



## STATE BOARD OF EQUALIZATION

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Executive Director

August 21, 1996

Re: Long term lease/base year value

Dear Mr. :

This is in response to your letters of July 15 and 16 to Larry Augusta, Assistant Chief Counsel, State Board of Equalization, and our telephone conversation of July 31, 1996. You are seeking a refund from County for a portion of taxes paid for the 1995-96 tax year for the property located at in and an adjustment of the base year value for the property to its 1995 pre-lease value. You present the following facts:

A lease was made with tenant Limited Partnership (AKA ) (lessee) in June 1995 for a period of time which the county assessor concluded was for 35 years. The lessor (owner) was not aware that such leases were changes in ownership that subjected leased properties to reassessment. The property was reassessed for the 1995-96 tax year; the reassessed amount showed an increase in value which resulted in higher taxes as shown on the supplemental tax bill. The lessee failed to make payments as due and on June 13, 1996, through a default judgment in superior court, the lease was declared forfeited; the owner obtained possession of the property on May 28, 1996.

As will be discussed below, it is our opinion that the reassessment of the property for the 1995-96 tax year was proper; that there was a change in ownership pursuant to the 35 year lease in June 1995 and that the owner is not entitled to a refund for taxes paid for that year. For June 1996 forward, we note that it is the County Assessor who is required to determine the base year value of the property. It is our opinion that the court-ordered forfeiture was a termination of the lease and that a second change of ownership occurred at that time; thus, the base year is 1996, the assessor will determine the new base year value, and the property should not revert to its pre-lease base year value.

For the purposes of this letter, we assume that you are protesting the valuation of the land only and not of the improvements on the land. New construction is valued pursuant to Revenue and Taxation Code section 71 as of the date of completion.<sup>1</sup>

#### **Leasehold interests/change in ownership**

You state that the lease signed in June 1995 was for "a two-ten year each term, with options for extensions for three-five year periods." This is considered a leasehold of 35 years pursuant to Revenue and Taxation Code section 61, subdivision (c) which provides in part:

[Except as otherwise provided in Section 62, change in ownership, as defined in Section 60, includes, but is not limited to:]

(c) (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 property which had an original term of 35 years or more (including renewal options), . . .

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<sup>1</sup> All statutory references are to the Revenue and Taxation Code unless otherwise specified. Section 71 provides: "The assessor shall determine the new base year value for the portion of any taxable real property which has been newly constructed. The base year value of the remainder of the property assessed, which did not undergo new construction, shall not be changed. New construction in progress on the lien date shall be appraised at its full value on such date and each lien date thereafter until the date of completion, at which time the entire portion of property which is newly constructed shall be reappraised at its full value."

Because renewal options are considered in the calculation of 35 years, the total number of years in the lease agreement at issue is 35 years. Pursuant to section 61, subdivision (c)(1), both the signing of the lease and the termination of the lease constituted changes in ownership. In June 1995, a leasehold interest was created for a period of 35 years. That the lease actually ended much sooner does not effect the reassessable events occurring in June 1995 and in June 1996.

There are some constitutional and statutory exclusions which provide that certain transfers of real property are not included in "changes in ownership." Articles XIII A of the California Constitution and sections 62 through 64 describe such exclusions; the lease agreement and lease forfeiture described herein are not within any of the exclusions. Further, there is no authority for an "exemption" based on hardship, breach of contract or any other basis which would exempt the owner from the payment of property taxes levied or entitle the owner to a refund as the result of the June 1995 reassessment herein.

That the owner was not aware that the creation of the lease would result in a change in ownership is not relevant; it is a well-settled principle that "If a taxpayer having a choice of methods of accomplishing an economic or business result pursues a particular means to accomplish his ends, he must abide the tax consequences resulting from his choice of methods, even though had he made another choice, the tax consequences would have been less severe or even nonexistent." *Freeman v. CIR.* (1962) 303 F.2d 580, 584.

Thus, based on section 61, subdivision (c)(1), there was a change in ownership in June 1995. Section 75.10 provides that base year value is established as of the date of a change in ownership.<sup>2</sup> Thus, it was proper that the county assessor reassessed the property and changed the base year value.

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<sup>2</sup> Section 75.10 provides in part: "... whenever a change in ownership occurs ..., the assessor shall appraise the property changing ownership ... at its full cash value ... on the date the change in ownership occurs .... The value so determined shall be the new base year value of the property ...."

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**Termination of lease - base year value from June 1996 forward**

A default judgment was granted, and filed on June 12, 1996. According to the court document, the owner was awarded certain damages for nonpayment of rent from January 1996 to May 28, 1996, and the owner received possession of the premises on May 28, 1996. The court ordered "that the Ground Lease between [lessee and owner] under which the property was held by [lessee] is forfeited."

You have requested that the base year value for the property revert to its pre-lease value.

Authority of county assessor

Pursuant to section 401 et seq., it is within the authority of the local county assessor to assess all property subject to general property taxation. This is a function of local governments and the State Board of Equalization (Board) does not have the power to adjust, increase, or reduce individual local assessments made by counties or to order refunds of local taxes; this authority is vested exclusively in the counties. The opinions of the Board are advisory and it is the county assessor who will determine the applicable base year value.

Thus, it will be the task of the County Assessor to determine the legal and factual issue of whether the "forfeit" as termed by the court is a termination or a rescission.

Termination of lease/change in ownership

The above cited portion of section 61, subdivision (c) (1) provides that "the termination of a leasehold interest [of 35 years]" is a change in ownership. The word "termination" is defined in Black's Law Dictionary as follows:

"With respect to a lease or contract, [termination] refers to an ending, usually before the end of the anticipated term of the lease or contract, which termination may be by mutual agreement or may be by exercise of one party of one of his remedies due to the default of the other party."

The court action declaring the lease "forfeited" and awarding damages to the owner as a result of a breach of certain terms in the lease is a "termination" of the lease. It is not a "rescission" because "a 'rescission' amounts to the unmaking of a contract, or an undoing of it from the beginning." A "rescission of contract" is "to declare a contract void in its inception and to put an end to it as though it never were." Black's Law Dictionary, Sixth Edition.

Therefore, pursuant to section 61, subdivision (c)(1) and section 75.10, a change in ownership occurred on June 13, 1996, the date the default judgment was filed; the new base year is 1996 and the value as of June 1996 should determine the new base year value.

#### Rescission

In order to have the property revert to its pre-lease base year value, the County Assessor would have to determine that there was a rescission of the lease. We do not think the facts support a determination of rescission but, for your information, note that Annotation 220.0390, Property Taxes Law Guide, Vol. III. provides:

A rescission relates back to the formation of a contract and dissolves it as though it had never been made. Thus, once a contract for the sale of real property is rescinded by mutual consent, the parties are placed in the same position they were in before the contract was executed, and the value of the real property reverts to its previous base year value with appropriate adjustment(s) for inflation. However, taxes incurred after the contract had been executed and before it was rescinded remain owing since they have become owing because of the facts which existed on the applicable lien date(s), and no refund(s) thereof should be made. C 1/16/85.

Annotations 220.0391 and 220.0392 refer to court ordered rescissions and are consistent with the cited annotation with regard to re-establishing the prior base year value.

In this case, the court awarded certain damages pursuant to the lease to the owner. Such award is inconsistent with "rescission" as described in Civil Code sections 1689 and 1691; Civil Code section 1691 requires that a party seeking a rescission "Restore to the other party everything of value which he has received from him under the contract." Because the owner in this case received some benefit under the lease through the award of damages and no doubt retained the rents paid until the time of nonperformance, the lease was not rescinded and the cited annotation is not applicable.

**Request for refund of taxes paid for the 1995-96 tax year**

The owner paid taxes for the 1995-96 tax year based on a new base year value as determined by the creation of the 35 year lease in June 1995. As discussed above, this reassessment is consistent with section 61, subdivision (c)(1) and was proper. The assessed value for the new base year was higher than the prior value and the owner requests a refund of the higher amount paid.

It is the board of supervisors who has statutory authority regarding refunds, and a claim for refund must be filed with the county tax collector or other designated county official's office. However, it is our opinion that, based on the facts and the references set forth above, the owner is not entitled to a refund. The criteria for refunds is set forth in section 5096 and none of the qualifying conditions apply to this case. Whether the base year from June 1996 forward is established based on a theory of termination or rescission, the lease was in effect from June 1995 to June 1996, and the reassessment as the result of the lease was appropriate. Further, as discussed above, there is no basis for exclusion from change in ownership or exemption from the payment of tax.

**Conclusion**

Based on the above discussion, pursuant to section 61, subdivision (c)(1), it was proper to reassess the subject property as of June 1995. The property is subject to a second reassessment in June 1996; it is a question of law and fact within the jurisdiction of the County Assessor to set the base year value. It is our opinion that the assessor should

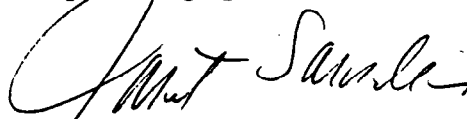
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consider the "forfeit" a termination of the lease; under section 61, subdivision (c)(1), a termination is a change in ownership and the property should be reassessed with a June 1996 base year value.

The views expressed in this letter are, of course, only advisory in nature. They are not binding upon the assessor of any county.

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,



Janet Saunders  
Tax Counsel

JS:jd  
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cc:

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