

660.0132 Lease. The lease and lease-back of city-owned property to a nonprofit public benefit corporation may create a taxable possessory interest in the corporation. Property tax may be avoided if the corporation meets the requirements of Revenue and Taxation Code Section 231. C 9/9/87.



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P.O. BOX 942879, SACRAMENTO, CALIFORNIA 94279-0001)
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September 9, 1987

Dear _____

Your letter of August 12, 1987, to the Assessment Standards Division requesting advice on the application of property tax to property owned by the City of Vernon has been referred to this office for response. You ask whether property owned by the City will lose its tax exempt status as the result of a proposed lease-leaseback arrangement designed to raise funds for municipal purposes.

Your letter states that the City will lease its city hall and a power generation substation to a nonprofit public benefit corporation formed by the mayor and city councilmembers. The lease payment for the property will be a single lump sum representing the principal amount of certain certificates of participation which will be sold to investors. The certificates are tax exempt obligations. Under a leaseback arrangement, the City will make semiannual payments sufficient to pay all principal and interest on the certificates. It is anticipated that the certificates will be fully retired in seven years. Although not specifically stated, we assume that during the entire period of this lease-leaseback arrangement, the City will continue to own its city hall and power generation substation. We also assume that the described property is located wholly within the boundaries of the City and is not subject to assessment pursuant to section 11 of article XIII of the California Constitution.

Based upon the above facts, we are in agreement with your conclusion that the city property subject to the proposed lease-leaseback arrangement will not lose its tax-exempt status. Section 3(b) of article XIII of the California Constitution provides, in part, property "owned by a local government," except property subject to assessment pursuant to section 11(a), is exempt from property taxation. Revenue and

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Taxation Code section 202(a)(4) provides that this exemption applies to property "belonging to . . . a city." The California Supreme Court has stated that "while provisions exempting private property from taxation are to be strictly construed, the rule is otherwise as to public property which is to be taxed only if there is express authority therefor." (The Housing Authority v. Dockweiler (1939) 14 Cal.2d 437, 454.) Since, under the terms of the proposed lease-leaseback arrangement, the City of Vernon will retain both legal title and equitable and beneficial ownership of its city hall and power substation, we conclude that the property will retain its exempt status. (Compare Los Angeles Dodgers, Inc. v. County of Los Angeles (1967) 256 Cal.App.2d 918.)

It should be recognized, however, that the real question is not whether the property continues to retain its exemption, but whether the interest of the lessee nonprofit public benefit corporation in the city-owned property constitutes a taxable possessory interest. The courts have recognized that where there is a lease of land owned by a municipality, the reversion being exempt from taxation, the usufructuary interest is subject to tax in proportion to its value. (Tilden v. County of Orange (1949) 89 Cal.App.2d 586.) See also Revenue and Taxation Code sections 103, 104, and 107 defining "property," "real property," and "possessory interests," respectively.

It is apparent that the lease-leaseback arrangement between the City of Vernon and the nonprofit public benefit corporation will be a financing arrangement and it can be argued that this arrangement does not constitute a taxable possessory interest. The California cases on this subject reflect two different views. In Collins Electrical Co. v. County of Shasta (1972) 24 Cal.App.3d 864, a contractor constructed a transmission line and power substation over public utility district land pursuant to a contract under which title in the line and substation vested in the contractor. The powerline and substation were leased to the district for ten years with an option to purchase for \$300 at the end of the term. It was stipulated that this was a financing transaction. The court found that this was a financing arrangement and did not constitute a taxable possessory interest since the district had possession, control and risk of loss of the property. See, however, City of Desert Hotsprings v. County of Riverside (1979) 91 Cal.App.3d 441, involving the lease of city land to a contractor for construction of a civic center (city hall and library) with a leaseback to the city with options to purchase. While the court also found this was a financing arrangement, it concluded that the contractor had a taxable possessory interest in the city-owned land. In part, the court based its conclusion on section 231 of the Revenue and Taxation Code.

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Section 231 extends the property tax Welfare Exemption to property owned by a qualified nonprofit corporation which is leased to and used exclusively by government for its interest and benefit. The term "property" includes any possessory interest of the nonprofit corporation. (See subdivision (b)(3).) If the lessee nonprofit public benefit corporation leasing the property from the City of Vernon meets the various requirements of section 231, its possessory interest in the city-owned property could qualify for exemption under the terms of that section. We recognize, of course, that there may be arguments based upon the Collins Electrical decision or other authorities that the City of Vernon arrangement does not create a taxable possessory interest. In light of the divergent views on this subject, however, it would be prudent to seek the protection of section 231.

The views expressed herein are advisory in nature and are not binding upon the assessor of any county. You may wish to consult with the Los Angeles County Assessor in order to determine whether the subject property will be assessed in a manner consistent with the views expressed above.

It has recently come to our attention that the League of California Cities has actively assisted a number of member cities in financing arrangements similar to those described in your letter. You may wish to consult the League in order to receive the benefit of its experience. The League is located at 1400 K Street, Sacramento, California 95814 (telephone number (916) 444-5790).

I trust the foregoing will be helpful to you.

Very truly yours,



Richard H. Ochsner
Assistant Chief Counsel

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- cc: Honorable John J. Lynch
- Los Angeles County Assessor
- Mr. Gordon P. Adelman
- Mr. Robert H. Gustafson
- Mr. Verne Walton
- Mr. J. Kenneth McManigal