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February 7, 2007

Honorable Gary E. Hazelton
Santa Cruz County Assessor
701 Ocean Street
Santa Cruz, CA 95060

Re: Conference Grounds

Dear Mr. Hazleton:

This is in response to your letter wherein you made two inquiries regarding change in ownership consequences of certain leases under Revenue and Taxation Code section¹ 61, subdivision (c).

The facts relevant to your inquiry are set forth as follows:

1. P Conference of the Church owns the Conference Grounds.
2. Certain portions of the conference grounds are subject to long-term ground leases known as "presidential lots."
3. Each ground lease (lease) is for a term of 99 years. Each lease provides that "[L]essor may terminate this Amended and Restated Lot Lease without cause at any time by giving twelve months written notice" to the lessee.
4. Each presidential lot contains a personal residence for which a homeowner's exemption can be claimed.
5. The lessee of each presidential lot owns the improvements on their respective parcels and leases the land.
6. Some of the homes situated on the parcels are the primary residence of the lessee; others are not.
7. Your office has typically treated the creation of leases with terms of 35 years or more as changes in ownership pursuant to section 61, subdivision (c).

¹ All section references are to the Revenue and Taxation Code unless otherwise indicated.

Based on the preceding facts, you have asked the following questions:

Law and Analysis

1. Does the creation of a leasehold interest in real property for a term of 99 years result in a change in ownership pursuant to subdivision (c)(1) of section 61 despite the lessor's right to terminate the lease with 12 months notice?

Yes. Since the original term of the lease is for more than 35 years, the creation of these leasehold interests are subject to change in ownership reassessment, despite the lessor's right to terminate the lease.

A change in ownership occurs when there is 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. (Rev. & Tax. Code, § 60.) Subdivision (c) of section 61 states, in part, that a change in ownership includes:

- (1) The creation of a leasehold interest in taxable real property for a term of 35 years or more (including renewal options), the termination of a leasehold interest in taxable real property which had an original term of 35 years or more (including renewal options), and any transfer of a leasehold interest having a remaining term of 35 years or more (including renewal options).

Thus, pursuant to section 61, subdivision (c)(1), the creation of the leasehold interest for a term of 99 years results in a change in ownership of the property which subjects the property to reassessment.

As to the provision which gives the lessor the right to terminate the lease upon twelve months notice, it has been our position that a right to terminate a lease does not diminish the change in ownership consequence following the creation of a leasehold interest for a term of 35 years or more at the time of the lease's execution. See, for example, Property Tax Annotation 220.0352, which states:

Leases. A lease with a term longer than 35 years, which includes an option for the lessee to terminate the lease within 3 years lessee (1) has not obtained final, nonappealable governmental approvals regarding site and building plans and environmental reports or (2) is unable to obtain satisfactory financing for construction of the project, results in a change in ownership at the time the lease is executed. The lessee's option to terminate the lease does not diminish the creation of a leasehold interest for a term of 35 years or more at the time of the lease's execution as (1) the duration of the lease term expressed in the agreement was for a term of 35 years or more, (2) the beneficial interest in the property passed to the lessee, and (3) the obligations created by the option to terminate do not diminish the value of the lessee's equity in the property.

A copy of Annotation 220.0352 and a copy of the March 17, 2000, letter upon which the annotation is based are enclosed for your review.

In this instance, as in the March 17, 2000 letter, the original lease term expressed in the lease is for 99 years, which is greater than 35 years. In addition, once the lessee acquired a leasehold interest for a term greater than 35 years, that lessee acquired all incidences of ownership in the leased property for change in ownership purposes. Further, the obligations created by the lessor's right to terminate these leases do not diminish the value of the lessees' interest in the property. However, in this case, whether the right to terminate is that of the lessor, as here, or is that of the lessee, as in the case of Annotation 220.0352, is not determinative where the obligations created thereby do not diminish the value of the lessee's interest in the property. Additionally, in this instance, as in the March 17, 2000 letter, the party with the right to terminate may, or may not, exercise that right. Termination is discretionary, not mandatory. Therefore, a change in ownership of the property subject to the leasehold results.

2. Are the parcels that are ineligible for the homeowners' exemption to be treated differently than those that are not?

Section 61, subdivision (c)(1) provides:

For the purpose of this subdivision, for 1979-80 and each year thereafter, it shall be conclusively presumed that all homes eligible for the homeowners' exemption, other than manufactured homes located on rented or leased land and subject to taxation pursuant to Part 13, that are on lease land have a renewal option of at least 35 years on the lease of that land, whether or not, in fact, that renewal option exists in any contract or agreement.

Thus, if a parcel is subject to a lease of less than 35 years but the lessee is eligible to claim the homeowner's exemption, then the lease, regardless of the actual term, is presumed to be for more than 35 years and a change in ownership of the property has occurred at issue. (See Rev. & Tax. Code, § 61, subd. (c)(1).) However, in this case, even without the application of the quoted statute, as previously discussed, since the initial term of the lease is for more than 35 years, the property is subject to reassessment. (See Property Tax Annotation 220.0352.)

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/ Dana Flanagan-McBeth

Dana Flanagan-McBeth
Tax Counsel

DFM:pb

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cc: Mr. David Gau, MIC:63
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