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January 25, 2005

**Re: RTC §61(b) – Creation of a Taxable Possessory Interest**

Dear Mr. \_\_\_\_\_ :

This is response to your letter dated October 27, 2004, addressed to Ms. Kristine Cazadd, Assistant Chief Counsel, in which you request our opinion as to whether the lease of a 125-acre container terminal by E \_\_\_\_\_ (E \_\_\_\_\_) from the City of Los Angeles under Permit No. 8xx resulted in a change in ownership. As discussed below, we conclude that the lease at issue resulted in a change in ownership because it created a taxable possessory interest.

**Factual Background**

You have provided the following factual background:

On September 6, 1985, E \_\_\_\_\_ executed an agreement (Permit No. 5xx) to lease a 125-acre container terminal, owned by the City of Los Angeles, commencing on September 6, 1985, through March 31, 2003. On May 24, 1998, E \_\_\_\_\_ and the City of Los Angeles executed another lease agreement (Permit No. 8xx), which became effective on November 16, 2001, for the term November 16, 2001, through January 1, 2039. Permit No. 8xx supercedes Permit No. 5xx. Under Permit No. 8xx, in addition to the 125-acre container terminal, E \_\_\_\_\_ agreed to lease a 23.9-acre rail yard and a 9.2-acre container storage land, which were previously leased under Permit Nos. 65xx and 66xx, respectively.

You have provided a copy of Permit Nos. 5xx and 8xx. As relevant herein, Permit No. 8xx provides the following:

Section 1. Effective Date and Term.

(a) Effective Date. This Agreement shall become effective on the thirty-first (31<sup>st</sup>) day after publication of the ordinance adopted by the City Council of the City of Los Angeles ('Council') approving this Agreement.

\* \* \*

(d) Agreement Superseded. This agreement supersedes Permit No. 5xx, as amended, granted to Tenant by City by Order No. xxxx of the Board of Harbor Commissioners, effective September 6, 1985. Except as otherwise

provided herein, Permit No. 5xx shall govern the rights and obligations of the parties hereto until the effective date of this Agreement. Except to the extent that either party has incurred any rights or obligations under Permit No. 5xx, the same shall terminate immediately when this Agreement becomes effective.

The Los Angeles County Assessor's Office determined that the lease of the 125-acre container terminal, 23.9-acre rail yard and the 9.2-acre container storage land under Permit No. 8xx created a taxable possessory interest in those properties on November 16, 2001, resulting in a change in ownership. E does not dispute the change in ownership determination of the 23.9-acre rail yard and the 9.2-acre container storage land. However, E contends that the 125-acre container terminal did not change ownership until March 31, 2003, the lease termination date under Permit No. 5xx.

### **Law and Analysis**

Revenue and Taxation Code<sup>1</sup> section 60 defines "change in ownership" as a "transfer of a present interest in real property, including the beneficial use thereof, the value of which is substantially equal to the value of the fee interest." Section 61, subdivision (b) provides that a change in ownership includes "[t]he creation, renewal, extension, or assignment of a taxable possessory interest in tax exempt real property for any term." Thus, the creation of a taxable possessory interest results in a change in ownership of the real property subject to the lease.

In addition to conveying an estate in real property to the tenant, a lease constitutes a contract between the landlord and the tenant that provides for possession to the tenant and the rights and obligations of the parties. (7 Miller & Starr, Cal. Real Estate (3<sup>rd</sup> ed. 2003) Landlord and Tenant § 19:2, pp. 15-16.) Pursuant to Civil Code section 1933 a lease may be terminated by the mutual consent of the parties and, when a lease terminates, the parties are relieved of their respective obligations under the lease. (7 Miller & Starr, Cal. Real Estate (3<sup>rd</sup> ed. 2003) Landlord and Tenant § 19:139, p. 433.)

Under the subject lease provisions, the execution of Permit 8xx effectively terminated Permit 5xx. Section 1(d) of Permit No. 8xx specifically provides that Permit No. 8xx "supercedes Permit No. 5xx" and that Permit No. 5xx "shall terminate immediately when this Agreement [Permit No. 8xx] becomes effective." Thus, the clear and unambiguous language in Permit No. 8xx states the parties' mutual agreement and intention to terminate Permit No. 5xx on the date that Permit No. 8xx became effective. Therefore, on November 16, 2001, the prior lease under Permit No. 5xx was terminated and the lease under Permit No. 8xx created a taxable possessory interest in the 125-acre container terminal, which resulted in a change in ownership of that property.

You contend that the container terminal should not be reappraised prior to the March 31, 2003, the end of the stated lease term under Permit No. 5xx. However, as discussed above, the parties terminated Permit No. 5xx when Permit No. 8xx became effective. Therefore, the lease under Permit No. 5xx terminated on November 16, 2001, and none of the terms under Permit No. 5xx was operative after that date.

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<sup>1</sup> Unless otherwise specified, all section references are to the Revenue and Taxation Code.

You also contend that Permit No. 8xx falls within the exception set forth in section 61, subdivision (b)(2), which provides that:

Any ‘renewal’ or ‘extension’ of a possessory interest during the reasonably anticipated term of possession used by the assessor to value that interest does not cause a change in ownership until the end of the reasonably anticipated term of possession used by the assessor to value that interest. . . .

However, contrary to your contention, subdivision (b)(2) does not apply to the lease at issue because the execution of Permit No. 8xx was not a “renewal” or “extension” of a taxable possessory interest created by Permit No. 5xx. Instead, as discussed above, by mutual consent, the parties terminated Permit No. 5xx, and thereafter, executed a new lease agreement under Permit No. 8xx. Thus, Permit No. 8xx created a new taxable possessory interest resulting in a change in ownership of the 125-acre container terminal.

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 entities.

Very truly yours,

*/s/ Sophia H. Chung*

Sophia H. Chung  
Senior Tax Counsel

SC:eb

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