



STATE OF CALIFORNIA

STATE BOARD OF EQUALIZATION

450 N STREET, SACRAMENTO, CALIFORNIA
(PO BOX 942879, SACRAMENTO, CALIFORNIA 94279-0082)
TELEPHONE (916) 322-6083
FAX (916) 323-3387
www.boe.ca.gov

CAROLE MIGDEN
First District, San Francisco

BILL LEONARD
Second District, Ontario

CLAUDE PARRISH
Third District, Long Beach

JOHN CHIANG
Fourth District, Los Angeles

STEVE WESTLY
State Controller, Sacramento

TIMOTHY W. BOYER
Interim Executive Director

October 24, 2003

Honorable James B. Rooney
Amador County Assessor
Attn:
500 Argonaut Lane
Jackson, CA 95642

RE: Land Use Restrictions—Federal Income and Estate Tax Elections

Dear Mr. Rooney:

This is in reply to a request from Ms. _____ of your office in which Ms. _____ asked whether federal qualified family business elections, such as those available under Internal Revenue Code (I.R.C.) section 2032A, constitute "enforceable restrictions" for purposes of Revenue and Taxation Code section 402.1. Since federal qualified family business elections under I.R.C. section 2032A do not legally restrict the use of real property and do not run with the land, it is our opinion that they are not enforceable restrictions for purposes of Revenue and Taxation Code section 402.1.

On the following pages we restate the facts and questions posed in your memorandum and the accompanying letter, as well as the relevant provisions of I.R.C. section 2032A (hereafter "Section 2032A").

Background

1. Property owner _____ (CG) received an interest in the _____ Trust (FHG Trust).
2. Pursuant to Section 2032A, real property in the FHG Trust was the subject of a federal qualified family business election. That election allowed the real property in the trust to be appraised at its "value in use" instead of its fair market value for estate tax purposes.
3. In an opinion dated April 15, 2003, CG's attorney concluded that Section 2032A federal qualified family business elections were "enforceable government restrictions" for purposes of Revenue and Taxation Code section 402.1.

4. That opinion was based on the rationale that:

The limitations placed on the use of the Property by the federal elections are essentially the same as those imposed by the Williamson Act, i.e., the use of the Property is limited to farming or agriculture. (Aldridge letter, 4/15/03, page 2.)

5. It was the attorney's opinion that the federal elections are just a variation on Williamson Act contracts and promote the same policy as the Williamson Act, namely the preservation of farmland through effective land use planning.

Summary of I.R.C. Section 2032A

Attached to this letter is the complete text of I.R.C. section 2032A. Relevant portions of Section 2032A are summarized below.

1. For federal estate tax purposes, Section 2032A authorizes heirs of farmland and other real property used in a family-operated trade or business to make an irrevocable estate tax election that reduces the amount of a gross estate.
2. Making a Section 2032A election will result in an appraisal of the real property used in that family-operated trade or business at its "value in use" instead of its fair market value when calculating the value of the gross estate.
3. In exchange for the favorable estate tax treatment described above, Section 2032A requires that the heir retain his/her ownership interests in the real property, and maintain the qualified use of the real property subject to the election, for 10 years after the decedent's death.
4. Additional estate tax will become due if, within 10 years after the decedent's death—and before the death of the heir—either of the following occur:
 - (a) An heir disposes of any interest in the real property, except through disposition to a member of that heir's family; or,
 - (b) An heir ceases to use the real property for the purpose for which it was acquired.
5. Upon such an event, subdivision (c) of Section 2032A provides the method for calculating the amount of that additional estate tax.
6. Although the additional estate tax imposed by subdivision (c) of Section 2032A may affect an heir's decision whether to alienate or change the use of the real property subject to the irrevocable election, the conditions imposed by subdivision (c) are personal to the heir and his/her descendants. Those conditions do not run with the land.

Law and Analysis

As you are aware, section 1 of article XIII of the California Constitution establishes that the fair market value of real property is the assessable value of that property for property tax purposes:

Unless otherwise provided by this Constitution or the laws of the United States.

(a) All property is taxable and shall be assessed at the same percentage of fair market value. When a value standard other than fair market value is prescribed by this Constitution or by statute authorized by this Constitution, the same percentage shall be applied to determine the assessed value. The value to which the percentage is applied, whether it be the fair market value or not, shall be known for property tax purposes as the full value. (Emphasis added.)

Subdivision (a) of Revenue and Taxation Code section 110 defines "fair market value" as:

[T]he amount of cash or its equivalent that property would bring if exposed for sale in the open market under conditions in which neither buyer nor seller could take advantage of the exigencies of the other, and both the buyer and seller have knowledge of all the uses and purposes to which the property is adapted and for which it is capable of being used, and of the enforceable restrictions upon those uses and purposes.

The foregoing constitutional and statutory provisions require assessors to appraise real property as though it were unencumbered or unrestricted by a lease, mortgage or other private agreement even though the property may, in fact, be so encumbered. See *Clayton v. Los Angeles County* (1972) 26 Cal.App.3d 390; *Carlson v. Assessment Appeals Board No. 1* (1985) 167 Cal.App.3d 1004; *Dennis v. County of Santa Clara* (1989) 215 Cal.App.3d 1019; and, Assessors' Handbook Sections 501 and 502.

Revenue and Taxation Code section 402.1 (hereafter "section 402.1") requires assessors to consider the effect that enforceable restrictions may have on the value of taxable land. Section 402.1 provides in part:

402.1. **Land use restrictions.** (a) In the assessment of land, the assessor shall consider the effect upon value of any enforceable restrictions to which the use of the land may be subjected. Those restrictions shall include, but are not limited, to all of the following:

(1) Zoning.

(2) Recorded contracts with governmental agencies other than those provided in Section 422 . . .

(3) Permit authority of, and permits issued by, governmental agencies exercising land use powers concurrently with local governments . . .

(8) A recorded conservation, trail, or scenic easement, as described in Section 815.1 of the Civil Code, that is granted in favor of a public agency, or in favor of

a nonprofit corporation organized pursuant to Section 501(c)(3) of the Internal Revenue Code that has as its primary purpose the preservation, protection, or enhancement of land in its natural, scenic, historical, agricultural, forested, or open-space condition or use.

(b) There is a rebuttable presumption that restrictions will not be removed or substantially modified in the predictable future and that they will substantially equate the value of the land to the value attributable to the legally permissible use or uses.

(c) Grounds for rebutting the presumption may include, but are not necessarily limited to, the past history of like use restrictions in the jurisdiction in question and the similarity of sales prices for restricted and unrestricted land. The possible expiration of a restriction at a time certain shall not be conclusive evidence of the future removal or modification of the restriction unless there is no opportunity or likelihood of the continuation or renewal of the restriction, or unless a necessary party to the restriction has indicated an intent to permit its expiration at that time.

(d) In assessing land with respect to which the presumption is un rebutted, the assessor shall not consider sales of otherwise comparable land not similarly restricted as to use as indicative of value of land under restriction, unless the restrictions have a demonstrably minimal effect upon value . . .

(g) . . . [T]he further purpose and intent of the Legislature in enacting this section and Section 1630 is to avoid an assessment policy which, in the absence of special circumstances, considers uses for land that legally are not available to the owner and not contemplated by government . . .

Thus, pursuant to section 402.1, assessors must consider the effect that enforceable restrictions have upon the value of real property subject to such restrictions. Consequently, assessors may not consider sales of otherwise comparable land without similar restrictions when appraising restricted property, unless those restrictions have a demonstrably minimal effect upon value.

In Assessors' Handbook Section 502, *Advanced Appraisal* (hereafter "AH 502"), January 2001, the Board has advised assessors to distinguish between enforceable restrictions and private encumbrances voluntarily entered into by the property owner:

As a general rule, private parties cannot reduce the taxable value of their property by imposing private encumbrances upon it; only enforceable government restrictions under section 402.1 are recognized as limiting the full fee simple interest.¹

In summary, assessors are not permitted to consider the effect of private encumbrances when appraising taxable property. However, pursuant to section 402.1, they are required to consider the effect of enforceable government restrictions.

¹ Assessors' Handbook Section 502, *Advanced Appraisal* (AH 502), December 1998, page 6.

1. Federal Qualified Family Business Elections Do Not Legally Restrict the Use of the Subject Real Property.

In the letter accompanying your request, CG's attorney correctly notes that some programs enable property owners to voluntarily impose limits on the use of their real property and that those limits have the effect of "enforceable restrictions." Examples given in that letter include California Land Conservation Act (CLCA) Contracts and conservation easements.² Government Code section 51243.6 provides, in part, that the Legislature finds and declares that the "enforceability of contracts" under the CLCA is necessary to permit preferential tax treatment pursuant to article XIII, section 8 of the California Constitution. In addition, Civil Code section 815.10 provides that a conservation easement constitutes an enforceable restriction for purposes of Revenue and Taxation Code section 402.1.

Despite the similarity of the restrictions imposed by voluntary Section 2032A elections, CLCA Contracts, and conservation easements, it is our opinion that Section 2032A elections are not "enforceable restrictions" for purposes of section 402.1 since Section 2032A elections do not legally restrict the use of the subject real property. In support of that opinion, we draw your attention to subdivision (g) of section 402.1, which provides, in part:

(g)... [T]he further purpose and intent of the Legislature in enacting this section and Section 1630 is to avoid an assessment policy which, in the absence of special circumstances, *considers uses for land that legally are not available to the owner* and not contemplated by government . . . [Emphasis added]

Thus, the Legislature's intent, as codified in section 402.1 "is to avoid an assessment policy which . . . considers uses for land that legally are not available to the owner." Unlike CLCA Contracts and conservation easements, Section 2032A elections *do not* legally restrict the use of property subject to such an election. Instead, Section 2032A elections *merely place conditions* on the heir's use and alienation of the real property in exchange for an estate tax benefit.

Unlike owners of enforceably restricted property, owners of real property subject to a Section 2032A election are never actually prohibited from transferring the property or changing the use of that real property. Should an owner of property subject to a Section 2032A election decide to transfer the property or change its use within the 10-year period, that decision will merely result in additional estate tax. Without restricting those uses legally available to the property owner, Section 2032A elections do not qualify as enforceable restrictions.

² Aldridge letter, 4/15/03, page 3.

2. Since Section 2032A Elections Do Not Run with the Land, Section 2032A Elections Do Not Affect the Fair Market Value of Real Property.

No provisions in this section of the I.R.C. result in a Section 2032A election running with the land. In contrast, enforceable restrictions listed in section 402.1 are restrictions that run with the land to bind successive owners of the real property subject to those restrictions.

As noted above, CG's attorney cites CLCA Contracts and conservation easements as two examples that support the argument that Section 2032A elections are enforceable government restrictions. With regard to CLCA Contracts, Government Code section 51243 provides, in part:

Every contract shall: (a) Provide for the exclusion of uses other than agricultural, and other than those compatible with agricultural uses, for the duration of the contract.

(b) Shall be binding upon, and inure to the benefit of, all successors in interest of the owner. Whenever land under a contract is divided, the owner of any parcel may exercise, independent of any other owner of a portion of the divided land, any of the rights of the owner in the original contract, including the right to give notice of nonrenewal and to petition for cancellation. [Emphasis added]

For conservation easements, California Civil Code section 815.1 provides that:

For the purposes of this chapter, "conservation easement" means any limitation in a deed, will, or other instrument in the form of an easement, restriction, covenant, or condition, which is or has been executed by or on behalf of the owner of the land subject to such easement *and is binding upon successive owners of such land*, and the purpose of which is to retain land predominantly in its natural, scenic, historical, agricultural, forested, or open-space condition. [Emphasis added]

Under the foregoing statutory revisions, both CLCA Contracts and conservation easements run with the land to bind successive owners of the real property, legally restricting the successive owners' uses of the real property. Section 2032A elections differ in that Section 2032A elections bind only the heir and any member of that heir's family who acquires an interest in the property during the 10-year period—any person outside the heir's family is not bound.

Without binding successive owners of real property subject to a Section 2032A election, such an election does not limit the real property uses available to a prospective buyer. Successive owners of property subject to a Section 2032A election may change the use of the property and dispose of it without penalty.

Absent restrictions that bind successive owners of the real property, making a Section 2032A election does not affect the fair market value of the property subject to the election. Subdivision (a) of section 110 defines "fair market value" as the amount of cash or its equivalent that a property would bring if:

- (A) Exposed for sale in the open market;
- (B) Under conditions in which neither buyer nor seller could take advantage of the exigencies of the other; and,
- (C) Both the buyer and seller have knowledge of all the uses and purposes to which the property is adapted and for which it is capable of being used, and of the enforceable restrictions upon those uses and purposes.

Under this definition of "fair market value," it is our opinion that Section 2032A elections do not affect the "uses and purposes to which the property is adapted and for which it is capable of being used, and of the enforceable restrictions upon those uses and purposes" since a Section 2032A election does not run with the land to bind the buyer. Potential buyers may make any legally available use of property as if the election never occurred.

Conclusion

Federal qualified family business elections under Section 2032A affect only the amount of the gross estate for estate tax purposes. Since such elections do not restrict the uses legally available to a property owner, they are not enforceable restrictions under Revenue and Taxation Code section 402.1. We also note that Section 2032A elections do not run with the land. Absent restrictions that bind successive owners of the real property, such an election does not affect the fair market value of the land subject to that election. We recommend that you disregard federal qualified family business elections when appraising real property subject to such an election.

The views expressed in this letter are only advisory in nature. They represent the analysis of the Board's Legal Department staff based on the present law and facts set forth herein, and are not binding on any person or entity.

Sincerely,

/s/ Michael Lebeau

Michael Lebeau
Tax Counsel

MTL:lg
Prop/prec/Restric/03/06ML.doc

Attachment

cc: Mr. David Gau MIC:63
Mr. Dean Kinnee MIC:64
Ms. Mickie Stuckey MIC:62