



STATE OF HAWAII
DEPARTMENT OF TAXATION

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TAX INFORMATION RELEASE No. 92-5

RE: Application of the General Excise Tax on the Recovery of Real Property Taxes from Lessees and Sublessees

The purpose of this Tax Information Release is to remind taxpayers that the general excise tax applies to the total payments, including real property taxes (common area maintenance fees, etc.) received from a lessee or sublessee as consideration or rental for use or occupancy of real property.


The Tax Appeal Court held in In the Matter of the Tax Appeal of Waikiki Development Company, Inc., Tax Appeal Court Case No. 1799 (1979), that real property tax payments, including that portion assessed on sublessee-constructed improvements, received from sublessees were rental income to the sublessor taxable under the General Excise Tax Law. The sublessor contended that where the sublessees are required to build and pay for the improvements, the sublessees were primarily liable to pay the real property tax on the improvements, and, therefore, such payments were not income to the sublessor. The Court, however, held that such payments of the real property tax were income to the sublessor because the sublessees were required under the subleases to make payments of taxes in consideration for the use of the land. These payments were rental income, no different from those payments described as rent under the sublease contract. The sublessor, therefore, was subject to the general excise tax on those payments.

Payment of real property taxes directly to a county taxing authority by a lessee or sublessee on an owner/lessor/sublessor's real property does not affect the inclusion of the real property taxes in the owner/lessor/sublessor's income subject to the general excise tax where both the rent and the requirement to pay taxes are in consideration for the use of the property. Even if these payments are separately referred to as rent and taxes, both constitute rental income for use of the property and are subject to the general excise tax.

The following are examples of situations which illustrate the Department's position on the matter.

- Owner/lessor A agrees to lease a building to Lessee B. County real property tax of \$100 is assessed on the property. The terms of the lease require Lessee B to pay A stated rent and the \$100 county real property tax for the use of the property. The \$100 real property tax is paid by Lessee B to the county. The real property tax paid as well as the stated rent, are both rental

- income for use of the property received by Owner/lessor A and subject to the general excise tax at the rate of 4 percent.
- The facts are the same as in the preceding example, but Lessee B, in turn, subleases the building to Sublessee C. The terms of their lease require that, in order to use the building, Sublessee C must pay an amount called rent as well as additional real property taxes on the improvements made by Sublessee C, which equal \$25. The amount called rent paid by Sublessee C to Lessee/sublessor B includes all other real property taxes, but these real property taxes are not separately stated. The \$25 designated real property tax, as well as the amount called rent paid to Lessee/sublessor B, is rental income to Lessee/sublessor B, for use of the building.
 - Owner/lessor A leases a building to Lessee B. The lease provides that Lessee B will pay all real property taxes and establishes rent for the lease of the building. The rental income for the use of the property is the amount deemed to be rent in the lease and any amount the lessee pays for real property taxes under the lease. Lessee B offers to pay the real property taxes directly to the county taxing authority, tells Owner/lessor A that this reduces Owner/lessor A's rental income, and that Owner/lessor A should reduce any general excise taxes passed on to Lessee B by the general excise tax due on the amount that Lessee B pays for real property taxes. This arrangement does not reduce, by real property taxes directly paid by Lessee B, the amount of rental income received by Owner/lessor A for use of the property. The real property taxes paid are rental income received by Owner/lessor A for the use of the property, even though Lessee B pays the taxes directly to the county taxing authority. Real property taxes are a cost of doing business and are not deductible from gross income under the General Excise Tax Law, chapter 237, Hawaii Revised Statutes. Whether or not Owner/lessor A passes the general excise taxes assessed on rental income to Lessee B is up to Owner/lessor A.


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