

PRIVATE TAXPAYER RULING LR94-022

January 17, 1995

The following private taxpayer ruling is in response to your letter dated December 6, 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 presented in your letter.

Statement of facts:

The ... occupies premises located at ..., Arizona, which it leases from an out-of-state lessor. The premises consist of a building containing ... square feet of usable space, plus adjacent parking. ... has entered into an agreement with ... to sublease ..., or 13%, of the space plus a proportionate amount of the adjacent parking.

Your position:

You propose that the lessor's gross income should be prorated by an allocation method which represents the percentage of square feet used by the lessee\sublessor when the lessee enters into a sublease with a third party.

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 liability is measured by the income received by a lessor exclusive of the portion which is subleased by the lessee\sublessor. 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. This ratio is then multiplied by the total income received under the primary lease which results in the taxable income of the 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/sublessor which fulfills the requirements specified by A.R.S. 42-1316, including 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 under the commercial lease classification on the income of-state lessor from ... attributable to the portion of the property which is subleased to ... may be deducted from the tax base of the out-of-state lessor when computing its tax liability under the commercial lease classification. The department also accepts the proposed methodology for determining the taxable rental income under the lease between the out-of-state lessor and

The conclusion in this private taxpayer ruling does not extend beyond the facts as presented in the letter dated December 6, 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.