

## ***Sales Tax Applies to Payments by Tenants for Leasehold Improvements Unless Certain Conditions are Satisfied***

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Florida imposes sales tax on the renting or leasing of commercial real property and short-term renting or leasing of residential real property in the State of Florida. Taxable rent includes not only payments made by the tenant to or for the benefit of the landlord in exchange for the use of the real property, but also any property, consideration, or “other thing of value” provided by the tenant for the benefit of the landlord. Many years ago, the Florida Department of Revenue (the “**Department**”) started taking the position that sales tax was due where (i) the tenant was required under the lease to make or pay for leasehold improvements, and (ii) the leasehold improvements became the property of the landlord at the end of the lease. The Department argued that the payments made for the leasehold improvements were rent subject to sales tax. If the landlord failed to collect sales tax from the tenant on the leasehold improvements, then the landlord would be liable for the sales tax.

The Department’s position was challenged by a mall owner in *Department of Revenue v. Ruehl No. 925, LLC*, 76 So. 3d 398 (Fla. 1<sup>st</sup> DCA 2011). In that case, the appellate court held for the mall owner and found that there was no evidence of any intent by the tenant and landlord that the tenant’s obligation to make the leasehold improvements was consideration for the lease. The Department did not appeal this case, but there was uncertainty whether the Department would accept the decision by the First District Court of Appeal with respect to other taxpayers. Perhaps, some tax advisors speculated, the Department would try to find a case with better facts for the Department’s position in another District and litigate that case.

However, the Department recently indicated in a private ruling that it would follow the Ruehl decision under certain circumstances. In Technical Assistance Advisement 13A-023, the Department concluded that when a tenant is required to make leasehold improvements pursuant to a lease agreement, and such leasehold improvements become the property of the landlord at the end of the lease, the leasehold improvements would not be considered rent subject to sales tax if all of the following five conditions are satisfied:

1. The leasehold improvements are made to put the premises in a condition suitable for the operation of the tenant’s business;
2. There is no requirement for the tenant to spend a specific or minimum amount of money on the improvements;
3. There is no credit given against rental payments for the leasehold improvements furnished by the tenant;
4. The leasehold improvements are not explicitly classified as rent, additional rent, rent-in-kind, or in lieu of rent; and
5. There is no evidence that the tenant and landlord attempted to reclassify rental payments to avoid tax.

With respect to condition three, it should be noted that a Florida appellate court has held that leasehold improvements funded by the tenant were taxable rent, because the lease agreement provided that these expenditures were credited against the rent otherwise due. *Department of Revenue v. Seminole Clubs, Inc.*, 745 So. 2d 473 (Fla. 5<sup>th</sup> DCA 1999).

On condition four, it should be noted that in addition to making sure the lease agreement does not classify the leasehold improvements as rent, the landlord and tenant should also make sure that their accounting books and records, financial statements, and tax returns also do not classify the leasehold improvements as rental income or expense. In other contexts, the Department will frequently examine these records, statements, and returns to discern the intent of the parties.

These five conditions must be analyzed under the specific facts and circumstances of each lease where the tenant is obligated to pay for any leasehold improvements. Although not explicitly addressed by the Department in its ruling, the current position of the Department is that leasehold improvements made by a tenant pursuant to a lease that does not meet all five of these conditions are taxable. Furthermore, this ruling by the Department is not binding upon the Department with respect to any other taxpayers. Taxpayers that want certainty should seek their own ruling from the Department.

Up to this point, this article has addressed sales tax consequences associated with tenant-funded leasehold improvements. However, in some lease agreements, landlords are to fund all or a portion of leasehold improvements. The amount to be funded is oftentimes referred to as the “tenant allowance.”

In leases with a tenant allowance for leasehold improvements, there can be sales tax consequences when the actual the cost of the leasehold improvements is less than the previously agreed amount of the tenant allowance. These consequences were recently addressed by the Department in Technical Assistance Advisement 14A-006. If the lease agreement provides that the unused portion of the tenant allowance is applied as a credit to reduce the tenant’s rent obligation, then sales tax is imposed on the reduced rent amount (i.e., the gross rent amount reduced by the unused portion of the tenant allowance). If instead the lease agreement provides that the unused portion of the tenant allowance is to be paid to the tenant in money or other consideration (rather than explicitly providing for a rent credit) or gives the tenant the option of being paid the unused portion of the tenant allowance or receiving a rent credit, then sales tax will be imposed on the gross amount of rent due under the lease agreement without any reduction or offset for the unused portion of the tenant allowance.

If you have any questions regarding sales tax issues associated with leases of commercial real property or require assistance in connection with other sales tax issues, please contact the author, Michael J. Wilson, at (941) 536-2043 or [mwilson@williamsparker.com](mailto:mwilson@williamsparker.com).