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June 16, 2008

**Re: Leasehold Improvements
Assignment No. 07-198**

Dear _____ :

This is in response to your letter to the Taxpayers' Rights Advocate Office of the Board of Equalization received May 14, 2007, in which you request information regarding assessment of leasehold improvements and audits with "no change" determinations.

You indicated in a subsequent email to us that G_____ filed applications for reassessment and/or claims for refund with numerous assessment appeal boards in California which have been denied, and G_____ currently has an appeal scheduled with the Assessment Appeals Board for the _____ County Assessor's office. As you know, we asked the _____ County Assessor's Office to respond to your letter because you have a current appeal pending before them, and their response was forwarded to you via email on March 20, 2008.

Because you have provided neither specific facts nor specific information, however, concerning the properties involved, we are only able to provide you with a general legal overview regarding the issues you have presented.

Issue 1 – Assessment of Leasehold Improvements

Our historical advice in addressing questions of the ownership of improvements built on leased land has been the application of the *doctrine of accession* pursuant to Civil Code section 1013. Regarding the ownership of improvements the statute provides that "when 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 . . ." (Civ. Code, § 1013.) Thus, absent lease provisions under which the lessee

retains title to the improvements, title passes to the lessor upon the completion of the construction. (*Cryan v. Wardell* (1920) 263 F. 248.) Moreover, whether title actually passes to the lessor upon the completion of construction of improvements or upon termination of the lease is irrelevant for ownership purposes because, in either case, the lessor has a reversion or vested remainder interest equivalent to the fee in such improvements. (*Lewis v. Pope Estate Co.* (1941) 116 F.2d 328, cert. den. (1941) 314 U.S. 630; *Alamo School District v. Jones* (1960) 182 Cal. App.2d 180.)

Thus, we have advised that, in the absence of other equities, permanent improvements made to realty by one other than the owner of the realty belong to the owner, and a party is not entitled to reimbursement for improvements that are voluntarily made to another's land unless there is an express or implied contract between the parties for reimbursement. (See Civ. Code, § 1013.) While it is true that lessees and tenants at will are entitled to remove improvements made by them which are not affixed to the realty, California statutes and the application of the general doctrine of accession require that permanent improvements to land become part of the land itself, unless the lessor and lessee have agreed otherwise. (See Civ. Code, §§ 1013, 1013.5, 1019; see also *Valley Fair Fashions, Inc. v. Valley Fair* (1966) 245 Cal.App.2d 614, 617 (tax assessment against lessee for property improvements was valid; and the issue of tax liability between the lessor and lessee had to be determined by their agreement).) Furthermore, where improvements are owned by a person other than the owner of the land on which they are located, the owner of the improvement or the owner of the land may file a written statement with the assessor before the lien date attesting to their separate ownership, so that the land and improvements will be assessed separately to each party. (Rev. & Tax. Code, § 2188.2.)

However, irrespective of any agreement between the parties, the assessor may assess the person who owns, claims, possesses or controls property on the secured roll, which could include the lessor or lessee of that property. (Rev. & Tax. Code, § 405.) Further, subdivision (b) of section 405 specifically provides that the assessor may assess all taxable property on the unsecured roll to both the lessor and lessee of such property. Consequently, the assessor may assess the lessee for leasehold improvements even though ownership of that property is vested in the landlord (lessor).

In valuing leaseholds and leasehold improvements an assessor may use any valuation approach authorized in Property Tax Rule 3 in the exercise of the assessor's appraisal judgment. (See also Chapter 5 of the Assessors' Handbook section 504 on *Appraisals of Improvements Related to Business Property*.) While it is possible that it may be more likely that improvements are assessed twice depending on the valuation method used, Assessors' Handbook section 502, *Advanced Appraisal* specifically warns appraisers of that possibility. Furthermore, for leasehold improvements, the real property and business property divisions of the assessor's office usually coordinate their efforts to determine the proper classification of this property to ensure appropriate assessment by each division, consistent valuation amongst similar types of properties, and to avoid escapes and double assessments.

In your case, because you have not provided any specific information, we can not opine on whether the leasehold improvements, which could be either fixtures or structure items, are properly assessed to the lessor. Nor can we form any opinion on the specific valuation method used by the assessor.

Issue 2 – No Change Determination

You state that "[a]udits that result in a 'no change' determination should not be considered closed and should be able to be appealed." We take this to mean that it is your position that a "no change" audit should be appealable to a county board of equalization or an assessment appeals board. As discussed below, generally a no change audit is only appealable for a prior assessment period if an audit for that period *discloses property subject to an escape assessment*. However an application for reduction in assessment or claim for refund can be filed as long as the time periods for filing have not lapsed.

Section 469 provides that an assessor shall audit taxpayers with locally assessable trade fixtures and business personal property worth \$400,000 or more at least once every four years. Section 469(b)(3) provides that:

If the result of an audit for any year *discloses property subject to an escape assessment*, then the original assessment of all property of the assessee at the location of the profession, trade, or business for that year shall be subject to review, equalization and adjustment by the county board of equalization or assessment appeals board pursuant to Chapter 1 (commencing with Section 1601) of Part 3 of this division, except in those instances when the property had previously been equalized for the year in question. [Emphasis added.]

Further, Rule 305.3, subdivision (b)(2) provides that:

"Property subject to an escape assessment" means any individual item of the assessee's property that was underassessed or not assessed at all when the assessor made the original assessment of the assessee's property, and which has not been previously equalized by an appeals board, regardless of whether the assessor actually makes or enrolls an escape assessment. Property is subject to an escape assessment even if the audit discloses an overassessment of another portion of an item of the property, and the amount of the underassessment could be offset completely by the amount of overassessment. If the audit discloses that any property was subject to an escape assessment, the assessor shall include that fact as a finding presented to the taxpayer as required by Rule 191. If no such finding is made by the assessor, the taxpayer may file an application and present evidence to the board of the existence and disclosure of property of material value subject to escape assessment. For purposes of this regulation only, "material value" means value of no less than 1 percent of the audited value of the taxpayer's trade fixtures and tangible personal property for the year under audit. If the board determines that property subject to escape assessment was disclosed as a result of an audit, the board shall permit the taxpayer's section 469 appeal.

In this case, however, you do not state whether an escape assessment for the period(s) and county(ies) you are concerned with was disclosed. While you state that a "no change" determination was made, a "no change" determination can be made when either: (1) the audit of the taxpayer's property determines that its property was correctly assessed for the period at issue

and no property subject to escape assessment is found, or (2) when it is determined that the taxpayer has property subject to escape assessment, and other properties that were overassessed, with such overassessment cancelling out the amount of any escape assessment. Therefore, the mere fact that an audit resulted in a "no change" determination is not necessarily dispositive since an escape assessment could be offset by an overassessment resulting in no overall changes (i.e., a "no change" determination). In such a case, the audit would be subject to appeal to the county board of equalization or assessment appeals board. On the other hand, if no escape assessment was disclosed, the audit findings may not be appealed to a county board of equalization or assessment appeals board.

However, even if an escape assessment was not disclosed, that fact would not preclude you from filing an application for reduction in assessment under section 1603, or a claim for refund under section 5097 if the requirements to file under those sections are met. Additional information regarding the application process and filing deadlines may be found on our website at www.boe.ca.gov.

The views expressed in this letter are only advisory in nature. They represent the analysis of the legal staff of the Board based on present law and the facts set forth herein, and are not binding on any person or public entity.

Sincerely,

/s/ Kiren Kaur Chohan

Kiren Kaur Chohan
Tax Counsel III

KKC:pb

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cc:

California Assessors' Association

County Assessor

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