

220.0195 **Estate For Years.** A lease agreement that requires the lessee to construct improvements which, on termination of the lease, become the property of the lessor creates in the lessor a reversion interest in the improvements. The lessee's interest is an estate for years which if transferred to a third party at a time when less than 35 years remain on the lease term does not constitute a change of ownership per rule 462(d)(2). The termination of the estate for years and vesting of full ownership in the reversioner-lessor is a change of ownership. C 8/29/91.

Carson



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August 29, 1991

Mr. _____
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Re: Prentiss Properties, Inc. - Estate for Years

Dear _____

This is in response to your letter of June 21, 1991 to Richard H. Ochsner, Esq. in which you request our opinion regarding the proper characterization of certain improvements constructed by a lessee ("Lessee") on leased land.

The lease agreement (the "Lease") submitted with your letter provides for an initial term commencing May 11, 1969, the date of the lease, and ending on the sooner to occur of (a) the date upon which rent first becomes due and payable from a sublessee of the premises or (b) May 11, 1971 and thereafter for a term of thirty years unless extended or terminated sooner under the terms of the Lease. The Lessee was granted an option to extend the term for two periods of ten years each. The Lease required the Lessee to construct a new building and other improvements on the leased property within a two year period. The Lease provided that until the expiration or sooner termination of the Lease, title to any building or improvements situated or erected on the leased property would remain in Lessee and that Lessee alone could deduct all depreciation for any such building or improvements on Lessee's income tax returns. (Article 3, section 3.03). Upon any expiration or earlier termination of the Lease, Lessee must vacate and surrender to the owner ("Lessor") the leased property (which pursuant to Article 1, section 1.01 includes tenant constructed improvements) Article 12, section 12.01. There is no provision in the Lease giving the Lessee the right to remove improvements (without a corresponding obligation to replace such improvements with a "more modern, efficient, and otherwise more desirable building" having a market value equal to

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or greater than the existing building. (See Article 3, section 3.05.) Further, Article 4 of the Lease provides that Lessee has an obligation to rebuild any improvements which are destroyed by damage, fire or other cause or condemned. Additionally, the Lease gives Lessee no right to compensation from Lessor for such improvement on termination of the Lease.

Apparently, the stock of Lessee, a corporation, was acquired by another corporation on or about October 15, 1987. The County Assessor reappraised the leased property including both land and improvements. Later, the Assessor decided that the land should not have been reappraised because the remaining term including renewal options was less than 35 years. The Assessor, however, continues to contend that reappraisal of the improvements was proper because of the provision that title to the improvements remained in Lessee and that Lessee was therefor the owner of the improvements. The issue, therefore, is whether Lessee's interest in the improvements was an estate for years or a fee simple.

Civil Code section 1013 provides that "[w]hen a person affixes his property to the land of another, without an agreement permitting him to remove it, the thing affixed . . . belongs to the owner of the land, unless he chooses to require the former to remove it" This provision has been interpreted by one court to mean that absent lease provisions under which the lessee retains title to the improvements, title passes to the lessor upon completion of the construction. Cryan v. Wardell (1920) 263 F. 248. However, whether title to such improvements passes to the lessor upon completion of construction of improvements or upon termination is irrelevant because, in either case, the lessor has a reversion in such improvements. Lewis v. Pope Estate Co. (1941) 116 F. 2d 328, 138 A.L.R. 235, certiorari denied 62 S. Ct. 63 314 U.S. 630, 86 L. Ed. 506; Commercial Real Property Lease Practice (Cont. Ed. Bar 1976) page 287. Since a fee simple is perpetual, the lessor's reversion in the improvements is clearly inconsistent with fee simple ownership of the improvements by the lessee regardless of whether title passes to the lessor upon completion of construction or upon termination of the lease. Alamo School District v. Jones (1960) 182 Cal. App. 2d 180.

Accordingly, since Lessee had no right of removal in this case, Lessee did not have a fee simple interest in the improvements even though title to the improvements was to remain in Lessee during the term of the Lease. Since Lessee's estate in the improvements was not a fee simple and since its duration was capable of exact computation once it became possessory, it is properly characterized as an estate for years. Camp v. Matich (1948) 87 Cal. App. 2d 660. Since the remaining term of Lessee's estate for years including renewal options, was less than 35

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years, no change in ownership in the improvements occurred when Lessee's stock was acquired in 1987 pursuant to Property Tax Rule 462(d)(2).

The views expressed in this letter are advisory only and are not binding upon the assessor of any county. You may wish to recontact the Los Angeles County Assessor in order to confirm that the described property will be assessed in a manner consistent with the conclusion stated above.

Our intention is to provide timely, courteous and helpful responses to inquiries such as yours. Suggestions that help us to accomplish this goal are appreciated.

Very truly yours,



Eric F. Eisenlauer
Tax Counsel

EFE:ta
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cc: Mr. John W. Hagerty
Mr. Verne Walton
Mr. James Jochimsen