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Interim Executive Director

December 11, 2003

Subject: Lease Rescissions – Change in Ownership Consequences

Dear Mr. _____ :

This is in response to your letter of October 1, 2003, regarding change in ownership consequences related to the rescission of leases greater than 35-years.

As discussed further below, since leases of 35 years or greater are treated as transfers of real property, it is our opinion that the rescission of a 35-year lease may “relate back” to its formation and dissolve the lease, and thus dissolve the transfer, as though never made. A rescission has the result of returning the parties to a transaction to their original position prior to the reappraisal of the subject property taking effect, so that a property reverts back to its previous base year value with appropriate inflation factor adjustments. Only the parties to the transaction need to be returned to their original position, and the mutual consent of the parties alone is sufficient to effectuate a rescission. However, a rescission can only be applied prospectively, and no refund of taxes is available to the parties for the period of time under which the lease is treated as a change in ownership.

Factual Background

As detailed in your letter, _____ (“C _____”) is a mobile home park with _____ of a number of mobile homes situated on individual sites. C _____ leased the sites to individuals for various terms including a number of long-term leases of greater than 35 years (up to 99 years in many cases). C _____ and the individuals leasing the sites, who are responsible for the property taxes, erroneously believed that the property taxes on the sites would not change as a result of the 99-year leases.

California law provides that leases of 35 years or greater are treated as changes in ownership, and the assessor reassessed the property after the execution of each lease agreement. Because of the parties’ mistaken belief with respect to the property tax consequences of long-term leases, C _____ and the individuals involved mutually wish to rescind the long-term leases. The leases will be rescinded, and the parties to the leases will be restored to their original positions. The parties intend to enter into new leases of less than 35 years, and the lessees will lose the benefit of a longer than 35-year lease. Third-party lenders or other third parties may have relied on the longer leases to provide financing or other benefits for the lessees; however, numerous lenders provide conventional loans for mobile homes on less than 35-year leases.

We have restated your questions followed by summary responses. A detailed analysis follows below.

1. Does a lease rescission have to be approved by a court order to be recognized or is the parties' mutual consent sufficient?

Answer: No. Parties may mutually consent to a rescission absent a court order.

2. When parties rescind a greater than 35-year lease, does an assessor's office restore the base-year value of the original transferor (e.g., the lessor) as of the date of the greater than 35-year lease?

Answer: Yes, with the appropriate inflation factor adjustments.

3. Would the parties be returned to their original position if the parties agree that the value of use of the leased premises and the payments the lessor received under the lease are of equal value?

Answer: Yes. If the parties agree that the value of the use of the leased premises and the payments made under the lease are of equal value, then no further action is required to place the parties in their original position.

4. When considering whether the parties were returned to their original position, are you required to take into account third-party reliance on the original lease and the effect the rescission may have on third-party lenders or other third parties that were not parties to the lease transaction?

Answer: No. Only the parties to the lease must be returned to their original position as if the lease had never occurred. Third-party lenders or other third parties may have other rights, but such rights do not affect the rescission and are irrelevant in determining that the leases have been rescinded. Only the mutual consent of the parties to the lease is necessary to effectuate a rescission.

Law and Analysis

California law provides that leases of 35 years or greater are treated as transfers of real property and changes in ownership. The rescission of a transfer of real property may "relate back" to its formation and dissolve the transfer as though it had never been made. (*See Long v. Newlin* (1956) 144 Cal.App.2d 509.) Each party to a transaction must restore, or offer to restore, to the other party all of the consideration that was received under the contract, upon the condition that the other party do likewise. (Civ. Code §1691, subd. (b)). Upon rescission, the lease contract becomes a nullity and each of its terms and provisions cease to exist and are unenforceable against the other party. (*See Holmes v. Steele* (1969) 269 Cal.App.2d 157.)

Parties to a lease may, on their own accord, mutually consent to the rescission. (Civ. Code §1689, subd. (a)). The provisions of the Civil Code do not require a court order or approval for a lease contract rescission to be valid when the parties to the contract mutually agree to rescind it. Thus a rescission does not have to be approved by a court order to be recognized by an assessor's office. (*see e.g.* Property Tax Annotation No. 220.0599 (6/29/01), attached).

A party seeking rescission must restore to the other party everything of value that it received under the contract. (Civ. Code §1691, subd. (b).) In the case of a lease, the lessor receives payments under the terms of the lease and the lessee receives use of the property. If a lease is rescinded, the lessee must restore the value of use of the leased premises (*Bush v. Vernon* (1955) 135 Cal.App.2d 33) and the lessor must restore the payments it received under the lease (*Hannah v. Steinman* (1911) 159 Cal. 142). If the parties agree the value of the use of the leased premises and the payments made under the lease are of equal value, no further action will be necessary to return the parties to their original position. The condition that the parties must be placed in their original position only applies to the parties to the lease. Third-party lenders or other third parties that may have relied on the original lease as a condition to financing or otherwise are not parties to the lease.

A rescission has the result of returning the parties to a transaction to their original position prior to the transaction. In the property tax context, however, the rescission can only be applied prospectively, and no refund of taxes paid by the parties for periods prior to the rescission will be made. This is so because property taxes are determined by the facts that exist as of the lien date or the date of change in ownership for the supplemental roll. (*See Doctors General Hospital v. County of Santa Clara* (1957) 150 Cal.App.2d. 53.) Also, see Property Tax Annotation No. 220.0595, 1/16/85, attached.

Since the purpose of a rescission is to return the parties to their original position prior to the reappraisal of the subject property, the rescission is not considered a change in ownership. Rather, the rescission causes a property to revert back to its previous base-year value, and it should be enrolled at that value with appropriate inflation factor adjustments.

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/ Shirley Johnson

Shirley Johnson
Tax Counsel

Attachments

SJ:lg

Precedent/Rescission/03/01

cc: Mr. David Gau, MIC:63
Mr. Dean Kinnee, MIC:64

Mr. Todd Gilman, MIC:70