220.0355 **Leases/subleases.** If property is subject of a lease for a term of 35 years or more and a sublease of the same property is for a term of 35 years or more, the transfer of the primary lease is not a change in ownership because of the continued existence of the sublease. C 11/9/90.

STATE OF CALIFORNIA

STATE BOARD OF EQUALIZATION
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November 9, 1990

Dear M[illegible],

This is in response to your letter of October 12, 1990 to Richard Ochsner in which you request our opinion with respect to the change in ownership implications concerning a lease and a sublease of taxable real property.

As stated in your letter, the lease itself is for a term of more than thirty-five years and the sublease also is for a term of more than thirty-five years. You correctly assume that if the sublessee's interest were transferred, such action would constitute a "change in ownership" since the sublessee's term is for more than thirty-five years. You ask, however, whether a "change in ownership" would occur upon a transfer of the lessee-sublessor's interest or if the lessee-sublessor surrendered his lease to the property owner and the sublessee simply attorned to the owner with the sublease remaining in place.

As you know, Revenue and Taxation Code* section 60 defines "change in ownership" to mean "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."

Section 61 provides in relevant part that "[e]xcept 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 real property which had an original term of 35 years or more (including renewal options),

*All statutory references are to the Revenue and Taxation Code unless otherwise indicated.

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options), and any transfer of a leasehold interest having a remaining term of 35 years or more (including renewal options); or (2) any transfer of a lessor's interest in taxable real property subject to a lease with a remaining term (including renewal options) of less than 35 years."

Section 62 provides in relevant part that "[c]hange in ownership shall not include . . . (g) [a]ny transfer of a lessor's interest in taxable real property subject to a lease with a remaining term (including renewal options) of 35 years or more."

The rationale behind the foregoing provisions was stated by the Task Force on Property Tax Administration in pertinent part as follows:

> The "value equivalence" test is necessary to determine who is the primary owner of the property at any given time. Often, two or more people have interests in a single parcel of real property. Leases are a good example. The landlord owns the reversion; 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 the change in ownership?
>
> The example illustrates that in determining whether a change in ownership has occurred it is necessary to identify but one primary owner. Otherwise assessors would be forced to value, and account for separate base year values for landlords and tenants on all leases, and for other forms of split ownership. This would enormously complicate the assessor's job.
>
> A major purpose of this third element [i.e., the "value equivalence" element], therefore, is to avoid such unwarranted complexity by identifying the primary owner, so that only a transfer by him will be a change in ownership and when it occurs the whole property will be reappraised. If the hypothetical lease previously mentioned was a short term lease (the landlord owned the main economic value), the landlord's sale, subject to the lease would count. 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 count. In either case, the entire fee value of the leased premises would be reappraised.
>
> The Task Force recommends that its general definition of change in ownership (proposed section 60 Revenue and

Taxation Code) should control all transfers, both foreseen and unforeseen. The Task Force also recommends the use of statutory "examples" to elaborate on common transactions. Lay assessors and taxpayers would otherwise have difficulty applying legal concepts such as "beneficial use" and "substantially equivalent". Thus, common types of transfers were identified and concrete rules for them were set forth in proposed sections 61 and 62.

It is important that the specific statutory examples be consistent with the general test. The entire statutory design would be destroyed by providing statutory treatment for specific transfers which are inconsistent with the general test. In that case, the general test would be overruled by the specific rules and the entire statutory design might be held invalid because of the lack of any consistent, rational interpretation of the constitutional phrase, "change in ownership".

Specific Statutory Examples

1. Leases. Leases are a good illustration of the necessity of concrete statutory examples. Both taxpayers and assessors need a specific test - rather than the broad "value equivalence" test - to determine the tax treatment of leases. The specific test, however, must be consistent with the "value equivalence" rule and have a rational basis. Lenders will lend on the security of a lease for 35 years or longer. Thus 35 years was adopted as the concrete dividing line. If the term of a lease, including options to renew, is 35 years or more, the creation of the lease is a change in ownership and so is its expiration. If a lessee under such a lease assigns or sublets for a term of 35 years or more, that is another change in ownership. However, if the lease,
including options, is for less than 35 years, the lessor remains the owner and only the transfer of his interest is a change. In all cases, the entire premises subject to the lease in question are reappraised. (Report of the Task Force on Property Tax Administration, January 22, 1979, pages 39-41.) See also, Implementation of Proposition 13, Volume 1, Property Tax Assessment, October 29, 1979, pages 19, 20, 25 and 26.

It is clear under the foregoing that in order to determine whether a change in ownership has occurred where two or more people have interests in a parcel of real property, it is necessary to establish who the primary owner of the property is.

Since the sublessee is under a sublease with more than 35 years to run, the sublessee is the primary owner of the real property under the one-primary-owner concept discussed above. A transfer by the sublessee of his or her interest would clearly be a change in ownership under section 61(c) and the transferee would then be the primary owner of the real property. Thus, although a transfer by the lessee-sublessor would be a transfer of a leasehold interest having a remaining term of more than 35 years, it would also be a transfer of a lessor's interest in taxable real property subject to a lease with a remaining term of more than 35 years under the sublease. Under the one-primary-owner concept, we are of the opinion that this transfer should be treated as a transfer of a lessor's interest under section 62(g) and not as a transfer of a lessee's interest under section 61(c).

If the lessee-sublessor were to transfer his or her interest to the property owner, there would be no merger because of the outstanding sublease. Standard Oil Co. v. Slye (1913) 164 Cal. 435; Bailey v. Richardson (1885) 66 Cal. 416. Since no merger would occur under such circumstances, the lease would not terminate as a result of a transfer by the lessee-sublessor to the property owner and no change in ownership would occur under section 61(c). If, for any reason, however, the sublease were to terminate resulting in a change in the right to possession, there would be a change in ownership under section 61(c).

The views expressed in this letter are, of course, advisory only and are not binding upon the assessor of any county. You may wish to consult the appropriate 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

Eric F. Eisenlauer
Tax Counsel

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