



Memorandum

To : [Redacted]

Date : October 16, 1989

From : [Redacted]

Eric F Eisenlander

Subject : Transfer of Lessor's (Government Entity) Interest in Real Property Subject to a Lease With a Remaining Term in Excess of 35 Years

This is in response to your memorandum to [Redacted] of September 6, 1989 wherein you ask whether a change in ownership occurred under the following circumstances:

Real property owned by the City of Anaheim was leased to a private party for 50 years, creating a taxable possessory interest. With 37 years remaining on the lease, the City sold the property to a private entity.

Revenue and Taxation Code* section 60 defines "change in ownership" to mean "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."

Section 61 provides in relevant part that "[e]xcept as otherwise provided in section 62, change in ownership, as defined in section 60, 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); or (2) any transfer of a lessor's interest in taxable real property subject to a lease with a remaining term (including renewal options) of less than 35 years."

Section 62 provides in relevant part that "[c]hange in ownership shall not include . . . [¶] (g) [a]ny transfer of a lessor's

*All statutory references are to the Revenue and Taxation Code unless otherwise indicated.

interest in taxable real property subject to a lease with a remaining term (including renewal options) of 35 years or more."

The rationale behind the foregoing provisions was stated by the Task Force on Property Tax Administration in pertinent part as follows:

The "value equivalence" test is necessary to determine who is the primary owner of the property at any given time. Often, two or more people have interests in a single parcel of real property. Leases are a good example. The landlord owns the reversion; the tenant, the leasehold interest. Suppose the landlord sells the property subject to the lease and the lessee assigns the lease. Which sale or transfer is the change in ownership?

The example illustrates that in determining whether a change in ownership has occurred it is necessary to identify but one primary owner. Otherwise assessors would be forced to value, and account for separate base year values for landlords and tenants on all leases, and for other forms of split ownership. This would enormously complicate the assessor's job.

A major purpose of this third element, therefore, is to avoid such unwarranted complexity by identifying the primary owner, so that only a transfer by him will be a change in ownership and when it occurs the whole property will be reappraised. If the hypothetical lease previously mentioned was a short term lease (the landlord owned the main economic value), the landlord's sale, subject to the lease would count. If, on the other hand, the lease was a long term lease (the lessee's interest was the main economic package), the lease assignment would count. In either case, the entire fee value of the leased premises would be reappraised.

Specific Statutory Examples

1. Leases. Leases are a good illustration of the necessity of concrete statutory examples. Both taxpayers and assessors need a specific test--rather than the broad "value equivalence" test--to determine the tax treatment of leases. The specific test, however, must be consistent with the "value equivalence" rule and have a rational basis. Lenders will lend on the security of a lease for 35 years or longer. Thus 35 years was adopted as the concrete dividing line. If the term of a lease, including options to renew, is 35 years or more, the creation of the lease is a change in ownership and so is its expiration. If a lessee under such a lease assigns or sublets for a term of 35 years or more, that is another

change in ownership. However, if the lease, including options, is for less than 35 years, the lessor remains the owner and only the transfer of his interest is a change. In all cases, the entire premises subject to the lease in question are reappraised.

2. Possessory Interests. The creation, assignment or sublease of a possessory interest in tax exempt property are changes in ownership regardless of their term. That is not inconsistent with private leases, however. In possessory interest there is only ONE owner of taxable real property, the lessee, because the lessor's interest is tax exempt. The lessee's interest, therefore, is always "substantially equivalent" to the fee interest in the taxable real property. (Report of the Task Force on Property Tax Administration, January 22, 1979, pages 39-41.) See also, Implementation of Proposition 13, Volume 1, Property Tax Assessment, October 29, 1979, pages 19, 20, 25 and 26.

It is clear under the foregoing provisions that both before and after the transfer by the City of its interest in the property the one primary owner of the property was the lessee. Following that rationale, the transfer should not constitute a change in ownership notwithstanding the fact that such transfer results in "the creation of a leasehold interest in taxable real property for a term of 35 years or more."

This conclusion is consistent with the approach taken in Rule 462(e) which provides that "[t]he creation, renewal, sublease, or assignment of a taxable possessory interest in tax-exempt real property for any term is a change in ownership except when the interest, whether an estate for years or an estate for life, is created by a reservation in an instrument deeding the property to a tax exempt governmental entity." (Emphasis added.)

The apparent rationale for the exception noted in Rule 462(e) is that since the grantor owned the fee interest prior to the transfer and was the one primary owner of taxable real property after the transfer, the transfer of a remainder interest in the real property to the tax exempt governmental entity should not be a change in ownership notwithstanding the fact that the transfer resulted in the "creation . . . of a taxable possessory interest in tax exempt real property." See Property Tax Rule 21(a) and 21(b). We are of the opinion that the same rationale is applicable here. Accordingly, we conclude that the transfer by the City of Anaheim of real property subject to a lease with a remaining term exceeding 35 years is not a change in ownership for property tax purposes.

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cc: Mr. John W. Hagerty