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PRIVATE TAXPAYER RULING LR03-003

May 2, 2003

This private taxpayer ruling is in response to your letter dated September 23, 2002, as updated on October 10, 2002, in which you request a ruling on behalf of . . . ("Taxpayer-Lessor") regarding whether a certain commercial lease between Taxpayer-Lessor, as lessor, and . . . , as lessee (the "Lessee"), is excludable from Arizona Transaction Privilege Tax ("TPT") pursuant to Arizona Revised Statutes ("A.R.S.") § 42-5069(C)(5).

Statement of Facts:

The following is a restatement of the facts presented in your letters dated September 23, 2002, October 10, 2002, and November 14, 2002 and your clarifying email message dated December 4, 2002.

Taxpayer-Lessor, a . . . corporation that has elected to be treated as a real estate investment trust ("REIT") for federal tax purposes, is in the business of real estate investment. Taxpayer-Lessor owns various property sites that it leases to the Lessee, a . . . corporation, under a master lease agreement dated . . . (the "Lease"). Prior to entering the Lease, the Lessee owned 100% of outstanding Taxpayer-Lessor stock. On . . . , the Lessee transferred Taxpayer-Lessor stock to . . . ("Third Corporation"), creating a nested corporate ownership relationship between Taxpayer-Lessor and the Lessee. The line of corporate ownership that has been in place from the time the Lease was executed works as follows: Third Corporation, a . . . corporation that is not a party to the Lease, holds 100% of the shares of Taxpayer-Lessor common stock. The Lessee owns 100% of Third Corporation common stock. Each share of Taxpayer-Lessor common stock entitles its holder to vote in shareholder elections. Likewise, Third Corporation common stock represents voting stock.

The Lease applies to property located in Arizona (as well as other states) that Taxpayer-Lessor leases to the Lessee for purposes of operating retail stores. Site designation supplements to the Lease permit adding other sites to the initial group of leased sites. Each site carries an initial lease term of 20 years, with 5 renewal options of 5 years each. With respect to each site, the Lessee must pay an annual base rent on a monthly basis as well as any additional rent resulting from Taxpayer-Lessor's

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payment of taxes, assessments, existing rents, insurance, maintenance, repairs, management fees, landscaping costs, utility bills, and other charges assessed against the leased site.

Issues:

Does the lease of real property by a REIT to an affiliated corporation qualify for exemption from TPT under A.R.S. § 42-5069(C)(5)? Are the gross proceeds from the Lease exempt from taxation under the TPT commercial lease classification?

Your Position:

It is your position that the Taxpayer-Lessor REIT constitutes a "corporation" for purposes of the "affiliated corporation" exemption from TPT under the commercial lease classification. Additionally, the Lessee's control of Third Corporation voting stock and Third Corporation's control of Taxpayer-Lessor voting stock sufficiently "affiliate" Taxpayer-Lessor and the Lessee as required under A.R.S. § 42-5069(C)(5). You have concluded that the organizational structure of the parties to the Lease and the three-step control relationship between them create a lease that falls within the express language of the § 42-5069(C)(5) exemption from taxation under the TPT commercial lease classification.

Conclusion and Ruling:

On the basis of the information provided, Taxpayer-Lessor's lease of real property for commercial purposes to the Lessee is subject to TPT under A.R.S. § 42-5069 unless specifically exempt. Taxpayer-Lessor's REIT status does not disqualify it from satisfying requirements for an affiliated corporation exemption under A.R.S. § 42-5069(C)(5). Furthermore, the Lessee controls Taxpayer-Lessor by virtue of its indirect ownership of 100% of voting shares of Taxpayer-Lessor. Therefore, the Lessee controls at least 80% of Taxpayer-Lessor and constitutes an "affiliated corporation" within the meaning of A.R.S. § 42-5069(C)(5). As the lease of real property by a corporation to an affiliated corporation, Taxpayer-Lessor's leasing activities under the Lease qualify for exclusion from the commercial lease classification pursuant to A.R.S. § 42-5069(C)(5).

The following ruling is given based on the facts presented in your request.

The Department rules that a real estate investment trust, if validly incorporated, may qualify for exemption from Arizona Transaction Privilege Tax under the commercial lease classification as permitted under § 42-5069(C)(5)'s exclusion for leases by a corporation to an affiliated corporation.

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The Department further rules that the lease dated . . . between the Taxpayer-Lessor and the Lessee is not subject to Arizona Transaction Privilege Tax under the commercial lease classification.

The conclusions in this private taxpayer ruling do not extend beyond the facts presented in your letters dated September 23, 2002, October 10, 2002, and November 14, 2002 and your email message dated December 4, 2002.

This response is a private taxpayer ruling and the determinations herein are based solely on the facts provided in your request. The determinations are subject to change should the facts prove to be different on audit. If it is determined that undisclosed facts were substantial or material to the Department's making of an accurate determination, this taxpayer ruling shall be null and void. Further, the determination is subject to future change depending on changes in statutes, administrative rules, case law or notification of a different Department position.

The determinations in this private taxpayer ruling are applicable only to the taxpayer requesting the ruling and may not be relied upon, cited nor introduced into evidence in any proceeding by a taxpayer other than the taxpayer who has received the private taxpayer ruling.