

## Memorandum

**To:** Honorable Antonio Vazquez, Chairman  
Honorable Mike Schaefer, Vice Chair  
Honorable Ted Gaines, First District  
Honorable Malia M. Cohen, Second District  
Honorable Betty T. Yee, State Controller

**Date:** June 12, 2020

**From:** /s/ Henry Nanjo  
Henry D. Nanjo  
Chief Counsel

**Subject:** *June 23-24, 2020 Board Meeting*  
*Chief Counsel Matters - Item G – Rulemaking.*  
*Authorization to Publish Proposed Amendments to Property Tax Rule 462.500, Change in Ownership of Real Property Acquired to Replace Property Taken by Governmental Action or Eminent Domain Proceedings*

Senate Bill 803 (Stats. 2015, ch. 454) (SB 803) amended Revenue and Taxation Code<sup>1</sup> section 68 to specify that if a taxpayer files a request for exclusion from property taxation after the four-year deadline, rather than becoming ineligible for exclusion, the base year value transfer will be applied on the lien date of the assessment year in which the taxpayer files the request, and the assessor is to apply the exclusion to the lien dates for the last four fiscal years with appropriate roll corrections, refunds, or cancellations. Additionally, the assessor is to adjust the base year value of the replacement property for annual inflation and any new construction.

Board of Equalization (BOE) staff announced in Letter to Assessors (LTA) 2019/016 (June 13, 2019) that it initiated a project to amend Property Tax Rule<sup>2</sup> (Rule) 462.500, *Change in Ownership of Real Property Acquired to Replace Property Taken by Governmental Action or Eminent Domain Proceedings*, to make it consistent with SB 803. Staff requests the Board's authorization to publish a notice of proposed regulatory action for amendments to Rule 462.500 in the California Notice Register.

### **I. Procedural History**

Based on Senate Bill 803 described above, BOE staff announced its initiation of a project to amend Rule 462.500 to conform to Revenue and Taxation Code section 68 as amended by Senate Bill 803. Interested parties were encouraged to participate in the rulemaking process and were notified that the Board would hear presentations on issues regarding the language for the rule and vote to place the rule into the formal rulemaking process.

<sup>1</sup> All statutory references are to the Revenue and Taxation Code, unless otherwise provided.

<sup>2</sup> All references to Property Tax Rule or Rules are to sections of title 18 of the California Code of Regulations.

BOE staff received one suggestion to include an additional example, which was accepted, and published the amendment in LTA 2019/031 (September 13, 2019). Subsequently, another comment was received, and BOE staff made a nonsubstantive change to Example 11 and clarified in subdivision (i)(2) that the reference to “Board” means the State Board of Equalization. BOE staff published notice of these changes in LTA 2020/004 (January 21, 2020), which also stated that there were no outstanding issues.<sup>3</sup>

## **II. Legal Framework – Discussion of Change in Ownership of Real Property Acquired to Replace Property Taken by Governmental Action or Eminent Domain Proceedings**

Article XIII A, section 2 of the California Constitution requires the reassessment of real property upon a “change in ownership.” This section has been implemented by statutes enacted by the Legislature and Property Tax Rules promulgated by the Board of Equalization. Section 60 of the Revenue and Taxation Code 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 68 provides an exception to that definition, as subdivision (a) of section 68 states:

For purposes of Section 2 of Article XIII A of the Constitution, the term “change in ownership” shall 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.

In other words, section 68 excludes from a “change in ownership” the acquisition of real property as a replacement for property from which a person has been displaced by eminent domain proceedings, acquisition by a public entity, or a judgment of inverse condemnation. In order to qualify for this exclusion, the replacement property must be similar in size, utility, and function to the taken property. Property 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. Property is similar in function and utility if the property taken and the replacement property both fall into the same category of use—residential, commercial, or agricultural. (See Rule 462.500, subd. (c)(2).)

Previously, property tax law required the person acquiring replacement property on and after January 1, 1983, to request the transfer of their property’s base year value within four years of the governmental acquisition. Rule 462.500, which interprets and further implements section 68, also required the taxpayer to timely file a request in order to obtain the exclusion from reassessment.

However, Senate Bill 803 (Stats. 2015, ch. 454) amended section 68 to specify that if a taxpayer files a request for exclusion after the four-year deadline, the base year value transfer will be applied on the lien date of the assessment year in which the taxpayer files the request, and is to apply to the lien dates for the last four fiscal years with appropriate roll corrections, refunds, or cancellations. Additionally, the assessor is to adjust the base year value of the replacement property for annual inflation and any new construction.

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<sup>3</sup> All documents regarding this project, including a matrix of all comments received, are posted on the BOE’s website at <https://www.boe.ca.gov/proptaxes/prop462500-eminentdomain.htm>.

While preparing the draft amendments and through the interested parties process, staff also believed that the following amendments are reasonably necessary for the specific purposes of:

- Clarifying in new Example 9 the property tax relief available when a taxpayer has a parcel taken, and subsequently two additional parcels taken, that the taxpayer may then purchase one parcel to replace the three properties taken.
- Clarifying that when property is replaced with two separate properties, pro-rata relief is applicable to both replacement properties in Example 4 and Example 6.
- Clarifying that floating homes are included in the definition of “real property” in subdivision (b)(5) of Rule 462.500.
- Clarifying that the terms and conditions for qualifying for property tax relief described in each subdivision of the rule are applicable to Rule 462.500 rather than any particular section, by replacing the word “section” with the word “rule”.
- Clarifying that only the person whose property was taken may receive the exclusion under this rule up to 120 percent of his or her ownership interest in the replacement property, in new Example 14.
- Clarifying that the reference to “Board” means the State Board of Equalization.
- Make formatting and grammatical changes for clarification.

### III. Staff’s Recommendation

Since all of the proposed changes to Rule 462.500 conform to existing law, have undergone the Interested Parties process and there are no outstanding issues, BOE staff recommends that the Board authorize commencement of the official rulemaking process by authorizing the publication of a notice of proposed regulatory action regarding amendments to Rule 462.500 in the California Notice Register. The proposed amendments to the Rule are attached hereto, in strikeout and underline format.

If you need more information or have any questions, please contact Henry Nanjo, Chief Counsel, at (916) 323-1094.

HN:sy

Attachment: Proposed Amendments to Rule 462.500

cc: Ms. Rose Smith

Approved:

/s/ Brenda Fleming

Brenda Fleming  
Executive Director

Board Approved on: \_\_\_\_\_

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Henry Nanjo, Chief Counsel and  
Acting Chief, Board Proceedings Division

**RULE 462.500. CHANGE IN OWNERSHIP OF REAL PROPERTY ACQUIRED TO REPLACE PROPERTY TAKEN BY GOVERNMENTAL ACTION OR EMINENT DOMAIN PROCEEDINGS.**

*Authority:* Section 15606, Government Code.

*References:* Article XIII A, Section 2(d), California Constitution; and Section 68, Revenue and Taxation Code.

**(a) GENERAL.** The term "change in ownership" shall not include the acquisition of comparable real property as replacement for property taken if the person acquiring the replacement real property has been displaced from property in this state by:

- (1) Eminent domain proceedings instituted by any entity authorized by statute to exercise the power of eminent domain, or
- (2) Acquisition by a public entity, or
- (3) Governmental action which has resulted in a judgment of inverse condemnation.

**(b) DEFINITIONS.** The following definitions govern the construction of the words or phrases used in this ~~section~~rule.

- (1) "Property taken" means real property taken or property acquired as provided in subdivision (a) of this rule.
- (2) "Replacement property" means real property acquired to replace property taken.
- (3) "Award or purchase price" means the amount paid for "property taken" but shall not include amounts paid for relocation assistance or ~~any thing~~anything other than the replaced real property. The award or purchase price may not reflect full cash value.
- (4) "Displaced" means a property owner is removed, expelled, or forced from property as a result of eminent domain proceedings, acquisition by a public entity in lieu of instituting eminent domain proceedings, or governmental action resulting in a judgment of inverse condemnation.
- (5) "Real property" includes land, land improvements, living improvements, manufactured homes, floating homes, and fixed machinery and equipment. Personal property is not entitled to relief under this ~~section~~rule.
- (6) "Adjusted base year value" means the base year value, as determined in accordance with Revenue and Taxation Code ~~Section~~section 110.1, with the adjustments permitted by subdivision (b) of ~~Section~~section 2 of ~~Article~~article XIII A of the California Constitution and subdivision (f) of Revenue and Taxation Code ~~Section~~section 110.1.

**(c) COMPARABILITY.** Replacement property, acquired by a person displaced under circumstances enumerated in subdivision (a) of this rule, shall be deemed comparable to the property taken if it is similar in size, utility, and function.

(1) The size of property is associated with value, not physical characteristics. Property 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.

A replacement property, or portion thereof, that has a full cash value which exceeds 120 percent of the award or purchase price shall be considered, to the extent of the excess, not similar in size.

(2) Property 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:

**Category A:** Single family residence or duplex. Small miscellaneous buildings may be included when used with a residence.

**Category B:** Commercial, investment, income, or vacant property. Single family residences and duplexes that are used as investment property may be considered income property if sufficient proof is provided to the assessor. Proof may include, but is not limited to, rental or lease agreements, cancelled checks, income tax returns, or other investment records.

If property does not fall within Category A or Category C, it falls within Category B.

**Category C:** Agricultural property. "Agriculture" includes farming in all its branches, and, among other things, includes the cultivation and tillage of the soil, dairying, the production, cultivation, growing, and harvesting of any agricultural or horticultural commodities, the raising of livestock, bees, furbearing animals, or poultry, and any practices (including any forestry or lumbering operations) performed incidental to or in conjunction with such farming operations, including preparation for market and delivery to storage or to market or to carriers for transportation to market.

Agricultural property that is in transition may be considered similar to property described in Category B if property in its vicinity has been changing from historically agricultural use to another use. Factors that may be considered to determine whether agricultural property is in transition include, but are not limited to:

- Restrictions that would prohibit the property taken from converting to property described in Category B such as the general plan, community plan, or special plan. Current zoning restrictions are not such a restriction if the general plan, community plan, or special plan contemplate a zoning change.
- The highest and best use of the property ~~taken;~~ taken.
- The type of comparable property that was used by the acquiring government body to value the property taken.

(3) To the extent that replacement property, or any portion thereof, is not similar in function, size and utility, the property, or portion thereof, shall be considered to have undergone a change in ownership.

EXAMPLE 1: An owner-occupied single family residence is replaced by a combination dwelling and commercial property. Relief is applicable to only the dwelling portion of the replacement property; the commercial portion shall be considered as having changed ownership.

EXAMPLE 2: A combination dwelling and commercial property is replaced with an owner-occupied single family residence. Only the dwelling portion of the property taken shall be considered in determining the comparability and the amount of relief. The right to relief on the commercial portion of the property taken is waived unless replacement Category B property is acquired after the date of displacement and a ~~timely~~ request is made for assessment relief.

EXAMPLE 3: A combination dwelling and commercial property is replaced with a Category A single family residence, and later the displaced person also acquires a separate replacement Category B property. Pro-rata relief shall be granted on both the replacement Category A single family residence and Category B property.

EXAMPLE 4: An owner-occupied single family residence is replaced with an owner-occupied single family residence and a vacation home. ~~Relief~~Pro-rata relief is applicable to both properties.

EXAMPLE 5: An owner-occupied single family residence that has a homeowners' exemption is replaced with a single family residence that is to be used as a rental property. The replacement property qualifies for relief because a Category A property is replaced by another Category A property.

EXAMPLE 6: A duplex in which the property owner lived in one unit and rented the other unit is replaced with two single family residences, one of which will be owner occupied. ~~Relief~~Pro-rata relief is applicable to both properties.

EXAMPLE 7: Three single family residences that were owned by a taxpayer and used as rental properties were replaced by a small apartment complex. Relief is available under Category B if the taxpayer provides proof to the assessor that the single family residences were held as income property.

EXAMPLE 8: A taxpayer owns a 40-acre vineyard which includes an owner-occupied single family residence. The owner-occupied single family residence is taken along with 5 acres of grapevines. To qualify for relief, the owner-occupied single family residence must be replaced with Category A property; the vineyard must be replaced with other Category C property or, if the property is in transition to another use, it may be replaced with a Category B property.

EXAMPLE 9: A taxpayer had a parcel taken to accommodate the widening of a freeway. Two years later, the taxpayer had two additional parcels taken. The taxpayer may purchase one parcel to replace the three properties taken. If the replacement property meets the comparability test for all three properties taken, then the combined base year values of the three properties taken may be transferred to the replacement property or portion thereof.

**(d) BASE YEAR VALUE OF REPLACEMENT PROPERTY.** The following procedure shall be used by the assessor in determining the appropriate adjusted base year value of comparable replacement property:

- (1) Compare the award or purchase price paid by the acquiring entity for the property taken or acquired with the full cash value of the comparable replacement property.
- (2) If the full cash value of the comparable replacement property does not exceed 120 percent of the award or purchase price of the property taken, then the adjusted base year value of the property taken shall become the replacement property's base year value, regardless of the allocation between land and improvements.
- (3) If the full cash value of the replacement property exceeds 120 percent of the award or purchase price of the property taken, then the amount of the full cash value over 120 percent of the award or purchase price paid shall be added to the adjusted base year value of the property taken. The sum of these amounts shall become the replacement property's base year value.

(4) If the full cash value of the comparable replacement property is less than the adjusted base year value of the property taken, then that lower value shall become the replacement property's base year value.

(5) If there is no award or purchase price paid by the acquiring entity (i.e., an exchange) for the property taken, then the full cash value of the acquired property and the full cash value of the replacement property shall be determined by the assessor of the county in which each property is located for the purpose of applying the other provisions of this subdivision. The procedure set forth in subdivision (d)(1) through (d)(4) shall then be applied to determine the replacement property's base year value.

(6) A base year value may be reallocated upon the transfer of the replacement property. The appraisal unit that is normally bought and sold in the market place may be used to determine the amount of base year value that is allocated to the property taken.

EXAMPLE 9-10: A commercial property, consisting of land and improvements, is taken and replaced with a Category B structure that was built on land that the taxpayer already owned. The land is ineligible for relief because it was previously owned. Despite the ineligibility of the land, the base year value of the property taken (land and improvements) may be transferred to the newly constructed improvements to the extent it meets the value and timing requirements.

**(e) OWNERSHIP REQUIREMENTS.** 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~~-rule. Relief under this ~~section~~-rule 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.

EXAMPLE 10-11: A and B each own an undivided 50 percent interest as joint tenants in a home ~~which~~-~~that~~ is taken through eminent domain proceedings by the state. A purchases a replacement property which is comparable to the property taken. B contributes his share of the award or purchase price to a limited partnership ~~which~~-~~that~~ owns a home which is comparable replacement property. A's relief ~~under this section~~ is limited to 120 percent of one-half of the award or purchase price of the property taken. B is entitled to no relief.

EXAMPLE 11-12: A partnership composed of two corporations owns commercial property ~~which~~-~~that~~ is taken through eminent domain proceedings. The partnership uses the award or purchase price to acquire Category B property. The partnership is entitled to relief under this ~~section~~-rule.

EXAMPLE 12-13: A partnership composed of two corporations owns commercial property ~~which~~-~~that~~ is taken through eminent domain proceedings. The partnership distributes the award or purchase price to the partner corporations in the same percentage as their ownership interests and the corporations separately or jointly acquire comparable replacement property retaining the same percentage of ownership interest in the partnership. No tax relief may be granted under this ~~section~~-rule.

EXAMPLE 14: A is the sole owner of a primary residence that is taken through eminent domain proceedings by a school district. A and B (not the spouse of A) purchase a replacement property as joint tenants. A's relief is limited to 120 percent of A's ownership interest in the replacement property. B's interest in the property is reassessed at current fair market value.

For purposes of this section, owner means the fee owner or life estate owner of the real property taken and excludes the lessee thereof unless the lessee owns improvements located on land owned by another, in which case, the lessee shall be entitled to property tax relief for comparable replacement improvements.

**(f) NEW CONSTRUCTION.** Any new construction required to make replacement property comparable to the property taken shall, to that extent, be eligible for property tax relief, if such new construction is completed on or after the earliest of the dates listed in subdivision (g)(3), and if a ~~timely~~ request is made for assessment relief.

**(g) REQUEST FOR ASSESSMENT TIME LIMITS FOR QUALIFICATION.**

(1) The provisions of this ~~section-rule~~ shall apply to property acquired as replacement property for property taken by eminent domain proceedings, public acquisitions, or judgments of inverse condemnation, provided the person acquiring replacement property makes a ~~timely~~ request for such assessment with the assessor. The replacement property must be acquired before a request is made. ~~Reassessments and refunds shall be made retroactively to the date of acquisition of replacement property for property taken, provided a timely request is made therefor.~~

(2) Reassessments and refunds shall be made retroactively to the date of acquisition of replacement property for property taken, provided a timely request is made. For purposes of this ~~section-rule~~, a request shall be deemed timely if made within four years after one of the following dates, whichever is applicable:

- (A) The date final order of condemnation is recorded or the date the taxpayer vacates the property taken, whichever is later, for property acquired by eminent domain;
- (B) The date of conveyance or the date the taxpayer vacates the property taken, whichever is later, for property acquired by a public entity by purchase or exchange; or
- (C) The date the judgment of inverse condemnation becomes final or the date the taxpayer vacates the property taken, whichever is later, for property taken by inverse condemnation.

(3) If a request is made after four years of the applicable date listed in subdivision (g)(2) of this rule, relief shall apply to the lien dates for the last four fiscal years with appropriate roll corrections, refunds, or cancellations. As of the fourth lien date prior to the date of the request and any subsequent lien dates, the base year value of the replacement property shall be adjusted for both of the following:

- (A) Inflation, as annually determined in accordance with paragraph (1) of subdivision (a) of Revenue and Taxation Code section 51.
- (B) Any subsequent new construction occurring with respect to the subject real property.

**(h) LIMITS BASED ON ACQUISITION AND DISPLACEMENT DATES.**

(~~3~~1) Replacement property shall be eligible for property tax relief under this ~~section-rule~~ if it is acquired on or after the earliest of the following dates:

- (A) The date the initial written offer is made for the property taken by the acquiring entity;



(B) The date the acquiring entity takes final action to approve a project which results in an offer for or the acquisition of the property taken;

(C) The date the "Notice of Determination," "Notice of Exemption," or similar notice, as required by the California Environmental Quality Act (CEQA), is recorded by the public entity acquiring the taxpayer's property and the public project has been approved; or

(D) The date, as declared by the court, that the replaced property was taken.

(42) No property tax relief shall be granted to replacement property, however, prior to the date of displacement. The date of displacement shall be the earliest of the following dates:

(A) The date the conveyance of the property taken to the acquiring entity or the final order of condemnation is recorded;

(B) The date of actual possession by the acquiring entity of the property taken; or

(C) The date upon or after which the acquiring entity may take possession of the property taken as authorized by an order for possession.

**(hi) ADMINISTRATION.**

(1) The assessor shall consider any of the following documents as proof of actual displacement of a taxpayer when a request has been made for the assessment relief provisions under this ~~section~~ rule:

(A) A certified recorded copy of the final order of condemnation, or, if the final order has not been issued, a certified recorded copy of the order for possession showing the effective date upon or after which the acquiring entity is authorized to take possession of the property taken;

(B) A copy of a recorded deed showing acquisition by a public entity; or

(C) A certified copy of a final judgment of inverse condemnation.

(2) Upon receipt of a taxpayer request and proof of actual displacement, the assessor shall forward to the ~~Board~~ State Board of Equalization such information regarding the identification of a displaced property as the ~~Board~~ State Board of Equalization may require. The ~~Board~~ State Board of Equalization shall review such information to determine whether more than one request for assessment relief has been made as a result of a single taking or governmental acquisition and if so shall advise the appropriate assessor(s).