(916) 445-4588

November 23, 1981

In your letter of November 5, 1981, you requested our opinion as to the California Property Tax consequences of a proposed transfer, as contemplated by Section 168(f)(8) of the Internal Revenue Code of 1954, of the Federal investment tax credits and capital cost recovery allowances applicable to real property located in California.

Background Facts Concerning Corporate Parties

A. L

1. L ("User") is a corporation organized in the State of Delaware, having its principal offices at G

2. User's principal business is the production and sale of cement.

3. Between January 1, 1981, and August 13, 1981, User caused certain property to be placed in service in California that qualified for cost recovery allowances and investment tax credits under federal income tax law (the "Property").

B. A

1. A ("Purchaser") is a corporation organized in the State of Delaware, having its principal offices at C

2. Purchaser is a wholly owned subsidiary of S

Background of Proposed Transaction

In enacting the Economic Recovery Tax Act of 1981 (the "Act"), Congress recognized that some businesses may not be able to use completely the increased cost recovery allowances and the increased investment tax credits therein made available. Congress determined that these increased tax benefits would provide the greatest benefits to the economy if they were more easily distributable throughout the corporate sector; therefore, §168(f)(8) of the Code was enacted to make such benefits more easily transferable from one corporation to another.

Plan of Proposed Transfer

It is contemplated that User and Purchaser will enter into an Agreement (the "Agreement"), under which User agrees to sell to Purchaser, and Purchaser agrees to purchase, the federal income tax benefits applicable to the Property. Under the Agreement, the User sells to the Purchaser the limited right to be treated as the owner of the Property "solely for federal income tax purposes" and, simultaneously, Purchaser leases back to User the right to be treated as the lessee of the Property "solely for federal income tax purposes."

Besides making an initial cash payment to the User for the tax benefits, the Purchaser acknowledges for federal income tax purposes only an indebtedness to the User. The User, in turn, agrees to make certain payments to the Purchaser over the term of the Agreement. Such payments are intended to constitute rental payments for federal income tax purposes only. User and Purchaser agree that the payments on the indebtedness and the rental payments shall be offset against each other.

Analysis of Change in Ownership Rules to Proposed Transactions

A "change in ownership" of real property is defined in Section 60 of the Revenue and Taxation Code as . . . "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."

The rationale for this basic definition is important. As conceived by the Task Force whose work led to the adoption of this section, the general definition would be controlling in all cases where a more specific provision to the contrary was absent.[1] The general definition provides a consistent,

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[1]Property Tax Assessment Implementation of Proposition 13 Vol. 1 prepared by staff of the Assembly Revenue and Taxation Committee, October 29, 1979, No. 748.

three-part test for determining change in ownership:

1. It transfers a present interest in real property.

2. It transfers a beneficial use of the property.

3. The property rights transferred are substantially equivalent in value to the fee interest.

A pivotal point in this case is whether the property rights transferred is "substantially equivalent to the fee interest." This portion of the basic definition was deemed necessary to determine the owner of the primary property interest at a given time. Often two or more people have interests in a single piece of property, such as with leases, where the landlord owns the reversion, and 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 a change in ownership? This test avoids such unwarranted complexity by identifying the primary interest so that only its transfer will be a change in ownership resulting in a reappraisal of the entire property. If a lease is for a short term (the landlord owned the main economic value), the landlord's sale, subject to the lease, would be a change in ownership. If on the other hand, the lease was a long term lease, (the lessee's interest was the main economic package), the lease assignment would be a change in ownership.

As was stated earlier, and as evidenced above, the rationale of the drafters of this basic definition is crucial in analyzing the transactions in question.

Arguments in Favor of Treating the Transaction as a Change in Ownership

1. The parties agree that a title sufficient to satisfy federal tax requirements is transferred.

2. The rights of the "purchaser-lessor" to claim investment tax credits is generally associated with the ownership or use of tangible property.

Arguments Against Treating the Transaction as a Change in Ownership

1. The contract reserves title for all purposes, except for federal tax purposes, in the "seller-lessee."

2. The "loan" payments and "rental" payments are offset against one another.

3. The loan payment debt and rents are non-recourse.

4. Risk of loss to the property remains in seller-lessee.

5. The Congressional Committee Report indicated the sole purpose for inactment was the sharing of certain income tax benefits.

6. Seller-lessee can assign its interests in the property subject to the existing agreement. It would receive proceeds from the sale of the property on a condemnation award.

I recognize that the right to take the tax credits and/or depreciation is a valuable right; however, even if the tax credit is a real property interest, it is not in and of itself, substantially equivalent to the fee interest in the property with which it is associated. I am influenced in this conclusion by the fact that under the analysis of Proposition 13 legislation, it was emphasized that we are dealing with a single ownership concept rather than multiple ownership. Under this concept, the one who has the substantial ownership interests in the property under the terms of the contract related above is, in my opinion, in the "seller-lessee."

The other pivotal point is whether there has been a transfer of the beneficial use of the property.

The Task Force felt this test was necessary to protect custodianships, guardianships, trusteeships, security interests, and other fiduciary relationships from unintended changes in ownership treatment. For example, a father buys land for his minor son taking title as trustee for the son. There is a change in ownership when the father buys the property; however, when the son reaches majority and gets the property outright, there is no change in ownership. This is because the trust rather than the father had the beneficial use of the property. The son was the real owner from the outset; and when he reached majority, there was no transfer of the beneficial use, since all users while in trust were for the benefit of the son as beneficiary of the trust.

In a "safe harbor" lease situation, the only "beneficial" use, if you can describe it as such, is the lessor-purchaser's right to use the tax credit. Since the majority of the "beneficial" uses were never transferred to the lessor-purchaser, it is my opinion this test has not been satisfied.

Summarily, it is my opinion that the proposed "safe harbor" lease I reviewed would not be regarded as resulting in changes in ownership for property tax purposes under Section 60 of the Revenue and Taxation Code.

Very truly yours,

Glenn L. Rigby
Assistant Chief Counsel

GLR:jlh