

***ASSESSMENT  
PRACTICES  
SURVEY***

**A Report on the Assessment of  
Possessory Interests**

**1985**

---

ASSESSMENT STANDARDS DIVISION  
DEPARTMENT OF PROPERTY TAXES  
CALIFORNIA STATE BOARD OF EQUALIZATION

## Memorandum

To: Honorable Ernest J. Dronenburg, Jr.  
Honorable Conway H. Collis  
Honorable William M. Bennett  
Honorable Richard Nevins  
Honorable Kenneth Cory

Date: November 1985

From: Gordon P. Adelman

Subject: A Special Study of Possessory Interest Assessments

This comprehensive report is the fifth in a series of special topic surveys authorized by you to supplement the Assessment Practices Survey Program. It presents the findings of our statewide survey of the assessment of possessory interests. It summarizes in one report the practices and procedures employed by fifty-seven county assessors in assessing this important type of real property (the San Luis Obispo County Assessor refused to provide data and did not participate in this survey). This report will direct attention to procedures found to be effective and should also promote equalization among the fifty-seven counties who participated in this survey.

We are grateful to those county assessors, their staffs, and to all others who cooperated in this report and thereby played a role in improving California's property tax system.

GPA:wpc

cc: Mr. Douglas D. Bell  
Mr. Jesse R. Huff, Director  
Department of Finance  
Mr. David R. Doerr, Chief Consultant  
Assembly Committee on Revenue and Taxation  
Mr. Martin Helmke, Consultant  
Senate Committee on Revenue of Taxation

AS-41-2636A

## PREFACE

The State Board of Equalization conducts two different types of surveys of county assessment practices. The first, required by law to be made at least once every five years, involves comprehensive field and office audits performed in each county, the results of which are published as assessment practices surveys. The second type of survey focuses on assessment issues of concern to the entire California property tax community. These single-issue reports are prepared on an as-needed basis as authorized by law. A special topic survey typically involves questionnaires mailed to the 58 counties, rather than visits to county assessors' offices. When published, the results of these surveys are distributed to county assessors, elected Board Members, the Legislature, and concerned individuals in the private sector.

This survey deals with the assessment of taxable possessory interests. Its goals are:

- (1) To gather and interpret statistical data relating to possessory interest assessment practices.
- (2) To identify problems commonly encountered when assessing possessory interests and to suggest solutions to them.
- (3) To present, in a single paper, the current property tax laws, regulations and Board advisory letters dealing with possessory interests.

A questionnaire which contained 29 questions was mailed to all counties in late 1983. Responses to this questionnaire formed the background for this report, which was written by the staff of the Assessment Standards Division, Department of Property Taxes.

Verne Walton, Chief  
Assessment Standards Division  
Department of Property Taxes  
California State Board of Equalization  
November 1985

TABLE OF CONTENTS

|   | <u>Page</u> |
|---|-------------|
| I. INTRODUCTION . . . . .                                     | 1           |
| II. CONCLUSIONS . . . . .                                     | 3           |
| A. Survey Questionnaire Categories . . . . .                  | 3           |
| 1. Management and Staffing . . . . .                          | 3           |
| 2. Sources of Information . . . . .                           | 3           |
| 3. Methodology . . . . .                                      | 4           |
| 4. Workload and Staff Productivity. . . . .                   | 7           |
| 5. Economic Rent and Anticipated Term of Possession . . . . . | 7           |
| 6. Mining and Quarrying Properties . . . . .                  | 8           |
| 7. Special Methodology . . . . .                              | 9           |
| B. Additional Issues. . . . .                                 | 9           |
| 1. Short-term Possessory Interests. . . . .                   | 9           |
| 2. Possessory Interests in Federal Enclaves . . . . .         | 10          |
| 3. The Role of Proposition 8 . . . . .                        | 11          |
| 4. Possessory Interests at Public Airports . . . . .          | 13          |
| 5. Possessory Interests in Taxable Government-Owned Lands     | 14          |
| 6. Applying the income Approach to Value to Possessory        |             |
| Interests . . . . .   | 15          |

APPENDICES

|   |    |
|---|----|
| 1. Questionnaire for Special Topic Survey Regarding Possessory Interests . . . . .          | 18 |
| 2. Possessory Interests Statistics . . . . .  | 24 |
| 3. Possessory Interest Statutes . . . . .   | 26 |
| A. Constitutional Provisions. . . . .   | 26 |
| B. Administrative Code Sections . . . . .   | 27 |
| C. Civil Code Sections . . . . .  | 35 |
| D. Revenue and Taxation Code Sections . . . . .   | 36 |
| E. Streets and Highways Code . . . . .  | 44 |
| 4. Summary of Board Letters to County Assessors Dealing with Possessory Interests . . . . . | 46 |
| 5. Listing of Possessory Interest Property Tax Legislation . . . . .                        | 49 |

## I. INTRODUCTION

Since almost one-half of California's land is in the public domain, the taxation of private interests in such land is of major importance as a source of revenue. Such possessory interests have been taxed in California since 1859 and have also been the subject of court action since that date.<sup>1</sup> This coincidence illustrates the difficulty inherent in applying the property taxation scheme to possessory interests. This difficulty has beleaguered both the county assessors and the courts in California.

Prior to 1955, possessory interests in tax-exempt real property were assessed only on the basis of any incremental value of the lease, i.e., the marginal excess of value of economic rents over contract rent. The result was often little or no tax on the possessory interest.

The California Supreme Court, in the 1955 case De Luz Homes, Inc. v. San Diego County (45 Cal. 2d 546, 290 P. 2d 544), changed all this in ruling that when valuing possessory interests by the income approach there must be no deduction from revenue for either the present worth of unexpired contract rents or the amortization of tenant improvements. The Court also found that the value of the possessory interest must include more than the value of the lessee's "equity;" it must reflect the full cash value on the open market of the leasehold interest.

The De Luz principles, applicable to leases executed subsequent to December 25, 1955, continue to govern the assessment of possessory interests. The advent of Proposition 13 in 1978 really did not alter the concept of what a taxable possessory interest is; it did, however, affect the frequency of reappraisal, resulting in the likelihood that short-term possessory interests would be assessed at levels closer to current market value than those at which property owned in fee was assessed.<sup>2</sup>

The problems that county assessors now encounter with possessory interests are the same ones they have always confronted: how to correctly identify taxable possessory interests and best determine their value for property tax purposes. We have included several of these specific problem areas for discussion in this report.

The possessory interest questionnaires we sent to all counties in the fall of 1983 contained 29 questions, grouped in seven categories:

- (1) Management and staffing
- (2) Sources of information
- (3) Methodology
- (4) Workload and staff productivity

---

<sup>1</sup> State of California v. Moore (1859) (12 Cal. 56), an early Supreme Court case, involved the right to extract gold from land in the public domain.

<sup>2</sup> Revenue and Taxation Code, Section 61(b) requires reappraisal of a possessory interest upon its creation or renewal for any term. See Appendix 3.

- (5) Economic rent and anticipated term of possession
- (6) Mining and quarrying properties
- (7) Special methodology

County responses to these questions are presented in this same order in Section A of Chapter II of this report. Section B of the chapter consists of Board recommendations for dealing with six individual areas of difficulty involving possessory interests. Although not all of these areas were addressed in the survey questions, we have included them in order to enhance the usefulness of this report to county assessors and their staffs.

Finally, there are five appendices included with this report. They include information on the questionnaire itself, numerical data collected from county responses to it, current statutes governing possessory interest assessments, summarized Board letters to assessors, and chaptered legislation affecting taxable possessory interests. Knowing that the questionnaires were necessarily outdated, we included these appendices to insure that this survey report would be up-to-date and relevant.

The summary of numerical data (Appendix 2) suffers from incomplete reporting and frequent estimation on the part of responding counties. Many other counties simply could not state precisely the quantities or values requested by various questions. The San Luis Obispo County Assessor did not participate in this survey. Please use this appendix only as a general indicator of value levels and distributions of various types of possessory interests throughout the state.

## II. CONCLUSIONS

### A. SURVEY QUESTIONNAIRE CATEGORIES

#### 1. Management and Staffing

Questions 1-4 of the survey questionnaire (see sample questionnaire, Appendix 1) concerned how county assessors assign responsibility for the assessment of taxable possessory interests. All 57 counties that participated in this survey report indicated that they do have taxable possessory interests. In 50 counties, either the county assessor or a real property appraiser handles the possessory interest assessments; in three counties, only auditor-appraisers are assigned to this work; in three counties, both real property appraisers and auditor-appraisers do the job; and in one county the assessment roll supervisor handles the possessory interests.

Because property tax law states that possessory interests are real property<sup>3</sup>, they have traditionally been the responsibility of the real property appraiser. This may explain why the vast majority of county assessors delegate the responsibility for possessory interests to their real property types.

Roughly one-half of the responding counties have possessory interest specialists who spend all or most of their time processing possessory interest appraisals. Naturally, these specialists are most commonly found in larger counties where sheer parcel volume requires specialization in a specific type of real property.

Twenty counties feel that in recent years budget constraints have precluded adequate training for their personnel in the assessment of possessory interests. They would like to see more emphasis on the subject in training conducted by the Board of Equalization. The remainder of responding counties are satisfied with the adequacy of training for their staff in possessory interest appraisal. We should note that the Board has offered Course 9 (The Appraisal of Possessory Interests) for many years. There is a possibility that the course will be lengthened beyond its present 24 hours and that Assessors' Handbook Section 517, dealing with possessory interests, will be substantially revised and updated at some time in the future.

#### 2. Sources of Information

Questions 5, 6, and 7 relate to the difficult job of discovering the existence of taxable possessory interests. Responding counties were virtually unanimous in naming public agency reports as their best source of information. Such reports were usually made in response to a written inquiry or telephone call placed by the county assessor's staff.

Current legislation<sup>4</sup> has attempted to improve the flow of information from public agencies to the county assessor by requiring public agencies conveying the use of tax-exempt

---

<sup>3</sup> Section 104, Revenue and Taxation Code. See Appendix 3.

<sup>4</sup> Assembly Bill 2922 (Chapter 872, Statutes of 1984), referenced in Appendix 5, added Section 480.4 to the Revenue and Taxation Code (see Appendix 3).

real property to any person to notify the county assessor within 60 days of the transaction. The drawbacks to this law are that it applies only in counties in which the board of supervisors adopts it by local ordinance or resolution and further, that it is automatically repealed as of January 1, 1991, unless another statute extends its “sunset” date. It should be regarded as a “pilot program” to determine the feasibility of mandating additional reporting by local governments.

Secondary methods of discovering newly created possessory interests and the extension, renewal, or assignment of existing interests, as reported by all counties, include newspaper accounts, leases transmitted by the county recorder to the county assessor, and field inspection by staff appraisers. These supplemental methods prevent possessory interests from going undetected due to incomplete reporting by public agencies.

Counties were not consistent in naming uncooperative agencies. The federal agencies from which counties find it difficult to obtain information are the Bureau of Land Management, Bureau of Indian Affairs, Department of Defense, Bureau of Reclamation, U.S. Forest Service, and the Army Corps of Engineers. State agencies listed as uncooperative include the Department of Transportation, State Lands Commission, Department of Parks and Recreation, and Department of Water Resources. Even a few local (county or city) agencies were reported by several counties to be uncooperative. There seems to be a positive correlation between the size of the government agency and the likelihood that it will be difficult to obtain any information from it; the larger the bureaucracy, the harder it is to penetrate.

### 3. Methodology

Questions 8 through 12 are concerned with appraisal methods applicable to possessory interests. The first item was pre-De Luz possessory interests, which require a different treatment than do post-De Luz interests. According to the law<sup>5</sup>, when valuing a possessory interest created prior to December 25, 1955 (the date of the landmark California Supreme Court case), and not since extended or renewed, the property tax appraiser must deduct from the preliminary possessory interest value the present worth of the unexpired contract rents and, if applicable, the present worth of future amortization of lessee improvements. That is, the appraiser must first value the leasehold at its value on the open market (usually by capitalizing economic rents), then deduct from indicated value the amount computed for rents and amortization. In essence, pre-De Luz possessory interest assessments must reflect only the present lessee's equity in the lease; post-De Luz assessments, however, must be based on capitalized net earnings of a prospective assignee of the lease, not on those of the present lessee. Only four counties report having any pre-De Luz possessory interests remaining on their tax rolls. They report a total of 77 individual assessments having a total 1982-83 taxable value of nearly 50 million dollars.

Regarding the concept of “exclusive use” as it applies to the determination of whether the use of real property constitutes a taxable possessory interest, only 12 counties have had difficulty with it. These counties mentioned widely diverse uses of exempt land, such as river rafting outfitters who operate under permits from the Bureau of Land Management, medical

---

<sup>5</sup> Section 107.1, Revenue and Taxation Code; Property Tax Rule 26. See Appendix 3.



corporations operating under contract to a county hospital, cable television franchises, boat slips at public marinas, trade fixtures at a naval base, and a city hall leased to local government.

The California Administrative Code addresses the problem of “exclusive use” and should be referred to as a guide to solving this problem. Its pertinent section<sup>6</sup> provides that “exclusive use” refers to a beneficial use of tax-exempt land or improvements coupled with the legal right to protect this use against interference caused by other persons' occupancy. Further, this use can be shared with others in multiple, concurrent, or alternating manner without losing its exclusive nature.

The question of whether river rafting businesses have taxable possessory interests has been reviewed in the past by the Board to the effect that a permit issued by the Bureau of Land Management allowing commercial rafting on the Merced River did not provide the degree of exclusiveness and independence necessary for a taxable possessory interest. However, one county assessor has since 1982 assessed all commercial river rafting operations in the county. These operations work under county-issued permits. The river rafting companies have collectively filed a suit in superior court against the county assessor and tax collector. The matter has not yet been resolved, although oral arguments are soon to be presented in court. Counties having questions about river rafting operations and possessory interests should submit actual permits and other documents to the State Board for evaluation and recommendation on a case-by-case basis, because circumstances may differ from one jurisdiction to the next.

Estimating a reasonably anticipated term of possession is a problem for 12 counties, and involves possessory interests at airports (tie downs, car rental agencies), marinas and port facilities (boat slips, shipping terminals), and in public lands (grazing permits). The common element in all of these interests is that they feature fairly short contract terms, such as one year or even one month. Although the Board has not issued an advisory letter to county assessors specifically recommending a minimum term, the guidelines established in the Administrative Code<sup>7</sup> should be followed by all counties. Contract terms should be used unless it conflicts with a reasonably anticipated term of possession derived from the selling price of the subject interest or of comparable interests, the history of the property's use, public agency policy, or the assessee's action.

Nearly half of responding counties have experienced difficulty estimating economic income attributable to possessory interests. The properties involved covered the full spectrum, ranging from airports to ski lifts. The more uncommon the property type or land use, the more difficult it is to find comparable fair rents. The tendency is to rely on contract rent for lack of anything else. Even here there can be trouble, as when the contract rent is based on a percentage lease. This practice is common for freight terminals at port facilities, where the wharfage fee is tied to the tonnage shipped, and also for certain other leases of publicly owned land for commercial uses.

Eleven counties report having trouble with the Board's position that month-to-month tenancies of possessory interests should be treated as annual renewals and annually

---

<sup>6</sup> Property Tax Rule 21, subdivision (e). See Appendix 3.

<sup>7</sup> Property Tax Rule 23. See Appendix 3.

reappraised. More accurately, the counties are having trouble with the assesses of such interests, who, because they may have already held the interest for a period of years, feel that it is unjust that they are continually reappraised and have to pay higher taxes. The most common month-to-month tenancies are boat slips, airport tie downs, and grazing leases. However, the law<sup>8</sup> defines the creation, renewal, sublease, or assignment of a taxable possessory interest for any term as a change in ownership. This means that month-to-month possessory interests are reappraised much more often than other real property and hence are probably assessed closer to their current full cash value than is most land owned in fee.

There are two alternative methods of countering the perceived inequity in continually reappraising short-term possessory interests. One is to reappraise a short-term possessory interest only at the end of the term of possession actually imputed in the original estimation of its full cash value, regardless of the fact that the tenancy exists only on the basis of month-to-month rental or annual permit renewal. According to this method, it would be appropriate to reappraise a boat slip rental at a public marina at the end of its predicated term of possession of say, three years. This method tempers the longer term of possession (and consequently higher present worth factor) with less frequent reappraisal, which usually means lower economic rents will be capitalized into a value indicator.

The second alternative for equitable treatment of short-term possessory interests is to annually reappraise the interest based on an anticipated term of possession of only one year. In this manner the fair rent and capitalization rate used in the income approach to value would always be current, but the reduced term of possession would offset any tendency toward a high full cash value of the taxable interest.

The argument can be made that these foregoing alternatives are not viable remedies for the inequitable treatment of short-term taxable possessory interests. The first method seems to violate Revenue and Taxation Code Section 61(b), which provides that “change in ownership” includes, among other things, the renewal of a taxable possessory interest for any term. The second alternative, to impute only a one-year term of possession upon reappraisal of a short-term possessory interest, could be construed to violate the concept of “reasonably anticipated term of possession” provided for in Property Tax Rule 23(b). There seems to be an inherent conflict in that, for reappraisal purposes, the actual term of possession is controlling, while for valuation purposes, the anticipated term of possession is controlling. Unless a legislative solution can be found, there may be no strictly legal method for granting tax relief to assesses of short-term possessory interests.

---

<sup>8</sup> Section 61(b) Revenue and Taxation Code. See Appendix 3.

#### 4. Workload and Staff Productivity

Questions 13 through 16 dealt with how many roll items each county generated by assessing possessory interests and how much appraiser's and clerk's time were required to process them. Appendix 2 following this text offers a summary of data obtained from county responses to these questions. Please be aware that for the 1980-81 roll, only 41 counties could supply figures showing the total assessed value of taxable possessory interests; for 1981-82, only 44; and for 1982-83, only 47. For 1980-81 and 1981-82, 47 counties indicated the number of possessory interests appearing on those rolls; and for the 1982-83 roll only 50 counties supplied this information. This means that the estimates of volume and value are very low and understate the significance of possessory interests as a component of local tax rolls.

Since nearly one-third of the 57 responding counties did not answer any part of Question 14, regarding the number of possessory interest appraisals completed for each of three roll years (see Appendix 1), we have not included it in the statistical summary. Apparently the question was unclear to respondents; they could not distinguish it from Question 13 (how many possessory interest assessments made for three years).

Estimates of appraiser's time required to complete the annual possessory interest workload for each of the roll years involved (1980-81, 1981-82, and 1982-83) ranged from five days to 5.2 appraiser years. For clerk's time, the range was from one day per year to 1.6 clerk years. This disparity illustrates the vast difference between the workloads sustained by various county assessors.

#### 5. Economic Rent and Anticipated Term of Possession

Questions 17 through 23 concerned typical rents and terms of possession imputed by county assessors' staff when valuing certain kinds of possessory interests. Specifically, these interests were grazing rights, aircraft tie downs, boat slips (both pleasure and commercial), and cable television systems.

Only 29 counties supplied answers to Question 17 (grazing lease data-- see Appendix 1). The rent per acre per month ranged from twenty-five cents to five dollars as a minimum; from \$1.40 to sixty dollars for a maximum; and from one dollar to \$25.23 for an average.

Twenty-eight counties either did not respond to Question 18, dealing with aircraft tie downs, or answered that they had no tie downs. A few indicated that they assessed all tie downs to the fixed base operator rather than to the owners of the individual aircraft. Of the 29 counties that responded to this question, the longest imputed terms of possession ranged from one year to 25; the shortest, from one month to eight years; and the average from one year to 25 years (two counties used a single term for all tie downs and thus had no "highs" or "lows" to report).

The longest term of possession used by any of the 21 counties that report having assessable pleasure boat slips is 50 years, while the shortest is one year. One county indicates that all boat slips are assessed only to the marina operator under a master lease, not to individual owners of pleasure boats. Nine counties do not use different estimated terms of possession, but rather apply a single term to all pleasure boat slips.

Only seven counties have assessed possessory interests in commercial boat docks. Anticipated terms of possession range from one to 50 years, with the average term being about five years. Three counties use a single fixed term of possession for all their commercial boat docks.

Of the 31 counties reporting cable television companies with taxable possessory interests, 11 use a standard term of possession for all such assessments. Among the remaining 20 counties, the imputed terms of possession range from one to 50 years. The most common average term is 15 years, which is the typical duration of the franchise agreement between cable television companies and cities or counties.

Most counties (33) use the average turnover time as an imputed term of possession for aircraft tie downs and boat docks. Only a handful link the term of possession to either the physical or economic lives of the improvements themselves.

Two-thirds of the counties that have tie downs and boat docks favor exempting these and other low-valued possessory interests from taxation and instead prefer collecting an in-lieu fee along with the rent. Among the types of interests that counties wish to see included in this category are aircraft tie downs, grazing permits, mining claims, boat slips, certain employee housing, and concessionaire areas at county fairs. One third of the counties do not favor such a method of handling low-valued possessory interests. They point out that there is already a provision in the law<sup>9</sup> for exempting low-valued property. At least one county assessor feels that in-lieu payments result in a loss of local revenue, citing the vehicle license fee for mobilehomes and the timber yield tax in place of general property taxation of standing timber.

## 6. Mining and Quarrying Properties

Question 24 concerned the total statewide volume and value of possessory interests that are mining operations. The figures in Section E of Appendix 2 reveal a steady increase in both the number of units assessed and their total taxable value from 1980 to 1982.

The responses to Question 25 indicate that the predominant materials mined in the 24 counties that have active mining operations are precious metals such as gold and silver. Tungsten, mercury, manganese and many other minerals are also commercially extracted in California. For a complete listing of mineral producers in California, we recommend that readers consult Special Publication 67, Mines and Mineral Producers Active in California, published by the Division of Mines and Geology of the California Department of Conservation (1983). This valuable reference booklet contains an exhaustive list of mineral producers in California, cross-

---

<sup>9</sup> Section 155.20, Revenue and Taxation Code. See Appendix 3.

indexed by name of producer, commodity, and county. Of course, many of these producers operate on private land not subject to possessory interest assessment.

The number of possessory interests in quarrying properties likewise showed an increase from 1980-81 to 1982-83 (see Section F, Appendix 2). However, the total taxable value, although higher on the 1982-83 roll than on the 1980-81 roll, showed a decline from the 1981-82 level. The main substances extracted from quarries statewide are sand and gravel, cinders, decorative rock, and shale. Again, the Department of Conservation maintains a comprehensive listing of quarry operators and quarried materials in Special Publication 67.

## 7. Special Methodology

Question 28 asked counties whether there were any unusual possessory interests on their tax rolls. Unusual uses of exempt land reported were several small hydroelectric plants, a geothermal site, a photovoltaic generating plant, and various possessory interests on military reservations.

The final survey question dealt with any special appraisal techniques that counties had developed for their own use that might be helpful to others in the assessment community. Three worthwhile suggestions came to light:

- (1) Persuade county board of supervisors to adopt an ordinance pursuant to Section 155.20, Revenue and Taxation Code, authorizing the exemption of low-valued property having a full cash value of less than \$2,000. This would eliminate the need to track creations and transfers of low-valued taxable possessory interests in aircraft tie downs, boat slips, unpatented mining claims, and all other such interests of negligible value.
- (2) Assign responsibility for the appraisal of tie downs and boat slips to an auditor-appraiser who also appraises the boats and airplanes.
- (3) Employ a separate property statement for possessory interests, which would contain change in ownership questions.

## B. ADDITIONAL ISSUES

### 1. Short-term Possessory Interests

The issue here is when to reappraise short-term possessory interests that exist on the basis of month-to-month tenancy. Examples of this type of interest are aircraft tie downs at public airports, boat slips at public marinas, grazing leases, and surplus highway properties owned by the Department of Transportation (single-family residences).

County assessors usually establish a term of possession for these interests that is much longer than one month. One year is really the shortest practical term for valuing an interest to which a low economic rent can be imputed. Many such interests are given terms of three or more years. However, current law requires supplemental assessments of real property subject to Article XIII A of the Constitution whenever such property changes ownership or is newly constructed on or after July 1, 1983.<sup>10</sup> This poses a problem for the county assessor; since it is administratively unworkable to send a supplemental tax bill for every renewal-- that is, for every monthly rental-- the county assessor must establish an annual date of change in ownership for purposes of calculating supplemental assessments. If the value of the possessory interest is determined not to have increased above the existing enrolled value, of course, there will be no supplemental assessment.

According to current California law<sup>11</sup>, an estate in real property other than an estate at will or for a term not exceeding one year may be created only by an instrument in writing by the lessor or the lessor's agent. Further, an agreement to lease for a term longer than one year is invalid, unless it is in writing and signed by the party to be charged.<sup>12</sup> These sections limit the imputed term of possession and frequency of reappraisal of taxable possessory interests that are month-to-month tenancies or else are not evidenced by written agreements.

## 2. Possessory Interests in Federal Enclaves

Many possessory interests exist in lands owned by the Federal Government, but not all of them are taxable. Many such interests exist in federal “enclaves”-- in effect, federal islands surrounded by state territory—where federal jurisdiction is absolute. Although there are several degrees of federal jurisdiction that may pertain to federal enclaves, ranging from exclusive to proprietorial, it is exclusive jurisdiction that is of greatest concern to the county assessor. On lands where federal jurisdiction is exclusive, possessory interests may not be assessed because California (through its counties) has no power to tax private property located thereon.

Uncertainty about taxability can lead county assessors to overlook many of the taxable possessory interests in federal lands. It is often difficult for county assessors' staff to obtain adequate information from the federal officials in charge of certain federal reservations. The lengthy delay in responding to the county assessor's inquiry discourages all but the most aggressive staff members.

The date of federal acquisition of lands in California is very important. As we have pointed out<sup>13</sup>, prior to September 19, 1939, California generally failed to reserve the right to tax private property located in federal enclaves. Due to an urgency statute passed by the State Legislature (Chapter 710, Statutes of 1939), which took effect on that date, the state generally thereafter reserved to itself the power of taxation over lands acquired by the federal government.

---

<sup>10</sup> Chapter 3.5 of Part 0.5 of Division 1 of the Revenue and Taxation Code, titled “Change in Ownership and New Construction After the Lien Date.”

<sup>11</sup> Section 1091, California Civil Code. See Appendix 3.

<sup>12</sup> Section 1624, California Civil Code; Specifically, Condition 4. See Appendix 3.

<sup>13</sup> The Board's Letter to Assessors 77/110, dated August 15, 1977. See reference in Appendix 4.

However, date of acquisition alone is not a certain test of taxability. Some federal enclaves grew to their present size through several cessions, of which some occurred prior to 1939 and some after 1939. In addition, the federal government, through the procedure of retrocession, may lessen its degree of control over lands or may even return title to the State of California. The reverse may also occur; federal lands formerly in the public domain and once subject to federal control only in a concurrent, partial or proprietary status may be formally withdrawn from the public domain. The federal government can do this when, for instance, a military reservation is created and base security becomes a prime concern. In this event the land could be “upgraded” to the level of exclusive federal jurisdiction.

It is important that county assessors follow a threefold program with respect to federal enclaves:

- (1) Determine whether the county has the power to tax private property located within the specific enclave.
- (2) Identify taxable possessory interests existing in the federal land.
- (3) Assess and enroll these interests.

Of the three steps, the first is often the most difficult. To help county assessors determine the jurisdictional status of federal enclaves, the Assessment Standards Division has obtained limited information from the State Lands Commission and the federal General Services Agency. We recommend that county assessors contact the Board's Assessment Standards Division when they have questions about a specific federal site. We will endeavor to determine whether the enclave or portion of the enclave is subject to local property taxation.

### 3. The Role of Proposition 8

Article XIII A, Section 2(b) of the California Constitution provides that the full cash value base of real property may be reduced to reflect losses in value due to damage, destruction, or other factors. This provision, commonly referred to as “Prop 8” (from the original ballot entry in November 1978) is applicable to taxable possessory interests, which are defined in property tax statutes as real property.

Because many possessory interests are valued by the income approach via capitalization of income for an anticipated term of possession, much confusion surrounds the correct application of “Prop 8” to possessory interests. Although the Board has stated its position on declines in value relative to possessory interests<sup>14</sup>, it has become apparent from the findings of periodic assessment practices surveys and the questions directed to the Assessment Standards Division by county assessors' offices that there is still much uncertainty surrounding this “gray area.”

---

<sup>14</sup> The Board's Letter to Assessors 79/39, dated February 27, 1979. See reference in Appendix 4.

If a possessory interest becomes terminal-- that is, if actions taken by the public owner of the tax-exempt real property clearly demonstrate that the existing possessory interest will not be renewed at the end of the contract term, and that the public owner does not intend to enter into new agreements with any other private party-- there is good reason to review the possessory interest for possible reduction in taxable value pursuant to "Prop 8." In this instance, there is strong evidence that the reasonably anticipated term of possession coincides with the actual remaining contractual term. The taxable value of the possessory interest will of course be the lesser of its factored base year value or its current full cash value. For purposes of comparison, the most recent enrolled value, indexed to the appropriate lien date, will be contrasted with a current value estimate based on an up-to-date fair rent imputed for the use of the real property, capitalized at a current market yield rate, including a property tax component, for the likely remaining term of possession. Where nonrenewal is anticipated, the actual remaining contract term of possession should be used. A decline in the probable term of possession may or may not mean a decline in the taxable value of the possessory interest. The following examples will illustrate the possibilities.

A lease originally written for 15 years and assessed as a possessory interest on the basis of this anticipated term has five years remaining and cannot be renewed. There has been no change in its ownership since the base year of 1975. The rent of \$500 per month for the use of the land, which was in line with 1975 market levels, is determined to be very low when reviewed for the 1985 lien date. Current fair rent is \$1,100 per month. In addition, the yield rate of 11 percent applied to the land income for the 1975 lien date should be lowered to a current market rate of return of 7 percent for investments in comparable land. The applicable property tax rate is 1 percent. The resulting comparison looks like this:

| <u>Factored Base Year Value</u>                                | vs. | <u>Current Full Cash Value</u>                                |
|--|-----|---|
| \$50,285<br>(\$500 x 83.3216* x 1.207**)                       |     | \$54,250<br>(\$1,100 x 49.3184***)                            |
| * Present worth of one per month<br>at 12 percent for 15 years |     | ***Present worth of one per<br>month at 8 percent for 5 years |
| **Cumulative Inflation Index<br>1975-85                        |     |   |

Under these conditions, there is no "Prop 8" reduction called for, since the factored base year value is less than the current market value. If, however, the term of possession originally anticipated were 25 years and all other elements remained as above, the comparison would look like this:

| <u>Factored Base Year Value</u>                                       | vs. | <u>Current Full Cash Value</u> |
|---|-----|--------------------------------|
| \$57,300<br>(\$500 x 94.9465***** x 1.207)                            |     | \$54,250                       |
| ***** Present worth of one per<br>month at 12 percent for<br>25 years |     |                                |



Here the current full cash value of the possessory interest is less than its factored base year value, so the value on the current tax roll must be reduced.

In summary, Proposition 8 should not be indiscriminately applied to possessory interest assessments. A decreasing contractual term of possession does not necessarily mean a declining taxable value. The variables of anticipated remaining term, current market rent and market yield rate must be considered in every "Prop 8" comparison.

#### 4. Possessory Interests at Public Airports

In determining economic rents to be applied to taxable possessory interests of commercial air carriers at government-owned airports, a common problem encountered is how to treat landing fees. Some counties consider both landing fees and lease payments for exclusive-use terminal areas as economic income, while some counties exclude them. Landing fees are usually based on the gross landing of weight of an airplane and can amount to sizable charges. Their inclusion or exclusion from gross income greatly affects the value of the possessory interest. This issue affects every county in California where there are public airport facilities. Currently, landing fees are charged only to commercial air carriers, but some airport authorities are considering charging fees for private aircraft landings as well. This issue could therefore also affect the assessments of tie downs and hangar spaces for private airplanes at public airports.

Landing fees are calculated on the basis of the number of landings and takeoffs made. Ordinarily, there are written agreements, separate from the leases of exclusive-use counter and terminal areas, that require the payment of landing fees. The argument has been made that landing fees are not rent for the exclusive use of real property and that the transitory nature of landings and takeoffs defeats the essential requirement for a possessory interest of durability. It has been further argued that, because any number of commercial carriers, air taxis and private aircraft may land on and take off from the same runway, there is no exclusivity to any user's interest. Therefore, the argument concludes, landing fees are not properly part of the rent paid for the exclusive use of tax-exempt real property.

The Board of Equalization's position is that landing fees should be considered as rent paid for the use of publicly owned land and improvements. The important point is that the total economic income for all the rights in real property must be considered. It does not matter that part of the rent charged is arbitrarily allocated among commercial airlines on the basis of the frequency with which they use runways. The charges for runways, ticket counters, and office space may all be stated separately, but the focus should still be on the unit of use, which includes offices, ticketing counters, docking, parking and baggage claim areas, repair facilities and runways. The separation of charges is only a means of charging for the total rights granted on the basis of the extent of each carrier's use.

We advise counties to include landing fees in the total rent paid for use of government-owned airport facilities. Although the written agreements may specify higher square-foot charges for exclusive-use areas than for joint-use areas, this only reflects that fact that multiple users share the cost of maintaining joint-use areas. The county assessor must still value the possessory interest by reference to all the rights that make the interest viable. This includes rights to both exclusive-use and joint-use areas.

#### 5. Possessory Interests in Taxable Government-Owned Lands

The usual assessable possessory interest is an interest in nontaxable publicly owned real property. However, most possessory interests in taxable publicly owned real property subject to the provisions of Section 11 of Article XIII of the California Constitution are also subject to assessment.<sup>15</sup> The only possessory interest in such land that is excluded from taxation is a lease for agricultural purposes. Land so leased must be valued by the Phillips factor formula; in other words, just as all other taxable government-owned land is assessed. This factor is derived for each year by dividing the statewide total assessed value of land only for that fiscal year by the statewide total civilian population as of July 1 of that fiscal year. The resulting land value per capita is then divided by \$766 to obtain the factor for land assessed in 1966 and by \$856 for land assessed in 1967. There is, however, a limitation on the taxable value of possessory interests in Section 11 lands in that the aggregate value of the Section 11 assessment and all other assessments of the land cannot exceed the current market value of the land.<sup>16</sup>

The taxable value of an assessable possessory interest in taxable government-owned land should be reviewed annually through a comparison of the land's current market value, as of the lien date, the Section 11 value of the land, and the factored base year value of the possessory interest. This latter value is the full cash value of the interest as of March 1, 1975 (or, if there has been a subsequent change in ownership of the possessory interest, its full cash value as of that later date), indexed by the annual inflation factor determined pursuant to Section 51(a)(1) or (2) of the Revenue and Taxation Code. The possessory interest, being subject to Article XIII A, will have a definite base year and base year value, modified only by the inflation index unless there is a change in ownership (which includes a renewal of the interest by the same lessee); the Section 11 value of the land, however, changes annually as the Phillips factor changes. This means that the relationship between the taxable value of the possessory interest and the value of the land calculated according to Section 11 is constantly shifting. In addition, the current market value of the land without regard to either Proposition 13 or Section 11 may change from year to year. It is possible that the allowable assessment of the possessory interest may increase if an amount lower than the factored base year value was previously enrolled, or decrease if the full amount of the factored base year value had already been previously enrolled. The maximum amount of the possessory interest assessment cannot exceed the lowest of its current market value, its factored base year value, or the amount of the difference between the current market value of the land and the current Section 11 value of the land. The following example will clarify this principle.

---

<sup>15</sup> See Property Tax Rule 21, subdivision (b) in Appendix 3.

<sup>16</sup> California Constitution, Article XIII, Section 11(f). See Appendix 3.

A long-term lease is executed for purposes of recreational development of lakefront lands abutting a reservoir which is taxable government-owned land (a source of domestic water for one county, located outside of that county). The county assessor has determined the base year value of the possessory interest in the land to be \$90,000. The Section 11 value of the land and associated water rights to the reservoir for the current roll is \$81,000. The current market value of the land and water rights is \$150,000. For the current roll, the taxable value of the possessory interest is \$150,000 - \$81,000, or \$69,000. For the next year's roll, the current market value of the land and water rights is found to be \$180,000, the factored base year value of the possessory interest is \$91,800, and the Section 11 value of land and water rights is \$87,000. The difference between current market value and Section 11 value is \$180,000 - \$87,000, or \$93,000. Since this figure exceeds factored base year value, the taxable value of the possessory interest for that year is \$91,800, its value according to Article XIII A.

The foregoing example illustrates our position that each year the separate values must be reviewed and compared to determine the allowable assessment of a possessory interest in taxable government-owned land.

#### 6. Applying the Income Approach to Value to Possessory Interests

Many possessory interests, such as grazing leases, airport tie downs, and boat slips at public marinas, lend themselves to valuation by direct capitalization of income. It is a common practice among county assessors to value such interests using actual contract rents from the subject property or from other comparable publicly owned properties.

However, in the course of conducting assessment practices surveys we have noticed that many counties capitalize net contract rents at a rate which includes a property tax component. Although we have stated that theoretically a property tax component should be included in the capitalization rate when valuing possessory interests by the income approach<sup>17</sup>, it is apparent that some counties are failing to distinguish between gross and net rents.

Fair rents derived from the market of privately owned, similar properties, wherein property taxes are anticipated as a typical cost of doing business, may be set on a gross basis, with the lessor picking up all operating costs including property taxes. However, governmental agencies, being tax exempt and therefore unconcerned with property taxes, will often charge rents on a net basis. The property taxes that result from the lessee's assessment for his or her possessory interest are usually the lessee's obligation. When capitalizing a gross rent that includes an amount for anticipated property taxes, a rate must be applied that includes a property tax component; when capitalizing a net rent, the tax component should be excluded. If a rate which includes a property tax component is used on a net income, the capitalization process will understate the full cash value of the possessory interest.

---

<sup>17</sup> See Assessors' Handbook Section 517 (1974 edition), pages 20 and 21.

Some counties also fail to consider whether other operating expenses besides property taxes are being borne by the lessor. They will capitalize a gross rent which has not been reduced by the estimated operating expenses to be paid by the tax-exempt lessor. As previously mentioned, public agencies seldom assume responsibility for the lessee's possessory interest property taxes, but they may agree to pay certain other operating costs, such as fire insurance, building maintenance, or utilities. The actual lease or other instrument creating the taxable possessory interest should be carefully reviewed to determine whether it is necessary to adjust contract rent. It is important to remember that it is the future net returns from the use of the property during the anticipated period of possession that must be capitalized into an indicator of value.

## APPENDICES

COUNTY \_\_\_\_\_

QUESTIONNAIRE FOR SPECIAL TOPIC SURVEY REGARDING  
POSSESSORY INTERESTS

I. MANAGEMENT AND STAFFING

1. Are there assessable possessory interest properties in your county?  
\_\_\_yes; \_\_\_no (If no, please note and return this questionnaire to the  
Assessment Standards Division, State Board of Equalization.)
  
2. Who (which position) in your office has direct responsibility to see that all  
assessable possessory interests are correctly and timely assessed?  
\_\_\_\_\_  
\_\_\_\_\_
  
3. Do you have separate possessory interest appraisal section (staff) or are  
possessory interests appraised by all appraisers as part of their regularly  
assigned properties or work areas?  
Special staff \_\_\_\_\_  
Part of regular work \_\_\_\_\_  
Other \_\_\_\_\_
  
4. Has your budget in recent years allowed adequate staff training in the  
identification and valuation of all types of possessory interests in your  
county? \_\_\_yes; \_\_\_no. If no, would you like to see more emphasis placed  
by the Board on courses and/or seminars on this subject? \_\_\_yes; \_\_\_no

II. SOURCES OF INFORMATION

5. What are the reliable sources of information that lead to the discovery of  
assessable possessory interest properties in your county? \_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_
  
6. Do you have an effective method to discover "renewals," "extensions,"  
"assignments," and "terminations" of possessory interests that require  
reappraisal? \_\_\_yes; \_\_\_no. If yes, would you please describe it:  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

7. Do all public agencies who own, manage, or hold public property in trust willingly provide you the information you require to assess possessory interests in accordance with current property tax laws? \_\_\_yes; \_\_\_no. Which agencies, if any, do not willingly provide you the information you require?

---

---

---

III. METHODOLOGY

8. Are there any possessory interest properties in your county that must still be assessed under the pre-De Luz court case rules? \_\_\_yes; \_\_\_no. If yes, how many properties (roll items)\_\_\_\_, and what amount of taxable value \$\_\_\_\_\_ (1982 roll).

9. Have you experienced severe difficulty in applying the concept of "exclusive use" in establishing the existence of any assessable possessory interests? \_\_\_yes; \_\_\_no. If yes, what types of properties?\_\_\_\_\_

---

---

10. Have you experienced severe difficulty in using "anticipated" rather than "contract" terms of possession in the assessment of possessory interests? \_\_\_yes; \_\_\_no. If yes, please note the types of properties and the circumstances:

---

---

---

---

11. Have you experienced difficulty in estimating "economic income" from the unrestricted market for the assessment of possessory interests? \_\_\_yes; \_\_\_no. If yes, what type of properties?

---

---

---

12. Month-to-month tenancies are considered to be "annual renewals." Have you experienced difficulty with this concept? \_\_\_yes; \_\_\_no. If yes, why?

\_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

IV. WORKLOAD AND STAFF PRODUCTIVITY

13. How many possessory interests (total roll items) were assessed in your county for the following years and what was the total taxable value each year?

|      | <u>Number</u> | <u>Total taxable value</u> |
|------|---------------|----------------------------|
| 1980 | _____         | _____                      |
| 1981 | _____         | _____                      |
| 1982 | _____         | _____                      |

14. How many possessory interest appraisals were completed by your staff for the following years and what was the total taxable value each year?

|      | <u>Number</u> | <u>Total taxable value</u> |
|------|---------------|----------------------------|
| 1980 | _____         | _____                      |
| 1981 | _____         | _____                      |
| 1982 | _____         | _____                      |

Note special circumstances that had an impact on these figures:

\_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

15. How many appraiser years were required to complete the appraisals reported in question number 14?

1980 \_\_\_\_\_ years

1981 \_\_\_\_\_ years

1982 \_\_\_\_\_ years



Note any circumstances that had a favorable or unfavorable impact on these numbers:

---

---

---

---

---

---

16. How many clerical years were required to complete the appraisals reported in question number 14?

1980 \_\_\_\_\_ years  
1981 \_\_\_\_\_ years  
1982 \_\_\_\_\_ years

Note any circumstances that had a favorable or unfavorable impact on these numbers: \_\_\_\_\_

---

---

---

---

V. STATISTICS

17. If there are assessable possessory interest grazing rights in your county, please list the current highest, lowest, and average rent per acre and per AUM used in your appraisals.

| <u>Per Acre</u> |         |         | <u>Per AUM</u> |         |         |
|-----------------|---------|---------|----------------|---------|---------|
| High            | Low     | Average | High           | Low     | Average |
| \$_____         | \$_____ | \$_____ | \$_____        | \$_____ | \$_____ |

18. If there are assessable possessory interests in pleasure and light commercial aircraft tie downs in your county, please list the current longest, shortest, and average term of possession you used in your appraisals.

| <u>Longest</u> | <u>Shortest</u> | <u>Average</u> |
|----------------|-----------------|----------------|
| _____yrs       | _____yrs        | _____yrs       |



VI. Mining and Quarrying Properties

24. Please list the number and total taxable value of assessable possessory interests in mining properties in your county for the following years:

|      | <u>Number</u> | <u>Assessed Value</u> |
|------|---------------|-----------------------|
| 1980 | _____         | _____                 |
| 1981 | _____         | _____                 |
| 1982 | _____         | _____                 |

25. Please list the major types of material mined under possessory interest agreements in your county: \_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

26. Please list the number and taxable value of assessable possessory interests in quarrying property in your county:

|      | <u>Number</u> | <u>Assessed Value</u> |
|------|---------------|-----------------------|
| 1980 | _____         | _____                 |
| 1981 | _____         | _____                 |
| 1982 | _____         | _____                 |

27. Please list the major types of material taken from possessory interest quarries in your county: \_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

VII. SPECIAL METHODOLOGY

28. Are there any particularly unusual possessory interest properties in your county? (Describe) \_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

29. Have you developed any special methodology or appraisal techniques that you feel could be useful to other assessing officers in the assessment of possessory interests? If so, please enclose a brief discussion of your findings.

POSSESSORY INTEREST STATISTICS

A. (Question 8 – 57 counties responded)

(1) Number of pre-De Luz possessory interests assessed on 1982-83 roll:  
77

(2) Total taxable value of pre-De Luz possessory interests on 1982-83 roll:  
Approximately \$49.7 million

B. (Question 13 - 42 counties responded)

(1) Number of possessory interests assessed:  
1980-81 roll: Approximately 54,000  
1981-82 roll: Approximately 60,000  
1982-83 roll: Approximately 64,000

(2) Total taxable value of possessory interests assessed:  
1980-81 roll: Approximately \$4.15 billion  
1981-82 roll: Approximately \$6.57 billion  
1982-83 roll: Approximately \$7.29 billion

C. (Question 15 - 44 counties responded)

Number of appraiser years required to complete appraisals indicated in B:  
1980-81 roll: Approximately 22  
1981-82 roll: Approximately 25  
1982-83 roll: Approximately 26

D. (Question 16 – 40 counties responded)

Number of clerk years required to complete appraisals indicated in B:  
1980-81 roll: Approximately 13  
1981-82 roll: Approximately 13  
1982-83 roll: Approximately 13

E. (Question 24 – 42 counties responded)

(1) Total number of possessory interests assessed in mining properties:  
1980-81 roll: 9,027  
1981-82 roll: 10,428  
1982-83 roll: 12,961

- (2) Total taxable value of possessory interests in mining properties:
  - 1980-81 roll: Approximately \$991 million
  - 1981-82 roll: Approximately \$1.11 billion
  - 1982-83 roll: Approximately \$1.175 billion

F. (Question 26 – 39 counties responded)

- (1) Total number of possessory interests assessed in quarries:
  - 1980-81 roll: 34
  - 1981-82 roll: 43
  - 1982-83 roll: 56
  
- (2) Total taxable value of possessory interests in quarries:
  - 1980-81 roll: \$13,378,103
  - 1981-82 roll: \$14,152,195
  - 1982-83 roll: \$13,728,446

## POSSESSORY INTEREST STATUTES

### A. CONSTITUTIONAL PROVISIONS

Article XIII, Section 11. Lands owned by local governments that are outside their boundaries. (a) Lands owned by a local government that are outside its boundaries, including rights to use or divert water from surface or underground sources and any other interests in lands, are taxable if (1) they are located in Inyo or Mono County and (a) they were assessed for taxation to the local government in Inyo County as of the 1966 lien date, or in Mono County as of the 1967 lien date, whether or not the assessment was valid when made, or (b) they were acquired by the local government subsequent to that lien date and were assessed to a prior owner as of that lien date and each lien date thereafter, or (2) they are located outside Inyo or Mono County and were taxable when acquired by the local government. Improvements owned by a local government that are outside its boundaries are taxable if they were taxable when acquired or were constructed by the local government to replace improvements which were taxable when acquired.

(b) Taxable land belonging to a local government and located in Inyo County shall be assessed in any year subsequent to 1968 at the place where it was assessed as of the 1966 lien date and in an amount derived by multiplying its 1966 assessed value by the ratio of the statewide per capita assessed value of land as of the last lien date prior to the current lien date to \$766, using civilian population only. Taxable land belonging to a local government and located in Mono County shall be assessed in any year subsequent to 1968 at the place where it was assessed as of the 1967 lien date and in an amount determined by the preceding formula except that the 1967 lien date, the 1967 assessed value, and the figure \$856 shall be used in the formula. Taxable land belonging to a local government and located outside of Inyo and Mono counties shall be assessed at the place where located and in an amount that does not exceed the lower of (1) its fair market value times the prevailing percentage of fair market value at which other lands are assessed and (2) a figure derived in the manner specified in this section for land located in Mono County.

If land acquired by a local government after the lien date of the base year specified in this Section was assessed in the base year as part of a larger parcel, the assessed value of the part in the base year shall be that fraction of the assessed value of the larger parcel that the area of the part is of the area of the larger parcel.

If a local government divests itself of ownership of land without water rights and this land was assessed in Inyo County as of the 1966 lien date or in Mono County as of the 1967 lien date, the divestment shall not diminish the quantity of water rights assessable and taxable at the place where assessed as of that lien date.

(c) In the event the Legislature changes the prevailing percentage of fair market value at which land is assessed for taxation, there shall be used in the computations required by Section 11(b) of this Article, for the first year for which the new percentage is applicable, in-lieu of the statewide per capita assessed value of land as of the last lien date prior to the current lien date, the statewide per capita assessed value of land on the prior lien date times the ratio of the new prevailing percentage of fair market value to the previous prevailing percentage.

(d) If, after March 1954, a taxable improvement is replaced while owned by and in possession of a local government, the replacement improvement shall be assessed, as long as it is owned by a local government, as other improvements are except that the assessed value shall not exceed the product of (1) the percentage at which privately owned improvements are assessed times (2) the highest full value ever used for taxation of the improvement that has been replaced. For purposes of this calculation, the full value for any year prior to 1967 shall be conclusively presumed to be 4 times the assessed value in that year.

(e) No tax, charge, assessment, or levy of any character, other than those taxes authorized by Sections 11(a) to 11(d), inclusive, of this Article, shall be imposed upon one local government by another local government that is based or calculated upon the consumption or use of water outside the boundaries of the government imposing it.

(f) Any taxable interest of any character, other than a lease for agricultural purposes and an interest of a local government, in any land owned by a local government that is subject to taxation pursuant to Section 11(a) of this Article shall be taxed in the same manner as other taxable interests. The aggregate value of all the interests subject to taxation pursuant to Section 11(a), however, shall not exceed the value of all interests in the land less the taxable value of the interest of any local government ascertained as provided in Sections 11(a) to 11(e), inclusive, of this Article.

(g) Any assessment made pursuant to Sections 11(a) to 11(d), inclusive, of this Article shall be subject to review, equalization, and adjustment by the State Board of Equalization, but an adjustment shall conform to the provisions of these Sections.

## B. ADMINISTRATIVE CODE SECTIONS

### Rule 21. Possessory Interest Definitions.

The following definitions govern the construction of the words in the rules pertaining to possessory interests.

- (a) "Possessory interest" means an interest in real property which exists as a result of possession, exclusive use, or a right to possession or exclusive use of land and/or improvements unaccompanied by the ownership of a fee simple or life estate in the property. Such an interest may exist as the result of:
- (1) A grant of a leasehold estate, an easement, a profit a prendre, or any other legal or equitable interest of less than freehold, regardless of how the interest is identified in the document by which it was created, provided the grant confers a right of possession or exclusive use which is independent, durable, and exclusive of rights held by others in the property;
  - (2) Actual possession by one intending to use the property to the exclusion of any other interfering use, irrespective of any semblance of actual title or right.

- (b) "Taxable possessory interest" means a possessory interest in nontaxable publicly owned real property, as such property is defined in section 104 of the Revenue and Taxation Code, and in taxable publicly owned real property subject to the provisions of sections 3(a), (b) and 11, Article XIII of the Constitution.

Excluded from the meaning of "taxable possessory interest" is any possessory interest in real property located within an area to which the United States has exclusive jurisdiction concerning taxation. Such areas are commonly referred to as federal enclaves.

- (c) "Possession" means:
- (1) Actual possession, constituting the occupation of land or improvements with the intent of excluding any occupation by others that interferes with the possessor's rights, or
  - (2) Constructive possession, which occurs when a person, although he is not in actual possession of land or improvements, has a right to possession and no person occupies the property in opposition to such right.
- (d) "Possessor" means the party in possession or having exclusive use.
- (e) "Exclusive use" means the enjoyment of a beneficial use of land or improvements, together with the ability to exclude from occupancy by means of legal process others who interfere with that enjoyment. Co-tenants may each make such use of land or improvements without impairing the other's right to use the property, as this constitutes but a single use jointly enjoyed. Exclusive use is not destroyed by one or more of the following:
- (1) Multiple use by persons making different uses of the same property in such a manner that they do not prevent the enjoyment of co-existing rights held by others, as, for example, the development of mineral resources by one person and the enjoyment of recreational uses by others;
  - (2) Concurrent use when the extent of each party's use is limited by the other party's right to use the property at the same time, as for example, when two or more parties each have the independent right to graze cattle on the same land;
  - (3) Alternating use when the duration of each party's use is limited, as, for example, the use of premises by a professional basketball team on certain days of each week and by a professional hockey team on certain other days;



- (4) Persons lawfully passing over or taking things from the land;
  - (5) The existence of noninterfering easements, covenant rights, or servitudes in other persons or attached to other lands;
  - (6) Occasional trespassers.
- (f) "Contract rent" means payment in money or in kind for the right to use real property as required by the terms of the possessory interest agreement. It includes royalty payments and other rights to share in production, the value that the public owner is expected to realize from improvements erected at the expense of the possessor which will remain when the possessory interest terminates, and any other form of compensation paid or payable for the right to occupy the property. It does not, however, include payments for services such as utilities and janitorial labor or for the use of property not subject to the possessory interest.
- (g) "Economic rent" means the amount that would be paid in money or kind for the right to use real property if (1) the contract rent were currently negotiated under the conditions which exist in a free and competitive market and (2) the fee owner paid property taxes on the value of the fee.
- (h) "Extended or renewed" means the lengthening of the term of possession of agreement by mutual consent or by the exercise of an option by either party to the agreement.
- (i) "Created" includes (1) the addition of land or improvements not previously subject to the agreement and (2) the addition of valuable permitted uses not previously permitted.

Rule 22. Continuity of Possessory Interests.

- (a) The continuity of possession or exclusive use necessary to establish a possessory interest will vary according to the location and character of the property. The continuity of use necessary for finding a possessory interest to exist is satisfied when the possessor of the property uses it to substantially the same extent as would an owner engaged in the same activity.
- (b) Standards for determining the existence of taxable possessory interests based on continuity are:
- (1) Actual or constructive possession or exclusive use of property on the lien date for the current year.

- (2) Recurrent possession or exclusive use, whether or not the period extends through the lien date, when there is a history on the lien date of recurring use by the present or former possessors making a similar use of the property.
- (3) Infrequent actual possession or exclusive use on a recurrent basis when the continuation of the right to possession or exclusive use is conditioned on or evidenced by the possessor having made a contribution to the value of the property by way of investment on or near the property occupied.

Rule 23. Written Agreements as to Term of Possessory Interest.

(a) When a written instrument creating a possessory interest specifies a period of occupancy which is to exist, the stated period shall be taken as the term of possession for purposes of valuation except as provided in this section. An option period shall be considered part of the stated period if it is reasonable to conclude that the option will be exercised.

(b) Should a period thus determined be in conflict with the reasonably anticipated term of possession by the possessor and any successor to or assignee of the property interest, the reasonably anticipated term of possession, whether shorter or longer, shall be used instead of the stated period. In determining the reasonably anticipated term of possession, the assessor shall be guided by the intent of the public owner and the possessor, as indicated by such evidence as (1) sale price of the subject or similar possessory interests, (2) the history of the property's use, (3) the policy of the public agency administering the lands, and (4) the actions of the possessor. No reduction or increase of the specified period shall be based on life expectancy of the possessor if it is reasonably anticipated that possession will continue under his successors or assigns.

(c) When there is no stated term of possession, the term shall be determined in accordance with subsection (b).

Rule 24. Possessory Interest Rights to be Valued.

Except as otherwise provided in sections 26 and 27 of this title, the taxable value of a possessory interest is the sum of the value of all property rights in land and improvements held by the possessor. This value is not diminished by any obligation to pay rent or to retire debt secured by the possessory interest. Stated in other terms, the taxable value of a possessory interest is the value of the fee simple estate reduced by the value of any rights, except security interests, held by the public owner (other than the right to receive rent) or granted by the public owner to other persons. Examples of rights held by the public owner are:

- (a) The right to take possession of the property upon termination of the possessory interest by reason of expiration of the term or the happening of a condition or breach of a limitation contained in the agreement granting possession.

- (b) The right to put the property to a higher and better use or otherwise restrict the possessor's use of the property.
- (c) The right to terminate possession on notice.
- (d) The right to approve a sublessee or assignee.
- (e) The right to approve a loan secured by the possessory interest.

Rule 25. Valuation of Post-De Luz Possessory Interests.

The value of a taxable possessory interest created, extended, or renewed after December 24, 1955 (other than one for production of gas, petroleum, or other hydrocarbons) may be measured by one or more of the following methods:

- (a) The "comparative sales approach," wherein the possessory interest is valued by either direct or indirect comparison as follows:

In the indirect comparison method, the subject property is compared with itself on the date of a prior or subsequent sale or with similar possessory interests which have been sold on dates prior or subsequent to the date as of which the property is being valued. To the sale price of such an interest there shall be added (1) the present worth of any unpaid future contract rents for the estimated remaining term of possession, (2) the value of any debt (other than the debt for future rents) assumed by the purchaser of the possessory interest, and (3) the present worth of any obligated cost of the purchaser, such as the cost of site restoration at the end of the term, less the present worth of any contractual benefits to the purchaser, such as salvage value of, or reimbursement for, improvements at the end of the term. The interest sold should be reasonably comparable to the possessory interest being valued in location, physical characteristics, terms of possession, risk of cancellation, and permitted use.

In the indirect comparison method, the value of the possessor's rights is first measured as if perpetual by comparison with fee interests which have been sold, which have similar locations and physical characteristics, and for which the highest and best use corresponds to or is comparable with the permitted use of the property subject to the possessory interest. This value is reduced by the present worth of those rights for the period subsequent to the estimated term of possession. This method is not well suited to valuation of a short-term possessory interest when the fee interests in the comparable properties are sold at prices that appear to reflect the expectation of higher incomes after the expiration of the possessory interest than during its existence.

- (b) The "income approach," wherein the possessory interest is valued either directly by capitalizing all future net income that the possessory interest is capable of generating under typical management during the estimated term of possession, or indirectly by first capitalizing the net income to estimate the value of the possessor's rights as if perpetual and then deducting the present worth of those rights for the period subsequent to the term of the possessory interest.

The direct income method is preferred over the indirect income method when the remaining economic life of wasting assets does not exceed the estimated term of possession or when a constant income stream is projected. The indirect income method is preferred when the remaining economic life of wasting assets exceeds the estimated term of possession.

The net income to be capitalized is either the imputed economic rent, which may be estimated by reference to rentals recently negotiated in a competitive market or, if such evidence is inadequate, by reference to the anticipated gross income of a typical operator of the property subject to the possessory interest, less cost of goods sold and typical management and other operating expenses. When the second of these methods of estimating economic rent is employed, the "other operating expenses" to be deducted do not include amortization, depreciation, depletion charges, debt retirement, interest on funds invested in the possessory interest, the contract rent for the possessory interest, property taxes on the possessory interest, income taxes, or state franchise taxes measured by income.

The imputed economic rent or gross income estimate is to reflect the restrictions on use inherent in the possessory interest.

When using a recently negotiated or percentage contract rent for a possessory interest as an indicator of the economic rent, the appraiser shall:

- (1) Include in the contract rent his estimate of the amount, if any, by which the cash or share rent has been reduced because the possessor has assumed the cost of improvements that will revert to the public owner of expiration of the possessory interest;
- (2) Add to the contract rent his estimate of the taxes that will be paid on the possessory interest if the capitalization rate contains a property tax component;
- (3) Add to the contract rent his estimate of the amount, if any, by which the contract rent was reduced because the possessor has agreed to bear the cost of restoring the property to its original condition when it reverts to the public owner, or the cost of removing improvements and restoring the site to its original condition (less any estimated salvage value), or any similar obligations.

The capitalization rate shall be derived (1) by extraction of a rate from sales prices of comparable possessory interests or from sale prices of fee interests in similar properties that are not expected to yield substantially higher incomes after expiration of the possessory interest being valued than during its existence or (2) by combining weighted components for debt and equity yields as described in section 8, subsection (g)(2) of this chapter. In either case, the capitalization rate shall include a property tax component as required by section 8, subsection (f) of this chapter when the property tax has not been netted out of the rent or other income being capitalized.

- (c) The "cost approach," wherein the cost of replacing reproducible property with new property which offers utility that will satisfy the requirements of the possessor's permitted use, less accrued depreciation and less the present worth of the estimated value, if any, of such property at the termination of possession, is added to the value of the restricted right to occupy the land for the limited term derived by the comparative sales or income method.

Rule 26. Valuation of Pre-De Luz Possessory Interests.

The value of a taxable possessory interest created prior to December 25, 1955, and not since extended or renewed (other than one for the production of gas, petroleum, or other hydrocarbons) is the excess of the market value of the possessory interest over the present worth of unpaid future contract rents for the unexpired term of possession. Such value may be measured by one or more of the following methods:

- (a) The "comparative sales approach," wherein the possessor's interest is valued either directly or indirectly as previously described in section 25, subsection (a), except that, in the direct comparison method, the present worth of unpaid future contract rents is not added to the sale price of a possessory interest and, in the indirect comparison method, the value of a fee interest is reduced by the present worth of unpaid future contract rents of the possessory interest being appraised as well as by the present worth of the property rights for the period subsequent to the estimated term of possession.
- (b) The "income approach," wherein the possessor's interest is valued either directly or indirectly as described in section 25, subsection (b), except that, in the direct method, the unpaid future contract rents, as well as other expenses, are deductible and, in the indirect method, the present worth of unpaid future contract rents, as well as the present worth of the property rights for the period subsequent to the term of the possessory interest, is deductible.
- (c) The "cost approach," wherein the possessor's interest is valued as described in section 25, subsection (c), and the present worth of any unpaid future contract rents for the term of the possessory interest is deducted.

Rule 27. Valuation of Possessory Interests for the Production of Hydrocarbons.

(a) The taxable value of all possessory interests for the production of gas, petroleum, and other hydrocarbon substances from beneath the surface of the earth shall be determined by application of the comparative sales or income approach in the manner prescribed in subsection (a) or (b) of section 25 except as provided in subsection (b) of this section.

(b) The taxable value of a possessory interest for the production of hydrocarbon substances from beneath the surface of the earth shall be determined by application of the comparative sales or income approach in the manner prescribed in subsection (a) or (b) of section 26 if:

- (1) the interest was created or last extended or renewed on or before July 26, 1963, and the rate of royalties or other right to share in production was not reduced because of an increase in the assessed value of such interest or
- (2) the interest was created on or before July 26, 1963, and has been extended or renewed thereafter pursuant to authority which prohibits reduction of the rate of royalty or other right to share in production because of an increase in the assessed value of such interest.

Rule 28. Examples of Taxable Possessory Interests

The following are examples of commonly encountered taxable possessory interests:

(a) The right to explore for, capture, and reduce to possession gas, petroleum, and other hydrocarbons in public lands.

(b) The possession of an employee in housing owned by a public agency, irrespective of whether occupancy of the housing is a condition of employment except when the facility also serves as the employee's work area to which the employer has full access.

(c) The right to cut and remove standing timber on public lands.

(d) The right to graze livestock or raise forage on public lands.

(e) The possession of public property at harbors, factories, airports, golf courses, marinas, recreation areas, parks, and stadiums. Possessory interests may include land subject to the ultimate grant of a United States patent, commercial and industrial sites, and water rights.

C. CIVIL CODE SECTIONS

§1091. Method of transfer

Requisites for transfer of certain estates. An estate in real property, other than an estate at will or for a term not exceeding one year, can be transferred only by operation of law, or by an instrument in writing, subscribed by the party disposing of the same, or by his agent thereunto authorized by writing.

§1624. Statute of frauds

The following contracts are invalid, unless the same, or some note or memorandum thereof, is in writing and subscribed by the party to be charged or by his agent:

- (1) An agreement that by its terms is not to be performed within a year from the making thereof;
- (2) A special promise to answer for the debt, default, or miscarriage of another, except in the cases provided for in Section 2794;
- (3) An agreement made upon consideration of marriage other than a mutual promise to marry;
- (4) An agreement for the leasing for a longer period than one year, or for the sale of real property, or of an interest therein; and such agreement, if made by an agent of the party sought to be charged, is invalid, unless the authority of the agent is in writing, subscribed by the party sought to be charged;
- (5) An agreement authorizing or employing an agent, broker, or any other person to purchase or sell real estate, or to lease real estate for a longer period than one year, or to procure, introduce, or find a purchaser or seller of real estate or a lessee or lessor of real estate where such lease is for a longer period than one year, for compensation or a commission;
- (6) An agreement which by its terms is not to be performed during the lifetime of the promisor;
- (7) An agreement by a purchaser of real property to pay an indebtedness secured by a mortgage or deed of trust upon the property purchased, unless assumption of said indebtedness by the purchaser is specifically provided for in the conveyance of such property.

D. REVENUE AND TAXATION CODE SECTIONS

§61. "Change in ownership" includes. Except as otherwise provided in Section 62, change in ownership, as defined in Section 60, includes, but is not limited to:

(a) The creation, renewal, sublease, assignment, or other transfer of the right to produce or extract oil, gas, or other minerals for so long as they can be produced or extracted in paying quantities. The balance of the property, other than the mineral rights, shall not be reappraised pursuant to this section.

(b) The creation, renewal, sublease, or assignment of a taxable possessory interest in tax exempt real property for any term. (Emphasis added)

(c) (1) The creation of a leasehold interest in taxable real property for a term of 35 years or more (including renewal options), the termination of a leasehold interest in taxable real property which had an original term of 35 years or more (including renewal options), and any transfer of a leasehold interest having a remaining term of 35 years or more (including renewal options); or (2) any transfer of a lessor's interest in taxable real property subject to a lease with a remaining term (including renewal options) of less than 35 years.

Only that portion of a property subject to such lease or transfer shall be considered to have undergone a change of ownership.

For the purpose of this subdivision, for 1979-80 and each year thereafter, it shall be conclusively presumed that all homes eligible for the homeowners' exemption, other than mobilehomes located on rented or leased land and subject to taxation pursuant to Part 13 (commencing with Section 5800), which are on leased land have a renewal option of at least 35 years on the lease of such land, whether or not in fact such renewal option exists in any contract or agreement.

(d) The creation, transfer, or termination of any joint tenancy interest, except as provided in subdivision (f) of Section 62, Section 63 and in Section 65.

(e) The creation, transfer, or termination of any tenancy-in-common interest, except as provided in subdivision (a) of Section 62 and in Section 63.

(f) Any vesting of the right to possession or enjoyment of a remainder or reversionary interest which occurs upon the termination of a life estate or other similar precedent property interest, except as provided in subdivision (d) of Section 62 and in Section 63.

(g) Any interests in real property which vest in persons other than the trustor, (or, pursuant to Section 63, his spouse) when a revocable trust becomes irrevocable.



(h) The transfer of stock of a cooperative housing corporation, as defined in Section 17265, vested with legal title to real property which conveys to the transferee the exclusive right to occupancy and possession of such property, or a portion thereof.

(i) The transfer of any interest in real property between a corporation, partnership, or other legal entity and a shareholder, partner, or any other person.

§104. "Real estate," "real property." "Real estate" or "real property" includes:

(a) The possession of, claim to, ownership of, or right to the possession of land.

(b) All mines, minerals, and quarries in the land, all standing timber whether or not belonging to the owner of the land, and all rights and privileges appertaining thereto.

(c) Improvements.

§107. "Possessory interests." "Possessory interests" means the following:

(a) Possession of, claim to, or right to the possession of land or improvements, except when coupled with ownership of the land or improvements in the same person.

(b) Taxable improvements on tax-exempt land.

Any possessory interest may, in the discretion of the county board of supervisors, be considered as sufficient security for the payment of any taxes levied thereon and may be placed on the secured roll.

Leasehold estates for the production of gas, petroleum and other hydrocarbon substances from beneath the surface of the earth, and other rights relating to such substances which constitute incorporeal hereditaments or profits a prendre, are sufficient security for the payment of taxes levied thereon. Such estates and rights shall not be classified as possessory interests, but shall be placed on the secured roll.

If the tax on any possessory interest or leasehold estate for the production of gas, petroleum and other hydrocarbon substances is unpaid when any installment of secured taxes become delinquent, the tax collector may use those collection procedures which are available for the collection of assessments on the unsecured roll.

If the tax on any possessory interest or leasehold estate for the production of gas, petroleum and other hydrocarbon substances remains unpaid at the time set for the sale to the state for taxes carried on the secured roll, such possessory interest tax together with any penalty

and costs which may be accrued thereon while on the secured roll shall be transferred to the unsecured roll.

Appendix 3  
Page 13 of 20

§107.1. Valuation of certain possessory interests. The full cash value of a possessory interest, when arising out of a lease of exempt property, is the excess, if any, of the value of the lease on the open market, as determined by the formula contained in the case of *De Luz Homes, Inc. v. County of San Diego* (1955), 45 Cal. 2d 546, over the present worth of the rentals under said lease for the unexpired term thereof.

A possessory interest taxable under the provisions of this section shall be assessed to the lessee on the same basis or percentage of valuation employed as to other tangible property on the same roll.

This section applies only to possessory interests created prior to the date on which the decision of the California Supreme court in *De Luz Homes, Inc. v. County of San Diego* (1955), 45 Cal. 2d 546, became final. It does not, however, apply to any of such interests created prior to that date that thereafter have been, or may hereafter be, extended or renewed, irrespective of whether the renewal or extension is provided for in the instrument creating the interest.

This section does not apply to leasehold estates for the production of gas, petroleum and other hydrocarbon substances from beneath the surface of the earth, and other rights relating to such substances which constitute incorporeal hereditaments or profits a prendre.

§107.2. Valuation of certain oil and gas interests. The full cash value of leasehold estates in exempt property for the production of gas, petroleum and other hydrocarbon substances from beneath the surface of the earth, and all other taxable rights to produce gas, petroleum and other hydrocarbon substances from exempt property (all of which rights are hereinafter in this section referred to as "such oil and gas interests"), is the value of such oil and gas interests exclusive of the value of any royalties or other rights to share in production from exempt property owned by any tax-exempt entity, whether receivable in money or property and whether measured by or based upon production or income or both.

This section applies to such oil and gas interests created prior to the date on which the decision in *De Luz Homes, Inc. v. County of San Diego* (1955) 45 Cal. 2d 546, became final. This section does not, however, apply to any of such oil and gas interests created prior to such date which have been after such date or are hereafter extended or renewed, unless such extension or renewal is pursuant to authority in a contract, lease, statute, regulation, city charter, ordinance, or other source, which authority permits no reduction of the rate of royalty or other right to share in production on grounds of an increase in the assessed valuation of such oil and gas interest. Moreover, this section does not apply to any of such oil and gas interests if the rate of royalties or other right to share in production has, prior to the effective date of this section, been reduced to adjust for the fact that certain assessors have valued such oil and gas interests without excluding the value of said royalties or other rights to share in production.

§107.3. Valuation of certain oil and gas interests—extended. The full cash value of leasehold estates in exempt property for the production of gas, petroleum and other hydrocarbon substances from beneath the surface of the earth and all other taxable rights to produce gas, petroleum and other hydrocarbon substances from exempt property (all of which rights are hereinafter in this section referred to as "such oil and gas interests"), is the value of such oil and gas interests, exclusive of the value of any royalties or other rights to share in production from exempt property owned by any tax-exempt entity, whether receivable in money or property and whether measured by or based upon production or income or both.

This section applies to:

(a) Such oil and gas interests created prior to the date on which the decision in *De Luz Homes, Inc. v. County of San Diego* (1955) 45 Cal. 2d 546, became final to which Section 107.2 of this code does not apply because said interests were extended or renewed on or before July 26, 1963.

(b) Such oil and gas interests created on or after the date on which said decision became final and on or before July 26, 1963.

This section does not, however, apply to any of such oil and gas interests extended or renewed after July 26, 1963, unless such extension or renewal is pursuant to authority in a contract, lease, statute, regulation, city charter, ordinance or other source which authority permits no reduction of the rate of royalty or other right to share in production upon the ground of an increase in the assessed valuation of such oil and gas interest. Moreover, this section does not apply to any of such oil and gas interests if the rate of royalties or other right to share production has, prior to the effective date of this section, been reduced to adjust for the fact that certain assessors have valued such oil and gas interests without excluding the value of said royalties or other rights to share in production.

§107.4. "Possessory interest." For purposes of Section 107, "possessory interest" shall not include the possession of, claim to, or right to the possession of any berth, wharf, dock, pier, or similar harbor facility owned by a city, city and county, county, or harbor or port district, if such possession, claim, or right is granted for nonexclusive use of such berth, wharf, dock, pier, or similar harbor facility. Any nonexclusive possession, claim, or right described in this section shall not be subject to property taxation.

If the possession of, claim to, or right to the possession of, any such berth, wharf, dock, pier, or similar harbor facility is, in fact, exclusive, it shall be subject to property taxation, regardless of the manner in which such possession, claim, or right is created.

As used in this section, a "nonexclusive possession, claim, or right" means a right to the use of a specific berth, wharf, dock, pier, or similar harbor facility, when such specific facility is also used intermittently by others, even though such possession, claim, or right to use such facility is paramount to any use by others.

As used in this section, a "nonexclusive possession, claim, or right" includes a right to the use of a specific berth, wharf, dock, pier, or similar harbor facility, when the owner reserves the right to assign to others the right to use such facility.

§107.5. "Possessory interest"--"improvement"; "constructively affixed, attached, or annexed." [Operative January 1, 1985.] For purposes of Section 107, "possessory interest" as it applies to property owned by any agency of the government of the United States means possession of, claim to, or right to the possession of, land or improvements. "Improvements" include all buildings, structures, fixtures, and fences erected on or affixed to the land.

"Improvements" as it applies to property owned by an agency of the government of the United States mean items which are permanently affixed to land such as buildings, structures, fixtures, fences and movable items which have become a part of real property by having been physically incorporated therein or permanently affixed thereto. Items shall be considered physically incorporated or permanently affixed when they have lost their separate identity and have become an integral and inseparable part of the real property and perform functions usually associated with a building such as furnishing shelter, heating and cooling for the comfort of people, lighting, and other normal building functions, or are attached pursuant to Section 660 of the Civil Code. Items such as basic plumbing, heating and cooling, primary electrical lighting, and other essential building appurtenances are a part of the building to make the building useful in the normal course of business.

All other personal property owned by the United States government, including, but not limited to, machinery, general and special purpose equipment, dimensional tooling, special test equipment and furniture which is related to the commercial or industrial operations conducted within the building and which performs a testing, processing, research, manufacturing, computing, recording, or any similar function shall remain personal property, and shall not be construed to be constructively affixed, attached, or annexed to the realty, even though connected to improvements by power wiring, plumbing, or similar connections.

"Constructively affixed, attached, or annexed" means an item of personal property becomes a fixture if its function makes it a necessary integral part of the realty. The factors to be used in determining the necessary or integral nature of a nonattached item are all of the following:

(a) Whether it is specifically designed for use only with property permanently attached to the realty.

Appendix 3  
Page 16 of 20

(b) Whether the items can perform the functions desired by the designer without the nonattached items.

Personal property is not considered to be constructively affixed, attached, or annexed to the realty solely by reason of the fact that it merely rests on the floor (not in the manner specified by Section 660 of the Civil Code), or on a raised flooring and is connected to the realty by means of power or electronic cable which was installed in a trench under the floor, under raised flooring above the floor, on overhead racks, or any other similar means, merely for safety purposes or regulatory requirements. The personal property shall not be deemed to be constructively affixed, attached, or annexed to the realty solely by reason of the fact that it is connected to the realty by any other conduit such as a heating, cooling, or ventilation duct, the purpose of which is to provide for the proper functioning of the equipment and not of the building or the environment within it.

For purposes of this section, if the nature of use of an item of property is insufficient to determine whether the item is an improvement, the item shall not be considered an improvement unless: (1) removal would cause substantial damage to either the item or to the real estate to which the item is attached; or (2) the item is attached to the realty in such a manner that it is considered permanently affixed; or (3) in normal business situations, the item would remain as part of the realty if business operations ceased.

§107.6. Notification of taxability of possessory interests. (a) The state or any local public entity of government, when entering into a written contract with a private party whereby a possessory interest subject to property taxation may be created, shall include, or cause to be included, in such contract, a statement that such property interest may be subject to property taxation if created, and that the party in whom the possessory interest is vested may be subject to the payment of property taxes levied on such interest.

(b) Failure to comply with the requirements of this section shall not be construed to invalidate the contract. The private party may recover damages from the contracting state or local public entity, where the private party can show that without the notice, he had no actual knowledge of the existence of a possessory interest tax.

The private party is rebuttably presumed to have no such actual knowledge.

In order to show damages, the private party need not show that he would not have entered the contract but for the failure of notice.

(c) For purposes of this section:

(1) "Possessory interest" means any interest described in Section 107 and shall include any interest described in Section 107.4.

Appendix 3  
Page 17 of 20

(2) "Local public entity" shall have the same meaning as that set forth in Section 900.4 of the Government Code and shall include school districts and community college districts.

(3) "State" means the state and any state agency as defined in Section 11000 of the Government Code and Section 89000 of the Education Code.

(4) "Damages" means the amount of the possessory interest tax for the term of the contract.

§155.20. Exemption of property having low value. A county board of supervisors may exempt from property tax all real property with a base year value (as determined pursuant to Chapter 1 (commencing with Section 50) of Part 0.5, and personal property with a full value so low that, if not exempt, the total taxes, special assessments and applicable subventions on the property would amount to less than the cost of assessing and collecting them.

The board shall have no authority to exempt property with a base year value or full value of more than two thousand dollars (\$2,000).

In determining the level of the exemption, the board of supervisors shall determine at what level of exemption the costs of assessing the property and collecting taxes, assessments and subventions on such property exceeds the proceeds to be collected. The board shall establish the exemption level uniformly for classes of property. In making this determination, the board may consider the total taxes, special assessments and applicable subventions for the year of assessment only or for the year of assessment and succeeding years where cumulative revenues will not exceed the cost of assessments and collections.

This section does not apply to those real or personal properties enumerated in Section 52.

The exemption authorized by this section shall be adopted by the board on or before the lien date for the fiscal year to which the exemption is to apply and may, at the option of the board, continue in effect for succeeding fiscal years. Any revision or rescission of the exemption shall be adopted by the board on or before the lien date for the fiscal year to which that revision or rescission is to apply.

Nothing in this section shall authorize a county board of supervisors to exempt new construction of two thousand dollars (\$2,000) or less, unless the new base year value of the property, including this new construction is two thousand dollars (\$2,000) or less.

Nothing in this section shall authorize an assessor to exempt or not to enroll any property of any value, unless specifically authorized by a county board of supervisors, pursuant to this section.

Appendix 3

Page 18 of 20

§201.5. Possessory interests of California Pollution Control Financing Authority.

(a) Possessory interests in property acquired by or for the California Pollution Control Financing Authority pursuant to Division 27 (commencing with Section 44500) of the Health and Safety Code, whether in real or personal property, shall be subject to taxation under this code.

(b) If the amount determined pursuant to subdivision (a) is less than the amount of tax which would have been imposed if the participating party owned the pollution control facility, the contract or lease between the California Pollution Control Financing Authority and such party shall provide that the difference between the amount of tax paid pursuant to subdivision (a) and the amount determined on the basis of the full cash value of the property shall be paid by such party to the tax collector for the taxing agency at the same time as the property tax is paid.

§480.4. Real property usage reports. (a) Every owner of tax-exempt real property shall report to the local assessor the creation, renewal, sublease, or assignment of any lease, sublease, license, use permit, or other document which conveys the right to use that real property within 60 days of the transaction. The report shall include all of the following:

- (1) The name and address of the owner.
- (2) The names and addresses of all other parties to the transaction, including an identification of each party and of his or her possessory interest.
- (3) The type of transaction, whether creation, renewal, sublease, or assignment.
- (4) A description of the property.
- (5) The date of the transaction.
- (6) The terms of the transaction, including all of the following:
  - (A) The consideration for the possessory interest, whether paid in money or otherwise.
  - (B) The term of the possessory interest, including any renewal or extension options.
  - (C) If a sublease, the original term, the remaining term, and the consideration paid for the master lease.

(D) If an assignment, the original term, the remaining term, and the consideration paid for the underlying lease.

Appendix 3  
Page 19 of 20

(b) This section shall be applicable only in those counties in which the board of supervisors, by ordinance or resolution, specifically elects to have this section applicable in the county. This section shall remain in effect only until January 1, 1991, and as of that date is repealed, unless a later enacted statute which is chaptered on or before January 1, 1991, deletes or extends that date.

§2190. Assessment of possessory interest in tax exempt property. Notwithstanding any provision of law to the contrary, the assessment of any possessory interest in tax-exempt real estate to which the exemption authorized by Section 218 of this code has been applied shall be entered on the secured roll; provided, however, that such assessment shall not be a lien on such tax-exempt real estate and such fact shall be noted on the secured roll.

If the tax thereon is unpaid when any installment of taxes on the secured roll become delinquent, the tax collector may use the procedures which are applicable to the collection of taxes on the unsecured roll.

If the tax thereon remains unpaid at the time set for the sale to the state, the tax applicable to such possessory interest together with such penalties and costs as may accrued thereon while on the secured roll shall be transferred to the unsecured roll.

§2190.2. Possessory interests. Every tax on an assessment of a possessory interest or a tax on an assessment of improvements made pursuant to the provisions of Section 2188.2 shall become a lien on such possessory interest or such improvements, provided that in those instances where the real property that is the subject of such possessory interest or upon which such improvements are located is not tax-exempt land, the fact of such lien shall be indicated on the secured roll where the real property that is the subject of such possessory interest or upon which such improvements are located is listed.

#### E. STREETS AND HIGHWAYS CODE

§104.10. Payment of amount of rentals attributable to each county: Certification by department: Disposition of money distributed and received. The Department of Transportation shall, not later than the first day of November following the close of any fiscal year, pay the rents computed pursuant to Section 104.6 to the county in which such real property is situated. The Department of Transportation shall certify to the Department of Finance the amount of such rentals attributable to each county and shall notify each county of the rental and location of each piece of rental property for which rents are deposited in the State Highway Account in the State Transportation Fund.



The county auditor shall distribute any payment received by the county pursuant to this section, to the county, to each revenue district for which the county assesses and collects real property taxes or assessments, and to every other taxing agency within the county in which the property is situated in the amount as determined by the board of supervisors, except that one-half of the allocation for a rental property shall be allocated to the city in which the rental property is located.

As used in this section, the terms “taxing agency” and “revenue district” have the same meanings given them in the Revenue and Taxation Code.

The money received by the respective jurisdictions under this section shall be extended only for purposes authorized by Article XIX of the California Constitution.

§104.13. Department as agent for payment of possessory interest taxes due from lessees; Payment of tax by department.

(a) The department shall act as agent for the payment of possessory interest taxes due from persons to whom the department leases property of a type described in subdivision (e).

(b) The department shall annually provide a current list of all such property located in each county to the assessor of the county. Notwithstanding any other provision of law, the assessor shall submit the possessory interest tax bill for each property directly to the department, and the department shall be responsible for the payment of the tax in the manner described in subdivision (c).

(c) All funds distributed to a county pursuant to section 104.10 shall be deemed to be in full or partial payment on the total possessory interest taxes due on the property described in subdivision (e) located in the county. If the amount transferred to a county pursuant to Section 104.10 in any year is less than the total possessory interest tax due on all the property located in the county, the department shall promptly forward to the county the amount of the balance due.

(d) In-lieu of the information required by Section 107.6 of the Revenue and Taxation Code, all leases of property of a type described in subdivision (e) shall contain a statement that the department will pay all possessory interest taxes arising from the lease and that the amount of rent charged reflects the cost of this added responsibility of the department.

(e) This section shall apply only to real property held for future state highway needs and to real property originally held for that purpose, which the department has determined is no longer needed for that purpose, prior to its sale or exchange by the department.

SUMMARY OF BOARD LETTERS TO COUNTY ASSESSORS  
DEALING WITH POSSESSORY INTERESTS

| <u>Number</u> | <u>Date</u>        | <u>Highlights</u>   |
|---------------|--------------------|---|
| 75/17         | January 31, 1975   | The Department of Transportation will provide a rent credit or refund to tenants of state-owned real property acquired for highway purposes who are subject to possessory interest taxation by the county; but the amount of credit or refund will be deducted from the 24 percent of collected rents usually allocated to the county (Assembly Bill 2049). |
| 77/52         | March 28, 1977     | The appellate court decision in <u>American Airlines, Inc. v. County of Los Angeles</u> (1976) 65 Cal. App. 3d 325 does not invalidate the general application of Property Tax Rule 23(b).  |
| 77/110        | August 15, 1977    | Decision of United States Supreme Court in <u>United States et al. v. County of Fresno</u> (1977) 429 U.S. 452, 50 L.Ed. 2d 683, 97 S. Ct. 699, upholds California laws requiring assessment of property taxes for possessory interests in certain federal lands.   |
| No number     | January 3, 1978    | Public agencies leasing real property to private parties after January 1, 1978, must notify lessees that they may be liable for possessory interest taxes (Assembly Bill 253).  |
| 78/84         | May 16, 1978       | Possessory interests that qualify for the homeowners' exemption shall be entered on the unsecured roll (Assembly Bill 1535).  |
| 78/169        | September 29, 1978 | Procedures were established for valuing possessory interests in light of Proposition 13.  |

| <u>Number</u>            | <u>Date</u>       | <u>Highlights</u>   |
|--------------------------|-------------------|---|
| 78/189                   | October 25, 1978  | Any county could, by action of its board of supervisors, place all possessory interest assessments on the secured roll for the 1978-79 fiscal year only (Assembly Bill 2463).   |
| 79/39                    | February 27, 1979 | The taxable value of a possessory interest does not necessarily decline as the remaining contract term of possession shortens.  |
| (Question and Answer 12) |                   |   |
| 79/41                    | February 27, 1979 | In lease-purchase contracts between the United States and private contractors, no taxable possessory interest results from a lease of public lands executed to help the private developer obtain financing (Public Law 92-313). |
| 79/52                    | March 15, 1979    | County boards of supervisors in any county, irrespective of population, could allow non-homeowner possessory interests to be assessed on the secured roll (Senate Bill 239).  |
| 79/151                   | August 31, 1979   | The execution of a lease and sublease between a public entity and a private party can give rise to a taxable possessory interest ( <u>City of Desert Hot Springs v. County of Riverside</u> 91 Cal. App. 3d 441-1979).          |
| 79/182                   | October 16, 1979  | Neither the relocation of an aircraft to a tie down at the public airport nor the reassignment of a private boat to a different slip at a public marina are considered creations of taxable possessory interests.               |
| 80/25                    | February 19, 1980 | “Change in ownership” includes the creation, renewal, sublease, and assignment of a taxable possessory interest for any term (Assembly Bill 1488).  |

| <u>Number</u> | <u>Date</u>     | <u>Highlights</u>  |
|---------------|-----------------|--|
| 80/48         | March 21, 1980  | The State Board stated its position on taxable possessory interests involving concessionaires at public institutions of higher learning, privately owned improvements, public housing projects, and blind vendors in state-owned buildings.    |
| 82/77         | June 8, 1982    | The filing of an annual proof of labor on a mining claim is not a change in ownership of a possessory interest.  |
| 83/03         | January 6, 1983 | Public retirement systems must pay an in-lieu fee to local government for taxes lost due to the system's acquisitions of real property. Such acquisitions may also result in the creation of taxable possessory interests (Assembly Bill 662). |
| 83/81         | August 9, 1983  | The Department of Transportation will act as agent for the payment of possessory interest taxes on surplus highway property (Assembly Bill 574).   |



Assembly Bill 574

Chapter 213

July 13, 1983

The California Department of Transportation will act as agent in paying possessory interest taxes for tenants of excess state highway real property.

Assembly Bill 2922

Chapter 872

September 5, 1984

Public entities must notify the county assessor, in any county adopting an ordinance or resolution so requiring, within 60 days of conveying the right to use tax-exempt real property located in that county to any person.

AS-41-2636A