STATE OF CALIFORNIA

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STATE BOARD OF EQUALIZATION
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January 7, 1994

Mr. Gregory J. Smith
San Diego County Assessor
1600 Pacific Highway, Room 103
San Diego, CA 92101-2480

Attention: Mr. Michael Meza
Division Chief, Commercial

Dear Mr. Smith:

This is in response to your December 10, 1993, letter wherein you inquired concerning the proper application of Property Tax Rule No. 462.5 in the case of a replacement property subject to a ground lease.

According to your letter, a taxpayer lost a commercial property to a public agency. The property, both land and improvements, was owned by the taxpayer in fee. A comparable replacement property was acquired and an application for Proposition 3/Article XIIIA, Section 2, subdivision (d) relief was filed timely. However, the replacement property consisted of a fee interest in the improvements and a ground lease in excess of 35 years. You ask whether both land and improvements of the replacement property qualify for a transfer of taxable values from the "lost" property, or only the improvements since the replacement property land is leased? As explained below we conclude that only the improvements qualify.

As you know, Article XIIIA, Section 2(d) provides, in pertinent part:

> "For purposes of this section, 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 the property replaced by eminent domain proceedings, by acquisition by a public entity, or governmental action which has resulted in a judgment of inverse condemnation. The real property acquired shall be deemed comparable to the property replaced if it is similar in size, utility and function, or if it conforms to state regulations defined by the

Legislature governing the relocation of persons displaced by governmental actions...."

As enacted by the Legislature, Revenue and Taxation Code Section 68, which implements Article XIIIA, Section 2, subdivision (d), similarly provides as to the term "change in ownership", but it goes on to address matters other than the comparability of the acquired/replacement property. Thus, the Board, pursuant to its authority under Government Code Section 15606 and to implement, interpret and make specific Article XIIIA, Section 2, subdivision (d) and Section 68, adopted Property Tax Rule No. 462.5, which provides, in part:

"(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.

(1) 'Property taken' means both property taken and property acquired as provided in (a).

(2) "Replaced property' means real property taken.

(3) 'Replacement property' means real property acquired to replace property taken.

* * *

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

* * *

"(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. Relief under this section shall be granted to an owner(s) of replaced property obtaining 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: A & B each own an undivided 50 percent interest as joint tenants in a home which is taken through eminent domain proceedings by the state. A purchases a replacement home which is comparable to the replaced property. B contributes his share of the award or purchase price to a limited partnership which 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: A partnership composed of two corporations owns commercial property which is taken through eminent domain proceedings. The partnership uses the award or purchase price to acquire comparable commercial property. The partnership is entitled to relief under this section.

EXAMPLE: A partnership composed of two corporations owns commercial property which 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.

"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.

* * *"

We interpret Rule 462.5 as requiring ownership both of "replaced property" (Rule 462.5 (b)(2)) and of "replacement property" (Rule 462.5(b)(3)) in order for the full exclusion from change in ownership provided by Article XIIIA, Section 2(d), Section 68 and the rule to be available to a taxpayer. Rule 462.5(e), Ownership Requirements, states that only the owner of the property taken shall receive relief under the rule. "Owner" is defined to mean the fee owner or life estate owner of the real property taken,

and specifically excludes lessees, unless a lessee owns improvements located on land owned by another. Rule 462.5, subdivision (e) states further that relief under the rule shall be granted to an owner of replaced property obtaining title to replacement property. Title connotes ownership:

> "Title is the means whereby the owner of lands has the just possession of his property. The union of all the elements which constitute ownership. Full independent and fee ownership. The right to or ownership in land; also, the evidence of such ownership...." (Black's Law Dictionary, 5th Ed., 1979, Pg. 1331)

Accordingly, in our view, the proper application of Rule 462.5 in the situation you pose is that only the improvements of the replacement property qualify for the transfer of the taxable value from the "lost" property. While leases of taxable real property for terms of 35 years or more are changes in ownership for purposes of reassessment (Sections 60 and 61(c)), leases of such property do not convey ownership thereof under real property law, only certain rights such as possession and use of the property. Thus, one acquiring a ground lease in excess of 35 years is not obtaining title/ownership of the leased property.

A further indication that leased property was not intended to be excluded from change in ownership under Section 68 is a comparison of Section 68 to Section 69.5. In the latter, where the Legislature has intended that leases of taxable real property should qualify for the transfer of the taxable value, it has specifically so provided:

> "(g) For purposes of this section:
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> * * *
>
> "(3) 'Replacement dwelling' means.... For purposes of this paragraph,... 'land owned by the claimant' includes land for which the claimant either holds a leasehold interest described in subdivision (c) of Section 61....
>
> "(4) 'Original property' means.... For purposes of this paragraph,... 'land owned by the claimant' includes land for which the claimant either holds a leasehold interest described in subdivision (c) of Section 61....
>
> * * *"

A final consideration is an explanation of the basis for our conclusion that improvements only can qualify for the transfer of the taxable value from the "lost" property. As set forth in a September 13, 1988, memorandum to Mr. Verne Walton, Chief, Assessment Standards Division, the question turns on the meaning

of "replacement property" as used in Section 68 and Rule 462.5. As indicated, the term is defined in Rule 462.5, subdivision (b)(3) as real property acquired to replace property taken. While "real property" is not defined in Section 68 or in Rule 462.5, Section 104 defines the term as including both land and improvements. Thus, it seems clear that "replacement property" refers to both land and improvements acquired to replace land and improvements taken.

A related question, however, is whether replacement property must be considered as an appraisal unit or whether it can be divided, treating land separately from improvements. Nothing in Section 68 or in Rule 462.5 expressly says that replacement property can be divided. The examples in Rule 462.5, subdivision (c), however, demonstrate an intent to permit division of a replacement property unit on the basis of the utility of the property. That is, a combination dwelling and commercial property can be divided in order to allow property tax relief. And the dwelling portion of a property can be considered separately for purposes of determining comparability and the amount of relief. While not free from doubt, it is reasonable to conclude that the rule indicates an intent to permit division of a replacement property between land and improvements, and we have remained of that view.

As you know, the views expressed herein are advisory only. Our intention is to provide timely, courteous and helpful responses to inquiries such as yours. Suggestions that help up to accomplish this goal are appreciated.

Very truly yours,

James K. McManigal, Jr.
Staff Counsel III

JKM:jd
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cc: Mr. John W. Hagerty, MIC:63
Mr. Verne Walton, MIC:64