STATE OF CALIFORNIA

STATE BOARD OF EQUALIZATION
1020 N STREET, SACRAMENTO, CALIFORNIA
(P.O. BOX 1799, SACRAMENTO, CALIFORNIA 95808)
(916) 324-6594

May 7, 1987

This letter is in response to your letter to the attention of Ken McManigal dated March 23, 1987. Enclosed with your letter was a copy of a document entitled "Employment Contract" ("Contract") between , a limited partnership ("Manager") and the ("Band") for the operation of a high stakes bingo operation ("Bingo Enterprise") on the in County.

You have asked our opinion as to whether the Contract constitutes a lease "thereby creating a taxable possessory interest in the improvement and personal property classified as fixed equipment."

Article XIII, Section 1 of the California Constitution requires that all property be taxed unless otherwise provided by the California Constitution or the laws of the United States. Possessory interests in real property are deemed to be real property for tax purposes. (Foster Shipbldg. Co. v. County of L.A. (1960) 54 Cal.2d 450,455.) Possessory interests in personal property, however, are not taxable. (General Dynamics Corp. v. County of L.A. (1958) 51 Cal.2d 59, 65-66.) Also, Revenue and Taxation Code* section 104 classifies the right to use or possess land as real property. Section 107 defines "possessory interests" in pertinent part as "[p]ossession of, claim to, or right to the possession of land or improvements, except when coupled with ownership of the land or improvements in the same person."

Property Tax Rule 21 interprets section 107 and provides in relevant part that a "possessory interest" is "an interest in real property which exists as a result of possession, exclusive

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

use, or a right to possession or exclusive use of land and/or improvements unaccompanied by the ownership of a fee simple or life estate in the property." (Property Tax Rule 21(a).) A "taxable possessory interest" is "a possessory interest in nontaxable publicly owned real property. . . ." (Property Tax Rule 21(b).)

The rationale behind the taxation of possessory interest is that "[t]hese possessions . . . are recognized as a species of property subsisting in the hands of the citizen. It is not the land itself, nor the title to the land . . . . It is not the preemption right, but is the possession and valuable use of the land subsisting in the citizen. Why should it not contribute its proper share, according to the value of the interest, . . . of the taxes necessary to sustain the Government which recognizes and protects it?" (People v. Shearer (1866) 30 Cal. 645, 657.)

In determining the existence of a taxable possessory interest under a written instrument, an objective standard rather than the literal language of the written instrument controls in ascertaining the nature of the relationship established. Because of the variety of interests that may be created by written instruments, the question of whether a taxable possessory interest has been created must be decided on a case-by-case basis by weighing the factors of durability, exclusiveness, private benefit and independence. In each case, judgment is to be made by an examination of the writing in its entirety. (Stadium Concessions, Inc. v. City of Los Angeles (1976) 60 Cal.App.3d 215; Wells National Services Corp. v. County of Santa Clara (1976) 54 Cal.App.3d 579; Mattson v. County of Contra Costa (1968) 258 Cal.App.2d 205; see also Property Tax Rule 21(a)(1).) In order to determine whether a taxable possessory interest has been created in this case, it is necessary to analyze the Contract in light of the standard set forth above.

Durability

To satisfy the requirement of durability, the agreement must confer use for a determinable period and the use has to be reasonably certain to last for that period. (Kaiser v. Reid (1947) 30 Cal.2d 160.)

The Contract, which is dated July 1985, recites (p. 2) that the Band lacks the financial resources and management expertise necessary to operate the Bingo Enterprise and desires to enter into an agreement for a term sufficient to enable it to acquire such resources and expertise necessary to manage the Bingo Enterprise without assistance.

Paragraph II of the Contract provides for a limited term of five years unless terminated or extended under other provisions of the Contract. Paragraph II also provides for extension or renewal by mutual agreement and also gives Manager a right of first refusal if, after the expiration of five years, the Band should choose not to operate the Bingo Enterprise itself.

Some indication that it is reasonably certain that Manager will operate the Bingo Enterprise for at least the five-year-period is that fact that Manager has already advanced to the Bingo Enterprise nearly $327,000 for the construction of improvements, operating expenses, prize money and payroll incidental to the operation of the Bingo Enterprise. (Para. IV.A.1.) This sum is to be repaid with interest by Bingo Enterprise in sixty equal monthly payments out of the Bingo Enterprise net profits (Para. IV.A.2).

The fact that the Contract may be terminated for cause by the Board under paragraph VII does not detract from the factor of durability. For example, one appellate court found possessory interests were created by federal grazing permits even though the permits were temporary and revocable. (Board of Supervisors v. Archer (1971) 18 Cal.App.3d 717.) Similarly, in United State of America v. County of Fresno (1975) 50 Cal.App.3d. 633 (a case in which forest rangers residing in federally owned housing incident to employment were held to have possessory interests), the court stated at page 639:

> "However, the fact that a possessory right is . . . revocable at the will of the government [citations omitted] . . . does not mean, per se, that there is no taxable possessory interest. [This], as well as similar controls on the right of possession, are factors to be considered in fixing the value of the possessory interests."

From the foregoing, it appears reasonably certain that the Contract will be in effect for a period of at least five years which term is of sufficient duration to satisfy the factor of durability. (Mattson v. County of Contra Costa, supra, at p. 211.)

Private Benefit

The requirement of private benefit is met if there is an opportunity for the holder of the interest to make a profit. (Wells Nat. Services Corp. v. County of Santa Clara, supra, at p. 585.)

Paragraph III. B. of the Contract provides that in consideration of the satisfactory performance of its duties and obligations under the Contract, Manager shall be entitled to receive 40 percent of each month's net profit, if any, of the entire Bingo Enterprise for the initial term of the Contract. "Net profit" is defined in Paragraph VI. B. as the difference between total Bingo Enterprise revenues and Bingo Enterprise operating expenses. "Operating expenses" are defined in Paragraph VI. A. and are fairly typical except debt service on Manager's loan to the Bingo Enterprise is included as an operating expense and depreciation is not so included.

It therefore appears from the foregoing that Manager, through its operation of the Bingo Enterprise, has an opportunity to make a profit and the requirement of private benefit is thus clearly satisfied.

Exclusiveness

The test for exclusiveness is not exclusive possession against all the world including the owner. (Wells Nat. Services Corp. v. County of Santa Clara (1976) 54 Cal.App.3d 579, 584.) The right of use, however, must carry with it the degree of exclusiveness necessary to give the user something more than a right in common with others. (United States of America v. County of Fresno, supra, at p. 638.) To be exclusive, such use "must not be one shared by the general public and, at least until cancelled, must be enforceable against the public entity which permits the use." (Freeman v. County of Fresno (1981) 126 Cal.App. 3d 459, 463, 464; see also Property Tax Rule 21(e).)

Paragraph I of the Contract states that the purpose of the Contract is to employ Manager to resume and continue operation of the Band's Bingo Enterprise. The remaining provisions of the Contract are consistent with that stated purpose, and taken as a whole, there is nothing in the Contract to suggest that Manager's right to use the subject real property in operating the Bingo Enterprise lacks the element of exclusiveness under the guidelines set forth above.

Independence

To qualify as a possessory interest, the right to use property must be sufficiently exclusive, durable and independent of the public owner to constitute more than an agency. (Pacific Grove-Asilomar Operating Corp. v. County of Monterey (1974) 43 Cal.App.3d 675, 684.) "If, in practical effect, one of the parties has the right to exercise complete control over the operation, an agency relationship exists; . . ." (Nichols v. Arthur Murray, Inc. (1967) 248 Cal.App.2d 610, 613.) As a

general proposition, if exclusiveness and private benefit are present, the other requirements (durability and independence) are usually found to exist as well. (See Freeman v. County of Fresno, supra, at p. 463.)

The Pacific Grove case is the only California Court of Appeal decision of the twelve decided since 1966 which found no taxable possessory interest to exist. In that case, the court applied the objective standard set forth in Mattson and found that an agency was created by the agreement there in question.

The court concluded that Asilomar's management of the property was not independent, but subject to state control in every way. The court noted, however, that "the fact that the relationship between Asilomar and the state has no profit motive is an element material in determining the nature of Asilomar's interest." (Asilomar was a nonprofit corporation organized and established solely to manage the state-owned conference grounds in question and derived no private benefit from its management of the property.) The court also noted that Asilomar did not have exclusive use of the property since the property was open to the general public. In the commercial setting involved in Mattson, however, such public access (to the dining area of a public golf course operation) was held not to detract from the element of exclusiveness of possession. (Mattson, supra, 258 Cal.App.2d 205, 210.)

Since Manager is to receive 40 percent of the net operating profits each year, this case is clearly distinguishable from the Pacific Grove case. Moreover, the management agreement in that case listed 25 specific state controls which led to the court's conclusion that an agency relationship existed. Few such controls exist here. In fact, a comparison of the controls here with those in Pacific Grove and Mattson indicates that the relationship here is more like that in Mattson than in Pacific Grove. In Mattson, as here, the hiring of employees was up to the taxpayer. (Para. V. A. 3 and V. B. 2.) In Mattson, as here, everything connected with the enterprise was under Mattson's management subject to limited controls. (Para. V. A. 1, 2 and V. B. 1, 3-7.)

Also, Paragraph IX of the Contract provides that Manager must indemnify Band against liabilities connected with its operation of the Bingo Enterprise which is indicative of an independent operation. (Mattson, supra, at p. 211.) The court in Mattson characterized the operation in that case as "much too autonomous to be regarded as a mere agency." As indicated above, the level of control exercisable under the agreement in this case is much closer to that in Mattson than it is to the level of control in Pacific Grove.

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January 28, 1988

Honorable R. Gordon Young
County of San Bernardino Assessor
Hall of Records
172 West 3rd Street
San Bernardino, CA 92415-0310

Attention Mr. Adolfo Porras
Chief Appraiser

Dear Mr. Young:

This letter is in response to your letter to the attention of Mr. James Delaney of November 17, 1987. Enclosed with your letter was a copy of a document entitled "Management Agreement" ("Agreement") between Western Entertainment Corporation, an Ohio corporation ("Manager") and the San Manuel Band of Mission Indians, a federally recognized Indian tribe ("Tribe"). Under the Agreement, Manager will construct a building on land beneficially owned by Tribe and operate Bingo games ("Bingo Project") therein. You have asked our opinion whether a taxable possessory interest has been created as a result of the Agreement.

Article XIII, section 1, of the California Constitution requires that all property be taxed unless otherwise provided by the California Constitution or the laws of the United States. Possessory interests in real property are deemed to be real property for tax purposes. (Forster Shipbldg. Co. v. County of L.A. (1960) 54 Cal.2d 450, 455.) Also, Revenue and Taxation Code* section 104 classifies the right to use or possess land as real property. Section 107 defines "possessory interests" in pertinent part as "[p]ossession of, claim to, or right to the possession of land or improvements, except when coupled with ownership of the land or improvements in the same person."

Property Tax Rule 21 interprets section 107 and provides in relevant part that a "possessory interest" is "an interest in

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real property which exists as a result of possession, exclusive use, or a right to possession or exclusive use of land and/or improvements unaccompanied by the ownership of a fee simple or life estate in the property." (Property Tax Rule 21(a).) A "taxable possessory interest" is "a possessory interest in nontaxable publicly owned real property. . . ." (Property Tax Rule 21(b).)

The rationale behind the taxation of possessory interest is that "[t]hese possessions . . . are recognized as a species of property subsisting in the hands of the citizen. It is not the land itself, nor the title to the land . . . . It is not the preemption right, but is the possession and valuable use of the land subsisting in the citizen. Why should it not contribute its proper share, according to the value of the interest, . . . of the taxes necessary to sustain the Government which recognizes and protects it?" (People v. Shearer (1866) 30 Cal. 645, 657.)

In determining the existence of a taxable possessory interest under a written instrument, an objective standard rather than the literal language of the written instrument controls in ascertaining the nature of the relationship established. Because of the variety of interests that may be created by written instruments, the question of whether a taxable possessory interest has been created must be decided on a case-by-case basis by weighing the factors of durability, exclusiveness, private benefit and independence. In each case, judgment is to be made by an examination of the writing in its entirety. (Stadium Concessions, Inc. v. City of Los Angeles (1976) 60 Cal.App.3d 215; Wells National Services Corp. v. County of Santa Clara (1976) 54 Cal.App.3d 579; Mattson v. County of Contra Costa (1968) 258 Cal.App.2d 205; see also Property Tax Rule 21(a)(1).) In order to determine whether a taxable possessory interest has been created in this case, it is necessary to analyze the Agreement in light of the standard set forth above.

Durability

To satisfy the requirement of durability, the agreement must confer use for a determinable period and the use has to be reasonably certain to last for that period. (Kaiser v. Reid (1947) 30 Cal.2d 160.)

Paragraph 4 of the Agreement provides that Manager shall be engaged on an exclusive basis for two consecutive five-year

terms. Also, if the Tribe's share of the profits reaches a specified level during the term of the Agreement, Manager is entitled to a right of first refusal if the Tribe decides to continue the Bingo Project beyond ten years.

Paragraph 13.2 of the Agreement permits the Tribe to unilaterally terminate the Agreement in the event Manager or any of its officers or directors becomes the subject of any bankruptcy proceeding; or becomes the subject of an assignment for the benefit of creditors; or fails to provide an accounting under specified conditions; or Tribe fails to receive a specified sum in net profits in any consecutive 12-month period after repayment of the construction loan; or Manager fails to make any payment due to the Tribe within fifteen days of the due date; or if any of Manager's officers or directors is adjudged by a court of competent jurisdiction to be a party to any theft or appropriation of Bingo Project property; or if this Agreement is terminated by a final judgment of a court of competent jurisdiction as a result of Manager's material breach other than as enumerated above.

The fact that the Agreement may be terminated for cause by the Tribe under paragraph 13 does not detract from the factor of durability. For example, one appellate court found possessory interests were created by federal grazing permits even though the permits were temporary and revocable. (Board of Supervisors v. Archer (1971) 18 Cal.App.3d 717.) Similarly, in United State of America v. County of Fresno (1975) 50 Cal.App.3d. 633 (a case in which forest rangers residing in federally owned housing incident to employment were held to have possessory interests), the court stated at page 639:

> "However, the fact that a possessory right is . . . revocable at the will of the government [citations omitted] . . . does not mean, per se, that there is no taxable possessory interest. [This], as well as similar controls on the right of possession, are factors to be considered in fixing the value of the possessory interests."

Further, paragraph 14 of the Agreement provides that in the event the Bingo Project is terminated prior to the natural expiration of the term for any reason other than those set forth in paragraph 13.1-13.3, Manager shall have the right to manage the property on behalf of the Tribe and shall have the right to utilize the property for any purpose approved by the Tribe subject to the approval of the Bureau of Indian Affairs.

From the foregoing, it appears reasonably certain that Manager's use of the subject property will last for at least ten years. Such a term is of more than sufficient duration to satisfy the factor of durability. (Mattson v. County of Contra Costa, supra, at p. 211.)

Private Benefit

The requirement of private benefit is met if there is an opportunity for the holder of the interest to make a profit. (Wells Nat. Services Corp. v. County of Santa Clara, supra, at p. 585.)

Paragraph 8.4 of the Agreement provides that Manager shall receive forty percent of all net profits as its sole management fee and that Tribe is to retain the balance. Paragraph 8.4 further provides however that Manager's share of net profits shall be reduced to thirty-five percent for the second five-year term in the event specified average dollar levels are not attained by the Tribe during the fourth and fifth years of the term.

Paragraph 8.5(a) defines "net profits" to mean the excess, if any, of "gross receipts" from the Bingo Project over the total of the "operating expenses." "Gross receipts" are defined to mean all monies actually received in connection with the Bingo Project, including, but not limited to, admission fees, sale of Bingo game cards, food, beverages, cigarettes and parking fees (¶ 8.4(b)). "Operating Expenses" are defined to mean all sums necessary and proper for the maintenance and operation of the Bingo Project in the building in which it is maintained and are fairly typical except that debt service on the construction loan is included as an operating expense (¶ 8.4(c)).

From the foregoing, it is apparent that Manager has an opportunity to make a profit from its use and operation of the Bingo Project. The factor of private benefit is therefore clearly satisfied.

Exclusiveness

The test for exclusiveness is not exclusive possession against all the world including the owner. (Wells Nat. Services Corp. v. County of Santa Clara, supra, at p. 584.) The right of use, however, must carry with it the degree of exclusiveness necessary to give the user something more than a right in common with others. (United States of America v. County of Fresno, supra, at p. 638.) To be exclusive, such use "must not be one

shared by the general public and, at least until cancelled, must be enforceable against the public entity which permits the use." (Freeman v. County of Fresno (1981) 126 Cal.App. 3d 459, 463, 464; see also Property Tax Rule 21(e).)

Paragraph 3 of the Agreement recites that the Tribe engages Manager for the purpose of operating Bingo games and all matters reasonably related thereto on the subject property and that during the term of the Agreement the Tribe shall allow no other party to operate Bingo games under the Tribe's authority. Paragraph 4 provides further that Manager shall be engaged on an exclusive basis. The remaining provisions of the Agreement are consistent with the foregoing provisions and taken as a whole there is nothing in the Agreement to suggest that Manager's right to use the subject real property in operating the Bingo Project lacks the element of exclusiveness under the guidelines set forth above.

Independence

To qualify as a possessory interest, the right to use property must be sufficiently exclusive, durable and independent of the public owner to constitute more than an agency. (Pacific Grove-Asilomar Operating Corp. v. County of Monterey (1974) 43 Cal.App.3d 675, 684.) "If, in practical effect, one of the parties has the right to exercise complete control over the operation, an agency relationship exists; . . ." (Nichols v. Arthur Murray, Inc. (1967) 248 Cal.App.2d 610, 613.) As a general proposition, if exclusiveness and private benefit are present, the other requirements (durability and independence) are usually found to exist as well. (See Freeman v. County of Fresno, supra, at p. 463.)

The Pacific Grove case is the only California Court of Appeal decision of the twelve decided since 1966 which found no taxable possessory interest to exist. In that case, the court applied the objective standard set forth in Mattson and found that an agency was created by the agreement there in question.

The court concluded that Asilomar's management of the property was not independent, but subject to state control in every way. The court noted, however, that "the fact that the relationship between Asilomar and the state has no profit motive is an element material in determining the nature of Asilomar's interest." (Asilomar was a nonprofit corporation organized and established solely to manage the state-owned conference grounds in question and derived no private benefit from its management of the property.) The court also noted that Asilomar did not

have exclusive use of the property since the property was open to the general public. In the commercial setting involved in Mattson, however, such public access (to the dining area of a public golf course operation) was held not to detract from the element of exclusiveness of possession. (Mattson, supra, 258 Cal.App.2d 205, 210.)

Since Manager is to receive 40 percent of the net operating profits each year, this case is clearly distinguishable from the Pacific Grove case. Moreover, the management agreement in that case listed 25 specific state controls which led to the court's conclusion that an agency relationship existed. Few such controls exist here. In fact, a comparison of the controls here with those in Pacific Grove and Mattson indicates that the relationship here is more like that in Mattson than in Pacific Grove. In Mattson, as here, the hiring and firing of employees and the provision of workmen's compensation insurance for them was up to the taxpayer (¶ 6, 2.6). In Mattson, as here, everything connected with the enterprise was under Mattson's management subject to limited controls (¶¶ 5, 10(b) and 11).

Also, paragraph 11(d) of the Agreement provides that Manager must indemnify the Tribe against liabilities connected with its operation of the Bingo Project which is indicative of an independent operation. (Mattson, supra, at p. 211.) The court in Mattson characterized the operation in that case as "much too autonomous to be regarded as a mere agency." As indicated above, the level of control exercisable under the Agreement in this case is much closer to that in Mattson than it is to the level of control in Pacific Grove.

Further, although not necessarily controlling, paragraph 24 of the Agreement provides that Manager is not authorized to act on Tribe's behalf except where specifically authorized to do so and is not the attorney-in-fact for Tribe. This provision supports the conclusion that Manager is not the agent of the Tribe (Civ. Code § 2295).

Based on the foregoing, we believe that Manager's use of the subject property is sufficiently free of Tribe control to satisfy the element of independence. Moreover, even if Manager's independence were questionable here, there is recent authority to the effect that independence from public control is not necessary for taxability. (Freeman v. County of Fresno, supra, at p. 465.)

In summary, it appears that Manager's right to use the subject property in operating and managing the Bingo Project pursuant to the Agreement meets the requirements of durability, exclusiveness, private benefit and independence. Accordingly, it can reasonably be concluded that Manager has a taxable possessory interest in the subject land and improvements.

Very truly yours,

Eric F. Eisenlauer

Eric F. Eisenlauer
Tax Counsel

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cc: Mr. Gordon P. Adelman
Mr. Robert H. Gustafson
Mr. Verne Walton

We recognize that Paragraph V. A. 1. of the Contract characterizes Manager as the Band's agent. Paragraph XVI, however, characterizes the "Contract to be for the personal services of Manager, as an independent contractor . . . ." Also, Paragraph XII states "that this Contract is not a lease and does not create or convey to Manager any present or possessory or other interest whatever in the building or property on which the Band's Bingo Enterprise is located. . . ." These characterizations are not helpful, because as indicated above, the true nature of the relationship must be ascertained by examining the Contract in its entirety and the literal language is not controlling. Based on the foregoing, we believe that Manager's use of the subject property is sufficiently free of Band control to satisfy the element of independence. Moreover, even if Manager's independence were questionable here, there is recent authority to the effect that independence from public control is not necessary for taxability. (Freeman v. County of Fresno, supra, at p. 465.)

In summary, it appears that Manager's right to use the Band's bingo facilities in operating and managing the bingo operation pursuant to the Contract meets the requirements of durability, exclusiveness, private benefit and independence. Accordingly, it can reasonably be concluded that Manager has a taxable possessory interest in the subject land and improvements.

Very truly yours,

Eric F. Eisenlauer
Tax Counsel

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