disturbing your merchandise.
>
> . . .
>
> 15. The undersigned agrees that he/she will provide [Taxpayer] with two weeks prior notice to vacate.

Audit concluded that the rental of the indoor space did not constitute the rental of real estate because:

[4] The quoted sections are from the Agreement used for the period 2010-2014.

- tenants do not have 24/7 access to the space. Tenants can only freely access their space during the building's business hours. Entry to the space after business hours required contacting Taxpayer;

- tenants do not have control of the lights or temperature in their space; and,

- the Agreement can be terminated by Taxpayer with only a three day notice.

On October 20, 2014, Taxpayer's representative filed a petition with the Appeals Division requesting correction of the $ . . .1 assessment. Taxpayer maintained that Audit erred because the inside rental income was derived from the B&O tax exempt rental of real estate. In addition, Taxpayer argued that even if the tax was due it cannot be collected because of prior tax reporting instructions.

ANALYSIS:

The sale or lease of real property is not subject to B&O tax. WAC 458-20-118 ("Rule 118") explains the difference in taxation between the rental or lease of real estate and the granting of a license to use. Rule 118 explains:

> Amounts derived from the sale and rental of real estate are exempt from taxation under the business and occupation tax. 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.. . .
>
> 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 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 unless a relationship of "landlord and tenant" is created thereby.
>
> . . .
>
> LICENSE TO USE REAL ESTATE. A license grants 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.

Rule 118(2) describes the lease or rental of real estate as:

> 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 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. It is presumed that the sale of lodging by a hotel, motel, tourist court, etc., for a continuous period of thirty days or more is a rental of real estate. It is further presumed that all rentals of mini-storage facilities, apartments and leased departments constitute rentals of real estate.

Thus, for a lease to be considered a B&O tax exempt rental of real property, the property must be real estate and a landlord and tenant relationship created.

Rule 118(3) describes the granting of a license to use real property as:

> A license grants 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.

The Department's distinction between a "lease" and a "license" is based on case law. The distinction between a lease and a license is often difficult to make. "In theory the distinction is clear: the holder of a license, easement, or profit has only the use of another's land, while a tenant has the right of possession." 17 Wash. Prac., Real Estate §6.3. *Conaway v. Time Oil Co*., 34 Wn.2d 884, 210 P.2d 1012 (1949) is a leading Washington case on the distinction between a lease and a license. In order to make the distinction, the Court wrote:

> Whether a written instrument constitutes a lease or a license, the court must consider it in its entirety, together with the circumstances under which it was made and determined and the intention of the parties.
>
> A lease carries a present interest and estate in the property involved for the period specified therein, and requires a writing to comply with the statute of frauds. It gives exclusive possession of the property, which may be asserted against everyone, including the lessor. A license authorizes the doing of some act or series of acts on the land of another without passing an estate in the land and justifies the doing of an act or acts which would otherwise be a trespass. *Barnett v. Lincoln*, 162 Wash. 613, 299 P. 392; *Baseball Publishing Co. v. Bruton*, 302 Mass. 54, 18 N.E. 2d 362, 119 A.L.R. 1518; 32 Am.Jur. 30, § 5; 51 C.J.S., Landlord and Tenant, § 202(2), page 806.

Conaway, 34 Wn.2d at 893.

The case of *Tacoma v. Smith*, 50 Wn. App. 717, 722, 750 P.2d 647 (1988) affirms the differences between a lease and a license:

> A lease is created if a tenant is granted exclusive possession or control of the parcel or a portion thereof. *McKennon v. Anderson*, 49 Wn.2d 55, 58- 59, 298 P.2d 492 (1956). This is the case even if the tenant's possession of the real estate is restricted by reservations. *Barnett v. Lincoln*, 162 Wash. 613, 618, 299 P. 392 (1931). Such reservations can include the right to sell the leased property before the lease is over, *Coates v. Carse*, 96 Wash. 178, 164 P. 760 (1917); and to designate from time to time the

> place on the premises to be occupied by the tenant. See *Barnett*, 162 Wash. at 620, 299 P. 392. On the other hand, a license exists if a person is granted only the authority to do a particular act upon the owner's land. *Barnett*, 162 Wash. At 619, 299 P.392.

In Det. No. 96-173, 18 WTD 1 (1999), cited by Taxpayer, the Department considered a somewhat similar situation and concluded it was a rental of real estate. In that case, lessees received a designated area which was identified by a number in the agreement. However, the Administrative Law Judge in that case was also persuaded the situation represented a special type of situation, a "leased department" under WAC 458-20-200 ("Rule 200"). That Rule is intended to address the unique facts present when a retailer of goods, such as a department store, or personal services, such as a beauty salon, leases portions of its space to persons essentially operating as independent contractors under the umbrella of the leasing business. Examples included in the rule are hairdressers working in a salon or a paint department in a hardware store. The lessees are independents but may, in addition, receive a wide variety of services from the lessor. In 18 WTD 1, the variety of services was so great it actually included, in some cases, staffing by the lessor of the lessees' spaces, in addition to the normal services used by leased-department operators, such as bookkeeping. We do not have similar facts here.

Here, the test to determine whether an occupant has a lease, rather than a license, is whether the occupant is granted the rights of exclusive possession and control over the property. Facts in this case to consider include:

- Restrictions on the [Tenants'] Control of Lighting and Heating. Taxpayer's tenants do not control such things as lighting and heating. Rule 118 specifically provides that "[u]sually, where the grant conveys only a license to use, the owner controls such things as lighting [and] heating…."

- Restrictions on the [Tenants''] Access. Taxpayer's tenants are limited in their access to their assigned spaces. After the building closes, a tenant must contact Taxpayer to gain access to their space. Rule 118 specifically provides that where the owner controls the opening and closing of the premises, usually the grant conveys only a license.

- Restrictions on use of space. The Agreement states that the tenant is granted permission to "temporarily store his/her property at . . ., WA, subject to the following terms and conditions." By the terms of the Agreement, the tenant is only granted a limited right to use the space and not absolute control of the space.

- Restrictions on length of the tenancy. While the Agreement provides for a month to month tenancy, Taxpayer may revoke the permission to occupy the space "at any time upon serving the undersigned with a three (3) day written notice." Taxpayer does not have a true landlord/tenant relationship as required for a rental of real property.

We find that Audit properly concluded that Taxpayer's tenants are granted licenses to use the space they rent. Taxpayer's income from such licenses is subject to B&O tax under the service and other activities B&O tax classification.

Taxpayer, however, argued that even if the Department concluded that its income derived from the rental of indoor space was found to be taxable, the Department should be [precluded] from collecting the assessment because of prior written instructions.

Audit asserted in the audit narrative that it was not [precluded] from making the assessment:

> Auditors are not required to follow the same process and come to the same conclusions as the prior auditor. Auditors are required to perform their own review and come up with their own conclusions based on the facts provided by the taxpayer.

The audit narrative makes a correct statement of Audit's position regarding successive audits of the same taxpayer.

. . .
In this case, the dispute did not arise out of the Department's failure to discover reporting errors in a prior audit. Rather, this is a case where the prior audit examined Taxpayer's income reporting practices and gave specific reporting instructions. RCW 82.32A.020(2), affords taxpayers:

> The right to rely on specific, official written advice and written tax reporting instructions from the department of revenue to that taxpayer, and to have interest, penalties, and in some instances, tax deficiency assessments waived where the taxpayer has so relied to their proven detriment . . . .

Taxpayers are afforded the assurance that they can rely on the Department's written reporting instructions until informed otherwise. Det. No. 13-0034, WTD 32 WTD 20 (2013) (Taxpayer had the right to rely on the holding of a previous determination issued to taxpayer.). Here, the prior audit report's narrative was very clear in addressing the taxability of the income derived from the rental of indoor space. The prior audit report specifically stated: "[t]he indoor spaces are considered to be rental of real estate and not subject to B&O tax" and taxpayer followed those instructions. Accordingly, the assessment will be adjusted to reflect this ruling.

DECISION AND DISPOSITION:

Taxpayer's petition is granted in part.

Dated this 20th day of October, 2015.