State of Arizona
Board of Equalization
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SUBSTANTIVE POLICY STATEMENT
NUMBER SBOE-04-003
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This statement establishes the Board's policy on whether a landlord's use or a tenant's use of commercially leased property should govern its classification or status as exempt.

A.R.S. § 42-12001 provides specific types of class one (commercial) property and states that any other property devoted to commercial use and not belonging in another class is also class one property. This policy statement addresses the classification of commercially leased property that a tenant is using in a way consistent with another classification or an exemption.

Based on its interpretation of recent case law, including *Kraus v. Maricopa County*, 200 Ariz. 479, 28 P.3d 335 (App. 2001), and *U-Stor Bell v. Maricopa County*, 204 Ariz. 79, 59 P.3d 843 (App. 2002), the Board's policy is that the focus in all cases of commercially leased property should be on the landlord's use of the property. Thus, regardless of whether the tenant's use of the property is consistent with an exemption or another classification, the landlord's use of the property as a commercial lessor requires the property to be classified as class one commercial property.

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MEMORANDUM

To: All Board Members

Cc: All Board Hearing Officers and Staff

From: Harold Scott, Chairman

Date: June 11, 2004

Re: Krausz v. Maricopa County; Legal Classification of Commercial Leased Property

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Background

A.R.S. § 42-12001(1)-(11) provides a list of specific types of class one (commercial) property. The statute also provides that real property and improvements or personal property that is used for any other commercial or industrial use, and not specifically included in another class is also class one property (A.R.S. § 42-12001(12) & (13)).

A confusing issue developed about whether the property of commercial lessors should be classified as class one in a case where the tenant's use of the property is consistent with another property classification (i.e. class nine property) or a constitutional exemption (i.e. religious or governmental property).

In the case Krausz v. Maricopa County, Division One of the Arizona Court of Appeals addressed this issue. Briefly, in a case where a landlord rents property as a commercial lessor, the focus should be on the landlord's use of the property, and thus the property should be classified as class one, no matter how the tenant uses the property.

In the Krausz case, the taxpayer leased an office building to the Arizona Department of Environmental Quality (ADEQ), which used the building for government purposes. The county classified the property as class one, and the taxpayer appealed, arguing that the governmental use of the property precluded its classification as class one property.[1]

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[1] The taxpayer did not argue that the tenant's use was consistent with any other specific class.

The Court of Appeals disagreed, stating that "neither statute nor logic requires the conclusion that the tenant's use of the property must control its classification."

The Court quoted with approval a Kansas case called Appeal of Wirt:

> [A]n investor who owns valuable property, real or personal, and leases it for profit . . . is exercising his right to use the property just as surely as if he were utilizing it in a physical sense for his own objectives . . . . The renting by the lessor and the physical use by the lessee constitute simultaneous uses of the property and when an owner leases his property to another, the lessee cannot be said to be the only one using the property. The owner is using it as he sees fit to realize a profit from his investment just as surely as if he physically operated the property. (Supreme Court of Kansas, 1979).

The ruling in the Krausz case is consistent with other court decisions addressing similar issues.

In the case U-Store Bell v. Maricopa County, the Court of Appeals (Division One) addressed a situation, not addressed in the Krausz case, where the use of the property is consistent with a specific classification (a copy of this decision was distributed at our recent training classes). In this case, a commercial storage facility required its on-site manager to live in an apartment at the facility. The company claimed the apartment should have been classified as class four (rented residential).

Again, the Court focused on the owner's use of the property, holding that the apartment should be classified as class one. The reasoning behind this decision was that, though the manager lived in the apartment, the employer's use of the apartment to provide around-the-clock security and management to the complex should be the focus of the inquiry.

This principle should apply equally to a case where a tenant is using the property in a way consistent with a constitutional exemption. For example, even if the tenant is a religious organization (exempted by Article 9, Section 2(2) of the Arizona Constitution), the property should still be classified as class one if the landlord is leasing the property as a commercial lessor.

This conclusion is implied by an older case, Maricopa County v. North Phoenix Baptist Church (1966). In that case, the church agreed to sell church property, but the contract permitted the church to remain on the property until the deal was complete. The Arizona Court of Appeals held that, until the property transfer took place, the property still fit under the constitutional exemption. However, the Court there intimated that the exemption would not have applied if the church had been paying rent to the new owner.

Conclusion

Consistent with the cases on this issue, it is the Board's position that, in a case involving a dispute of a commercial lessor's property classification, the Board should focus on the issue of whether the landlord leases the property as a commercial lessor. If so, it is irrelevant whether the tenant's use of the property is consistent with an exemption or another classification. The property should be classified as class one commercial property, which is consistent with the landlord's use of the property.

This memorandum has been reviewed by the Assistant Attorney General assigned to the SBOE and he concurs with it.

Should you have any questions on this matter, please call me.