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July 27, 2010

**Re: *Interpretation of Property Tax Rules Relating to Reinvestment of Proceeds from
 Condemned Property***
Assignment No.: 10-064

Dear Mr. _____ :

This is in response to your letter to Assistant Chief Counsel Randy Ferris, wherein you requested our opinion regarding whether the acquisition by a trust of a condominium used for rental purposes qualifies for a base year value transfer for property acquired by a person displaced by eminent domain proceedings. As explained below, based on the information provided, it is our opinion that the acquisition of the property by the trust qualifies for a base year value transfer to the extent that the two properties are similar in size, function and utility.

Factual Background

Your letter concerns a commercial strip center (the "original property") that was owned by the D _____ Family Trust (the "Trust"). According to your letter, the City of _____ purchased the property using the power of eminent domain. A few months later, a limited liability company (LLC), owned 100 percent by the Trust purchased a condominium used for rental purposes located at _____, _____, CA (the "replacement property"). About one year later, the replacement property was transferred from the LLC to the Trust. You ask whether the transfer qualifies for a base year value transfer pursuant to Revenue and Taxation Code,¹ section 68.

Law & Analysis

Section 60 defines a change in ownership as a transfer of a present interest in real property, including the beneficial use thereof, the value of which is substantially equal to the value of the fee interest. The first paragraph of section 68 provides that a change in ownership does not include:

the acquisition of real property as a replacement for comparable property if the person acquiring the real property has been displaced from property in this state by eminent domain proceedings, by acquisition by a public entity, or by governmental action which has resulted in a judgment of inverse condemnation.

¹ All section references are to the Revenue and Taxation Code unless otherwise specified.

Your letter states that the original property was "purchased by the City of through eminent domain." This appears to meet the requirements of section 68, however, without documentation, we cannot comment conclusively on the issue of whether the Trust was displaced by eminent domain proceedings. For the purposes of this letter, we will assume that it was.

With regards to the ownership requirements of section 68, Property Tax Rule² (Rule) 462.500, subdivision (e), states:

Only the owner or owners of the property taken, whether one or more individuals, partnerships, corporations, other legal entities, or a combination thereof, shall receive property tax relief under this section. Relief under this section shall be granted to an owner(s) of property taken who obtains title to replacement property. The acquisition of an ownership interest in a legal entity which, directly or indirectly, owns real property is not an acquisition of comparable property.

According to your letter, the Trust was the record owner of the original property.³ Since the Trust owned the original property, the Trust must acquire the replacement property to obtain relief under section 68. For this reason, the purchase of the property by the LLC will not qualify for section 68. For property tax purposes, the separate identity of a legal entity is respected. (See Rule 462.500, subd. (e), Example 10.) Therefore, despite the fact that the trust owned 100 percent of the interests in the LLC, the acquisition of the replacement property by the LLC is not considered an acquisition by the Trust and will not qualify for relief under section 68.

The subsequent transfer of the property from the LLC to the Trust does qualify as an acquisition of property by a person displaced from property by eminent domain since the Trust was displaced from the original property and also acquired the replacement property. Because the replacement property was acquired within four years of the purchase of the original property, it was timely. (Rule 462.500, subd. (g)(2).)

Rule 462.500, subdivision (c), interprets section 68's comparable property requirement and provides that replacement property "shall be deemed comparable to the property taken if it is similar in size, utility, and function." Under subdivision (c)(3) of Rule 462.500, to the extent that a replacement property or any portion thereof, is not similar in size, function, and utility, the property undergoes a change in ownership.

Under subdivision (c)(2) of Rule 462.500, "[p]roperty is similar in *function* and *utility* if the replacement property is or is intended to be used in the same manner as the property taken. Property is similar in function and utility if the property taken and the replacement property both fall into the same category." (Emphasis added.) The three categories are:

² References to "Property Tax Rules" or "Rules" are section references to title 18 of the California Code of Regulations.

³ For property tax purposes, the beneficial owners of trust property in a revocable trust are the trustors; and of an irrevocable trust are the present beneficiaries of the trust. (Rev. & Tax. Code, § 62, subd. (d); Rule 462.160, subd. (b)(1).) Your letter did not indicate whether the Trust was revocable or irrevocable, nor did it identify the beneficiaries or trustors. As such we cannot say who owns the property for property tax purposes. For the purposes of this letter, we will refer to the Trust as the owner of the property, though in reality it is either the beneficiaries or trustors who are the actual owners.

- Category A: Single-family residence or duplex.
- Category B: Commercial, investment, income, or vacant property.⁴
- Category C: Agricultural property.

This means that property "held for productive use in a trade or business or held for investment . . . may be replaced with another property that is held for productive use in a trade or business or held for investment. The replacement property does not need to have the same zoning or use type as the property taken." (Letter to Assessors (LTA) 2005/007, *Property Tax Rule 462.500: Change in Ownership of Real Property Acquired to Replace Property Taken by Governmental Action or Eminent Domain Proceedings*, dated Jan. 14, 2005, p. 3.)

Based on the facts contained in your letter, the original property was a commercial strip center and should be classified as Category B, commercial, investment, income, or vacant property for purposes of applying the comparable property requirements of section 68 and Rule 462.500. The replacement property, which is a condominium used for rental purposes, should also be classified as Category B, commercial, investment, income, or vacant property, so long as the Trust holds it for investment and the generation of income. Thus, the original property and the replacement property are comparable in function and utility for purposes of section 68 and Rule 462.500.

Under subdivision (c)(1) of Rule 462.500, "[t]he size of property is associated with value, not physical characteristics." Specifically, "[p]roperty is similar in *size* if its full cash value does not exceed 120 percent of the award or purchase price paid for the property taken." (Emphasis added.) Pursuant to section 68, the adjusted base year value of the replacement property will be the lower of:

- (a) The fair market value of the property acquired; or
- (b) The sum of the adjusted base year value of the property from which the person was displaced and the amount, if any, by which the full cash value of the property acquired exceeds 120 percent of the amount received by the person for the property from which the person was displaced.

Your letter did not provide any information regarding either the fair market value of the replacement property or the amount received by the Trust from the City of Imperial Beach. Therefore, we cannot comment as to what extent the properties are similar in size for the purposes of Rule 462.500 except to say that the adjusted base year value will be the lesser of the two above-mentioned values.

In conclusion, since the purchase of the replacement property by the LLC did not constitute an acquisition by a person displaced by eminent domain, the property should have been reassessed at that time pursuant to section 60. Section 68 could not have applied until the Trust acquired the replacement property. As explained above, while the properties are similar in function and utility, we were given insufficient information to determine whether the properties were similar in size. As such, we cannot conclusively state to what extent section 68 applies to the acquisition of the replacement property by the Trust.

⁴ Category B property may also include historically agricultural property that is "in transition" to another use. (Rule 462.500, subd. (c)(2).) However, it appears that neither the property taken nor the property acquired in this case are agricultural or transitional in nature.

The views expressed in this letter are only advisory in nature. They represent the analysis of the legal staff of the Board based on present law and the facts set forth herein, and are not binding on any person or public entity.

Sincerely,

/s/ Daniel Paul

Daniel Paul
Tax Counsel

DP:yg

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cc: Mr. David Gau MIC:63
Mr. Dean Kinnee MIC:64
Mr. Todd Gilman MIC:70