

ARIZONA DEPARTMENT OF REVENUE

1600 WEST MONROE - PHOENIX, ARIZONA 85007-2650

FIFE SYMINGTON
GOVERNOR



HAROLD SCOTT
DIRECTOR

ARIZONA TRANSACTION PRIVILEGE TAX RULING TPR 95-17

(This ruling rescinds Sales Tax Ruling 1-13-85)

(Note: On 10/15/2020 the statute cites were updated to reflect the current numbers and footnotes were added. See footnotes for details. No substantive changes were made.)

ISSUE:

Gross income derived from business activity under the commercial lease classification.

APPLICABLE LAW:

Arizona Revised Statutes (A.R.S.) § 42-5069¹ levies the transaction privilege tax on the business of leasing for a consideration the use or occupancy of real property. A person who, as a lessor, leases or rents for a consideration under one or more leases or rental agreements the use or occupancy of real property that is used by the lessee for commercial purposes is deemed to be engaged in the business of commercial leasing.

A.R.S. § 42-5069(D)² provides that the tax base for the commercial lease classification is the gross proceeds of sales or gross income derived from the business.

A.R.S. § 42-5001(4)³ defines "gross income" as "the gross receipts of a taxpayer derived from trade, business, commerce or sales and the value proceeding or accruing from the sale of tangible personal property or service, or both, and without any deduction on account of losses."

Arizona Administrative Code (A.A.C.) R15-5-1604 provides that gross income under the commercial lease classification includes all amounts paid to or on behalf of the lessor.

DISCUSSION:

The commercial lease classification is comprised of the business of leasing for a consideration the use or occupancy of real property. A person who leases real property for commercial purposes under one or more lease or rental agreements is deemed to be engaged in business.

¹ This ruling originally cited A.R.S. § 42-1310.09 which was renumbered to A.R.S. § 42-5069.

² This ruling originally cited A.R.S. § 42-1310.09(D) which was renumbered to A.R.S. § 42-5069(D).

³ This ruling originally cited A.R.S. § 42-1301.4 which was renumbered to A.R.S. § 42-5001(4).

ARIZONA TRANSACTION PRIVILEGE TAX RULING

TPR 95-17

(Rescinds Sales Tax Ruling 1-13-85)

Page 2

However, for purposes of applying the one or more lease standard, commercial property does not include a single lease of residential or agricultural property.

The phrase "for commercial purposes" in subsection B under the commercial lease classification, is a clarifying phrase for purposes of distinguishing between commercial, agricultural, or residential property. In other words, one lease of agricultural or residential property would generally not be considered taxable as a commercial use of real property subject to applicable provisions. See TPR 93-7⁴ for further discussion regarding agricultural leases.

This ruling addresses the concept of gross income under the commercial lease classification for a lessor who leases or rents real property under one or more lease or rental agreements.

RULING:

A.A.C. R15-5-1604 defines the term "gross income" for purposes of the rule and for purposes of the commercial lease classification under A.R.S. § 42-5069⁵. The rule has been amended on several occasions in order to further clarify the definition of the term "gross income."

The following items represent taxable gross income sources typically received by persons engaged in business classified under the commercial lease classification. This list of typical income sources is not intended to be exhaustive nor all inclusive.

- Rent.
- Property tax paid by lessee either as reimbursement to lessor or paid directly to the county treasurer on behalf of lessor.
- Insurance reimbursement paid to lessor or direct payment by lessee to the insurance company on behalf of lessor.
- Payments to lessor by lessee for common area maintenance.
- Payments to lessor by lessee for promotion of the facility or of the lessee.
- If the lease price includes services such as clerical services, receptionist services, access to library services, etc., there shall be no deduction from the gross proceeds subject to tax under the commercial lease classification for amounts allocable to these services. However, if such services are contracted for, not as a part of the lease nor required by the lease, but as separable, identifiable, non-related service contracts which are not made part of or obligatory under the lease, then receipts from the services are not included in the tax base under the commercial lease classification.

⁴ TPR 93-7 was rescinded in 2012 because it was no longer necessary due to changes in statutes.

⁵ See footnote number 1.

ARIZONA TRANSACTION PRIVILEGE TAX RULING

TPR 95-17

(Rescinds Sales Tax Ruling 1-13-85)

Page 3

- Utility connect/disconnect charges when lessee reimburses lessor for the expense, i.e., phone, water, gas, electric, and cable television.
- Phone, food, and beverage machine commissions.
- Prior to September 30, 1992, utility payments made to lessor, except when lessor installed individual utility meters for each lessee and separately charged lessee for service based on the readings of each meter. From and after September 30, 1992, reimbursements to lessor for utility services are allowable as a deduction from the tax base regardless of the existence of separate meters. The amount of the allowed deduction is limited to the lesser of the amount of the reimbursement received from lessee or the amount of utility charges as shown on the utility company billing. Also see ruling on reimbursements for utility services, TPR 92-7.
- Direct payment to lessor for leasehold improvements.
- Improvements to leased property made on behalf of lessor. A.A.C. R15-5-1604, adopted effective April 21, 1995, defines gross income under the commercial lease classification as including payments made by tenants for leasehold improvements when such payments are made on behalf of lessor.

Examples:

Company A (lessor) enters into a contract with Company B (lessee) for the purpose of leasing real property. As part of the lease contract, Company A requires that Company B make certain improvements to the real property. Company B is responsible for payment of the cost of the improvements. The amount paid by Company B for the improvements is considered to be a payment made on behalf of the lessor, and is therefore includable in gross income under the commercial lease classification.

Company A (lessor) enters into a contract with Company B (lessee) for the purpose of leasing real property. Subsequently, Company A and Company B agree that Company B will make certain improvements to the real property and the cost of such improvements will be applied as rent to Company A. The amount paid by Company B for the improvements is considered to be a payment made on behalf of lessor and is therefore includable in gross income under the commercial lease classification.

The following items represent income sources which are not included in the taxable income of a person engaged in business under the commercial lease classification. This list of income sources is not intended to be exhaustive nor all inclusive.

- Transaction privilege taxes and applicable municipal taxes.
- Copy charges based on number of copies made. (These charges are taxable under the job printing classification.)

ARIZONA TRANSACTION PRIVILEGE TAX RULING

TPR 95-17

(Rescinds Sales Tax Ruling 1-13-85)

Page 4

- Utility charges which lessee pays directly to the utility provider for the individual lessee's own utility service.
- From and after September 30, 1992, reimbursements made to lessor for utility services. The amount of the allowed deduction is limited to the lesser of the amount of the reimbursement received from lessee or the amount of utility charges as shown on the utility company billing.
- Improvements to leased property contracted and paid directly by lessee at his own discretion even though such improvements may be subject to the approval of lessor when: a) lessee is not required to provide leasehold improvements as a condition of the contractual agreement between the parties; and, b) the value of the improvements is not in lieu of gross income from the business of renting real property for a consideration.

Example:

Company A (lessor) agrees to lease real property to Company B (lessee) for the purpose of operating a restaurant. In order to make the property appropriate for restaurant use, the lessee will need to make certain improvements. The lessee is responsible for making and paying for the improvements. The lessor has the right to approve any leasehold improvements by lessee but there is no contractual requirement to make the improvements nor do the improvements affect the lease payments. No gross income accrues to lessor as a result of these tenant improvements.

Harold Scott, Director

Signed: December 20, 1995

Explanatory Notice

The purpose of a tax ruling is to provide interpretive guidance to the general public and to department personnel. A tax ruling is intended to encompass issues of law which are not adequately covered in statute, case law or administrative rules. A tax ruling is a position statement which provides interpretation, details or supplementary information concerning the application of the law. Relevant statute, case law, or administrative rules, as well as a subsequent ruling, may modify or negate any or all of the provisions of any tax ruling. See GTP 92-1 for more detailed information regarding documents issued by the Department of Revenue.