Cite as 3 WTD 209 (1987)

BEFORE THE INTERPRETATION AND APPEALS SECTION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition For Refund of	)	D E T E R M I N A T I O N
	)	No. 87-185
. . .	)	Registration No. . . .

[1] **RCW 82.29A.010 AND RCW 82.29A.020:** LEASEHOLD EXCISE TAX -- CONCESSION OR OTHER RIGHTS -- EXCLUSIVITY. An exclusive right to operate a business in an area of leased public property is a non-leasehold taxable concession or other right if it is not inherent in the lease of the physical property per se. When, however, such a right is held in combination with a taxable leasehold interest for which the contract rent is inadequate, no deduction based on the exclusive right may be taken from the measure of the leasehold excise tax.

[2] **RCW 82.29A.020:** LEASEHOLD EXCISE TAX -- CONTRACT RENT -- PERCENTAGE LEASE. The measure of leasehold excise tax may be based on a lease which provides that the rent shall be a percentage of business proceeds. Such an arrangement does not necessarily mean that the compensation paid is for concession or other rights as opposed to a leasehold interest.

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.

TAXPAYER REPRESENTED BY: . . .

DATE OF HEARING: May 27, 1986

NATURE OF ACTION:

Petition for refund of leasehold excise tax.

FACTS AND ISSUES:

Dressel, A.L.J. -- [The taxpayer] is a privately-owned corporation which leases from the state certain facilities within . . . State Park in . . . Washington. Under terms of its written lease agreement with the State's Parks and Recreation Commission, the taxpayer pays rent in the annual amount of $1,500 or 5% of its gross income from the park, whichever is greater. Pursuant to RCW 82.27 the taxpayer has also been remitting to the Department of Revenue (Department) leasehold excise tax for its use of this publicly-owned property. In this action the taxpayer is requesting a refund of the leasehold tax on the theory that what it really holds by virtue of its contract with the state are concession rights rather than a leasehold interest and that concession rights are not subject to leasehold excise tax.

The original contract was titled "Lease Agreement" and was executed on September 12, 1958. It was replaced by "Amended Lease Agreement-- . . . State Park" (Agreement) dated February 19, 1960. Essentially, the amended Agreement says that the lessee taxpayer will run the entire operation at . . . State Park until the year 1998. In part the Agreement states:

> (3) The State hereby grants to the Lessee during the term of this amended lease agreement, the exclusive right to operate stores, restaurants, service stations, housekeeping cottages, cabins, room rentals, together with golf course, boating and horseback riding facilities and any other facility or operation which may be mutually agreed on in the future, or any extension thereof, and the State hereby agrees not to permit any other person, firm or corporation to engage in any of the above activities within said . . . State Park, or any extension thereof, provided that the exclusive right herein granted shall not be applicable to the present . . . concession.

Included among the property owned by the state and used by the taxpayer in its operation of the resort are the following items, among others: nine-hole golf course; combination store, service station, and restaurant; storage supply buildings; living quarters buildings; 30 frame cottages; restroom buildings; horse barn; saddle house; horse corral; 43 row boats; boat docks; irrigation sprinkling systems; sewage

disposal system; lawn mowing equipment; furniture; and linens. The Agreement also calls for the taxpayer to construct, operate, and maintain certain other facilities on the subject premises. Maintenance responsibility, generally, is borne by the taxpayer.

Reserved to the state are rights to regulate rental, sales, and service charges as well as hours of operation. The taxpayer is required to maintain liability and fire insurance payable to the state in the event of loss. All buildings constructed and improvements made on the land covered by the lease become property of the state upon termination of the lease subject to compensation to the lessee for the cost of acquisition less an amortization rate of 2.5% per year. The taxpayers are to keep appropriate records subject to inspection by the lessor Parks and Recreation Commission.

It is contended by the taxpayer that only the $1,500 minimum annual "rental" fee is subject to leasehold tax. It is the taxpayer's position that any rent above that figure is a result of the contract clause calling for 5% of the taxpayer's gross income and that that part of the Agreement constitutes compensation for concession rights rather than for a leasehold interest. That portion of compensation, then, should not be the subject of leasehold tax. In taking this stance the taxpayer emphasizes the exclusivity it has over commercial endeavors at the park. In its brief it writes in part:

> . . . (sic) has been granted the "exclusive right and privilege" to operate a resort under its name, ... The value in being the exclusive resort in the area as well as the regional advertising of the . . . name attendant therewith is properly the subject for a concession fee exacted by the State of Washington. This concession fee is over and above the fair rental charged for the area occupied by . . . .
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> Clearly, the separate concession fee is not includible as "contract rent" within the legislative meaning of R.C.W. 82.29A.020(2)(a). The percentage concession fee is compensation for the other benefits and privileges granted by the State, i.e. the exclusive merchandising rights for the exclusive use of the resort and the attendant regional advertising. The concession fee represents the value of these rights which do not inure in and depend upon the actual occupancy of the land which

> would be minimal. The real value of the agreement is that no other concessionaire is allowed to occupy the premises.

In support of its position it cites an unpublished 1980 Department Determination and, perhaps, the leading Washington case on leasehold excise tax, Mac Amusement Co. v. Department of Revenue, 95 Wn.2d 963 (1981). The taxpayer also points to the occasional use of the word, "concession," in the lease agreement. In addition it argues that a large part of its benefit from the Agreement is the fact that the state advertises the park through road signs and brochures as being within the state parks system. This results in increased traffic to the park and increased revenues for the taxpayer who suggests that this benefit is more properly labeled a "concession right" than it is a "leasehold interest."

Whether the taxpayer holds non-taxable "concession or other rights" in . . . State Park such that the measure of its leasehold excise tax is reduced or eliminated is the question to be answered in this proceeding.

DISCUSSION:

The logic for the leasehold excise tax is found in RCW 82.29A.010 which reads:

> **Legislative findings and recognition.** 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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> The legislature further recognizes that a uniform method of taxation should apply to such leasehold interests in publicly owned property.
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> The legislature finds that lessees of publicly owned property 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.

The tax is imposed on those holding a leasehold interest. The measure of the tax is the taxable rent. RCW 82.29A.030. "Leasehold interest" is defined as follows in RCW 82.29A.020:

> (1) "Leasehold interest" shall mean an 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 . . .

Generally speaking, "taxable rent" is the same as "contract rent." "Contract rent" is defined in RCW 82.29A.020(2):

> (a) "Contract rent" shall mean the amount of consideration due as payment for a leasehold interest, including: The total of cash payments made to the lessor or to another party for the benefit of the lessor according to the requirements of the lease or agreement; expenditures for the protection of the lessor's interest when required by the terms of the lease or agreement; and expenditures for improvements to the property to the extent that such improvements become the property of the lessor. Where the consideration conveyed for the leasehold interest is made in combination with payment for concession or other rights granted by the lessor, only that portion of such payment which represents consideration for the leasehold interest shall be part of contract rent. (Emphasis added.)

[1] In this situation there is no question that the taxpayer has an "interest in publicly owned real or personal property which exists by virtue of any lease, permit," etc. Thus, it appears to have what the above-cited statute defines as a leasehold interest. If, however, as indicated above in RCW 82.29A.020(2)(a), part of the consideration paid by the lessee/taxpayer is for "concession or other rights," that part may be excluded from the measure of the leasehold tax.

That the exclusive rights granted the taxpayer in the Agreement are "concession or other rights" is a notion that, indeed, finds support in Mac Amusement, supra, wherein the Court said:

> On the basis of these long-standing distinctions, we believe the exclusivity rights in this case constitute such a franchise and therefore must be nontaxable "other rights granted by the lessor."
>
> To tax franchise rights would render meaningless the phrase "concession or other rights." If monopoly rights do not fall within that category, it is difficult to envision what would. We must give effect to all statutory phrases, Knappett v. Locke, 92 Wn.2d 643, 600 P.2d 1257 (1979); Washington Water Power Co. v. State Human Rights Comm'n, 91 Wn.2d 62, 586 P.2d 1149 (1978), and thus franchise rights, such as the exclusivity rights in this case, are not taxable under RCW 82.29A. . . .

A problem here as in Mac Amusement, though, is to determine what portion of the total consideration paid, if any, is attributable to concession or other (exclusivity) rights. In the instant case the taxable rent upon which the leasehold tax is based is $1,500 a year or 5% of gross income, whichever is greater. It is apparent from the taxpayer's petition that it has consistently exceeded the minimum $1,500 figure so has paid tax based on 5% of gross income. The Department reports that as of January 10, 1986 in the past five years the taxpayer had paid leasehold tax averaging $4,200 per year.

The Department also came up with some other figures of interest. After the present difference of opinion developed, it sent several appraisers from its Property Tax Division to . . . State Park to valuate the property which is the subject of the lease between the taxpayer and the Parks and Recreation Commission. The appraisers thereafter produced a detailed report dated August 2, 1985, complete with photographs, in which they placed the following values on the following items subjected to the lease:

Land $878,000	
Buildings and Land Improvements	903,900
Miscellaneous Personal Property	67,260
Indicated Value by Cost Approach	$1,849,160

When the value attributable to improvements constructed by the taxpayer is excluded from the total above, the remaining value is $1,227,700. The millage rate of property taxation for . . . County in 1984-85 was $12 per $1,000 of assessed value. Using these figures one can calculate the ad valorem property

tax on the property at issue by multiplying 1,227.7 by $12. The resulting product is $14,732 which is the amount of property tax that would be payable if the subject premises were in private ownership.

As indicated previously, the purpose of the leasehold tax is to compensate for the revenue loss that results from the fact that public property is generally exempt of property taxation. RCW 82.29A.010. In the case sub judice such compensation is far from realized. Based on the valuation to which reference is made above and the average annual leasehold tax paid by the taxpayer over the past five years, we note a deficit of $10,532.40. That is the difference between the annual leasehold taxes realized and the tax revenue that would be achieved were the subject property in private ownership. While there is no statutory requirement that the two taxes must generate the same amounts, the difference is significant and is in favor of the taxpayer who would pay far more in property taxes if the taxpayer owned it in fee simple.

It should be pointed out here that the example above, in which the leasehold tax actually paid is compared to a theoretical calculation of the property tax, is not meant to be a new means of computing taxable rent. If the leasehold interest has not been established according to statutory requirements, through competitive bidding, or so as to yield maximum rent, the procedure by which the Department may set the taxable rent remains that specified in RCW 82.29A.020(2)(b). The criteria there include comparing the rentals of similar properties and figuring a fair rate of return based on market value. The comparison used in this case is simply advanced for illustrative purposes to show that the leasehold tax paid by the lessees is so reasonable that it is almost ridiculous, and that to reduce it by apportioning some out for concession rights is ludicrous. There is no fat to carve, so to speak.

The inequality in the two tax amounts suggests that either the valuation is faulty or the state is not charging enough rent. Although the taxpayer's representative has suggested the former, we find the latter more likely. The taxpayer implies that because the appraisers of the property are state employees, they had an interest in the outcome of the valuation which they artificially inflated to retain their jobs. We find no evidence of that. Indeed, we observe that the two individuals involved have achieved the rank of Real Property Appraiser V. We assume that the "V" designation exceeds that of "I-IV" and is a classification attained only by those who have experience and ability in the area of

property valuation. Without corroboration of any sort whatsoever, the taxpayer's suggestion of bias is deemed groundless and will be accorded no weight. The Department's input on the subject of valuation is certainly superior to that of the taxpayer who has provided none. We accept the Department figures.

Where the rent paid for the use of public property is not the maximum attainable by the lessor or has not been established through competitive bidding or according to statutory requirements, the Department may establish a rate more in compliance with market values for purposes of computing the leasehold excise tax. See RCW 82.29A.020(2)(a) and (b). From the apparent discrepancy noted above, it would appear that this is a situation where that authority could be invoked, the effect of which would likely be the escalation of the leasehold tax payable on the subject premises.

With that observation in mind, we proceed to our ruling in this matter. We agree with the taxpayer that Mac Amusement is on point vis-a-vis the exclusivity rights in this case. We would exclude them from the measure of leasehold tax if the taxable rent of the premises otherwise subject to tax was comparable to the market rate. We find that it is not, however, and as was stated in the unpublished Determination cited by the taxpayer, "in no case may a deduction for claimed 'concession and other rights' be allowed which would reduce 'contract rent' below reasonable rental for the value of the property used or occupied under a leasehold interest."[1] Here, contract rent is already below reasonable. A deduction for "concession or other rights" which would make it even more so will, likewise, not be allowed.

[2] Furthermore, we are not aware of authority to the effect that a percentage lease is not the proper subject of leasehold tax as is suggested by the taxpayer. The taxpayer says that the "percentage concession fee" is compensation for benefits and privileges other than actual occupancy of the land and improvements. First of all, "percentage concession fee" is the taxpayer's own self-serving language, not that contained in the lease agreement which states that "the lessee shall pay to the State for their lease privileges a sum equal to 5 percent (5%) of the gross annual revenue derived from their

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[1] Department of Revenue Determination No. 80-41. Taxpayer's representative in his petition mistakenly referred to it as No. 80-14.

operations . . . ." (Emphasis added.) Secondly, there is nothing in RCW 82.29A which says that taxable or contract rent for a legitimate leasehold interest must be based only a straight monthly or annual rate as opposed to a percentage of gross income generated by the taxpayer's use of the premises. The taxpayer's conclusion that contract rent is limited to the $1,500 minimum specified in the Agreement is without merit. There is nothing in the Agreement suggesting such a demarcation, and we will not presume one especially in light of the fact that the rent charged for the land and improvements alone is less than a reasonable amount.

DECISION AND DISPOSITION:

The taxpayer's petition is denied.

DATED this 2nd day of June 1987.