

Commercial Real Property Rental

Transaction Privilege (Sales) and Use Tax



Who must pay the tax?

A person who, as a lessor, leases or rents for a consideration under one or more leases or rental agreements for 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 person in the business of leasing, licensing, or renting a nonresidential land, building, or space to a tenant in actual possession (i.e., not subleased by them to someone else) must pay tax to the city of Phoenix on the units located within the city of Phoenix. Licensing means any agreement between the property owner and the user of real property that does not grant the full rights of a lease. Examples of taxable commercial rentals include, but are not limited to: office buildings, parking lots, stores, banquet halls, factories, meeting rooms, commissions on vending machines, storage facilities, vacant land, space at a swap meet, churches, or safe deposit boxes.

What is the city and county tax rate?

The city's tax rate is 2.4%; the combined rate (including county tax) is 2.9%. The state of Arizona does not impose a transaction privilege tax on the rental of commercial property.

When are tax payments due?

Tax returns and payments are due on the 20th day of the month following the reporting period.

What is taxable?

All amounts paid by the tenant under the terms of the lease agreement are gross income to the lessor. All amounts paid by the tenant to the lessor, or paid on the lessor's behalf, are gross income including common area maintenance, property tax (paid to the lessor or the county), mortgage, repairs, improvements, insurance, forfeited deposits, and recoveries due to court action. Gross income also includes commissions received from licensing space for vending and amusement game machines or similar charges for use of space, and charges for items like telecommunications, utilities, and pet fees as detailed in P.C.C. Section 14-445.

Subleasing

Income from subleasing is taxable, but the sublease provides an exemption to the primary lessor. The primary lessor is entitled to an exemption for the portion of the property subleased by their tenant. For example, Company A leases a 10,000-square foot building to Company B for \$6,000 per month. This is considered the primary lease. Company B subleases 2,500 square feet to Company C for \$3,000 per month. This is considered a sublease.

The taxable incomes of Company A and B are computed as follows:

	<u>Company A</u>	<u>Company B</u>
<i>Square Footage</i>	7,500 (10,000 minus 2,500)	2,500
<i>Percentage of Square Footage</i>	75% (= 7,500 ÷ 10,000)	25% (= 2,500 ÷ 10,000)
<i>Primary Lease Rental Income</i>	\$6,000	
<i>Taxable Income</i>	\$4,500 (= \$6,000 x 75%)	\$3,000

This exemption must be computed based on the square footage subleased, not the values of the primary lease and the sublease.

Affiliated Entities

The gross proceeds of a commercial lease of real property between affiliated companies, businesses, persons or reciprocal insurers are exempt, as detailed in P.C.C. Section 14-445(s). For the purposes of this business classification:

1. Affiliated companies, businesses, persons or reciprocal insurers means the lessor holds a controlling interest in the lessee, the lessee holds a controlling interest in the lessor, an affiliated entity holds a controlling interest in both the lessor and the lessee, or an unrelated person holds a controlling interest in both the lessor and lessee.
2. Controlling interest means direct or indirect ownership of at least 80 percent of the voting shares of a corporation or of the interests in a company, business, or person other than a corporation.
3. A reciprocal insurer has the same meaning as prescribed in Section 20-762, Arizona Revised Statutes.

What exemptions, deductions, and credits may apply to commercial real property rental gross income?

Please refer to the Phoenix Tax Code Section 14-445 and 14-446.

Common Deductions

<u>Deduction Code</u>	<u>Description of Deduction Code</u>
551	Factored Tax Deduction
558	Bad Debt Deduction
634	Commercial Lease between Affiliates
638	Commercial Lease to Nonprofits for Major League Baseball or Golf
708	Vendor Discounts or Customer Returns
714	CITIES ONLY – Qualified Hospital, Healthcare or Community Health Center

For a more detailed list of deductions, see the Arizona Department of Revenue’s deduction code list at https://azdor.gov/sites/default/files/TPT_SIMPLIFICATION_DED-NL.pdf or the Phoenix City Code, accessible at <https://www.codepublishing.com/AZ/Phoenix/?Phoenix14/Phoenix14.html>.

If you have questions or need assistance with the calculation of the commercial rental property tax, please contact the city of Phoenix, Finance Department, at (602) 262-6785 or email your questions to tax@phoenix.gov.

This publication is for general information regarding Transaction Privilege (Sales) Tax for commercial rental, leasing, or licensing for use of real property. For complete details, refer to the city of Phoenix Tax Code and related regulations. In the case of an inconsistency or omission in this publication, the language of the Tax Code will prevail. The transaction privilege tax is commonly referred to as a sales tax; however, under State of Arizona law, the tax is on the privilege of conducting business in Phoenix, imposed on the business and not the purchaser.