



STATE OF CALIFORNIA

[Handwritten signature]

STATE BOARD OF EQUALIZATION
450 N STREET, SACRAMENTO, CALIFORNIA
(PO BOX 942879, SACRAMENTO, CALIFORNIA 94279-0001)
TELEPHONE (916) 323-7713
FAX (916) 323-3387

RECEIVED
JUL 20 1998
DEPUTY DIRECTOR
PROPERTY TAXES

JOHAN KLEHS
First District, Hayward
DEAN F. ANDAL
Second District, Stockton
ERNEST J. DRONENBURG, JR.
Third District, San Diego
KATHLEEN CONNELL
Controller, Sacramento
JOHN CHIANG
Acting Member
Fourth District, Los Angeles
E. L. SORENSEN, JR.
Executive Director

July 17, 1998

[Handwritten circled 'P']

, Esq.

Attorneys At Law

In Re: Sublease of Residential Property: Life Estate or Lease for Less than 35 Years.

Dear Mr. :

This is in response to your letter of June 3, 1998, requesting our opinion as to whether the sublease of leased residential property, including the land and improvements, by the lessee for a term of 34 years and 11 months constitutes a change in ownership under Revenue and Taxation Code Section 61(c).

You have described the following set of facts for purposes of our analysis:

1. In 1985, the owners of a residential property, including both lot and residence, entered into a lease for a term in excess of 35 years, or for the life of one of the owners. This term was subsequently changed to the life of the lessee. You acknowledge that a change in ownership of the property occurred at that time.
2. On May 1, 1996, the lessee entered into a sublease with a corporation ("sublessee") which terminates on the earlier of (a) the termination of the lease (i.e., the master lease), or (b) March 31, 2031. The parties intended, however, that in no event would the maximum term of the sublease exceed 34 years and 11 months. As a corporate entity, sublessee will not occupy the property as a principal residence.

Based on the foregoing, you believe that the 1996 sublease of both the structure and the land was not a change in ownership, and should not be reassessed pursuant to Section 61(c)(1).

In evaluating the information you submitted in addition to a copy of the Sublease provided by the Orange County Assessor's office, we surmise that your questions are:

1) Whether the 1996 "Sublease" transferred a leasehold estate to a sublessee for a term of 34 years and 11 months, or a life estate based on the life of the lessee/sublessor; and

2) If the estate created is a leasehold, whether the conclusive presumption at the end of Section 61(c)(2) is applicable to residences not eligible for the homeowners' exemption and not on leased land.

For the reasons hereinafter explained, the answer to your first question is most likely a leasehold estate rather than a life estate, since language in the Sublease appears to create a leasehold estate for a term less than 35 years; and the answer to your second question is no, the conclusive presumption in Section 61(c)(2) does not apply.

LAW AND ANALYSIS

Within the definition of change in ownership in Revenue and Taxation Code Section 60, there are two types of transfers (leaseholds and life estates) indicated by the facts of this case which could result reappraisal of the property.

The first is the creation or transfer of a leasehold interest, which is governed by Section 61(c). This statutory provision includes as a change in ownership:

"(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);

* * *

"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 (commencing with Section 5800), that are on leased 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."

As to the lease exclusion from change in ownership set forth in Section 62(g),¹ the language in Rule 462.100(b) concerning (sublease) transfers by lessees clearly excludes transfers of lessees' interests in a leasehold estate for a term of less than 35 years.

The second type of transfer relevant here is the creation, transfer, or termination of a life estate. Under Section 61(g) and Rule 462.060, a change in ownership includes:

The creation of a life estate in real property is a change in ownership at the time of transfer unless the instrument creating the life estate reserves such estate in the transferor or the transferor's spouse. However, the subsequent transfer of such a life estate by the transferor or the transferor's spouse to a third party is a change in ownership. Upon termination of such a reserved life estate, the vesting of a right to possession or enjoyment of a remainderman (other than the transferor or the transferor's spouse) is a change in ownership.

Under the life estate exclusion of Section 62(e), the transfer of an estate for life does not constitute a change in ownership only if the transfer is to the transferor or the transferor's spouse.

1. Did the 1996 "Sublease" transfer a leasehold estate to a sublessee for a term of 34 years and 11 months, or a life estate based on the life of the lessee under the master lease?

Answer: Probably a leasehold estate for a term of less than 35 years.

A life estate is defined as an estate whose duration is **limited to the life of a person** holding it, or to the life of some other person. Estate of Smythe (1955) 132 Cal.App.2d 343. A life estate can be granted or reserved by deed, created by will, or by any other written instrument. No particular language is required to create a life estate. It is any reservation of a lifetime interest (estate) in a recorded instrument creating a right or privilege for the benefit of the grantor or others in the land and withholding that right or privilege from the operation of the grant. By the reservation, the grantor reserves something in himself or others which is newly created by the grant. Victory Oil Co. v. Hancock Oil Co. (1954) 125 Cal.App.2d 222.

This definition is consistent with the rationale for the exclusion adopted by the Legislature in Section 62 (e). The rationale, stated in Implementation of Proposition 13, Vol. I, Property Tax

¹ The exclusion from change in ownership applicable to leasehold transactions is found in Section 62(g), which provides as follows:

"Change in ownership shall not include:

* * *

"(g) Any 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. 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 mobilehomes located on rented or leased land and subject to taxation pursuant to Part 13 (commencing with Section 5800), which are on leased land and 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."

Assessment, by the Assembly Revenue and Taxation Committee, October 29, 1979, page 29, is as follows:

(3)...Transfers with a retained life estate are not ownership changes **until the life tenant dies**. The life tenant has the dominant or primary interest under the value equivalence element of the general change in ownership definition, and there is no transfer of the present interest in the property until the life tenant dies and the property vests in the remainder. At that time, the provisions of trusts and interspousal transfers permitting, a change in ownership shall be deemed to have occurred (Section 62(e)).

In contrast to an instrument creating a life estate, a lease is any instrument creating the relationship of landlord and tenant. California courts have followed the view that a lease has a dual nature in that it is a *conveyance* of an estate in land, and it is a *contract* between the lessor and the lessee. Therefore, a lease creates dual rights and obligations on the parties creating such an estate.² In this respect, a lease is significantly different from a life estate, which is generally a unilateral grant or reservation by the transferor in favor of the transferee. While no particular words are required to create a lease, there must be an expression of the parties sufficient enough to indicate their intention to create the rights and duties establishing the lessor/lessee relationship, including specification of the term.

For purposes of determining a change in ownership, the **term of any lease** is the most important factor. Under Section 61(c) and Rule 462.100(a), where the term specified, including any options for renewal, exceeds 35 years, the lessee is considered the owner of the property, because a term in excess of 35 years is considered to be substantially equivalent to the value of the fee interest in the property pursuant to Section 60.³ Where the term of the tenancy (including

² 4 Witkin, *Summary of California Law*, Vol 4, "Real Property," 9th ed., p712.

³ Report of the Task Force on Property Tax Administration, presented to the Assembly Committee on Revenue and Taxation (1979), explained the value equivalence requirement as follows:

"[T]he '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, 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." (Rep. of the Task Force

any renewal options) is less than 35 years, the lessor is considered the primary owner of the property. Where the term is not stated, various statutory provisions (Civil Code Sections 1943 et. seq.) presume a designated term, generally 1 month or 1 year, but less than 35 years. Furthermore, where the term in lease is for the life of the lessor or lessee and no other definite term is recited, we have stated that the "lease" is in effect, a life estate, even though it does not use the words, "life estate," because its duration is measured solely by the life of another person. (See Annotation No. 220.0366, Eisenlauer Letter, 4/12/84.) The characterization of the "lease" as a "life estate" in such instances has been recognized by California courts as explained in *Kendall v. Southward*, (1957) 149 CA2d 827.

Here however, the Sublease specifies two seemingly **contradictory terms**: (1) the life of the lessee/sublessor plus 90 days, and (2) the ending date of March 31, 2031 (a term of 34 years and 11 months). The question, therefore, is the parties' intent in memorializing the two terms in the Sublease: i.e., whether the duration of the lessee's life is to control the length of the term characteristic of a life estate, or whether the death of the lessee is one of many dates or events which terminate the sublessee's tenancy-characteristic of a leasehold estate.

In analyzing terms and conditions in instruments creating life estates in past situations, we stated that if the language imposing conditions places burdens on the life tenant which do not invalidate the grant of a life estate, (i.e. the life tenant shall hold the estate as long as she resides on the property, does not encumber the property, or pays the taxes and expenses on the property, etc.) and the term of the estate is otherwise indefinite, then in all likelihood, the term of the estate survives until the life tenant's death. Thus, even though some life estates might be more restrictive than others, if it is clear from the language in the creating instrument that the grant or reservation to the remaindermen to possession or enjoyment of the property does not vest until the death of someone or until the occurrence of one of the conditions imposed on the life tenant, then the property interest created should be treated as a life estate or similar precedent property interest.⁴ The fact that the remainder persons or other tenants lease or possess the property and act as the owners of the property while the life tenant is still living, does not prove that the life tenant's estate is terminated or that the estate created was a leasehold. (See Annotation No. 220.0369 attached.)

Where however, the language of the creating instrument manifests an intention by the parties to create a landlord/tenant relationship rather than a life estate, and the term of the estate is definite, specifying a date as well as breach provisions for the termination or forfeiture of the estate even though the life tenant is still alive, it seems fairly clear that the creating instrument is in reality a lease. We note that under the statutory provisions of Civil Code Section 1934, the death of a lessee does not terminate the a leasehold estate which is created for a specified term. Thus, unless the parties include a specific provision in the lease stating that it terminates at the lessee's/sublessor's death, a leasehold with a term of 34 years and 11 months would continue, even if the lessee died before the expiration of that term. For this reason, parties entering a lease

on Property Tax Admin., presented to the Assem. Com. on Rev. & Tax. (1979) pp. 39-40, italics in original.)

⁴ Property Tax Law Guide Vol. III, Annotation No. 220.0369, Life Estate.

arrangement sometimes add, as a cause for termination, the death of the lessee, such as the provision found in this Sublease. Other causes for termination in this Sublease are the date (March 31, 2031), the breach or termination of the master lease, sublessor's breach, sublessee's breach, waste or destruction of the premises, etc. All of these provisions are grounds which could cause an earlier termination of the Sublease, before the death of the life tenant. Taken as a whole, these and other provisions tend to show that the parties established a leasehold estate, rather than a life estate, and that the lifetime provision in the Sublease is intended to counter the operation of Civil Code Section 1934, and is only one of the events, (and not the controlling event) that could cause a termination of the lease.

Notwithstanding the foregoing, the assessor has the ultimate responsibility of determining whether an interest in real property is a life estate, a leasehold estate, or some "other similar precedent property interest," (Section 61(g)) for change in ownership purposes. Therefore, the assessor's determination, following his/her examination of the express language in the Sublease, the master lease, and in any other written instruments stating the intentions of the parties, is final in regard to the type of estate they were creating.

2. If the estate created is a lease, is the conclusive presumption in Section 61(c)(2) applicable to residences not eligible for the homeowners' exemption and not on leased land?

Answer: No.

The conclusive presumption at the end of Section 61(c) establishes that the lessee owns the "equivalent fee interest" in property where "homes eligible for the homeowners' exemption" are on leased land, because the lease is presumed to have a 35-year renewal option, regardless of its actual term. This provision was adopted in 1979, shortly after the original statute, as the Legislature's solution to a unique problem pertaining to certain leased lands in Orange County. A large number of residential lots, some improved with single family homes, were transferred by the lessor to the Irvine Company. Many of the lots were leased to homeowners under leases that had less than 35 years to run, subjecting those properties to change in ownership and reappraisal. To avoid that result, the Legislature adopted the conclusive presumption language in Sections 61(c) and 62(g), which expressly provides that wherever a home eligible for the homeowners' exemption is on leased land, the term of such lease shall be conclusively presumed to have a 35-year renewal option for all purposes. Under this "fictional term exception," the real term of the lease was to be disregarded by the assessor, and the 35-year "fictional term" applied. The fact that the remaining term of the lease may actually be less than 35 years is not relevant or material, because the conclusive presumption makes the tenant the "property owner" for all transfers.

It is quite clear that this presumption is not applicable to the facts here, since two of the main requirements under Section 61(c)(2) and Section 62(g) cannot be met. First, neither the lessee nor the sublessees are homeowners who are eligible for the homeowner's exemption.⁵

⁵ The homeowners' exemption in Section 218 does not apply to persons holding property in the name of a corporation. See Letter to Assessors No. 82/50, p.13, question and answer numbers G5 - G7.

Secondly, there is no indication that the property includes leased land. The conclusive presumption does not apply in any case unless the land is leased, because in every other situation the "owner" of the land is the owner of the improvements for change in ownership purposes.

Thus, change in ownership and reappraisal determinations for the facts described here are governed by the provisions for transfers of leaseholds subject to terms of less than 35 years under Rule 462.100(b)(1)(A). That exclusion states that "the creation of a leasehold (or subleasehold) interest in real property for a term of less than 35 years" does not constitute a change in ownership. The lessee/sublessor here is in exactly the same position as a fee owner of the property, and its 1996 sublease is not a transfer subject to change in ownership and reappraisal.

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,



Kristine Cazadd
Senior Tax Counsel

KEC:ba

Attachments

cc: The Honorable Brad Jacobs
Orange County Assessor

Mr. Richard Johnson ...

Mr. Rudy Bischof

Mr. David Gau

Ms. Jennifer Willis

precednt\trustsle\1998\98005.kec