

Memorandum

To: Mr. Dean R. Kinnee (MIC:64)
Chief, County Assessed Properties Division

Date: October 14, 2008

From: J. K. McManigal, Jr.
Senior Tax Counsel

Subject: *Household Furnishings, Personal Effects, and Pets Exemption California Constitution Article XIII, section 3, subdivision (m); Revenue and Taxation Code section 224; and Property Tax Rule 134 Assignment No. 08-198*

This is in response to your request for our opinion regarding a June 25, 2008 letter (the letter) submitted by an attorney on behalf of his client, a lessor of medical and ambulatory equipment (the business). The letter requests a formal opinion, on the following question:

Is medical and ambulatory equipment that is leased to individuals for home use eligible for the exemption from property taxation, as set forth in California Constitution Article XIII, section 3, subdivision (m)?

The client's business is described as follows: "our client provides on a lease, or lease-to-own-basis various types of medical and ambulatory equipment for individuals to use in the privacy of their homes. Examples of the specific types of medical and ambulatory equipment include canes, crutches, walkers, wheelchairs, hospital-type beds, commodes, and shower benches. Other medical equipment that our client may lease to its customers for in-home use includes respiratory equipment and infusion equipment."¹

The letter cites several court cases to support the opinion that the business's property should be exempt from property tax when out on lease because it is "personal property of the type or class normally found or used in, or associated with, a household and which is held or kept for household use or purposes."² The letter further states that the attorney's analysis leads "to the conclusion that the determinant criteria for the application of the HFPE is based on how the property is used and not in the actual ownership."³

As hereinafter discussed, Revenue and Taxation Code⁴ section 224 implemented the constitutional provision; and Property Tax Rule 134, *Household Furnishings, Personal Effects, and Pets Exemption*, construed section 224 to require ownership of property, "household

¹ June 25, 2008, Gangloff letter, page 1.

² June 25, 2008, Gangloff letter, page 10.

³ June 25, 2008, Gangloff letter, page 4.

⁴ All statutory references are to the Revenue and Taxation Code, unless otherwise specified.

furnishings and personal effects owned by a householder,” initially, and “household furnishings, personal effects, and pets . . . owned by any individual,” currently. Accordingly, the owner/lessor of the equipment using the equipment in his/her leasing business for the production of income is not the individual/owner the rule requires. Furthermore, the household furnishings exemption specifically excludes household personal property held or used in connection with a trade, profession or business or for the production of income.

Taxable Property vs. Exempt Property

Unless otherwise exempt as provided by the State Constitution or the laws of the United States, all property is taxable.⁵ While real property may be exempt specifically by the State or U.S. Constitution only, the Legislature has been granted general power to exempt personal property in whole or in part. Article XIII, section 2 of the California Constitution states, in part:

The Legislature may provide for property taxation of all forms of tangible personal property, shares of capital stock, evidences of indebtedness, and any legal or equitable interest therein not exempt under any other provision of this article. The Legislature, two-thirds of the membership of each house concurring, may classify such personal property for differential taxation or for exemption.

Personal property is and can be exempt by reason of its *ownership, use, and/or type*. For example, personal property owned by banks, financial corporations, and insurance companies is exempt by *ownership*⁶ while property used by free public libraries is exempt by *use*.⁷ Business inventories and household personal property are exempt by *type*.⁸ Property may be exempt by one or more of these reasons. (See Assessors' Handbook Section 504 (AH 504), *Assessment of Personal Property and Fixtures*, page 3.)

Exemption of Household Personal Property

California Constitution Article XIII, section 3, subdivision (m), exempts "household furnishings and personal effects not held or used in connection with a trade, profession, or business." Section 224 implemented the constitutional provision and Property Tax Rule 134, *Household Furnishings, Personal Effects, and Pets Exemption*, provides further guidance on the exemption.

Section 224 provides that:

The personal effects, household furnishings, and pets of any person shall be exempt from taxation.

The phrase ‘personal effects, household furnishings, and pets’ does not include boats, aircraft, vehicles, or personalty held or used in connection with a trade, profession or business or pets so held or used.

⁵ California Constitution, article XIII, section 1.

⁶ California Constitution, article XIII, section 28 prohibits taxation of personal property to insurance companies. California Constitution, article XIII, section 27 and Revenue and Taxation Code section 23182 provide for exemption of personal property owned by banks and financial corporations; this exemption does not apply to personal property owned by federal credit unions.

⁷ California Constitution, article XIII, section 3.

⁸ Revenue and Taxation Code sections 219 and 224, respectively.

For purposes of this section, ‘pets’ mean and include any animals held for noncommercial purposes and not as an investment.

Rule 134 provides further guidance for the exemption of household furnishings. The first paragraph of the rule states that:

Household furnishings, personal effects, and pets, as defined in section 224 of the Revenue and Taxation Code, owned by any individual but not held or used in connection with a trade, profession, or business or for the production of income are exempt from ad valorem taxation.

As indicated in the latter citation, the Board’s construction of section 224 from its enactment in 1968 has been that ownership of household furnishings, personal effects, and pets is required. Section 224 was added by Statutes 1968,⁹ operative March 1, 1969. Rule 134 was adopted by the Board on January 8, 1969, effective February 12, 1969,¹⁰ to state in this regard:

Household furnishings and personal effects owned by a householder and not used for the production of income are exempt from ad valorem taxation

Accordingly, ownership of household furnishings, personal effects, and pets has been and continues to be required for such property to be eligible for the household furnishings exemption. So long as Rule 134 remains in force and effect, personal property, including medical and ambulatory equipment, leased to individuals for home use is not eligible for the exemption.

As you know, interpretations of statutory provisions by state administrative agencies are entitled to great weight when construing such provisions.¹¹ The courts have articulated certain factors that indicate that an administrative agency’s construction is entitled to deference or that it is not. The rule that courts should defer to an administrative agency’s construction of a statute is more likely to be applied where the agency’s interpretation is substantially contemporaneous with the statute’s enactment and is not clearly erroneous,¹² as is the case of Rule 134.

Also, while administrative construction of a statute does not acquire legal acceptance merely from long usage, administrative construction of a statute that has been long continued will be given great respect by the courts and upheld if not clearly erroneous,¹³ particularly where persons with an interest in the matter have long acquiesced in the interpretation.¹⁴ Such is the case with respect to Rule 134. And a further factor signifying that an agency’s interpretation of a given statute is probably correct includes evidence that the agency consistently followed the interpretation in question.¹⁵ Such is the case with respect to Rule 134.

⁹ 1st Extra Session, chapter 1, section 5, in effect September 23, 1968.

¹⁰ While Rule 134 was subsequently amended in 1969 and in 1972, the requirement in the first paragraph thereof that household furnishings and personal effects, and pets, be owned has remained unchanged.

¹¹ *Yamaha Corp. of America v. State Board of Equalization* (1998) 19 Cal.4th 1; *General Dynamics Corporation v. San Diego County* (1980) 108 Cal.App.3d 132.

¹² *Yamaha Corp. of America v. State Board of Equalization*, *supra*.

¹³ *Whitcomb Hotel v. California Employment Commission* (1944) 24 Cal.2d 753.

¹⁴ *California Motor Express v. State Board of Equalization* (1955) 133 Cal.App.2d 237.

¹⁵ *Slocum v. State Board of Equalization* (2005) 134 Cal.App.4th 969.

Finally in this regard, an administrative construction of a statute may be approved and confirmed by subsequent legislation. Lawmakers are presumed to be aware of long-standing administrative practice. Thus, reenactment of a provision, or the failure to substantially modify a provision, is a strong indication the administrative practice was consistent with underlying legislative intent and an implied adoption of that practice.¹⁶ While section 224 was subsequently amended by the legislature in 1969 and 1971, was repealed and added in 1972, and was again amended in 1974, at no time did the legislature contradict the Board's longstanding construction of section 224, set forth in Rule 134, that ownership of household furnishings, personal effects, and pets is required for such property to be eligible for the household furnishings exemption.

Further, as indicated in the above citations, the household furnishings exemption specifically excludes household personal property held or used in connection with a trade, profession or business or for the production of income. The business is the owner/lessor of medical and ambulatory equipment that is used in its leasing business for the production of income. The above citations do not make any distinction between leased and/or owned personal property in this regard. Therefore, if the property is held or used in any way in connection with a trade, profession or business and/or for the production of income, by the owner/lessor or by the lessee, the property is not eligible for the exemption.

Leased Equipment vs. Leased to Own Equipment

The letter further describes the business as providing equipment to individuals on a lease or lease-to-own basis. The following information is provided to identify a distinction in the difference in assessment of property that is under a true lease versus the assessment of property under a conditional sales contract or financing lease.

True Leases

True leases, whether short-term or extended-term, are agreements under which an owner gives up possession and use of his/her property for valuable consideration and for a definite term and at the end of the term, the owner has the absolute right to retake, control, or convey the property. It is an agreement under which there is no intention of transferring ownership. At termination of the lease, the property will be returned to the lessor.

Conditional Sales Contracts or Financing Leases

Conditional sales contracts or financing leases (agreements) are purchases rather than true leases. They can be short-term or extended-term agreements whereby the seller (vendor) accepts periodic payments for the purchase price while retaining title to the property for security purposes. Possession of the property transfers to the buyer (vendee) without full legal title until payment of the purchase price or a predetermined date occurs.

These contracts provide possession, use and control to the vendee. The vendee is the beneficial owner of the property and, therefore, becomes the assessee, regardless of whether or not he or she holds title. Property under a conditional sales contract is usually assessed to the vendee because the vendee is technically the owner of the property.

Assessment of Property Under a Conditional Sales Contract

¹⁶ *Whitcomb Hotel v. California Employment Commission, supra.*

If the equipment is leased under a conditional sales contract or financing agreement, the lessee is the beneficial owner of the equipment and, therefore, the assessee of the equipment, whether or not the vendee holds title to the equipment. In these situations, the medical and ambulatory equipment may be considered household furnishings and personal effects not held or used in connection with a trade, profession, or business.

Conclusion

The attorney takes the position that "ownership is not the prevailing criteria when determining the exempt status of a property. The property's use is the one constant and prevailing criteria and the only criteria which results in consistent and equal treatment of all involved, when determining the exempt status of property".¹⁷ As indicated above, Rule 134 is to the contrary.

Rule 134 notwithstanding, the letter cites several court cases to support this position, for example *Ross v. City of Long Beach* (1944) 24 Cal.2d 258 and *Honeywell Information Systems, Inc. v. County of Sonoma* (1974) 44 Cal.App.3d 23, which deal with property leased to a school district, property eligible for the public schools exemption if used exclusively for public school purposes. However, California Constitution, article XIII, section 3, subdivision (d) and section 202, subdivision (a)(3) explicitly state that property *used exclusively* for public schools, community colleges, state colleges, and state universities is exempt from property taxation. Therefore, the property is exempt from taxation on the basis of its exclusive use for public school purposes. By contrast, as indicated above, household furnishings, personal effects, and pets are exempt by ownership and by type. While exclusive use is the requirement when determining the status of property used for public school purposes, these cases are not determinative in instances involving the household furnishings exemption.

The letter also cites *Lake Forest Community Assn., v. County of Orange* (1978) 86 Cal.App.3d 394. That case dealt with household furnishings owned by a community association and used in a common clubhouse. In that case, however, the property was owned by the community association and was not used in connection with a trade, profession, or business or for the production of income. As indicated above, the business in question is the owner/lessor of medical and ambulatory equipment that is used in its leasing business for the production of income.¹⁸

The letter concludes that the "medical equipment, when out on lease, is personal property of the type or class normally found or used in, or associated with, a household and which is held or kept for household use or purposes. When not on lease the property is stored and unused for any business purposes. As a result, Rule 134's requirement of 'ownership' or held 'for the production of income' are not relevant to determining the taxability of leased equipment."¹⁹

In review of property eligible for any property tax exemption, all exemption requirements must be met in order for the property to receive the benefit of tax exemption. In reference to the household furnishings exemption, California Constitution Article XIII, section 3, subdivision (m), exempts "household furnishings and personal effects not held or used in connection with a

¹⁷ June 25, 2008, Gangloff letter, page 9.

¹⁸ For additional information, see annotated letter 630.0014. Available on the Board's website (www.boe.ca.gov) and may be accessed by selecting Property Taxes, and then Annotations.

¹⁹ June 25, 2008, Gangloff letter, page 10.

trade, profession, or business," section 224 excludes personalty held or used in connection with a trade, profession or business, and Rule 134 requires ownership of household furnishings, personal effects, and pets not held or used in connection with a trade, profession or business.

The business is the owner/lessor of medical and ambulatory equipment that is used in its leasing business for the production of income. This property owned is not eligible for the household furnishings exemption because the medical and ambulatory equipment is owned by it and used in connection with its business for the production of income.

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