

## TENANT IMPROVEMENTS

### I. INTRODUCTION

Section 11-701.6 of the Administrative Code defines “Rent” for purposes of the Commercial Rent Tax (CRT) as:

“The consideration paid or required to be paid by a tenant for the use or occupancy of premises, valued in money, whether received in money or otherwise, including all credits and property or services of any kind and including any payment required to be made by a tenant on behalf of his or her landlord for real estate taxes, water rent or charges, sewer rents or any other expenses (including insurance) normally payable by a landlord who owns the realty other than expenses for the improvement, repair or maintenance to the tenant’s premises.”

A landlord may satisfy a debt that it owes to a tenant by allowing the tenant to take a credit against the rent payable under a lease. That credit represents a payment of rent by the tenant to the landlord. Thus, if under the terms of a lease, a tenant makes improvements to the leased premises that the landlord is obligated to make and the tenant takes a credit against rent for the improvement costs, the statutory exclusion from rent for “expenses for the improvement, repair or maintenance to the tenant’s premises” does not apply to the credited amount. It is as if the tenant paid the rent as set forth under the lease and the landlord then used those funds to pay a debt owed to the tenant.

The statutory exclusion applies only when the landlord is not obligated to make leasehold improvements and the tenant makes the leasehold improvements.

This may be illustrated by the following example. Lease A provides for a fixed monthly rental of \$40,000. It further provides that the landlord is obligated to make \$400,000 worth of improvements to the tenant’s premises. Lease B also provides for a fixed monthly rental of \$40,000 after the first ten months. The tenant may make \$400,000 worth of leasehold improvements. Under Lease B, the landlord has no obligation to make leasehold improvements.

Under Lease A, if the tenant makes the \$400,000 worth of improvements itself and does not pay rent for ten months, the \$400,000 expended for improvements would be subject to the CRT. Under Lease B, if the tenant makes the improvements, the \$400,000 expended for the improvements would not be subject to the CRT.

## **II. SCOPE**

This Statement of Audit Procedures will give guidance to auditors in determining when tenant expenditures for leasehold improvements may be subject to the Commercial Rent Tax.

## **III. PROCEDURE**

The auditor must review the lease to determine the taxability of tenant expenditures.

If a lease specifies a dollar amount for a work allowance that the landlord is obligated to provide, then the tenant's payment of this obligation on behalf of the landlord in lieu of fixed rental payments, will be subject to the CRT.

If a lease does not obligate the landlord to provide a specified work allowance, then the tenant's leasehold improvement expenditures are not subject to tax.

This SAP will apply to all new leases and to all renewals or extensions of existing leases entered into on or after the thirtieth day following the date of this SAP other than any renewal or extension entered into after such date pursuant to the terms of a renewal or extension option contained in a lease entered into prior to such date.