Cite as Det. No. 96-173, 18 WTD 1 (1999)

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition For Correction of Assessment/Refund of	)	D E T E R M I N A T I O N
	)	No. 96-173
. . .	)	Registration No. . . .
	)	FY. . ./Audit No. . . .
. . .	)	Registration No. . . .
	)	FY. . ./Audit No. . . .
. . .	)	Registration No. . . .
	)	FY. . ./Audit No. . . .
. . .	)	Registration No. . . .
	)	FY. . ./Audit No. . . .
. . .	)	Registration No. . . .
	)	FY. . ./Audit No. . . .

[1] RULE 118 AND RULE 200: B&O TAX -- EXEMPTION -- REAL ESTATE -- LICENSE TO USE -- LEASE -- ANTIQUE MALL. Where the use of space in an antique mall is conveyed by a written agreement purporting to be a lease and where the space is identified with particularity in the agreement and at the physical location, and where the agreement specifies a certain term, as well as notice for termination, the arrangement will be construed as a rental or lease of real property, as opposed to a license to use same.

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.

NATURE OF ACTION:

Lessors of space at antique malls protest Department's characterization of rentals as licenses to use real estate.[1]

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

FACTS:

Dressel, A.L.J. -- . . . (collectively "taxpayers") operate or did operate antique malls. Their books and records were examined by the Department of Revenue (Department) for the periods January 1, 1990 through July 31, 1993; August 1, 1993 through December 31, 1993; January 1, 1992 through December 31, 1993; January 1, 1990 through February 28, 1993; and March 1, 1993 through September 30, 1993; respectively. As a result tax assessments, identified by the above-captioned numbers, were issued in the respective amounts of $ . . , $ . . . , $ . . . , $ . . . , and $ . . . Taxpayers appeal portions of the assessments.

These five commonly-owned taxpayers operated antique malls at three different locations during the named audit periods. Taxpayers, as lessors, entered into written sublease agreements with numerous lessees.[2] Under the terms of these arrangements, lessees received space within one of the three malls from which they could sell their antiques or "collectibles." Each lessee received a designated area which was identified by a number in the agreement. At the malls each space was marked with a corresponding number. The larger spaces were enclosed by temporary or permanent walls on, at least, three sides of the space. The smaller spaces were often separated from one another by only cabinets or display cases. Some of the spaces could be fully enclosed and locked. Generally, the cabinets and display cases could be locked by the lessees. The cabinets and display cases were, for the most part, owned by taxpayers, although the lessees were free to bring in their own, as long as they were approved by the lessor.

The subleases called for a flat monthly rental amount to be paid by the lessees to the lessors. In addition, during most of the audit periods, the agreements contained a provision under which a lessee could opt to have additional services performed by taxpayers. These additional services included actually selling the merchandise, collecting the money, collecting sales taxes, paying those taxes to the Department, keeping sales totals for each lessee, and performing other accounting functions. For these services, taxpayers received 12 percent of the lessees' gross sales. Most lessees opted for this service. Some did not. Taxpayers agree that this portion of their income is subject to the business and occupation (B&O) tax under the Service and Other Business Activities classification. This income is not at issue in the present appeal.

The income that is at issue is the flat monthly rental amount. Taxpayers contend that this is income from the rental of real estate and is exempt of the B&O tax. The Department's Taxpayer Account Administration Division (TAA), which issued the appealed assessments, characterized the described arrangements as licenses to use real property. Pursuant to WAC 458-20-118 (Rule 118), TAA also subjected this part of taxpayers' income to Service and Other Business Activities B&O tax.

[2]For the sake of convenience and because the written agreements identified them as such, we will refer to taxpayers as "lessors" and the persons to whom they granted use of space in the malls as "lessees". The reader should not interpret such identifications as dispositive of the ultimate issue in this case, which will be decided later in the "Discussion" section of this Determination.

Although the merchandise sold at the malls was owned by the lessees, most of the time it was actually sold to a customer by employees of taxpayers. It is our understanding that the lessees were not usually at the premises when the mall was open. Customers could browse through the various spaces. If an item caught their eye, they would summon a taxpayer employee sales clerk, who would unlock the display case, if necessary, and collect the money and sales tax for the article, if the customer decided to purchase it. Again, for those lessees who opted for the additional service, the taxpayers' sales clerk would record the sale. Monthly, taxpayers made available to lessees a paper accounting of the lessees' activities for the previous monthly period.

Taxpayers claim that all of the elements necessary for a legitimate lease of real property are present in this arrangement. Among other things, taxpayers state that the area conveyed is sufficiently identified, that the lessees have dominion and control of their designated areas, and that the fact the taxpayers have control over heating, lighting, and the opening and closing of the mall is not fatal to the status of the arrangement as a lease.

TAA, on the other hand, views the arrangement as a license to use real property because taxpayers control such things as lighting, heating, cleaning, repairing, opening and closing, and because taxpayers' employees made the sales for the vendor/lessees.

ISSUE:

Are persons granting others the use of space in an antique mall renting real property or granting a license to use same, when such use is pursuant to a written agreement which purports to be a lease?

DISCUSSION:

[1] Quite arguably, the lessees in this case are leasing a department of taxpayers' antique mall business operation. WAC 458-20-200 (Rule 200) is titled "Leased Departments." It reads, in part:

> (a) Where the lessor receives a flat monthly rental or a percentage of sales as rental for a leased department, such income is presumed to be from the rental of real estate and is not taxable. In a determination of whether an occupancy is a rental of real estate, all the facts and circumstances, including the actual relationship of the parties, are to be considered (see: WAC 458-20-118). Written agreements, while not required, are preferred and are given considerable weight in deciding the nature of the occupancy. While the fact that the written agreement may identify the occupancy as a "lease" is not controlling, agreements which contain the following provisions support the presumption that the occupancy is a rental of real estate:
> i. The occupant is granted exclusive possession and control of the space.
> ii. The occupancy is for a time certain which is more than 30 days, i.e. month to month, yearly, etc.
> iii. The parties are required to notify each other in the event of termination of the occupancy.

In this case the lessor receives a flat monthly rental and a percentage of sales. There is a written agreement which, without question, is in the form of a lease.

Under the terms of the agreement, the occupant (lessee) is granted possession and control of the space. In numbered paragraph two the lessor "leases" to the lessee a particular numbered space containing a particular number of square feet within a particular antique mall. The space is physically enclosed by walls or display cases. Although the language of the agreement in force during the audit period does not expressly state that the lessee has "exclusive dominion and control" of the space, it is apparent that that is what the parties intended.[3] There is no evidence that anybody other than the lessee could use, or did use, the space during the term for which the lessee was granted possession.[4] We recognize that taxpayer employees had access to the lessee's areas for the purpose of opening display cases for customers. This was in furtherance of the lessee's business, however, based on permission given by the lessee. We do not view this as interrupting possession and control by the lessee. Indeed, Washington courts have held that reservations by a lessor, wherein the lessor has some limited use of the leased premises, do not destroy the character of the contractual arrangement as a lease. See Tacoma v. Smith, 50 Wash.App. 717, 750 P.2d 647 (1988); and Barnett v. Lincoln, 162 Wash. 613, 299 P. 392 (1931). Further, as stated by taxpayers' counsel in his memorandum of September 2, 1994:

> In Regan v. City of Seattle, 76 Wn.2d 501, 504, 458 P.2d 12 (1969) the Supreme Court held that a one day rental agreement for the Seattle Center Coliseum (to be used for go-cart racing), which agreement contained a provision that the building would at all times remain under the charge and control of the Superintendent of Buildings of the City, who had a right to enter the building at any time and any matter not provided for in the lease would be left to the sole discretion of the Superintendent, did not divest the tenant of possession and control thereby converting a lease into something else.

As to other provisions which support the agreement as a rental arrangement according to Rule 200, the contract being construed is for a time certain, month to month. It also requires 30 days written notice for termination.[5]

---

[3]As Exhibit 5 of taxpayers' petition, they have included a revised rental agreement, which they began using April 1, 1994. In it the lessee is, by specific language, given exclusive possession and control of its space. Although this is a stronger expression of the lessee's necessary dominion, we do not believe that its absence in the previous agreement, given other evidence presented, vitiates the latter's status as a legitimate lease.

[4]In Det. No. 92-297, 12 WTD 461 (1992), an issue was whether a taxpayer had rented or leased a cold storage warehouse. Although there was no written agreement, we concluded that the parties' conduct demonstrated the necessary possession and control by a lessee for a lease to exist.

[5]Taxpayers' Petition for Correction of Assessment, Exhibit 4, page 1, numbered paragraph 3. Based on this requirement for notice of termination, it is probable that to remove an antique mall lessee for a breach of the written occupancy agreement, it would be necessary to invoke an action for unlawful detainer, according to the definition of that term in RCW 59.12.030 and the procedures set forth elsewhere in Chapter 59.12 RCW.

The characterization of the arrangement at issue as a rental of real estate is also consistent with Rule 118, which reads, in part:

> (2) 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.

In assessing the contested taxes, TAA has said, among other things, that because the lessees have no control in the mall buildings over such matters as lighting, heating, cleaning, repairing, and opening and closing the premises, the arrangement is a license to use real estate, as opposed to a rental. Indeed, Rule 118 does state that that is "usually" the case. In Barnett v. Lincoln, supra, however, the Supreme Court stated, quoting Tiffany, Landlord and Tenant, Vol.1, p. 23:

> One having a license on the other hand, has merely a permission to do certain acts, which he can assert against the licensor only, and which is ordinarily terminable or revocable at the will of the latter, and is not transferable.

Barnett, 162 Wash. at 618. The lessees in the instant case have more than permission to do certain acts. They are, in fact, contractually authorized to occupy the premises. Moreover, the interest that they have in the real property of the antique mall is not terminable or revocable at the will of the party who gave it. The sublease agreement states, at numbered paragraph two, that the lessor or the lessee must give 30 days written notice to terminate it.

We conclude that the arrangement at issue is a rental of real property. As such it is exempt of the business and occupation tax. RCW 82.04.390; and Rule 118.

DECISION AND DISPOSITION:

Taxpayers' petition is granted.

DATED this 9th day of October 1996.