



A Dash of SALT

Arizona's Sales Taxes on Proceeds From Leasing Real Property Apply to More Than Just Rent Payments

This month's state and local tax (SALT) column focuses on the scope of the tax base for the sales taxes that apply to persons or companies engaged in the business of leasing real property to the tenant in actual possession of that property.

Although the State of Arizona does not currently impose sales tax on proceeds from renting real property, four of Arizona's 15 counties (Gila, Maricopa, Pima, and Pinal) impose sales tax at the rate of 0.5% on such proceeds. In addition, most Arizona municipalities impose sales tax on proceeds from renting real property at rates that vary from 1.0% in Sierra Vista to 4.0% in Fredonia and San Luis.

The county version of this tax does not apply to transactions involving residential property. On the other hand, the real property rental tax imposed by most Arizona municipalities applies to proceeds from residential rental properties as well as to proceeds from commercial rental properties – but some Arizona municipalities do not impose tax on residential rental properties if the lessor only has one or two residential rental properties.

For real property rental transactions that are subject to Arizona county and/or municipal sales taxes, the tax base is the lessor's "gross income," less any allowable exemptions.

"Gross income" includes more than just the amount paid by the lessor's tenant as rent. Rather, it includes all amounts paid to or on behalf of the lessor, including items such as:

1. Property tax paid by the lessee, either as reimbursement to the lessor or paid directly to the tax collector on the lessor's behalf;
2. Insurance paid by the lessee, either as reimbursement to the lessor or paid directly on the lessor's behalf;
3. Common area maintenance charges paid by the lessee;

4. Payments by the lessee for the promotion of the facility or of the lessee;

5. Flat fees paid by the lessee for telephone and reception services, clerical services, library services, reproduction services or facsimile services when such services are contracted for as part of the lease or are obligatory under the lease;

6. Utility connect/disconnect charges;

7. Phone, food, and beverage machine commissions;

8. Repairs and improvements to the leased property made on behalf of the lessor;

9. Reimbursement for utility service in excess of the actual amount charged by the utility company;

10. Pet fees; and

11. Nonrefundable charges, such as cleaning charges.

See Arizona Administrative Code § R15-5-1604, Arizona Transaction Privilege Tax Ruling TPR 95-17, and Model City Tax Code § _ -445.

Refundable deposits are not part of gross income at the time of receipt if they are accounted for as a liability rather than as income. But:

1. Any portion of a refundable deposit that is retained by the lessor as a forfeited deposit shall be included in gross receipts subject to tax.

2. Any portion of a refundable deposit that is not claimed by the tenant at the time the tenant departs shall be presumed to be abandoned property if not claimed within five years from the



date of departure pursuant to A.R.S. Title 44, Chapter 3 and shall be reported and delivered as unclaimed property to the Department after the five-year period of time has elapsed.

3. If amounts reported as income are claimed as refundable deposits, the burden of proof shall be on the taxpayer to show that the income reported is not gross receipts subject to tax.

In addition to the forgoing items, Arizona municipalities also impose tax on proceeds from licensing the use of real property.

Practice Tip! Many real property owners who lease property to others do not realize that Arizona sales taxes often apply to their rental income. And, for those who are paying rental tax(es), the most common audit liability is for failure to pay tax on amounts they receive in addition to rent payments. Savvy CPAs help their clients make sure they are paying the taxes on their "gross income." **AZ CPA**

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Correction Notice: Last month's SALT column title should have read: *How Arizona Sales Tax Reform Will Affect All Businesses Subject to Arizona Sales Tax.*