

Memorandum

To : Mr. David J. Gau – MIC:64

Date: February 29, 2000

From : Dan Nauman
Tax Counsel

Subject: Comparability of Property; Rev. & Tax. Code § 68 and Property Tax Rule 462.500

This is in response to your May 24, 1999, memorandum to Larry Augusta regarding the comparability of properties purchased as replacement properties for a fourplex taken by a government entity. Please excuse the extreme delay in responding. The delay was due in part to turnover in personnel and reassignment, and in part to a need for thoroughgoing discussion of the issue within the legal staff.

From your memo, the facts are as follows:

Two couples owned a fourplex as joint tenants. Each couple lived in a unit of the fourplex; each had a homeowner's exemption on its respective unit. The other two units were rented out. The fourplex was taken by a governmental entity. Each couple purchased a separate, single family residence as a replacement for the unit taken. Will the single family residences qualify as replacements for the units taken?

You note that in the past we have opined that two single family residences are not comparable to a fourplex, but you also note that an argument can be made that they are similar in use -- a principal place of residence was purchased to replace the principal place of residence that was taken. You inquire whether the fourplex taken could be considered a multi-use property and likened to the second Example of Property Tax Rule 462.500(c)(3), in which a combination dwelling and commercial property is replaced with a home? For the reasons set forth below, we conclude that the residential uses of the fourplex and the single family residences permit the pro-rata transfers of the base year value of the fourplex to the replacement properties.

As you know, Article XIII A, Section 2(d) of the California Constitution provides, in pertinent part:

For purposes of this section, the term, "change in ownership" does 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 that 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

Revenue and Taxation Code Section 68 and Board of Equalization Property Tax Rule 462.500 (18 Cal. Code of Regs. § 462.500) implement Article XIII A, Section 2(d). Your question focuses on the test for the comparability of the replacement property to the original, or replaced property. As you note, that issue is addressed in subdivision (c) of Rule 462.500.

Subdivision (c) provides, as does Article XIII A, Section 2(d), that the replacement property shall be deemed comparable to the property replaced if it is similar in size, utility and function. The rule provides a three-part test to determine whether the replacement property is “similar in size, utility and function.” A property is similar in function if it is subject to similar governmental restrictions, such as zoning. We have previously written that the rule requires only that the properties must be subject to “similar government restrictions”, not identical ones. We have been of the view that whether zoning restrictions are “similar” is a question of fact for the assessor in each case, however. For purposes of this opinion, we will assume that the replacement single family residences are subject to government restrictions similar to those applicable to the fourplex/replaced property.

With respect to the tests of size and utility of the properties, Rule 462.500(c) specifies that such tests are “interrelated”, and that property “is similar in size and utility only to the extent that the replacement property is, or is intended to be, used in the same manner as the property taken . . .” and comparable in value. Thus, the similarity of the size and utility of the properties, for purposes of this transfer of base year value treatment, is measured by comparing the *actual* use of the property taken, with the *actual or intended* use of the replacement property, and their values, as set forth in section 68 and Rule 462.500(c). This “use” test is further reinforced by the provisions of paragraph (A) of Rule 462.500(c): “A replacement property or any portion thereof used or intended to be used for a purpose substantially different than the use made of the replaced property, shall, to the extent of the dissimilar use be considered not similar in utility.”

In the facts you pose, the fourplex was being put to several actual uses: it was, separately, used as the principal residence of each owning couple, as well as a rental property with respect to the two units not occupied by the owning couples. The replacement properties were used as the principal residences of the owning couples. This situation is, as you note, analogous to the second and third Examples set forth in subdivision (c)(3) of Rule 462.500. Those examples deal with a combination dwelling and commercial property, and permit the replacement of the dwelling portion of the replaced property with a home, and the

replacement of the commercial portion of the replaced property with a separate comparable replacement commercial property, on a pro-rata basis.

Moreover, although it does not explicitly so provide, Rule 462.500 clearly contemplates being able to sever the several parts of a single type of use by co-owners. The first Example set forth in subdivision (e) describes the situation in which two owners of an undivided 50 percent interest each in a home are each permitted, by implication, to transfer one-half of the base year value of that home to separate replacement homes which are comparable to the replaced property. There is, in other words, no requirement in the rule, Revenue and Taxation Code, or Constitution that the "replacement property" be limited to a single property or appraisal unit.

Therefore, we conclude that each couple may transfer its pro-rata base year value of the fourplex to the separate, single family residence acquired as a replacement property, where the replacement property is used in the same manner as the property taken.

The conclusion reached herein is a close question, and we could have concluded otherwise with justification. However, in the final analysis, we were persuaded by the underlying policy behind Article XIII A, Section 2(d). As we have written before, that section (Proposition 3) was designed to correct an inequity that occurs when a governmental agency forces a property owner to relocate to make way for a public project through eminent domain proceedings or inverse condemnation. The displaced property owner should not be faced with the double penalty of a tax increase after a government-caused relocation. Thus, the displaced property owner is allowed to replace what he lost through eminent domain proceedings, including transfer of the base year value, providing the replacement property is used in the same manner as the property taken.

DGN:jd

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cc: Mr. Dick Johnson – MIC:63
Mr. Charles Knudsen – MIC:62
Ms. Jennifer Willis – MIC:70

PROPOSED ANNOTATION

200.0300(B) GOVERNMENT ACQUISITION

200.0360 **Replacement Property.** The pro-rata base year value of a fourplex used as the primary residence of its owner may be transferred to a single family residence purchased as a replacement property. If two couples own the fourplex, and each couple resides in a unit and has received a homeowners' exemption for its unit, each couple may transfer its pro-rata base year value of the fourplex to separate, single family residences acquired as replacement properties for such single family residential use. **C 2/29 /00.**