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January 7, 2008

Honorable Kenneth Stieger
Assessor, County of Sacramento
3701 Power Inn Road, Suite 3000
Sacramento, CA 95826

Re: *Application of Change in Ownership Provisions to Leases of Thirty-Five Years or More that Commenced Prior to March 1, 1975*

Dear Assessor Stieger:

This is in response to your June 4, 2007, letter to Chief Counsel Kristine Cazadd. In that letter, you asked whether, in applying Revenue and Taxation Code sections¹ 61, subdivision (c) and 62, subdivision (g) to leases of 35 or more years that commenced operation prior to March 1, 1975, it is “legally appropriate for the county assessor’s office to consider only the period of such a lease beginning from March 1, 1975, onwards in making change in ownership determinations or should the full period of lease operation (before and after March 1, 1975) be considered in making change of ownership determinations.” Your letter also describes the situation where a 40-year lease executed on January 1, 1940, terminates on January 1, 1980, without any intervening “ownership” events and asks whether the termination of the lease is an event requiring reappraisal. For the reasons explained below, we conclude that county assessors should consider the entire term of each lease, including the periods before and after March 1, 1975, and that the factual scenario you described would result in a change in ownership under section 61, subdivision (c), unless an exclusion from change in ownership applies.

Discussion

The provisions of section 61, subdivision (c), which provide that “the termination of a leasehold interest in taxable real property which had an original term of 35 years or more (including renewal options)” is a change in ownership, require county assessors to look back in time to periods before the implementation of Proposition 13 to determine the “original term” of a lease “including renewal options” because:

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

- The language in section 61, subdivision (c) uses the term “35 years” without temporal limitation and the legislative history of section 61, subdivision (c) does not show any legislative intent to create a temporal limitation or exclude periods prior to March 1, 1975, from the calculation of lease terms;
- Property Tax Rule² (Rule) 462.100, subdivision (a)(1)(C), which implements section 61, subdivision (c) is broad and uses the term “35 years” without temporal limitation; and
- Three Property Tax Annotations³ (Annotations) applying the provisions of section 61, subdivision (c), regarding the termination of leases with an original term of 35 years or more, include periods prior to March 1, 1975, in calculating the original terms of the leases at issue therein.

A. Section 61, subdivision (c) Does Not Exclude Pre-1975 Lease Periods from the Calculation of Lease Terms and its Legislative History Does Not Indicate that the Legislature Intended to Exclude such Periods from the Calculation of Lease Terms

Section 60 defines a change in ownership as: (1) a transfer of a present interest in real property, (2) including the beneficial use thereof, (3) the value of which is substantially equal to the value of the fee interest. Section 61, subdivision (c) states that change in ownership, as defined in section 60, includes:

. . . [t]he 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. Only that portion of a property subject to that lease or transfer shall be considered to have undergone a change in ownership. (Emphasis added.)

This language does not expressly exclude periods prior to March 1, 1975, from the calculation of lease terms.

As Board staff explained in Annotation 220.0325, at page 5: “[S]ection 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 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.”

Section 61, subdivision (c) was enacted in 1979 in order to implement article XIII A of the California Constitution, which was added as a result of the adoption by the voters of Proposition 13 in the June 1978 election. After article XIII A was enacted, the Legislature’s

² Property Tax Rules are promulgated under title 18 of the California Code of Regulations.

³ Property Tax Annotations are summaries of the conclusions reached in selected legal opinions issued by the Board of Equalization’s Legal Department. See California Code of Regulations, title 18, section 5200, for more information regarding annotations.

Assembly Committee on Revenue and Taxation formed a task force to recommend implementing legislation. One of the recommended and enacted proposals became section 61, subdivision (c), which prescribes the property tax treatment of leases. The task force report clearly explained the change in ownership issues raised by leases by saying:

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? (Report of the Task Force on Property Tax Administration (Assem. Com. on Rev. & Tax.), 1979, Pub. No. 723, at p. 39.)

The report also addressed those issues by explaining that:

Both taxpayers and assessors need a specific test – rather than the broad ‘value equivalency’ 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. [Therefore, since] Lenders will lend on the security of a lease of 35 years or longer . . . 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 a 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. (*Id.* at p. 41.)

However, the report did not indicate that periods before March 1, 1975, should be ignored in determining whether the original term of a lease was 35 years or more at its inception. Thus, the Legislature did not demonstrate an intent to exclude pre-1975 years from the calculation of lease terms.

B. Rule 462.100, subdivision (a)(1)(C) Does Not Exclude Pre-1975 Lease Periods from the Calculation of Lease Terms

Rule 462.100 implements section 61, subdivision (c). Rule 462.100, subdivision (a)(1)(C) restates the statutory rule that the termination of a leasehold interest with an original term of 35 years or more results in a change in ownership and subdivision (d) states that “[t]he calculation of the term of a lease for all purposes shall include written renewal options.” However, Rule 462.100 does not expressly exclude periods prior to March 1, 1975, from the calculation of lease terms.

C. Three Annotations Include Pre-March 1, 1975, Periods in the Calculation of Lease Terms

- In Annotation 220.0325, Board staff concluded that the April 18, 1983, termination of a 45-year lease executed on November 14, 1962, resulted in a change in ownership because the lease term was originally 35-years or more,

including periods prior to March 1, 1975.

- In Annotation 220.0326, Board staff concluded that the 1989 termination of a 54-year ground lease executed in May 1961, resulted in a change in ownership. Board staff explained that “[a]s the original lease term exceeded 35 years; such termination resulted in a change of ownership.”
- Similarly, in Annotation 220.0338, Board staff concluded that the August 31, 1984, termination of a 75-year lease executed on September 1, 1958, would have resulted in a change in ownership if it had occurred.

Thus, all three annotations included pre-1975 periods in the calculation of the lease terms at issue therein. Therefore, based on the above-analysis, we conclude that, in determining whether the termination of a 35-year lease term results in a change in ownership, the entire term of a lease, including the lease term prior to March 1, 1975, should be considered.

The opinions expressed in this letter are only advisory in nature; they represent the analysis of the Legal Department based on current law and the facts set forth herein and are not binding on any person or public entity. You can contact me at (916) 322-8525 or via electronic mail at Steve.Kamp@boe.ca.gov, if you have further questions.

Sincerely,

/s/ Steven M. Kamp

Steven M. Kamp
Tax Counsel III (Specialist)

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