CHANGE IN OWNERSHIP – PARTITIONS

ASSESSMENT PRE- AND POST-PROPOSITION 13

In June 1978, when California voters approved Proposition 13 (article XIII A was added to the California Constitution) California property taxation was changed by:

1. Limiting the property tax rate applied to assessed values to 1 percent plus additional rates necessary to retire voter-approved bonded indebtedness;
2. Placing explicit limitations on the power of government to impose additional property taxes; and
3. Limiting increases in assessed values by significantly changing the method of property assessment.

Prior to Proposition 13, annual assessments for both real property and personal property were based on current fair market value. As a practical matter, fiscal and staffing constraints prevented County Assessors from physically revaluing each property in their respective counties every year. Consequently, reappraisals were usually conducted on a cyclical basis. Typically, these cycles ranged in duration from three to five years. Between physical reappraisals, County Assessors would often apply interim value increases based on trending factors. This system of assessment ensured that all property, subject to the limitations of cyclical appraisal programs, was assessed at its current fair market value.

Proposition 13 changed the method of property taxation from a current market value system to an acquisition-based value system. Under Proposition 13, property assessments were rolled back to the 1975-76 levels, and locally assessed property would thereafter be reassessed to fair market value only upon a change in ownership or completion of new construction. Acquisition-based value assessment refers to the process of assessing property at its fair market value at the time of a change in ownership or completion of new construction. The new assessment at such time becomes the property's new base year value, which is subject to the annual inflation adjustment discussed below.

Locally assessed real property is the only category of property subject to the provisions of article XIII A of the California Constitution. Locally assessed personal property and state-assessed properties are not subject to its provisions and are annually assessed as of the lien date at current fair market value by County Assessors and the State Board of Equalization, respectively.

Specifically, under Proposition 13:

- Property assessments were rolled back to their 1975-76 levels for the 1978-79 fiscal year. Properties that have not been sold or newly constructed, in whole or in part, since March 1, 1975 are said to have a 1975 base year value. The base year value is the current fair market value (or full cash value) of real property in 1975-76, or in any subsequent year in which a change in ownership or the completion of new construction occurs.

- Each property's base year value is adjusted annually to reflect inflation as measured by the California Consumer Price Index, but may not exceed an increase of 2 percent. This taxable value reflecting the annual inflation indexing is known as the adjusted or factored base year value. The adjusted base year value is the maximum assessable amount for a property for that particular year unless a change in ownership or completion of new construction occurs.
- When a change in ownership occurs, a new base year value is established at the current fair market value on the date of the change in ownership. The base year value of any newly completed construction is its current fair market value as of its date of completion. New construction in progress is appraised at its fair market value on the lien date.
- If a partial change in ownership occurs, only the portion that changes ownership is given a new base year value based upon its current fair market value on the date of the change in ownership, and the portion that did not change ownership retains its existing adjusted base year value. Similarly, with new construction (for example, the addition of a bedroom), the new construction is given a new base year value upon the completion of the construction at its current fair market value, while the pre-existing portion(s) of the property retains its existing adjusted base year value. Thus, an assessment for one parcel may have multiple base year values reflecting its separate portions.

Property assessments may be reviewed each year for a decline in value and if a property's fair market value drops below its adjusted base year value, it will be temporarily reassessed at the lower fair market value. This reduction is frequently referred to by the number of its ballot initiative approved by the voters—a Proposition 8 adjustment. Even though a property may be temporarily assessed at its current market value, its base year value is still annually adjusted by the inflation factor. When the property's current fair market value returns to or exceeds its adjusted base year value, the adjusted base year value is restored to the assessment roll.

Since Proposition 13 did not define change in ownership, the Assembly Revenue and Taxation Committee formed a task force to study the issue and make recommendations for law changes. This task force consisted of 35 members that included legislative and Board of Equalization staff, County Assessors, trade associations, and lawyers in the public and private sectors. The effort of this task force resulted in a report to the Assembly Revenue and Taxation Committee on January 22, 1979. The recommendations in the task force report resulted in the enactment of various Revenue and Taxation Code sections.[1] The provisions regarding change in ownership are codified beginning with section 60. Subsequent constitutional amendments to article XIII A and corresponding implementing statutes have resulted in additional exclusions from the definition of change in ownership.

[1] All statutory references are to the Revenue and Taxation Code unless otherwise specified.

CHANGE IN OWNERSHIP

Locally assessed real property subject to Proposition 13 is reassessed upon a change in ownership or new construction. Section 60 defines a *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. For those transfers that are not specifically addressed by statutes, regulations, or court decisions, section 60 provides the fundamental criteria for determining whether a change in ownership has occurred.

- A *transfer* may be voluntary or involuntary and may happen by operation of law or may result from: a purchase or sale; a grant, gift or devise through inheritance or through a trust; an addition or deletion of an owner; or a property settlement. Payment or consideration is not required. Consideration is something of value (for example, the exchange of other property, the assumption of a debt, the cancellation of an outstanding debt, the creation of a debt) that may be exchanged for the property.
- A *present interest* is one which entitles the person having such interest to the immediate possession, present use, or present enjoyment of the property. This requirement excludes from the definition of change in ownership the transfer of contingent and future interests, including revocable transfers.
- The term *beneficial use* means the right to enjoy the benefits of a property and includes the right to occupy a property and the right to receive income produced by a property. This requirement excludes from the definition of change in ownership transfers involving trustees, conservators, fiduciaries, security interest holders such as lenders, and other title changes where there are no transfers of the beneficial use.
- A change in ownership requires that the transferred property interest be substantially equal to the value of the fee interest in the property. *Fee simple ownership* means absolute ownership of property. Thus, substantially equal to the value of a fee interest means an ownership interest that is substantially equal to the value of absolute ownership. This is known as the value equivalency test, and it ensures that there is only one primary owner for property tax purposes at any point in time. A major purpose of this third element is to avoid unwarranted complexity so that only a transfer by the primary owner will be a change in ownership. Under this test, the primary owner may be someone other than the record owner of the property and may not be the person legally responsible for payment of property taxes.

PARTITION

A *partition* is any division of real property giving separate title to those who previously held undivided interests as co-owners, such as in a joint tenancy or a tenancy in common.

SECTION 62(A)(1) EXCLUSION

A partition may result in a transfer of property that is excluded from change in ownership under section 62(a)(1). These provisions are applicable only to transfers of interests held in tenancy in common or in joint tenancy and do not apply to transfers involving legal entities. Exclusions for transfers of real property between co-owners involving other forms of co-ownership (community property and legal entities) are specifically covered in other code sections.

Under section 62(a)(1), a real property transfer is excluded from change in ownership if the transfer results solely in a change in the method of holding title to the property transferred without a change in the proportional interests of the co-owners. The general rule is that if a partition has resulted in a change in proportional ownership interests, the property will be reassessed to the extent of the disproportionate transfer, as measured by market value.

APPRAISAL UNIT

The concept of appraisal unit is central to a determination of whether proportional interests in a property remain the same after a partition for purposes of applying the rule in section 62(a)(1). An *appraisal unit* is defined as that which persons in the marketplace commonly buy and sell as a unit, or that is normally valued separately.

A single farm consisting of ten parcels would be a single appraisal unit. The partition of that single farm to two equal co-owners would not result in a change in ownership if each co-owner's interest in the partitioned property were of equal value afterward.

However, the partition of jointly held interests in two separate and distinct properties (two appraisal units) would require the comparison of the proportional interests held before and after the transfer in each separate property. In other words, there will be a change in ownership of each separate property of the interest transferred.

PARTITIONS—VALUATION

In determining whether the same proportional ownership interest exists after a partition, it is necessary to establish and compare the fair market values of the separate properties post-partition. For example, if a two-acre parcel (single appraisal unit) is being partitioned into two separate one-acre parcels, the value of each individual parcel must be determined and the two values compared.

Example 1

> A, B, C, and D own as joint tenants a four-acre parcel of land that is a single appraisal unit. They split the parcel into two lots: a one-acre parcel and a three-acre parcel. A takes title to the one-acre parcel, and B, C, and D take title to the three-acre parcel.
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> These transfers can be excluded from reassessment as long as A's parcel is equivalent in value to 25 percent of the whole before the parcel split.

Example 2

> X and B are equal tenants in common in a farm consisting of ten parcels, a single appraisal unit. The adjusted base year value of the appraisal unit is $300,000 (each owner

has one-half interest valued at $150,000). The farm has a current fair market value of $1 million. X and B partition the farm and grant to X sole ownership of six parcels and to B sole ownership of the remaining four parcels.

The interests held by each owner must be appraised to determine if X or B acquired more than their respective proportional interests. If X's partitioned six parcels have a current fair market value of $600,000, and B's partitioned four parcels have a current fair market value of $400,000, there has been a change in ownership of a 10 percent interest (X now holds 60 percent and B now holds 40 percent ownership interest, whereas prior to the partition each owned 50 percent).

Since X owns more than he did prior to the partition, X's base year value must be increased. He owned 50 percent and now owns 60 percent. His original 50 percent interest had an adjusted base year value of $150,000, which remains intact. However, added to that would be the 10 percent interest he acquired, calculated at 10 percent of the current fair market value of the entire farm. His new base year value would be $250,000 [$150,000 + $100,000 (10 percent of partition date fair market value of $l,000,000)].

Since B now owns less than he did prior to the partition, B's base year value must be reduced. B's new base year value would be $120,000 (40 percent of $300,000 adjusted base year value of the appraisal unit).

Example 3

X and B are equal tenants in common in two residential vacant lots. Each lot is the same size and each has a $5,000 adjusted base year value and a fair market value of $10,000. X and B partition their tenancies, resulting in X owning one lot and B owning the other.

If each lot is a separate appraisal unit, this transfer would cause a change in ownership of the 50 percent transferred for each lot. The reasoning is that X and B began with each owning one-half of each lot (an undivided one-half interest in each appraisal unit) and after, each owned 100 percent of one lot. Therefore, one-half of each lot must be reassessed. The new base year value of each lot would be $7,500 [$2,500 (one-half of the original adjusted base year value) + $5,000 (one-half of partition date fair market value of $10,000)].

For the section 62(a)(1) exclusion to apply, X and B would need to each receive one-half of each lot by way of a lot split, thereby receiving one-half of each appraisal unit.

In some cases, the partition of property is legally challenged and the partition may take more than one assessment year to be fully executed. The section 62(a)(1) exclusion from change in ownership may still apply even though the partition takes more than one assessment year to fully execute.

PARTITIONS—CONVERSION TO CONDOMINIUMS

A partition is the method used when co-owners of an apartment building wish to convert their units to condominiums. In this case, the timing of the partition will determine whether there has been a change in ownership requiring a reappraisal.

A condominium project, like a standard subdivision, is assessed as a single parcel to the record owner for the year in which the subdivision tract map is filed. Unlike a standard subdivision, however, separate assessment of individual units in the ensuing years is not automatic, but occurs only after the conveyance of at least one condominium unit. If no units are ever sold, the entire condominium project will continue to be assessed as a single parcel. Thus, a condominium is treated as a single appraisal unit before the first individual unit is sold.

If the partition occurs before the condominium conversion, the entire apartment complex would be regarded as one appraisal unit. In that case, if after the partition the interests of each co-owner are in proportion to the interest held prior to the partition, no reappraisal occurs.

Example 4

> Four persons purchased a parcel of property as tenants in common with each owning a 25 percent undivided interest. A four-unit apartment complex was constructed on the property. While the complex has been approved for condominiums, no separate parcels have been created. The owners now intend to transfer one unit to each person. Each unit is identical and worth $100,000 for a total value of $400,000.
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> The transfer of each would be excluded as a partition since the ownership interests remain the same before and after the transfer.

On the other hand, if the condominium conversion and the sale of at least one unit precede the partition of the entire complex, then each condominium would be regarded as a separate appraisal unit and each person would be considered a partial owner of each condominium unit. A comparison of the proportional interests held before and after the transfer of each condominium unit would be required.

Example 5

> A and B purchased a parcel of property as tenants in common with each owning a 50 percent undivided interest. A three-unit building was constructed on the property. The building was approved for conversion to condominiums. One unit was sold to a third party, and separate parcels were created. A and B now intend to each take title of a separate condominium. Each condominium is worth $100,000 for a total value of $200,000.
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> Because each condominium is a separate appraisal unit and A and B own 50 percent of each unit as tenants in common, this transfer would result in a 50 percent change in ownership of each condominium.