



735.0015

# Memorandum

To: Mr. Dick Johnson

Date: April 29, 1996

From: Eric F. Eisenlauer

Subject: Possessory Interests in P.E.R.S. Properties

This is in response to your memorandum to Mr. Larry Augusta of March 8, 1996 in which you request that we provide you with a legal opinion regarding the proper assessment of taxable possessory interests in investment properties purchased by P.E.R.S. You request that we revisit the issue because, in your view, it "has apparently never been settled."

The issue is whether the possessory interests of tenant lessees in privately-owned investment real property are to be appraised as taxable possessory interests at current market value upon the acquisition of the real property by P.E.R.S., a tax exempt public entity. In other words, is the acquisition by P.E.R.S. the "creation...of a taxable possessory interest in tax exempt real property" and thus a change in ownership for purposes of Revenue and Taxation Code section 61(b) requiring each taxable possessory interest thereby created to be appraised at current market value?

The Board's Letter to Assessors dated January 6, 1983 (LTA 83/03) seems to take the position that such an acquisition does constitute the creation of taxable possessory interests for purposes of section 61(b). Assuming for the sake of argument that it does, Chief Counsel Jim Delaney took issue with that conclusion, among others, in LTA 83/03, in a memorandum to Larry Augusta dated December 19, 1983 stating:

The conclusion that a possessory interest is created as of the date it becomes separately assessable is bothersome. A tenant's interest in any facility is always taxable unless specifically exempted, otherwise the landlord could not be assessed for its value. While the language of Revenue and Taxation Code Section 61(b) provides that the creation of a taxable possessory interest constitutes a change in ownership, it does not provide that the sale to an exempt governmental entity of a reversionary

interest in property subject to a lease creates a taxable possessory interest. While such a sale results in separate assessment of the possessory interest, there is no change in the ownership of that interest nor is the interest created by the sale of the pre-existing reversionary interest.

Bob Keeling revisited the issue in a memorandum to Verne Walton dated September 23, 1988 and agreed with the Delaney conclusion stated above. Bob's memorandum states:

When a retirement system purchases property for investment purposes, which property has tenants in occupancy, the calculation of the value of the tenant's interest should not be based on the market value of the property at the time of the purchase. The system would take the property subject to the lease(s). The leases would not change ownership until the new owner negotiated a renewal, sublease or assignment with the existing tenants or created new possessory interests. Since the tenant's interests have not changed ownership there is no basis of reappraising those interests. They should be assessed at the value that they would have been assessed at had they been taxable possessory interests at the time of the system purchase.

\* \* \*

We recommend you disregard the provisions of Assessors' Letter 83/03 and the contents of Mr. James J. Delaney's memorandum of December 19, 1983, to the extent that either is inconsistent with the conclusions reached hereinabove. The discussion herein was reached after discussions with Mr. Delaney and with your division, so no useful purpose would be had by analyzing or commenting upon irrelevant portions of either Assessors' Letter 83/03 or Mr. Delaney's memorandum of December 19, 1983.

The quoted conclusions of the Delaney and Keeling memoranda, i.e., that taxable possessory interests are not created for

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purposes of section 61(b) when a leased income property is acquired by P.E.R.S. appeared in the Board's 1990 Assessment Practices Survey entitled "A Report on Section 11 and PERS Properties" which stated at page 13:

The value of the possessory interest is based on the rental agreements in effect when the income property is purchased by the retirement system. When the existing leases are renewed, subleased or assigned, a new possessory interest value will be established since a change in ownership of the possessory interest has occurred.

Based on the foregoing, we disagree with your conclusion that the issue has never been settled. It is clear to us that the issue has been settled and that the notion that the acquisition of leased income property by a public retirement system creates taxable possessory interests for purposes of section 61(b) was rejected by the Chief Counsel and legal staff after devoting considerable attention to the issue. In our view, no useful purpose would be served by again revisiting this question.

*Gene F. Eisenbauer*

EFE:ba

cc: Mr. Jim Speed - MIC:63 \  
Ms. Jennifer Willis - MIC:70

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