



STATE BOARD OF EQUALIZATION

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February 15, 1990

Your letter dated August 21, 1989 to Richard H. Ochsner, Assistant Chief Counsel, has been referred to the undersigned for reply. The fact set forth in your letter can be summarized as follows:

1. In May 1961, a California limited partnership as lessor, entered into a 54-year ground lease (the "lease") with a California limited partnership ("GLC"), as lessee.
2. the lessor, was also the sole limited partner in the lessee.
3. The ground lease covers several legally subdivided parcels of real property which have been developed for commercial purposes.
4. In 1989, with approximately 26 years remaining in the lease term, the lessee transferred to its partners, in kind, its leasehold interest (the "lease" or "leasehold") in one of the parcels (the "property"), with . . . each partner receiving an undivided interest in the distributed [lease].
5. Thereafter, lessor purchased the undivided leasehold interest of the other lessee partner(s).
6. As a result of the above-stated transactions, the lessor, acquired 100 percent of the lessee's interest in the property.

You have requested our opinion of the change in ownership consequences of the above-described transactions.

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Law and Analysis

Pursuant to section 61 of the Revenue and Taxation Code (unless otherwise noted, all code references shall be to the Revenue and Taxation Code):

Except as otherwise provided in Section 62, change in ownership . . . includes, but is not limited to:

* * *

(c) (1) The creation of a leasehold interest in taxable real property for a term of 35 years or more (including renewal options), the termination of a leasehold interest in taxable real property which had an original term of 35 years or more (including renewal options), and any transfer of a leasehold interest having a remaining term of 35 years or more (including renewal options);

Only that portion of a property subject to such lease or transfer shall be considered to have undergone a change of ownership.

* * *

As no renewal option is specifically mentioned in your letter, we will assume that no such option exists.

Section 61(c) is based upon a recognition that a long-term lease can serve as the means of conveying the equivalent of a fee interest to the lessee. It also reflects the need to identify one primary owner in order to simplify the assessment process. With these facts in mind, the Legislature has essentially provided that the holder of a leasehold interest with a term of 35 years or more is to be treated like the owner of the property for change in ownership purposes. Ehrman & Flavin, Taxing California Property (Callaghan, 1988), p. 42.

When GLC distributed in kind interests in the leasehold to its partners, RIC, as the sole limited partner in GLC, acquired an unspecified undivided interest in such leasehold estate. Pursuant to section 1933 of the Civil Code, such acquisition by the lessor of an undivided interest in the leasehold effected a merger of the lessor's and lessee's interests in the property to the extent of the undivided interest. Vucinich v. Gordon (1942) 51 Cal.App.2d 434, 436-437. Lewis v. Kohls (1945) 70 Cal.App.2d 20, 26-27. Such merger effected a termination of the lease of the property to the extent of the undivided interest distributed to RIC. As the original lease term exceeded 35 years, such

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termination resulted in a change of ownership of the property under Revenue and Taxation Code section 61(c)(1). See also Property Tax Rule 462(F)(1)(A)(iii) of Title 18 of the California Code of Regulations.

When lessor subsequently acquired the undivided leasehold interest of the other partner in lessee, a merger was effected as to the remaining portion of the lease. This merger terminated the balance of the leasehold and effected a change in ownership of the remaining portion of the property under section 61(c)(1).

You have given your opinion that no change in ownership should result, citing Property Tax Rule 462(F)(2)(A)(ii), as set forth below:

(2) The following transfers of either the lessee's interest or the lessor's interest in taxable real property do not constitute a change in ownership of such real property.

(A) Lessee's interest.

* * *

(ii) The transfer . . . or assignment of a leasehold interest with a remaining term of less than 35 years (regardless of the original term of the lease).

Specifically, you contend that there is an inconsistency between the above-cited Property Tax Rule 462(F)(2)(A)(ii) and Property Tax Rule 462 (F)(1)(A)(iii), which, in conformity with section 61(c)(1), provides that the termination of a leasehold with ~~an~~ original term of 35 years or more constitutes a change in ownership. In your opinion "transfers which result in a termination of the lease caused solely by operation of law (i.e., by merger)" should not be held to result in a change in ownership.

We do not concur with such opinion. To begin with, section 61(c)(1) does not differentiate between lease terminations effected by operation of law or otherwise. Further, the transfers of leasehold interests by and between GLC and its partners did not, in and of themselves, cause the changes in ownership. The respective changes in ownership were caused by the two lease terminations which resulted from the merger of the lessor's and lessees' interests in the property. Such lease terminations were the result of the application of California law, namely Civil Code section 1933, to the transactions in question.

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Since lease termination is dictated by state law, the provisions of section 61(c)(1) and Property Tax Rule 462(F)(1)(A)(iii) must, by their express terms, apply to the transactions, effecting the two changes in ownership referenced above.

The views expressed in this letter are, of course, advisory only and are not binding upon the assessor of any county. Please write or call me if you require any further information.

Very truly yours,



Robert W. Lambert
Tax Counsel

RWL:mw
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cc: Mr. Robert W. Frazier
San Diego County Assessor's Office