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No. 2018/023

May 29, 2018

TO COUNTY ASSESSORS AND INTERESTED PARTIES:

**INTERESTED PARTIES PROCESS:
CHANGE IN OWNERSHIP - RESCISSION**

Board staff has initiated a project to issue a Letter To Assessors to summarize the various written opinions by the Board of Equalization's Legal Department that address (1) a property owner's ability to rescind a recorded deed that triggered a reassessable change in ownership and (2) the property tax effect of such a rescission.

A copy of the draft Letter To Assessors is enclosed. Interested parties are encouraged to participate in the interested parties process for the above letter. Suggested revisions to the draft, in the form of alternative text, should be provided to Glenna Schultz at glenna.schultz@boe.ca.gov or mailed to the above address by July 31, 2018.

After reviewing comments received, it is anticipated that staff will meet with interested parties this fall to discuss comments received. All documents regarding this project will be posted to the BOE's website at www.boe.ca.gov/proptaxes/change-in-ownership-recissions.htm. If you have questions regarding this project, you may contact Ms. Schultz at 1-916-274-3362.

Sincerely,

/s/ David Yeung

David Yeung, Chief
County-Assessed Properties Division
Property Tax Department

DY:gs
Enclosure

1 contract.⁷ For mutual rescissions, the Civil Code does not specify any particular grounds for
2 rescission, so long as the parties to the contract consent to the rescission. The provisions of the
3 Civil Code do not require a court order or approval for a contract rescission to be valid when the
4 parties to a contract mutually agree to rescind.

5 Section 1689(b) provides that a contract may be *unilaterally* rescinded based on a specified
6 variety of grounds. Thus, a unilateral rescission is limited to the reasons listed in Civil Code
7 section 1689(b), which includes fraud, mistake, or duress. A mistake occurs when, among other
8 things, there is a misapprehension of the law by all parties, all supposing that they knew and
9 understood it, and all making substantially the same mistake as to the law.⁸

10 **Reasonable Time/Accepting Benefits**

11 Section 1691 provides that, subject to section 1693,⁹ a party to the contract must, promptly upon
12 discovering the facts which entitle him to rescind if he is free from duress, menace, undue
13 influence or disability and is aware of his right to rescind, give notice of rescission to the party as
14 to whom he rescinds and restore or offer to restore to the other party benefits received from the
15 contract. Section 1693 states:

16 When relief based upon rescission is claimed in an action or proceeding, such
17 relief shall not be denied because of delay in giving notice of rescission unless
18 such delay has been substantially prejudicial to the other party.

19 A party who has received benefits by reason of a contract that is subject to
20 rescission and who in an action or proceeding seeks relief based upon rescission
21 shall not be denied relief because of a delay in restoring or in tendering restoration
22 of such benefits before judgment unless such delay has been substantially
23 prejudicial to the other party; but the court may make a tender of restoration a
24 condition of its judgment.

25 In addition, courts have opined that "the right to rescind must be exercised promptly" and
26 "[w]hat is a reasonable time depends, as in other situations, upon the particular circumstances of
27 the case."¹⁰

28 For example, in *Osborne v. Cal-Am Financial Corp.* (1978) 80 Cal.App.3d. 259, a buyer of
29 property discovered that the seller misrepresented the subject property, and cancelled the escrow

⁷ *Dugan v. Phillips* (1926) 77 Cal.App. 268, 278.

⁸ Civil Code section 1578, subd. (1).

⁹ Section 1693 states: "When relief based upon rescission is claimed in an action or proceeding, such relief shall not be denied because of delay in giving notice of rescission unless such delay has been substantially prejudicial to the other party." A party who has received benefits by reason of a contract that is subject to rescission and who in an action or proceeding seeks relief based upon rescission shall not be denied relief because of a delay in restoring or in tendering restoration of such benefits before judgment unless such delay has been substantially prejudicial to the other party; but the court may make a tender of restoration a condition of its judgment.

¹⁰ *Cella v. Cosgro* (1953) 115 Cal.App.2d 816, 821.

1 within 60 days. The court held that "[t]he buyer has a reasonable time to make his discovery and
2 rescind, which was accomplished here within 60 days." On the other hand, in *Leeper v. Beltrami*
3 (1959) 53 Cal.2d 195, the court held that the plaintiffs were barred from rescinding a contract to
4 purchase land due to a two-year delay, providing, "[t]he failure to act promptly results in a
5 waiver of the right to rescind."

6 Furthermore, in *Pearson Candy Co. v. Waits* (1946) 27 Cal.2d 615, where a party sought to
7 rescind a contract on the grounds that it was coerced into signing it, the court stated that because
8 the party accepted the benefits of the contract and failed to exercise its right to terminate the
9 contract before the contract's renewal date, "any right that plaintiff might have had to rescind the
10 contract was waived by its failure to give prompt notice of its election to rescind, by its
11 adherence to the contract for several years, and by its failure to avail itself of its right to
12 terminate it." Similarly, in *Neet v. Holmes* (1944) 25 Cal.2d 447, the court stated, "[w]aiver of a
13 right to rescind will be presumed against a party who, having full knowledge of the
14 circumstances which would warrant him in rescinding, nevertheless accepts and retains benefits
15 accruing to him under the contract."

16 Therefore, while the Civil Code does not expressly specify a time frame for rescissions, case law
17 has established that a rescission must be made within a reasonable time. What period of time is
18 deemed "reasonable" should be determined on a case-by-case basis, taking into consideration
19 whether the parties have availed themselves of the benefits under the contract.

20 **Restoration of Status Quo: Rescission or New Contract?**

21 Civil Code section 1691 also requires the party requesting rescission to "restore to the other party
22 everything of value which he has received from him under the contract or offer to restore the
23 same upon condition that the other party do likewise." (Emphasis added.) Notably, "the question
24 of any sum not due under the contract calls for an adjudication of facts independent of the
25 contract itself, and this does not come within the scope of section 1691 of the Civil Code."
26 (*Dvorak v. Latimer* (1928) 91 Cal.App. 664 (*Dvorak*), 675.) In *Dvorak*, the vendee and vendor,
27 under a contract for the sale or exchange of real property, entered into an additional agreement
28 regarding real estate agent commissions, and advances that had been made to the vendee under
29 that other agreement. The court held that "the vendee, upon rescinding the contract for purchase,
30 is not obliged to offer restoration of a sum due under said independent agreement as a condition
31 precedent to the right to maintain an action to enforce rescission." (*Id.* at p. 675). However, the
32 court also noted that the equities between the parties had been properly adjusted, since the trial
33 court had credited the vendor with the moneys, taxes, and other expenditures paid to the vendee
34 in connection with the property. (*Ibid.*)
35

36 Thus, if the rescission agreement includes terms different from a return to the status quo, a
37 question may arise as to whether a rescission or a new contract was effected. (See *Young v. New*
38 *Pedrara Onyx Co.* (1920) 48 Cal.App. 1 [an agreement to rescind a stock transfer that included
39 terms in addition to the return of the status quo is not a valid rescission, but rather a new
40 contract].) Where the terms of the rescission are different from the original contract, the assessor
41 can and should look at all considerations paid to determine whether the transaction is indeed a

1 rescission, or instead a buyback of the same property by the original seller under different terms.
2 If a new contract was effected, a second change in ownership would occur upon the
3 reconveyance of the property to the original seller.

4 **Factors to Consider when Determining if a Rescission is Valid**

5 By definition, and as a principle of logic, it follows that if a transfer meets the Civil Code
6 requirements for a valid rescission, an assessor must accept the rescission as valid. However, an
7 assessor has discretion to determine whether a transfer is, in fact, a valid rescission. If the parties
8 to a contract to transfer real property have failed in fact to meet a requirement for rescission
9 provided in the Civil Code, the assessor has the discretion to deny the rescission for property tax
10 purposes.

11 For example, although the Civil Code provisions governing rescission were not specifically at
12 issue, in *Fashion Valley Mall v. County of San Diego* (2009) 176 Cal.App.4th 871, the parties to
13 a contract involving a transfer of real property attempted to effect a "reformation" of the
14 agreement that was operative ". . . solely for property taxes." The parties specified that the
15 contract, while "reformed" for property tax purposes, would remain in full force and effect for all
16 other purposes, including income tax and securities purposes and commercial and real estate
17 activities. The court considered the transaction to be a "sham" and "a mere fiction" that "cannot
18 be given effect for the purposes of determining . . . property tax liability." Viewed in the context
19 of the rescission requirements, we believe the parties in *Fashion Valley Mall* did not satisfy the
20 requirements for a rescission; because the contract purported to be in effect for all purposes other
21 than property tax purposes, the parties were not restored to their original positions.

22 We note, however, the difference between a "sham" rescission (i.e., one that is operative solely
23 for property tax purposes), versus a valid rescission effected solely to achieve certain property
24 tax consequences. The former, similar to *Fashion Valley Mall*, does not meet the requirement of
25 restoring the contracting parties to their original positions and may be denied by the assessor for
26 property tax purposes. The latter, however, if it satisfies the statutory requirements of a valid
27 rescission, must be accepted by the assessor.

28 Civil Code section 1689, which lists the reasons for which a contract may be rescinded, does not
29 limit rescissions to those not motivated by property tax benefits. In other words, if requirements
30 for a valid rescission are met, the motive for rescinding a contract is inconsequential to its
31 validity. Thus, for instance, if parties contract to transfer real property and subsequently discover
32 that the transfer results in an unintended change in ownership, the parties may rescind the
33 contract in order to avoid the change in ownership reassessment if all statutory requirements are
34 met. In our view, a mutual rescission should be recognized if all parties to the transaction
35 consent, all parties are restored to their original positions before the transfer, the rescission is
36 made promptly and within a reasonable time (to be determined on a case-by-case basis) with
37 consideration given to whether the parties have availed themselves of the benefits under the
38 contract, and the rescission agreement does not include terms different from a return to the status
39 quo. Conversely, if the parties to a contract or deed to transfer real property have failed in fact to

1 meet a requirement of rescission provided in the Civil Code, the assessor may deny the rescission
2 for property tax purposes.

3 Of course, an assessor may request documentation to verify whether a rescission was valid and
4 the parties were restored to the status quo. For example, an assessor might request copies of
5 deeds, a declaration or other evidence from the parties that consideration was in fact restored, an
6 explanation and description of the steps taken to effect the rescission, or tax returns that
7 demonstrate income from the property in question was reported by the proper party.

8 **Effect Upon Property Taxes**

9 Once a transfer of real property is rescinded and the parties are placed in the same position they
10 were in before the contract was executed, the value of the real property reverts to its previous
11 adjusted base year value prior to the transfer. However, the liabilities established while the
12 contract was in existence are not extinguished. Therefore, placing the parties in the position they
13 held before the transfer will not result in a refund of taxes paid while the contract was in effect.

14 For example, if Party A transferred the subject property to Party B with the expectation or
15 condition that Party B would immediately transfer the property to Party C, and due to a mutual
16 mistake, all parties wished to rescind the two transfers within a reasonable amount of time, such
17 rescissions may be acceptable, assuming all other requirements under the Civil Code are met. In
18 that case, the rescission relates back to the formation of the contract and dissolves it as though it
19 had never been made. Thus, once a contract for the transfer of real property is rescinded by
20 mutual consent, the parties are placed in the same position they were in before the contract was
21 executed, and the base year value of the real property reverts to its previous base year value with
22 appropriate adjustments for inflation. No refund of taxes should be made by the county to the
23 rescinding party while the transfer was in force. Therefore, if Party B and Party C mutually
24 rescind their contract transferring the property from Party B to Party C, then ownership reverts to
25 Party B, and the base year value of the property reverts to its base year value at the time of the
26 original transfer from Party B to Party C. If Party A and Party B concurrently mutually rescind
27 their contract to transfer the property from Party A to Party B, then ownership of the property
28 subsequently reverts to Party A, and the base year value of the property reverts to its base year
29 value as of the date of the original transfer from Party A to Party B. Thus, as a result of the two
30 rescissions effected concurrently in this example, in our opinion, the county assessor should
31 enroll the property at its factored base year value as of the original transfer from Party A to Party
32 B, as of the date of the rescission, with appropriate adjustments for inflation. No refund of taxes
33 should be made by the county assessor to the rescinding parties for the time during which the
34 transfers were in force.

35 By contrast, however, if Party A, for example, transfers the property to Party B, who benefits
36 from income or use of the property for an extended period of time, after which Party B transfers
37 the property to Party C, in our opinion, it is no longer reasonable to rescind the original transfer
38 between Party A and Party B. This is because Party B, after availing himself or herself of the
39 benefits of the original property transfer and for failing to exercise his or her right to rescind

- 1 within a reasonable time, may be considered to have waived his or her right to rescind such
- 2 transfer.

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