

PRIVATE TAXPAYER RULING LR94-011

September 30, 1994

The following private taxpayer ruling is in response to your letter dated July 21, 1994 requesting clarification of Arizona transaction privilege tax liability under the commercial lease classification in the context of a partial sublease. The following is a restatement of the facts as presented in your letter.

Statement of facts:

... leases the ... office building located at ..., from ..., an Arizona corporation. The total leased area on the ... is 19,020 square feet. ... subleases most of the 14th floor under two separate subleases. The two subleases encompass 13,500 square feet for the exclusive use of the two subtenants (B & C). In addition, B & C have nonexclusive use of common areas including a reception area, conference room, galley, hallways and restrooms. ... will retain 1,797 square feet of the ... floor for its exclusive use which it uses for file storage. ... does not have any rights to use the reception area, conference room or galley which is shared by the two subtenants. ... has a nonexclusive right to use hallways for access to its storage area.

Your position:

Because ... has only limited rights to the common areas, you suggest that a fair allocation method is a ratio that allocates not only the exclusive portions but also common areas among the three tenants in actual possession. This can be computed by taking a ratio of the exclusive areas.

Applicable statutory provision:

Arizona Revised Statutes (A.R.S.) 42-1310.09 levies the transaction privilege tax on the business of leasing for a consideration the use or occupancy of real property.

A.R.S. 42-1310.09.C.3 provides an exemption for the lease of real property to a lessee who subleases the property if the lessee is engaged in business classified under the commercial lease classification.

Discussion:

Arizona imposes a transaction privilege tax which differs from the sales tax imposed by most states. The Arizona transaction privilege (sales) tax is a tax imposed on the privilege of conducting business in the State of Arizona. This tax is levied on the vendor/lessor, not the purchaser/lessee. The vendor/lessor may pass the burden of the tax on to the purchaser/lessee; however, the vendor/lessor is ultimately liable to Arizona for the tax.

A lessor of real property is subject to tax under the commercial lease classification on the income received from the business of leasing commercial property. (A.R.S. 42-1310.09) There is a statutory

exemption for income received from the lease of real property to a lessee who subleases the property if the lessee is engaged in business classified under the commercial lease classification. The tax is imposed on the lessor closest to the lessee in possession.

The tax liability is measured by the income received by a lessor exclusive of the portion which is subleased by the tenant. The determination of taxable rental income under the primary lease may be made through the utilization of a ratio calculation which divides the portion of the property which is not subleased by the total amount of property, exclusive of common areas. This ratio results in a percentage which is applied to the total income received under the primary lease to equal the taxable income to the primary lessor.

In order for a lessor to establish entitlement to the exclusion under the statutory exemption, the lessor should obtain a certificate from the lessee which fulfills the requirements specified by A.R.S. 42-1316, which includes the lessee's tax license number and other identifying information about the lessee. Arizona Department of Revenue Transaction Privilege Tax Exemption Certificate, Form 5000, which may be used for this purpose is enclosed for your convenience.

Conclusion and ruling:

The following ruling is given based on the facts presented in your request. The department rules that ... is subject to tax on the income received from ... attributable to the portion of the property which is not subleased to B & C. The income received from ... attributable to the portion of the property which is subleased to B & C may be deducted from the tax base of ... when computing its tax liability under the commercial lease classification. ... is subject to tax under the commercial lease classification on the income it receives for the portion of the property it subleases to B & C. The department also rules that the proposed methodology for determining the taxable rental income under the primary lease between ... and ... is an acceptable one. The allocation ratio presented results in an accurate computation of taxable rental income received under the lease between ... and

The conclusion in this private taxpayer ruling does not extend beyond the facts as presented in the letter dated July 21, 1994 in this request for a private taxpayer ruling. This response is a private taxpayer ruling and the determination herein is based solely on the facts provided in your request. The determination in this taxpayer ruling is the present position of the department and is valid for a period of four years from the date of issuance except as set out herein. This determination is 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.