STATE OF CALIFORNIA

STATE BOARD OF EQUALIZATION
PROPERTY TAX DEPARTMENT
1020 N STREET, SACRAMENTO, CALIFORNIA
(PO BOX 942879, SACRAMENTO, CALIFORNIA 94279-0001)
916/ 445-4588

September 30, 1987

Legislative Representative
Redacted
Sacramento, CA 95814

Dear Redacted

I am returning herewith the three documents you furnished to me with your letter of July 22, 1987, relating to certain transactions involving the City of Thousand Oaks in Ventura County. These documents include the official statement for the issuance of certificates of participation in the amount of $2,915,000 by the California Cities Financing Corporation for projects involving the cities of Delano, Fontana, Santa Monica and Thousand Oaks; a site lease between the City of Thousand Oaks and the California Cities Financing Corporation; and a lease agreement between the same parties covering the improvement built upon the land covered the site lease.

Briefly stated, these documents describe a lease-leaseback arrangement involving land owned by the City of Thousand Oaks (City). City leased the land to the California Cities Financing Corporation (Corporation) for the sum of $1.00 for a term commencing on December 1, 1985, and ending on December 1, 2005, or when the certificates of participation obligations are otherwise retired. The proceeds from the certificates of participation issued by Corporation were used to construct a new $400,000 community information center. Construction was scheduled to commence on May 1, 1986, and would be completed by January 1, 1987. Corporation leased the land and the improvements back to the City, with an option to purchase beginning December 1, 1996, and every six months thereafter. The amount of the City's lease payments equaled the debt service due on that portion of the certificates of participation allocable to this project. Corporation is a nonprofit, public-benefit corporation established by the League of California Cities to assist its members in financing various capital projects. Section 4 of the site lease provides that Corporation shall use the land solely for the purpose of constructing the project thereon and leasing the site and the project to the City pursuant to the associated lease agreement, subject to the remedies provided in the event of a default by City. Section 12 of the site lease provides that City will pay all taxes "including possessory interest taxes, levied or assessed upon the Site (including land and improvements)".

On March 1, 1986, the city-owned land leased to Corporation was vacant and unused, awaiting commencement of the construction which was scheduled to start in May of that year. The Ventura County Assessor determined that on the 1986 lien date Corporation had a taxable possessory interest in the city-owned land which could not qualify for the welfare exemption under the provisions of Revenue and Taxation Code section 231, because, on that date, the property was not being used for an exempt purpose. After reviewing the enclosed documents and discussing this matter with the representative of the Ventura County Assessor's office, we are of the opinion that

the assessor properly determined that Corporation had a taxable possessory interest.

The property tax welfare exemption is founded upon section (4)(b) of article XIII of the California Constitution which provides that the Legislature may exempt from property taxation property "used exclusively" for religious, hospital or charitable purposes, etc. This exemption is implemented by Revenue and Taxation Code sections 214 and following. Subdivision (a) of section 214 again refers to property "used exclusively" for the designated purposes and expressly requires in subdivision (a) (3) that the property be used for "the actual operation of the exempt activity". Thus, actual use, as distinguished from intended use, of the property for the exempt purpose is one of the primary requirements of the exemption. This requirement of actual use has been affirmed by the California courts in First Baptist Church v. Los Angeles County (1952) 113 Cal.App[.2d 392; Cedars of Lebanon Hospital v. Los Angeles County (1950) 35 Cal.2d 729; Christward Ministry v. San Diego County (1969) 271 Cal.App.2d 805.

In recognition of the fact that the exemption authorized by the Constitution does not apply to vacant, unused property held for future qualifying use, California has specifically enacted section 5 of article XIII of the California Constitution providing, in part, that the exemption authorized under section 4(b) applies to buildings under construction, land required for their convenient use and equipment in them if the intended use would qualify the property for the exemption. Section 5 is implemented by section 214.1 and 214.2 of the Revenue and Taxation Code. These section include within the term "property used exclusively for religious, hospital, or charitable purpose" facilities in the course of construction and the associated land when the facilities will be used exclusively for qualifying purposes. Further the term "facilities in the course of construction" includes the demolition or razing of a building with intent to replace it with facilities to be used exclusively for such qualifying purposes.

These authorities demonstrate that the only exception to the general principle that vacant, unused property held for future use does not qualify for exemption is section 5 of article XIII which applies to property under construction. Since the exception for construction is expressly recognized by a provision of the Constitution, any further extension of the welfare exemption to unused land held for some specified future use would also require a constitutional amendment. For that reason, any attempt to legislatively extend the exemption provided by Revenue and Taxation Code section 231 to vacant property held for a future use would be invalid unless supported by such an amendment of the Constitution.

Ventura County assessed Corporation's possessory interest in the city-owned land because the property was vacant and unused on the lien date. This assessment could have been avoided by limiting the commencement date of the lease of the land to Corporation to the date on which the construction project began. If, under the lease, Corporation's right of use and occupancy did not arise until the start of construction operations, it appears that the use of the property would have qualified under existing statutory and constitutional standards, assuming the other requirements of Revenue and Taxation Code 231 were met.

As indicated in Revenue and Taxation Code section 214.2, construction also includes activities involved in the removal of existing improvements. Although there is no specific statute interpreting the term "commencement of construction" for purposes of the welfare exemption, that term is defined in property tax Rule 463.5 for purposes of supplemental assessments. That regulation provides, in part:

"Commencement of construction" means the performance of physical activities on the property which results in changes which are visible to any person inspecting the site and are recognizable as

the initial steps for the preparation of land or the installation of improvements or fixtures. Such activities include clearing and grading land, layout of foundations, excavation of foundation, footing, fencing the site, or installation of temporary structures. Such activities also include the severance of existing improvements or fixtures. "Commencement of construction" does not include activities preparatory to actual construction such as obtaining architect services, preparing plans and specifications, obtaining building permits or zoning variances or filing subdivision maps or environmental impact reports.

"Commencement of construction" shall be determined solely on the basis of activities which occur and are apparent on the property undergoing new construction. Where several parcels are adjacent and will be used as a single unit by the builder for the construction project, the commencement of construction shall be determined on the basis of the activities which occur on any part of the several parcels comprising the unit. Where a property has been subdivided into separate lots, the commencement of construction shall be determined on the basis of the activities occurring on each separate lot. Where the property has been subdivided into separate lots and several or all of those lots will be used as a single unit by the builder for the construction project, the commencement of construction shall be determined on the basis of the activities which occur on any part of the several parcels comprising the unit."

While the definition of "commencement of construction" found in Rule 463.5 is an element of the definition or the "date of completion of new construction" for purposes of supplemental assessments, we believe that most assessors would find the definition to be a reasonable standard for purposes or determining when activities qualify as construction for purposes of the welfare exemption.

Although municipalities, like the City of Thousand Oaks, which have already entered into lease-leaseback arrangements may not benefit from this advice, it would appear that the unnecessary assessment of taxable possessory interest can be avoided in the future if the transactions are properly planned and the terms of the leases are property designed. In this connection I would note that, based upon my review of the enclosed materials as well as other contacts involving similar transactions, it appears there has been a lack of understanding of the applicable property tax law. Not only should care be exercised in planning the transaction and drafting the lease terms, we would also recommend that the local county assessor be consulted as part of the planning process in order to determine how the assessor will treat the transaction. With proper attention to detail, unnecessary property tax assessments can be avoided in the future.

The constitutional principle which prevents the application of the welfare exemption to vacant, unused land held for future use is based upon sound public policy. Without this limitation, it would be possible for qualified organizations to shelter from local taxation large accumulations of unused property held on the vague promise that they would some day be used for an exempt purpose. The result would be substantially increased local revenue losses resulting from the exemption of property which may be held for many years without benefits to the community. It should be recognized, therefore, that the benefits to local government of the principle excluding vacant, unused land from the exemption far outweigh the occasional burdens imposed as a result of some lease-leaseback transactions.

When we discussed this problem in July I indicated that there was a possibility that an appropriate interpretation of the applicable law could determine that Corporation did not, in fact, receive a taxable possessory interest. After reviewing the attached materials, we have engaged in a thorough review of the applicable authorities in connection with this matter and some related problems. We

regret that our review has taken so long, but this has proven to be a very difficult area. After careful consideration, we have concluded that although the matter is not entirely free of doubt, the controlling authority in this area is City of Desert Hot Springs v. County of Riverside (1976) 91 Cal.App.3d 441. In a similar lease-leaseback situation involving a private contractor, the court found that the contractor had a taxable possessory interest even though the court conceded that this was a financing transaction. In light of the reasoning of that case we have concluded, as indicated above, that the Venture County Assessor properly determined that the Corporation had a taxable possessory interest in the city-owned land.

I hope the above analysis will be helpful. Please call me if I can be of further assistance.

Very Truly Yours,

Richard H. Ochsner
Assistant Chief Counsel

RHO/rz
Enclosures
cc: Honorable R.J. Sanford, Ventura County Assessor
Mr. Gordon P. Adelman
Mr. Robert Gustafson
Mr. Verne Walton
Mr. Ken McManigal
Ms. Margaret Boatwright
0997H

STATE OF CALIFORNIA

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August 2, 1995

Honorable Dick Frank
San Luis Obispo County Assessor
Room 100, County Government Center
San Luis Obispo, CA 93408

Attention:

Dear Redacted

This is to respond to your letter of July 24, 1995 in which you ask our interpretation of the California Revenue and Taxation Code as it applies to certain situations cited in your letter.

1. Nature Conservancy has certain parcels of land in the Carriso Plains area which are under the Conversation Reserve Program (CRP). Under the program, the federal government pays the Conservancy $50 per acre to refrain from growing crops and to maintain the property as open space. You ask, is the Conservancy eligible for exemption on the property under the CRP.

    A. Yes. Revenue and Taxation Section 214.02 exempts property that is used exclusively for the preservation of native plants or animals, biotic communities, geological or geographical formations of scientific or educational interest, or open-space lands used solely for recreation and for the enjoyment of scenic beauty and is open to the general public subject to reasonable restrictions concerning the needs of the land . . . . Payments of $50 by the federal government does not interfere with the eligibility requirements.

2. The Church of the Nazarene in Atascadero allows a traveling Evangelical minister to live in a trailer on the church parking lot in between his ministry tours, approximately one-third of each year. You ask, does the use of the property by the minister qualify for exemption and why could this not qualify as the “temporary housing” as set forth in the handbook.

A. We believe that if the trailer is used for temporary housing for the missionary while he is on furlough and the site is not being used merely as a mailing address, it could qualify.

3. The Temple New Shalom purchased property in April 1994 intending to convert it into a temple for worship purposes. Zoning changes were approved but the cost of construction was too expensive to permit development of the property. Accordingly, there has been no construction or worship services on the property but the building is used for committee meetings a few times a month. You ask, if supplemental and/or proration assessments for 1994-95 and the 1995/96 assessment would qualify under the religious, church and welfare exemptions.

A. Sections 214.1 and 214.2 relate to facilities under construction.

214.1. Welfare Exemption: Facilities under construction. As used in Section 214, “property used exclusively for religious, hospital or charitable purpose” shall include facilities in the course of construction on or after the first Monday of March, 1954, together with the land on which the facilities are located as may be required for their convenient use and occupation, to be used exclusively for religious, hospital or charitable purposes.

214.2. Welfare Exemption: Construction includes demolition. (a) As used in Section 214.1, “facilities in the course of construction” shall include the demolition or razing of a building with the intent to replace facilities to be used exclusively for religious , hospital or charitable purposes.
(b) As used in Section 214.1, "facilities in the course of construction" shall include definite onsite physical activity connected with construction or rehabilitation of a new or existing building or improvement, that results in changes visible to any person inspecting the site, where the building or improvement is to be used exclusively for religious, hospital, or charitable purposes. Activity as described in the preceding sentence having been commenced and not yet finished, unless abandoned, shall establish that a building or improvement is "under construction". _ for the purposes of Section 5 of Article XIII of the California Constitution. Construction shall not be considered "abandoned" if delayed due to reasonable causes and circumstances beyond the assessee's control, that occur notwithstanding the exercise of ordinary care and the absence of willful neglect.

In 214.2 the course of construction shall include definite onsite physical activity connected with construction or rehabilitation for new or existing building or improvement, that results in changes visible to any person inspecting the site. It is the physical activity on-site which is required rather than an intention to do something in the future. For the supplemental assessments, construction must begin no later than 90 days after the change of ownership; for the regular roll, construction should begin in a reasonable time in the opinion of the county assessor.

If you have further questions, please contact this office.

Sincerely,

James E. Barga
Supervising Property Appraiser
Assessment Standards Division

JEB: