State of California

Board of Equalization
Legal Department-MIC: 83
Office of the Chief Counsel
(916) 445-4380
Fax: (916) 323-3387

# Memorandum

To: Honorable Betty T. Yee, Chairwoman
Honorable Bill Leonard
Honorable Michelle Steel
Mr. Steve Shea, Acting Board Member
Honorable John Chiang
Honorable Dan Goodwin, President, California Assessors' Association

Date: August 7, 2009

From: Kristine Cazadd
Chief Counsel *K Cazadd*

Subject: **Annual Board Meeting with County Assessors**
**Item 5 – Legal Department Discussion of Current and Emerging Issues**

This memorandum summarizes the items (electronically attached) that will be discussed in the Legal Department's portion of the August 12, 2009 Annual Board Meeting with the County Assessors.

## I. Proposition 13 – Negative Inflation Factor

Letter to Assessors (LTA) 99/53, *Application of Inflationary Factoring to Base Year Values*, concludes that base year values should not be adjusted downwards for negative California Consumer Price Index (CCPI) changes while LTA 78/100, *Proposition 13, Jarvis-Gann Initiative*, (at p. 4, Item 7) states that if the consumer price index declines, that base year values statewide would be reduced by such percentage decline. The Legal Department is currently considering whether the proper interpretation of Proposition 13's inflation factor includes reducing base year values when the CCPI is negative, and welcomes any input from the county assessors.

## II. Case Updates

A. *Phelps v. Orange County Assessment Appeals Board No. 1* (2009) 175 Cal.App.4th 448. The Court of Appeal held that a shopping center complex owned by a trust was reassessable upon the death of an income beneficiary of the trust. Petitioner argued that the transfer of the income beneficiary's interest to his four children did not qualify as a change of ownership under RTC §60 because: (1) the trust's income beneficiaries did not have a present interest in the improvements on the property because the improvements were constructed and owned by the property's lessee and sublessees; (2) the income beneficiaries did not have the beneficial use of the property because they do not hold legal title; and (3) the beneficiaries' interest in the income from the property is not substantially equal to the value of a fee interest because a lifetime income interest is inherently inferior to a fee. The Court disagreed with all of petitioner's arguments. A petition for review was filed 7/27/2009.

B. *Air China Limited v. County of San Mateo* (2009) 174 Cal.App.4th 14. A Chinese airline sought a refund and a declaration that possessory interest taxes imposed against it were prohibited by a tax treaty between China and the United States. The Court of Appeal affirmed the trial court summary judgment ruling in favor of the county, finding that the county's assessment and collection of taxes on the airline's leasehold possessory interests and landing rights at the San Francisco International Airport was proper. A petition for review was filed 6/29/2009.

**III. Board Litigation Status Update**

A. *Elk Hills Power, LLC v. State Board of Equalization, County of Kern,* San Diego County Superior Court: 37-2008-00097074-CU-MC-CTL. Plaintiff, the owner of an electric generation facility, contends that the Board improperly included the costs of emission reduction credits (ERCs) in valuing its electric generation facility, and seeks a declaratory judgment construing the provisions of RTC §§ 110 and 212 as they apply to the Board's valuation and taxation of ERCs. A summary judgment motion hearing is scheduled for October 9, 2009.

B. *Western States Petroleum Association v. Board of Equalization,* Los Angeles County Superior Court, Case # BC403167. A trade association representing petroleum refineries has challenged Property Tax Rule 474 – *Petroleum Refining Properties*, which defines the petroleum refining property appraisal unit that normally will be used to determine the Proposition 13 "full cash value"; and establishes a rebuttable presumption that fixtures and machinery and equipment classified as improvements, for a petroleum refining property, are part of the same appraisal unit as the land for purposes of recognizing declines in value. The parties are currently in discovery.

If you need more information or have any questions, please contact Tax Counsel IV Richard Moon at (949) 440-3486.

Approved:

Ramon J. Hirsig
Executive Director

KEC:XX:xx
J:/Chief Counsel/Finals/xxxxxxx.Memo.doc
J:/Prop/FINALS.xxxxxxx.Memo.doc

| | | |
|---|---|---|
| cc: | Mr. Ramon Hirsig | MIC: 73 |
| | Mr. David Gau | MIC: 63 |
| | Mr. Randy Ferris | MIC: 82 |
| | Mr. Dean Kinnee | MIC: 64 |
| | Mr. Todd Gilman | MIC: 70 |
| | Mr. Richard Moon | MIC: 82 |

STATE OF CALIFORNIA

STATE BOARD OF EQUALIZATION
PROPERTY TAXES DEPARTMENT
450 N STREET, MIC: 63, SACRAMENTO, CALIFORNIA
(PO BOX 942879, SACRAMENTO, CALIFORNIA 94279-0063)
TELEPHONE (916) 445-1516
FAX (916) 323-8765



September 23, 1999

No. 99/53

TO COUNTY ASSESSORS:

APPLICATION OF INFLATIONARY FACTORING TO BASE YEAR VALUES

Article XIII A of the California Constitution generally provides that a base year value is established when real property undergoes a change in ownership or when new construction occurs. Following the year a base year value is first enrolled, the value shall be factored annually for inflation. If the date of change in ownership or completion of new construction occurs between the lien date and June 30, the new base year must be adjusted by an inflation factor on the ensuing January 1. The inflation factor may not exceed 2 percent.

The purpose of this letter is to re-emphasize that the application of the annual inflation factor to base year values is mandatory. Section 51 reads in pertinent part:

> (a) For purposes of subdivision (b) of Section 2 of Article XIII A of the California Constitution, for each lien date after the lien date in which the base year value is determined pursuant to Section 110.1, the taxable value of real property *shall*, except as otherwise provided in subdivision (b) or (c), be the lesser of:
>
> (1) Its base year value, compounded annually since the base year by an inflation factor, which *shall* be determined as follows:
>
> ...(C) For any assessment year commencing on or after January 1, 1998, the inflation factor *shall* be the percentage change, rounded to the nearest one-thousandth of 1 percent, from October of the prior fiscal year to October of the current fiscal year in the California Consumer Price Index for all items, as determined by the California Department of Industrial Relations.
>
> (D) In no event *shall* the percentage increase for any assessment year determined pursuant to subparagraph (A), (B), or (C) exceed 2 percent of the prior year's value. [Emphasis added.]

Under these provisions, the inflation factor is based on the California Consumer Price Index (CCPI) statewide, not a localized consumer price index or any other local or statewide economic factors. Further, the factoring of the base year value is applied annually regardless of whether the base year value is actually enrolled. The only instances in which the base year value would not be adjusted for inflation would be where the percentage change in the CCPI was zero or less than zero.

In conclusion, section 51 provides that base year values determined under section 110.1 shall be compounded annually by an inflation factor. The inflation factor is the annual percentage change in the CCPI for all items, as determined by the California Department of Industrial Relations. For any assessment year commencing on or after January 1, 1998, this percentage change is measured from October of the prior fiscal year to October of the current fiscal year, rounded to the nearest one-thousandth of 1 percent. The percentage increase for any assessment year shall not exceed 2 percent of the prior year's value.

Sincerely,

/s/ Richard C. Johnson

Richard C. Johnson
Deputy Director
Property Taxes Department

RCJ:grs:cdg

STATE OF CALIFORNIA

STATE BOARD OF EQUALIZATION
1020 N STREET, SACRAMENTO, CALIFORNIA
(P.O. BOX 1799, SACRAMENTO, CALIFORNIA 95808)
(916) 445-4982



June 8, 1978

No. 78/100

TO COUNTY ASSESSORS:

PROPOSITION 13, JARVIS-GANN INITIATIVE

Enclosed for your general information is an analysis of Proposition 13, the Jarvis-Gann Initiative. As you are undoubtedly aware, the language of the initiative is not completely clear, and in several places more than one interpretation is possible.

The preparation of an adequate 1978 assessment roll is at best difficult given the restrictions imposed by the passage of Proposition 13 and the time constraints provided by the Revenue and Taxation Code. Nevertheless, the task must be performed. The enclosed series of papers contain our interpretations of the initiative and while there are undoubtedly differences of opinion as to their correctness, we recommend them to you in the interest of statewide uniformity.

We invite your comments and ask that any questions be directed in writing to Alan Flory, who has been designated to coordinate the project within this division. Our objective is to provide you with periodic information letters designed to respond to questions that are raised.

Sincerely,

Jack F. Eisenlauer

Jack F. Eisenlauer, Chief
Assessment Standards Division

JFE:cmm
Enclosures

THE AMENDMENT

That Article XIII A is added to the Constitution to read:

Section 1.

(a) The maximum amount of any ad valorem tax on real property shall not exceed one percent (1%) of the full cash value of such property. The one percent (1%) tax to be collected by the counties and apportioned according to law to the districts within the counties.

(b) The limitation provided for in subdivision (a) shall not apply to ad valorem taxes or special assessments to pay the interest and redemption charges on any indebtedness approved by the voters prior to the time this section becomes effective.

Section 2.

(a) The full cash value means the county assessors valuation of real property as shown on the 1975-76 tax bill under "full cash value," or thereafter, the appraised value of real property when purchased, newly constructed, or a change in ownership has occured after the 1975 assessment. All real property not already assessed up to the 1975-76 tax levels may be reassessed to reflect that valuation.

(b) The fair market value base may reflect from year to year the inflationary rate not to exceed two percent (2%) for any given year or reduction as shown in the consumer price index or comparable data for the area under taxing jurisdiction.

Section 3.

From and after the effective date of this article, any changes in state taxes enacted for the purpose of increasing revenues collected pursuant thereto whether by increased rates or changes in methods of computation must be imposed by an Act passed by not less than two-thirds of all members elected to each of the two houses of the Legislature, except that no new ad valorem taxes on real property, or sales or transaction taxes on the sales of real property may be imposed.

Section 4.

Cities, counties, and special districts, by a two-thirds vote of the qualified electors of such district, may impose special taxes on such district, except ad valorem taxes on real property or a transaction tax or sales tax on the sale of real property within such city, county, or special district.

Section 5.

This article shall take effect for the tax year beginning on July 1 following the passage of this Amendment, except Section 3 which shall become effective upon the passage of this article.

Section 6.

If any section, part, clause, or phrase hereof is for any reason held to be invalid or unconstitutional, the remaining sections shall not be affected but will remain in full force and effect.

TABLE OF CONTENTS

Jarvis-Gann Initiative—Proposition 13

## I. SECTION-BY-SECTION INTERPRETATION OF INITIATIVE PROVISIONS*

### Section 1

(a) The maximum amount of any ad valorem tax on real property shall not exceed one percent (1%) of the full cash value of such property. The one percent (1%) tax to be collected by the counties and apportioned according to law to the districts within the counties.

The intent is to limit to 1 percent the amount of tax that can be collected on property with the proceeds distributed among the various taxing jurisdictions.

1. This section does not alter any of the existing exemptions whether contained in the Constitution or the Statute, e.g., timber continues to be exempt from ad valorem taxation.

2. Although the tax rate limit is determined by reference to market value, the appropriate rate will apply to the gross assessed value of property qualified for the homeowner's exemption with the state paying the tax on the first $1,750 of assessed value.

3. Cities, school districts and special districts are all included under the term "district" and shall share property tax revenues with the cities.

4. State-assessed properties are subject to the rate limitation.

5. Personal property is included under the rate limitation since Section 2, Article XIII, of the Constitution specifies "...the tax per dollar of full value shall not be higher on personal property than on real property in the same taxing jurisdiction."

6. The tax rate on aircraft (Section 5391) will be reduced to 1 percent of full value.

7. When preparing the 1978-79 unsecured roll, all real property contained on that roll will be under the 1-percent limitation. This, therefore, requires that personalty on the 1978-79 unsecured roll be under the limitation.

---

* Underlined sentences in this report are direct quotes from Proposition 13.

(b) The limitation provided for in subdivision (a) shall not apply to ad valorem taxes or special assessments to pay the interest and redemption charges on any indebtedness approved by the voters prior to the time this section becomes effective.

Section 2

(a) <u>The full cash value means the County Assessors valuation of real property as shown on the 1975-76 tax bill under "full cash value," or thereafter, the appraised value of real property when purchased, newly constructed, or a change in ownership has occurred after the 1975 assessment. All real property not already assessed up to the 1975-76 tax levels may be reassessed to reflect that valuation.</u>

This section rolls back the assessments to 1975-76 and restricts the rate of growth in assessed value thereafter, except as regards a property that has been purchased, been newly constructed, or has had a change in ownership since March 1, 1975.

1. Both state-assessed and locally-assessed <u>real property</u> will be rolled back to its 1975-76 value.

2. <u>Personal property will not</u> be rolled back to its 1975-76 value.

3. Although subject to special appraisal procedures when appraised, qualified nonprofit golf courses and open-space properties are otherwise subject to this provision. Reappraisal discussed subsequently should occur when property is brought under such a program.

4. "Newly constructed" means that any change in the property caused by "construction."

    a. Only that part "newly constructed" can be reappraised at its current value and includes:

        (1) Any new improvement: fixed equipment, taxable trees, etc., but excluding renovations.

        (2) Any addition to existing improvements.

        (3) Any improvements to land.

    b. Property removed during construction must be netted from new construction.

5. "Change in ownership" refers to any change in ownership, whether by sale, the addition or deletion of an owner, gift, property settlement, foreclosure, or inheritance.

    a. If only a divided partial interest is sold, then only the part sold will be revalued.

6. The assessor must revalue as of March 1, 1975, those properties not already at their 1975-76 full cash value. Such revaluations should be made for the 1978 assessment

roll. Obviously, it would be difficult for most assessors to complete a roll by July 1, 1978, which reflects accurate 1975-76 full cash values—we believe the only way to satisfy this requirement is to seek legislation that would permit review and correction of the 1975-76 values over a one- to two-year period.

7. The full value of real property as shown on the tax bill for 1975-76 will be binding on the county equalization board and the State Board of Equalization unless the assessor reappraises as of March 1, 1975, or for one of the reasons specified in this section.

8. The assessor can reappraise property to reflect physical damage, but the reappraisal can only apply to the damaged portion.

(b) <u>The fair market value base may reflect from year to year the inflationary rate not to exceed two percent (2%) for any given year or reduction as shown in the Consumer Price Index or comparable data for the area under taxing jurisdictions</u>.

This provision limits the growth in the fair market value of individual properties to no more than 2 percent per year.

1. The reference to "fair market value base" refers to the 1975-76 value of the individual property unless it has been purchased, newly constructed, or had a change of ownership since March 1, 1975.

2. The assessor <u>must reflect</u> the impact of inflation not to exceed 2 percent each year.

3. When preparing the 1978-79 assessment, the assessor <u>will add</u> 2 percent to the 1975-76 value base for each of the lien dates 1976, 1977, and 1978.

4. The Consumer Price Index for the state as a whole will be used in determining the annual percentage amount (not to exceed 2 percent) to be added to any given base year value.

5. The latest Consumer Price Index published for a period prior to March 1 of each year will be used.

6. If the increase in the Consumer Price Index is 2 percent or more, all real property in the state <u>will be increased</u> by 2 percent (unless it has been purchased, newly constructed, or had a change in ownership, in which case the property is reappraised and the percentage increase would be based on the index for the following lien date and added at that time).

7. There will be no reduction in the value of real property unless the statewide Consumer Price Index shows a decline, in which case all real property in the state will be reduced by the same percentage amount.

8. Machinery and equipment classified as real property will not reflect depreciation or price increases while under the same ownership at the same location. Newly acquired machinery and equipment classified as real property will be valued as "when purchased."

9. Personal property is not under the revaluation mechanism and will be reappraised annually as under present law.

10. Neither up-zoning nor down-zoning are grounds for reappraising a property.

11. If a property is reappraised as of any particular lien date then the automatic percentage increase applies as of the next lien date and is mandatory.

12. Real property of state assessees will be subject to the rollback and revaluation limits contained in this Initiative, but their personal property will not.

Section 3

From and after the effective date of this article, any changes in State taxes enacted for the purpose of increasing revenues collected pursuant thereto whether by increased rates or changes in methods of computation must be imposed by an Act passed by not less than two-thirds of all members elected to each of the two houses of the Legislature, except that no new ad valorem taxes on real property, or sales or transaction taxes on the sales of real property may be imposed.

This section increases the vote requirement needed on revenue increase legislation and precludes any new state taxes on real property.

<u>Section 4</u>

<u>Cities, counties and special districts, by a two-thirds vote of the qualified electors of such district, may impose special taxes on such district, except ad valorem taxes on real property or a transaction tax or sales tax on the sale of real property within such city, county or special district.</u>

This section sets the voting majority necessary to authorize new taxes by local government but precludes additional ad valorem taxes on real property.

1. "Special taxes" as used in this section means <u>new</u> taxes. Those taxes already in effect on June 6, 1978 are retained at their authorized rates except for the property tax rate which will be reduced.

2. Increases to or imposition of non-property taxes are subject to the voting majority requirement.

3. This section does not grant local jurisdictions the authority to impose taxes not now authorized by law.

Section 5

This article shall take effect for the tax year beginning on July 1 following the passage of this amendment, except Section 3 which shall become effective upon the passage of this article.

1. The Initiative affects the tax rate applicable to both the 1978-79 secured and unsecured rolls.

2. The timber yield tax rate will decline as the average tax rates in the timber counties declines over time. No special action is required to reduce the yield rate as the mechansim is already provided by statute. As the yield rate declines the Board will be required to increase the reserve rate to raise the revenue needed to achieve the existing statutory revenue guarantee.

Section 6

If any section, part, clause, or phrase hereof is for any reason held to be invalid or unconstitutional, the remaining sections shall not be affected but will remain in full force and effect.

## II. VALUATION OF REAL PROPERTY

### A. GENERAL

For the 1978 roll, the assessor must determine which properties on the 1975 roll were assessed at their then current market value. Where the assessor concludes that the 1975 values were below market, he must adjust values to the 1975 level.

In determining 1975 values, the taxable or exempt status of the property on the 1978 lien date must be ascertained. For example, property exempt in 1978 retains that status while property exempt in 1975 but now taxable must be enrolled and taxed at its 1975 value. Likewise, property now subject to an enforceable restriction that results in partial exemption, e.g., open-space, must be valued as though subject to the same restriction in 1975.

Zoning restrictions applicable in the base year shall be taken into account when valuing property. Subsequent zoning changes will not be recognized unless property is required to be revalued for another reason.

Example (zoning change 1977):

| | |
|---|---|
| 1975 Value, A-1 zoning | = \$100,000 |
| 1977 Property rezoned to C-1 value | = 400,000 |

1978 Property value determination = value of the property in 1975
\$100,000 x 1.0612 $[(1.02)^3]$ = \$106,120

Physical changes may require a different approach. This problem is discussed later.

1. Properties Eligible for 1975-76 Value Levels

Properties whose 1975 values, whether as enrolled or as reappraised, serve as the base value must be brought forward to their 1978 value level by the multiplication of the factor 1.0612 (2 percent compounded for three years) times the 1975 value.

The 2-percent factor has been used in each of the value years because the Consumer Price Index has exceeded 2 percent in each of the years.

2. Post-1975 Appraisals

Properties or portion of properties which have changed ownership or which have been newly constructed since the 1975 lien date, and prior to March 1, 1978, must be reappraised as of the date of the sale or the completion of construction. Such changes subsequent to lien date 1978 should be ignored until 1979, except that construction in progress on lien date 1978 should be enrolled at its 1978 market value and be reappraised for the subsequent assessment roll on completion of construction. This latter value should be added to the roll prepared for the lien date following completion of construction and would not be subject to factoring until the preparation of the next succeeding roll.

(a) Reappraisal Due to New Construction

Newly constructed includes land improvements, additions of improvements to bare ground, additions to already improved land, e.g., swimming pools, fences, barns, irrigation systems, and additions to existing improvements that increase their size, e.g., the addition of a room, whether horizontally or vertically.

New construction is not a basis for reappraising the entire property. Only the new construction is to be reappraised. The addition of an improvement to bare ground (with no change in ownership after March 1, 1975) should result in a value on the roll prepared for the lien date following completion of construction that is a combination of the 1975 land value factored plus the market value of the improvement on completion. The following year the combined total value would be factored.

Example:

| | |
|---|---|
| 1975 Value (lot only) | = \$10,000 |
| February 1, 1977, home completed value | = \$35,000 |

1978 Value

| | |
|---|---|
| Land \$10,000 x 1.0612 $[(1.02)^3]$ | = \$10,612 |
| Home \$35,000 x 1.02 | = 35,700 |
| Total | \$46,312 |

Since properties can be in part newly constructed, there will be instances where a property value will be a combination of a 1975 base year value, market value, and factored value. For example, assume a home has a room added to it in February 1976 and a swimming pool in May 1977. The valuation calculation for March 1, 1978, would be as follows:

| | |
|---|---|
| 1975 Base value = \$30,000 x $(1.02)^3$ | = \$31,836 |
| Addition completed February 1976 = \$6,000 x $(1.02)^2$ | = 6,242 |
| Pool—completed May 1977 = \$8,000 (not factored first year) | = 8,000 |
| 1978 Value | \$46,078 |

In 1979 the entire 1978 value would be multiplied by the 1.02 factor assuming no change in the trend of the economy.

(b) Reappraisal Due to Purchase or Other Change in Ownership

These terms both relate to a transaction that is usually recorded but do differ in that a change in ownership may occur as the result of a sale, gift, devise, or foreclosure. Lacking statutory definition, we are of the opinion all transfers should result in a reappraisal for determining a new base year value. The mere recording of a first deed of trust or mortgage given as security for a loan or a change in the name on a deed from John Jones to John J. Jones (the same person) should not result in a reappraisal as there has been no true change in ownership. The term "change in ownership" does not include transfers of stock held in publicly owned corporations, stock cooperatives, or community apartment projects. Sales of units in planned developments as defined in Sections 11003 and 11003.1 of the Business and Professions Code and condominiums as defined in Section 783 of the Civil Code would constitute changes in ownership and should result in reappraisal of the units transferred.

## B. SPECIAL PROPERTIES

### 1. Possessory Interests

Possessory interests in existence prior to lien date 1975 shall have as a base value their market value as of lien date 1975. The base values of possessory interests created after lien date 1975 shall be their market value as of the date of their creation. A change in ownership of a possessory interest in a given year shall result in a new base value, which is its market value at the time of the ownership change. This new base value will be enrolled as of the lien date following the change in ownership.

In the past the value of a fixed term possessory interest declined as the term expired provided it was not reasonably anticipated that the term would be extended or renewed as provided by Rule 23 (California Administrative Code). However, under Proposition 13 there is no basis for recognizing decreases in value except where there is a change in ownership of the property or the C.P.I. shows a decline. Therefore, the base value of all possessory interests shall be determined and thereafter factored in the same way as is the value of all other real property.

2. Mineral Rights

Because of the intricacies involved in the appraisal of mineral properties, we offer only general guidelines in their valuation under Proposition 13.

(1) Mineral (including oil and gas) and geothermal properties in existence and under the same ownership as in 1975 shall be placed on the assessment roll at the 1975 level factored at 2 percent compounded for three years.

Example: 1975 Value--$\$1,000,000 \times (1.02)^3 = \$1,061,208$

(2) Reserves

Depleted reserves must be removed annually from the assessment roll at their base value factored to the year of removal.

Example:

Reserves in 1975 100,000 Units
Value per unit in 1975 $8.00
10,000 units removed March 1, 1975-February 29, 1976
10,000 units removed March 1, 1976-February 29, 1977
10,000 units removed March 1, 1977-February 29, 1978

1978 Value Computation

1976 Value: $8.00 x 1.02 = $8.16 x 100,000 units x .9 = $734,400
1977 Value: $8.16 x 1.02 = $8.32 x 100,000 units x .8 = $665,600
1978 Value: $8.32 x 1.02 = $8.49 x 100,000 units x .7 = $594,048

Newly discovered reserves are to be appraised at their value when discovered and added to the value of reserves already determined.

(3) Development Costs

Mineral development costs typically enhance reserves and in the case of mines and quarries represent a minimum for the value of the minerals made available by the development. Continuing development costs should be enrolled each year if it is not possible to estimate the value of the reserves.

3. Trees and Vines (Unrestricted)

Existing tree and vine exemptions continue in force. Trees and vines which were planted prior to 1975, but were exempt in 1975, shall, on the lien date, following the end of the exemption period, be enrolled at their 1975 market value. On each succeeding lien date the previous year's value shall be adjusted in accordance with the percentage change in the C.P.I., not to exceed 2 percent per year.

Trees and vines planted subsequent to the 1975 lien date shall be enrolled on the lien date following the expiration of the exemption period at a value equal to their market value at planting time. This base year value shall be subject to the annual accumulative C.P.I. adjustments.

Trees and vines shall, upon a change of ownership, be valued as of the date of that change, to be enrolled the following lien date. The value shall be adjusted downward or upward each year in proportion to the value of any trees or vines which have been removed or newly planted, and after the first subsequent lien date factored by the annual adjustment.

Example No. 1

1975 Enrolled Value

| | |
|---|---|
| Land | $100,000 |
| Trees (three years old—value $2,500) | exempt |
| Total | $100,000 |

1978 Value to be Enrolled

| | |
|---|---|
| Land ($100,000 x $(1.02)^3$) | $106,120 |
| Trees (value of orchard in 1975 $2,500) $2,500 x 1.02* | 2,601 |
| Total | $108,721 |

* Exemption four years, property first assessable in 1977, 2 percent adjustment for 1978.

Example No. 2

1975 Enrolled Value

| | |
|---|---|
| Vacant land | $100,000 |
| Total | $100,000 |

1978 Value

| | |
|---|---|
| Land ($100,000 x $(1.02)^3$) | $106,120 |
| Trees (planted in 1977) | exempt |
| Total | $106,120 |

4. Fixed Machinery or Equipment and Fixtures

Any fixed machinery or equipment that is affixed or attached to realty and all fixtures are classified as real property. (See Assessors' Handbook Section 571 for information on how property is classified.) Therefore, the 1978-79 assessments on these types of property are subject to the valuation requirements as on other real property.

When preparing the 1978-79 assessments on these properties that have remained under the same ownership since March 1, 1975, only the 2-percent increase for each of the lien dates 1976, 1977, and 1978 can be added to the 1975-76 valuation except for additions and deletions. For example:

1975 Value

$$\$50,000 \times (1.02)^3 = 1978 \text{ Appraised Value, or } \$53,060$$

A property's value is determined when it is purchased thereafter. No interim depreciation or price changes can be reflected.

Machinery and equipment that has been classified as an improvement should be compared to the acquisition costs and corresponding appraised values on the 1975 property statement to the acquisition costs on the 1976 statement. The comparison will indicate property that has been disposed of, property acquired, and property remaining from the prior year.

The 1975 value of the property disposed of will be deleted. The property acquired between the 1975 and 1976 lien date will be appraised for 1976 (the 1976 appraisal should be sufficient), and the 1975 value of the property remaining will be increased by 2 percent. This procedure will also apply to 1977 and 1978 changes.

Example:

| | |
|---|---|
| Value of equipment in place 1975 | $10,000 |
| No additions or deletions between March 1, 1975, and March 1, 1976 | -0- |
| Value of equipment added between March 1, 1976, and March 1, 1977 | 9,000 |
| Value of equipment deleted between March 1, 1976, and March 1, 1977 | 3,000 |
| Value of equipment added between March 1, 1977, and March 1, 1978 | 8,000 |
| Value of equipment deleted between March 1, 1977, and March 1, 1978 | 3,000 |

1978 Appraisal Computation

| | |
|---|---|
| 1975 Equipment $10,000 | $10,000 |
| 1976 Equipment deleted (1975 value) | (3,000) |
| 1977 Equipment deleted (1975 value) | (3,000) |
| 1978 Value of equipment in place in 1975 = 4,000 x $(1.02)^3$ = | 4,244 |
| 1976 Equipment added 9,000 x 1.02 = | 9,180 |
| 1977 Equipment added 8,000 x 1.00 = | 8,000 |
| 1978 Value | $21,424 |

Where a percentage of the machinery and equipment has been classified as personalty, it will be necessary to delete the acquisition costs and appraised value of such equipment from the computations, since under the provisions of Proposition 13 personalty is to be appraised annually at its market value.

If it is possible to determine the value of the equipment from the purchase price, that figure should be used.

Example:

| | |
|---|---|
| Value of equipment in place 1975 | $10,000 |
| No equipment added in 1975 | -0- |
| Value of equipment added between March 1, 1976, and June 1, 1976 | 9,000 |
| Value of equipment deleted between March 1, 1976, and June 1, 1976 | (3,000) |
| Property purchased June 1, 1976, value of equipment | $16,000 |
| Value of equipment added between March 1, 1977, and March 1, 1978 | $ 8,000 |
| Value of equipment deleted between March 1, 1977, and March 1, 1978 | $ 3,000 |

1978 Appraisal (assuming value can be determined from purchase price)

| | |
|---|---|
| Property reappraised based on sale as of sale date but enrolled in 1977 $16,000 x 1.02 | $16,320 |
| Value of equipment added between March 1, 1977, and March 1, 1978 | 8,000 |

| | |
|---|---|
| Value of equipment deleted between March 1, 1977, and March 1, 1978 | \$(3,000) |
| 1978 Value | \$21,320 |

If in 1975 property was not appraised at its then market value, the assessor may reappraise and alter classifications.

## III. VALUATION OF REAL PROPERTY SUBJECT TO SPECIAL TREATMENT

### A. OPEN-SPACE

In all instances where an open-space contract imposing an enforceable restriction was in existence, prior to June 6, 1978, no matter when executed, the value of the property subject to the restriction shall be determined by using a 1975 restricted value factored up in accordance with the percentage gain each year in the C.P.I. not to exceed 2 percent per year.

When such a property transfers ownership, a new open-space value as of the ownership change date shall be computed and enrolled on the next succeeding lien date. On the lien date following addition to the roll, the C.P.I. factor shall be applied to the previously enrolled value. There is no need to reappraise such properties again until there is a change in ownership or there is new construction.

Example:

| | |
|---|---|
| Property value on July 1, 1976 (date of ownership change) | $100,000 |
| 1978 Value | |
| $100,000 x 1.02 (lower of C.P.I. factor or 2%) = | $102,000 |

All tree and vine exemptions will continue to be honored. Trees and vines that were planted prior to 1975 but were exempt in 1975 would be assessed at the expiration of the exemption period, at the open-space value that would have been applicable in 1975 had they not been exempt. The basis for valuing trees and vines planted subsequent to the 1975 lien date is their value at the time of planting. An assessment would not be enrolled until after the exemption period.

Example:

1975 Enrolled Value

| | |
|---|---|
| Land | $100,000 |
| Trees (three years old) | exempt |
| Total | $100,000 |

1978 Value

| | |
|---|---|
| Land $100,000 x $(1.02)^3$ | $106,120 |
| Trees (1975 value of three year old orchard $2,500)* $2,500 x $(1.02)^2$ | 2,601 |
| Total | $108,721 |

* This base value to remain constant accept for appropriate percentage changes until trees removed. The base value of trees planted in March 1975 and thereafter is their value on the date of planting.

All legal provisions applicable to open-space contracts, e.g., execution, termination, cancellation, etc., are unaffected by Proposition 13 except that the non-renewal valuation procedure is modified. When a non-renewal notice is given, the property will continue to be valued annually as though fully restricted until the expiration of the contract. Subsequently, the property will be valued at 1975 market value plus all appropriate factor increases compounded to the lien date for which a market value is added to the assessment roll.

Portions of contracted properties not subject to the enforceable restrictions, e.g., non-living improvements and homesites, will be valued as other real property.

Increases in value attributable to the planting of orchards, land leveling, or other land improvements, subsequent to the base year shall be regarded as resulting from new construction and shall be calculated by capitalizing the income attributable to the value of the leveling or improvements using the open-space capitalization rate and adding this increment to the value of the undeveloped land.

Example:

To arrive at the March 1978 Value

1975 Enrolled Value

| | |
|---|---|
| Land | $100,000 |
| No improvements | |

1976 (after March 1)

| | |
|---|---|
| Land leveled value | 5,000 |

1977 (after March 1)

| | |
|---|---|
| Irrigation system added value | 10,000 |

1978 Value on March 1

| | |
|---|---|
| Land $100,000 x $(1.02)^3$ | $106,121 |
| Leveling $5,000 x 1.02 | 5,100 |
| Irrigation system $10,000 | 10,000 |
| Total 1978 Value | $121,221 |

B. TAXABLE GOVERNMENT-OWNED PROPERTY

The specific provisions of Article XIII, Section 11, override the general provisions of Proposition 13 regarding the valuation of such properties except in one instance; i.e., the calculation of the properties' current market value. The properties' current market value should be determined by reference to the 1975 market value multiplied by the same annual percentage gains in the C.P.I. used on properties generally. After making these calculations, the Section 11 factored value or the Proposition 13 market value, whichever is lower, shall be used.

C. NONPROFIT GOLF COURSES

The specific provisions of Section 10 of Article XIII relating to the appraisal of nonprofit golf courses remain applicable to the determination of the 1975-76 lien date value of such properties whether they qualified at that time or became eligible in subsequent years. Once the base year nonprofit golf course value is ascertained, it should be factored as is all other real property.

D. TIMBER AND TIMBERLAND

We are of the opinion that the exemption from ad valorem taxation afforded to timber remains in effect just as does the homeowners', inventory, and all other exemptions. Since the timber tax is a state tax imposed in lieu of ad valorem property taxes, it is not directly within the provisions of Proposition 13. However, since the timber tax rate and the timber reserve fund tax rates are tied to general property tax rates, they will be affected by changes in those latter rates.

Timberland is subject to ad valorem tax and is thereby subject to the Proposition 13, 1-percent tax rate limit.

In recognition of the legislative exercise of authority and the nonexistence of bare timberland values on the 1975-76 assessment rolls, assessors should use the 1977 site class values as the value that would have been applicable in 1975 had the statutory site classification values been in effect on that date. Such values applied to the total acreage of the parcels should be factored forward one year to determine 1978 roll values.

## IV. PERSONAL PROPERTY

The approval of Proposition 13 does not subject personal property to any value limitations. Therefore, personal property will continue to be appraised annually at its full cash value.

The tax rate limitation specified in Proposition 13 must be applied to all assessments (both real and personal property) enrolled on the unsecured and secured portions of the 1978-79 assessment roll.

Section 2 of Article XIII of the Constitution provides that the tax per dollar of full value shall not be higher on personal property than on real property in the same taxing jurisdiction. Because the real property assessments enrolled on the secured and unsecured portions of the 1978-79 assessment roll are subject to Proposition 13's tax rate limitation, the tax rate limitation on personal property assessment must be similarly limited.

It is important to note that the tax rate limitation on personal property assessment will require an adjustment in the tax rate on aircraft. The rate of $1\frac{1}{2}$ percent of market value must be reduced to the tax rate limitation.

Proposition 13 has no effect on livestock head-day in-lieu tax or the racehorse in-lieu tax.

## V. PROPERTY TAX EXEMPTIONS

It is our view that the passage of Proposition 13 (Jarvis-Gann Initiative) will not affect constitutionally granted property tax exemptions.

The 1978 assessed value of taxable assets as computed pursuant to Proposition 13 and the current market value of non-taxable assets will continue to be used to determine the $5,000 limitation for the veterans' property tax exemption. The 1975-76 assessed valuation base factored forward for property tax purposes in 1978 could mean that some veterans would again be eligible for the exemption. It may be advisable to send a claim form to those veterans who received the exemption in 1975 but failed to receive the exemption in subsequent years because they exceeded the limitation. There is no provision for reconsidering the granting of the exemption for the years 1976 or 1977.

Among exemptions not affected by Proposition 13 are the following:

Works of Art
Disabled Veterans'
Church
College
Cemetery
Welfare
Public School
Free Public Library
Free Museum
Veterans' Organization
Exhibition
Livestock—Drought

Basically, the exemptions should continue to be administered the same as in the past.

## VI. ESCAPE ASSESSMENTS

Property escaping assessment prior to March 1, 1978 will be valued at the figure that would have applied on the lien date for which it escaped. The tax rate applicable on that date should also be applied.

For example, a property which escaped assessment in both 1977 and 1978 would be treated differently for each of those assessment years. The 1977 escape would be taxed at the rate in existence at that time; the value escaping assessment would not be subject to any of the provisions of Proposition 13 for 1977; the 1978 value of escaped property in 1978 and tax rate determination, on the other hand, would be subject to the 1 percent rate limitation and value criteria contained in Proposition 13.

**JAMES S. PHELPS, as Trustee, etc., Plaintiff and Appellant, v. ORANGE COUNTY ASSESSMENT APPEALS BOARD NO. 1, Defendant and Respondent; WEBSTER J. GUILLORY, as Assessor, etc., Real Party in Interest and Respondent.**

**G040428**

**COURT OF APPEAL OF CALIFORNIA, FOURTH APPELLATE DISTRICT, DIVISION THREE**

*175 Cal. App. 4th 448*; *2009 Cal. App. LEXIS 1059*

**May 27, 2009, Filed**

**SUBSEQUENT HISTORY:** [**1]
The Publication Status of this Document has been Changed by the Court from Unpublished to Published June 24, 2009.
Modification order at, Request granted, Rehearing denied by *James S. Phelps v. Orange County Assessment Appeals Bd. No. 1, 2009 Cal. App. LEXIS 1057 (Cal. App. 4th Dist., June 24, 2009)*

**PRIOR HISTORY:** Appeal from a judgment of the Superior Court of Orange County, No. 07CC09169, Geoffrey T. Glass, Judge.

**DISPOSITION:** Affirmed.

**SUMMARY:**

CALIFORNIA OFFICIAL REPORTS SUMMARY

The Orange County Assessor reassessed a shopping center complex held by trust upon the death of an income beneficiary of the trust, and the Orange County Assessment Appeals Board No. 1 upheld the reassessment. The trial court denied the trustee's petition for writ of mandate, concluding that the transfer of the beneficiary's interest to his four surviving children was a change in ownership under *Rev. & Tax. Code, § 60*, entitling the assessor to reassess the property. (Superior Court of Orange County, No. 07CC09169, Geoffrey T. Glass, Judge.)

The Court of Appeal affirmed the trial court's judgment denying the writ petition. The court held that the transfer of the beneficiary's interest to his four surviving children was a change in ownership under *Rev. & Tax. Code, § 60*. Under the first prong of the change-in-ownership test, the beneficiary held a present interest in the property's improvements, and that interest passed to the new income beneficiaries upon his death. There was a present interest in the lessee's improvements because they were part of the property and the lease required the improvements to be surrendered to the lessor in good condition at the close of the lease. Under the second prong, the beneficiaries had the beneficial use of the property because they received income from it; the law does not require legal title to be held by those who are entitled to the beneficial use of a property. Finally, under the third prong, a lifetime beneficiary receiving the rental value of a parcel of real property is considered under the law to be receiving value substantially equal to the value of the fee interest. The transfer of the beneficiary's one-third interest in the property did not result in a reassessment of the entire property, but only the third of it in which he had held an income interest. (Opinion by Aronson, J., with Rylaarsdam, Acting P. J., and Moore, J., concurring.) [*449]

**HEADNOTES**

CALIFORNIA OFFICIAL REPORTS HEADNOTES

**(1) Taxation § 3--Reassessment of Real Property--Full Cash Value.**--The term "full cash value" in *Cal. Const., art. XIII A, § 1, subd. (a)*, means the county assessor's valuation of real property as shown on the 1975-1976 tax bill, or, thereafter, the appraised value of real property when purchased, newly constructed, or a change in ownership has occurred after the 1975 assessment (*Cal. Const., art. XIII A, § 2, subd. (a)*).

**(2) Taxation § 3--Reassessment of Real Property--Change of Ownership.**--*Rev. & Tax. Code, § 60*, has three parts: A "change in ownership" means (1) a transfer of a present interest in real property, (2) including the beneficial use thereof, (3) the value of which is substantially equal to the value of the fee interest. The Task Force on Property Tax Administration has recommended that this definition should control all transfers, both foreseen and unforeseen.

**(3) Taxation § 3--Reassessment of Real Property--Change of Ownership--Trusts.**--A principle of trust law is that the creation of a trust divides title--placing legal title in the trustee, and equitable title in the beneficiaries. The focus of *Rev. & Tax. Code, § 60*, is on the person or entity that enjoys the benefits of the property, not upon the fiduciary that holds title to property for the benefit of another. A landlord who owns commercial property exercises its beneficial interest by exacting rent from the tenant rather than acquiring physical control of the demised premises. Accordingly, the receipt of income generated by property qualifies as a beneficial use of the property. The law does not require legal title to be held by those who are entitled to the beneficial use of a property.

**(4) Taxation § 3--Reassessment of Real Property--Change of Ownership--Trusts--Value Equivalency.**--A trust beneficiary's lifetime interest in income from trust-held real property meets the value equivalency prong of the change-in-ownership test under *Rev. & Tax. Code, § 60.*

**(5) Taxation § 3--Reassessment of Real Property--Change of Ownership--Value Equivalency--Life Estates.**--The Task Force on Property Tax Administration viewed the value equivalence prong of the change-in-ownership test under *Rev. & Tax. Code, § 60*, as necessary to determine who is the primary owner of the property at any given time. A major purpose of this third element is to avoid unwarranted complexity by identifying the primary owner, so that only a transfer by him or her will be a change in ownership and when it occurs the whole property will be [*450] reappraised. By focusing on the primary owner, the assessor is not burdened with separately assessing different estates within the same property, such as having to reassess a transferred life estate separately from the remainder interest. The task force's treatment of life estates focuses on those retained by the transferor. Transfers with a retained life estate are not ownership changes until the life tenant dies. The life tenant has the dominant or primary interest under the value equivalence element of the general change in ownership definition, and there is no transfer of the present interest in the property until the life tenant dies and the property vests in the remainder. Accordingly, the task force report expressly considers a life estate sufficiently equal in value to a fee interest to meet the change-of-ownership test.

**(6) Administrative Law § 10--Interpretation of Laws--Review.**--A contemporary administrative construction of a statute by the agency charged with its enforcement and interpretation is entitled to great weight unless it is clearly erroneous or unauthorized.

**(7) Taxation § 3--Reassessment of Real Property--Change of Ownership--Trust Beneficiary--Transfer to Surviving Children.**--Upon the death of an income beneficiary of a trust, it was proper to reassess a shopping center complex held by the trust because the transfer of the beneficiary's interest to his four surviving children was a change in ownership under *Rev. & Tax. Code, § 60.*

[*Cal. Forms of Pleading and Practice (2009) ch. 540, Taxes and Assessments, §§ 540.51, 540.53.*]

**COUNSEL:** Law Office of Paul D. Draper and Paul D. Draper for Plaintiff and Appellant.

Freeman Freeman & Smiley, Joanne M. Frasca, Jessica S. Dorman-Davis and Lisa M. Burkdall for Carol B. Phelps as Amici Curiae on behalf of Plaintiff and Appellant.

Paul, Hastings, Janofsky & Walker and Julian B. Decyk for Arthur D. Phelps as Amici Curiae on behalf of Plaintiff and Appellant.

No appearance for Defendant and Respondent.

Benjamin P. de Mayo and Nicholas S. Chrisos, County Counsel, and Laurie A. Shade, Deputy County Counsel, for Real Party in Interest and Respondent.

**JUDGES:** Opinion by Aronson, J., with Rylaarsdam, Acting P. J., and Moore, J., concurring.

**OPINION BY:** Aronson [*451]

**OPINION**

**ARONSON, J.**--Plaintiff James S. Phelps, as trustee of the John Wilson Phelps Trust (trust), challenges the action of respondent Webster J. Guillory, Orange County Assessor (Assessor), in reassessing a shopping center complex (property) held by the trust upon the death of Wilson W. Phelps (Wilson), an income beneficiary of the trust, [**2] and the decision of respondent Orange County Assessment Appeals Board No. 1 (appeals board) to uphold the reassessment. Plaintiff contends the transfer of Wilson's interest as an income beneficiary to his four children did not qualify as a change of ownership under *Revenue and Taxation Code section 60.* [1]

1 All statutory references are to the Revenue and Taxation Code, unless otherwise noted.

For a change of ownership to occur under *section 60*, there must be "a transfer of a present interest in real property, including the beneficial use thereof, the value of which is substantially equal to the value of the fee interest." Plaintiff contends the trust's income beneficiaries do not have a present interest in the improvements on the property because the improvements were constructed and owned by the property's lessee and sublessees. Plaintiff also contends the income beneficiaries do not have the beneficial use of the property because they do not hold legal title. Finally, plaintiff contends that the beneficiaries' interest in the income flowing from the property is not substantially equal to the value of a fee interest because a lifetime income interest is inherently inferior to a fee.

We [**3] conclude the trial court properly denied plaintiff's writ petition seeking to overturn the board's decision and the reassessment. The income beneficiaries have a present interest in the improvements because they are part of the property and the lease requires the improvements to be surrendered to the lessor in good condition at the close of the lease. The beneficiaries have the beneficial use of the property because they receive income from it; the law does not require legal title to be held by those who are entitled to the beneficial use of a property. Finally, a lifetime beneficiary receiving the rental value of a parcel of real property is considered under the law to be receiving value substantially equal to the value of the fee interest. We therefore affirm the trial court's judgment denying the writ petition.

I

FACTUAL AND PROCEDURAL BACKGROUND

The trustor, John Wilson Phelps, created the trust as part of his will in 1945, which became irrevocable upon his death in 1947. The trust held real [*452] estate from which it derived income, and distributed the income to its beneficiaries. The trust instrument directed the trust to hold the property in trust during the lifetimes of Adele N. Phelps, [**4] Wilson, Arthur D. Phelps, Adele Phelps Spellacy, and the trustor's grandchildren living at the time of his death. The trust is scheduled to terminate on the death of the last survivor of the trustor's children and grandchildren living when the trustor died. Afterward, the trust corpus will be distributed to the trustor's then living issue on the principle of representation.

Among the trust's income producing assets are parcels of real property in Fullerton now used as a shopping center. The trustees executed a lease of the property in 1964 to Montgomery Ward & Co. The lease required the lessee to construct improvements on the unimproved land subject to the lessor's approval. The lessee agreed to surrender the improvements in good condition to the trust at the termination of the lease.

After Montgomery Ward & Co. went bankrupt, Target Corporation (Target) became the current lessee of the property. When Target took over, it spent approximately $ 7 million to renovate the main store on the property. Both Montgomery Ward and Target subleased portions of the property (retail and restaurant pads) to others who constructed improvements for retail and restaurant use. These improvements were [**5] constructed by the sublessees at their own expense and are owned by the lessee or sublessees for the duration of the lease. At the conclusion of the lease, these improvements are surrendered to the trust.

Upon the trustor's death, trust provisions directed the trustees to divide the trust's income among the trustor's widow and his three children. The trust provided that if any of the trustor's children died before the termination of the trust, their issue would take per stirpes. If any of the trustor's children died without issue, the decedent's share of the trust's net income was to be divided among the other children.

As of January 2002, the trust had three trustees, Wilson, John W. Phelps II, and James S. Phelps, who collectively held legal title to the trust's assets. Wilson held a one-third interest as an income beneficiary. Wilson died in April 2002. Under the trust document, Wilson's interest in the net income of the trust was transferred to his four children, each of whom then became entitled to receive 1/12 of the trust's net income.

The assessor concluded the transfer of Wilson's interest to his four surviving children was a change in ownership under *section 60* and reassessed [**6] their share of the property. The assessor appraised the entire property at $ 27,740,000 for the 2002 tax year, with the land valued at $ 14,740,000, [*453] and the improvements valued at $ 13 million. Target paid all of the assessed real property taxes and the trust subsequently filed an application to challenge the assessments with the appeals board. After a hearing, the appeals board upheld the assessor's position as to the parcel involved in this appeal. [2] The trust filed its verified petition for writ of mandate in the superior court, seeking to set aside the board's findings. After hearing, the trial court denied the petition, concluding the transfer on Wilson's death constituted a change in ownership under *section 60*, entitling the Assessor to reassess the property. The trial court entered judgment and plaintiff now appeals.

2 The reassessments were issued against property described as parcels 10, 11, and 14. The board ruled in favor of the trust as to parcels 10, and the trust has received a refund of the taxes paid on that assessment. The trust did not dispute that finding and challenges only the board's findings as to parcels 11 and 14.

II

STANDARD OF REVIEW

"The interpretation and application of *section 60* is a question of [**7] law. We review de novo a determination that an assessable change in ownership occurred under *section 60*." (*Reilly v. City and County of San Francisco (2006) 142 Cal.App.4th 480, 487 [48 Cal. Rptr. 3d 291]* (*Reilly*).)

III

DISCUSSION

A. *Wilson Held a Present Interest in the Property's Improvements, Which Passed to the New Income Beneficiaries*

**(1)** On June 6, 1978, California voters passed Proposition 13, officially titled the "People's Initiative to Limit Property Taxation." Proposition 13 amended the California Constitution by adding article XIII A, which provides that "[t]he maximum amount of any ad valorem tax on real property shall not exceed One percent (1%) of the full cash value of such property." (*Cal. Const., art. XIII A, § 1, subd. (a)*.) The term "'full cash value' means the county assessor's valuation of real property as shown on the 1975-76 tax bill ... , or, thereafter, the appraised value of real property when purchased, newly constructed, *or a change in ownership* has occurred after the 1975 assessment." (*Cal. Const., art. XIII A, § 2, subd. (a)*, italics added.)

Proposition 13 left the phrase "change in ownership" undefined. To "create consistent and uniform guidelines to implement Proposition 13's undefined [**8] 'change in ownership' provision," the Legislature established a 35-member [*454] Task Force on Property Tax Administration (task force). Members included legislative and board staff, county assessors, trade associations, and lawyers in the public and private sectors. (*Pacific Southwest Realty Co. v. County of Los Angeles (1991) 1 Cal.4th 155, 161 [2 Cal. Rptr. 2d 536, 820 P.2d 1046]* (*Pacific Southwest*).) The task force's work culminated in the Report of the Task Force on Property Tax Administration (task force report), which was submitted to the Assembly Committee on Revenue and Taxation on January 22, 1979. [3] The task force report provided recommendations which the Legislature adopted largely unchanged in a series of code provisions.

3 We grant plaintiff's request for judicial notice.

**(2)** The task force report's key change-in-ownership test was adopted verbatim and is now codified as *section 60*, which has three parts: "'A "change in ownership" means [1] a transfer of a present interest in real property, [2] including the beneficial use thereof, [3] the value of which is substantially equal to the value of the fee interest.'" The task force recommended that this definition should control all transfers, both foreseen and unforeseen. [**9] (*Pacific Southwest, supra, 1 Cal.4th at p. 162*.) The task force also recommended the creation of " 'statutory "examples" to elaborate on common transactions... .'" (*Id. at p. 161*.) Accordingly, the Legislature identified common types of transfers and categorized them. Those transfers constituting a change in ownership are identified in *section 61*, and those not constituting a change in ownership are identified in *section 62*. (*1 Cal.4th at p. 161*.) The present situation does not fall within any of the examples in *section 61* or *62*. Accordingly, we must consider whether the current transfer meets *section 60*'s change-of-ownership test.

Plaintiff contends the transfer at issue was not a change in ownership under *section 60* because none of the three prongs have been met. We disagree.

As to the first prong--present interest--plaintiff notes the Assessor separately appraised and assessed the land and improvements of the property, with the value of the improvements constituting almost one-half of the assessments. Plaintiff contends the income beneficiaries do not have a present interest in the improvements and, accordingly, the assessor was not entitled to reassess them. Plaintiff notes that the lease [**10] requires the lessee to construct the improvements on the property, and asserts the lessee, not the lessor, holds the present interest in the improvements.

*Auerbach v. Assessment Appeals Bd. No. 1 (2006) 39 Cal.4th 153 [45 Cal. Rptr. 3d 774, 137 P.3d 951]* (*Auerbach*), is instructive. There, a retailer leased property owned by a trust. The lease required the retailer at its own expense to either renovate the existing building, or demolish it and construct [*455] a new one, but required the trust's approval before undertaking the improvements. The lease provided that the retailer owned the alterations or new improvements during the lease term, but the retailer agreed to turn over all improvements on the property in good condition to the trust at the conclusion of the lease. The lease required the retailer to repair any damage to the property at its expense, but required the lessor to make any insurance proceeds available to the retailer for the repairs. Although the lease was silent on the issue, the evidence established that the retailer paid rent for the land, not the building on it. The retailer elected to demolish the existing building, and constructed a new one.

When the beneficiaries in *Auerbach* [**11] received their interests in the trust, they applied for the $ 1 million grandparent-grandchild reassessment exclusion under *section 63.1*. Although the assessor granted the exclusion, he concluded the trusts owned the building as well as the land for property tax purposes, and applied the exclusion to both, allocating 92 percent of the exclusion to the building and 8 percent to the land. The trustee challenged this allocation, contending the trust owned only the land, not the building, and therefore the exclusion applied only to the land. The California Supreme Court agreed with the assessor, concluding the trust held a present interest in both the land and the building. The court noted that despite the lease's statement that the retailer owned the building, the provision requiring surrender of the building at the conclusion of the lease demonstrated that the trust held the fee interest in the building. (*Auerbach, supra, 39 Cal.4th at p. 162.*)

Here, as in *Auerbach*, the lease requires the lessee to surrender the improvements to the lessor in good condition when the lease concludes. This suggests the trust's income beneficiaries hold a present interest in the property's improvements. [**12] Plaintiff contends, however, the present situation is distinguishable from *Auerbach* because (1) the trust has no right to unilaterally sell the property and improvements, (2) the lessee is entitled to any insurance proceeds if the lessee's improvements are damaged or destroyed, and (3) the lessee is entitled to any compensation paid for the taking of any of the improvements through eminent domain. After reviewing the lease, we conclude none of these matters distinguish the present case from *Auerbach*.

True, nothing in the lease expressly authorizes the trust to sell the property and its improvements, but nothing prevents the trust from doing so either. Indeed, section 12(d) of the lease specifically contemplates the possibility the lessor may sell the property, providing that the lessee shall not be required to pay any taxes assessed "upon the sale, transfer or assignment of the title or estate of the Lessor ... ." Accordingly, the lack of an express provision authorizing the lessor to sell the entire property does not demonstrate the lessee owns the improvements. [*456]

Plaintiff's assertion the lessee is entitled to all of the insurance proceeds if the improvements are damaged or destroyed [**13] oversimplifies the issue. The lease's insurance provision requires the lessee to maintain insurance covering 100 percent of the replacement cost of the improvements, and that the lessee must hold any insurance proceeds as *a trust fund* for repairing and rebuilding the improvements. The lessee is required to repair or rebuild damaged or destroyed improvements on the property at its own expense, except that within two years of lease termination, the lessee may avoid this obligation by assigning the lessor all of the insurance proceeds. The lessee is entitled to keep any remaining insurance proceeds only after all of the improvements have been restored or rebuilt to meet or exceed their value before the loss. Thus, the lease's insurance provisions actually support the Assessor's position that the improvements are owned by the lessor.

Plaintiff's assertion the lessee is entitled to receive all of the compensation from an eminent domain action taking all or part of the improvements is also over simplistic. The lease does not give the lessee all the compensation received for the improvements, but only the "unamortized cost" of such improvements. In other words, as the lease term continues, [**14] the lessor obtains a greater right to any compensation received from an eminent domain proceeding affecting the improvements. This is consistent with the lease provision stipulating that the lessor is entitled to the improvements at the close of the lease term. Accordingly, we conclude Wilson held a present interest in the property's improvements, which passed to the new income beneficiaries upon his death.

B. *Wilson Had the Beneficial Use of the Property That Was Transferred to the Income Beneficiaries*

Plaintiff asserts the second prong of *section 60*'s test for change in ownership is not met because Wilson never owned legal title to the property. We again disagree.

**(3)** The question whether income beneficiaries of a trust have the beneficial use of the trust property was squarely addressed in *Reilly, supra, 142 Cal.App.4th 480*, in which the tax assessor reassessed trust-held real property after the income beneficiary died, and a new income beneficiary succeeded to the former's interests. The court noted the "'principle of trust law that the creation of a trust divides title--placing legal title in the trustee, and *equitable* title in the beneficiaries. [Citations.]'" (*Id. at p 489.*) After [**15] review of the task force report, the court concluded that *section 60*'s "focus is on the person or entity that enjoys the benefits of the property, not upon the fiduciary that holds title to property for the benefit of another." (*Reilly, at p. 495.*) The *Reilly* court noted the California Supreme Court in *Pacific Southwest* recognized "that a landlord who owned commercial property 'exercise[d] its [*457] beneficial interest by exacting rent from [the tenant] rather than acquiring physical control of the demised premises . ...' " (*Reilly, at p. 495*, quoting *Pacific Southwest, supra, 1 Cal.4th at p. 164.*) Accordingly, *Reilly* concluded that "[t]he receipt of income generated by property qualifies as a 'beneficial use' of the property ... ." (*Reilly, at p. 495.*)

Arguing that beneficial use prong requires the holder of the interest to also hold legal title to the property, plaintiff cites the Assessment Appeals Manual of the California State Board of Equalization (manual), which addresses the "beneficial use" requirement as follows: "The *beneficial use* element requires the transfer must convey both legal and beneficial interests in the property." He also cites the following observation by [**16] the California Supreme Court in *Pacific Southwest*: "The second prong of *section 60* requires that to constitute a change in ownership there must be a transfer not only of bare legal title but also of the transferor's beneficial or equitable interest in the land." (*Pacific Southwest, supra, 1 Cal.4th at p. 163.*) Plaintiff has taken these statements out of context.

Specifically, the manual and the Supreme Court in *Pacific Southwest* were addressing the situation where a person conveys bare legal title, but retains a beneficial interest in the property. On this point, the task force report noted: "'Revocable living trusts are merely a substitute for a will. The gifts over to persons other than the trustor are contingent; the trust can be revoked or those beneficiaries may predecease the trustor. ... [¶] If the trust is revocable it is excluded because the rights conferred are contingent. If the trustor is the sole beneficiary during his lifetime, his retained interest is considered to be "substantially equivalent in value" to the fee interest in any real property covered by the trust. He is therefore the true owner and the change in ownership does not occur *until* the property passes to [**17] the remaindermen on the trustor's death.'" (*Reilly, supra, 142 Cal.App.4th at pp. 488-489*, original italics.)

The present situation is different from the foregoing example because nothing was retained by Wilson when the new beneficiaries received their interests. Neither the manual nor *Pacific Southwest* touched on the situation where income from real property is passed on to new trust beneficiaries. We agree with the court's conclusion in *Reilly*, and hold that by receiving rent income from the property as a beneficiary, Wilson had a beneficial use of the property, which passed to his successor beneficiaries on his death.

C. *The Value of a Lifetime Interest in Income Is Substantially Equal to the Value of a Fee Interest*

Plaintiff contends the third prong of *section 60*'s change of ownership requirements, the value equivalency test, was not met because the value of [*458] Wilson's lifetime interest in income was not substantially equal to the value of a fee interest. The contention is not persuasive.

**(4)** Again, *Reilly* addressed this issue and held that a trust beneficiary's lifetime interest in income from trust-held real property meets the value equivalency prong of *section 60*. (*Reilly, supra, 142 Cal.App.4th at p. 498.*) [**18] In reaching its decision, *Reilly* relied in part on *Leckie v. County of Orange (1998) 65 Cal.App.4th 334 [76 Cal. Rptr. 2d 426]* (*Leckie*), in which our division held that the transfer of a life estate in real property, where the grantor retained no interest in the property, constituted a change of ownership.

Here, plaintiff does not directly argue our division's decision in *Leckie* is incorrect, but nonetheless challenges its basic holding citing, as support, portions of the Supreme Court's decision in *Pacific Southwest.* There, the plaintiff sold an office building complex, and simultaneously acquired from the buyer a leaseback in one building for 60 years, 21 months, which covered 73 percent of the property. The assessor viewed the sale and leaseback as a change of ownership and reassessed the entire parcel. The Supreme Court rejected the plaintiff's claim that the transaction satisfied none of *section 60*'s three prongs. Regarding the value equivalence prong, the Supreme Court explained: "Because [the purchaser] acquired the entire fee, not only did the value of the interest transferred 'substantially equal ... the value of the fee interest,' it was of identical value because it was a transfer of the fee itself. [**19] [Citation.] The property sold essentially for the market price, and plaintiff is now paying rent at the market rate. There is no indication that the property would resell for less than the market price. Hence, notwithstanding the reservation of an encumbrance in the form of an estate for years, the value of the transfer equaled that of a conveyance of fee simple." (*Pacific Southwest, supra, 1 Cal.4th at p. 164.*)

The Supreme Court then contrasted the situation in its case with the transfer of a life estate in which the grantor retained a reversionary interest. The court noted that such a transfer would not meet the value equivalency test "because the value of each divided interest in the estate would not approach that of a fee. A purchaser of the reserved estate would be buying a life estate *per autre vie*--a freehold estate, to be sure, but an estate of questionable value because subject to complete defeasance at an unknown time. Rare is the mortgagee willing to lend on the security of an estate so ephemeral." (*Pacific Southwest, supra, 1 Cal.4th at p. 165*, original italics.)

Our division in *Leckie* acknowledged the Supreme Court's comments regarding the value of a life estate, but noted [**20] that the Supreme Court's "comments were made, as dicta, in a discussion of a *retained* life estate, [*459] which is clearly exempt from the change of ownership provisions." (*Leckie, 65 Cal.App.4th at p. 340*, original italics.) The Court of Appeal in *Reilly* further distinguished *Pacific Southwest*, as follows: "The court noted in dicta that a purchaser of a retained life estate limited to the grantor's life would have 'an estate of questionable value' because it would be subject to defeasance at an unknown time. [Citation.] Upon the grantor's death, the purchaser's interest would disappear and the purchaser would retain nothing of value. Here, by contrast, [the income beneficiary]'s interest in the trust property was measured by his own lifetime and not someone else's. The fact the trustee could sell the property during the term of the trust does not render [the income beneficiary]'s interest of questionable value, because he still would have a right to the income from the sale proceeds for the rest of his life." (*Reilly, supra, 142 Cal.App.4th at p. 498.*)

**(5)** The distinction between the conveyance of a life estate in which the grantor retains the remainder and the conveyance of a life estate without [**21] any reservation becomes clearer when recognizing the purpose of the value equivalence test. The task force report viewed the value equivalence prong as "'necessary to determine who is the *primary owner* of the property at any given time. ... [¶] A major purpose of this third element ... is to avoid ... unwarranted complexity by identifying *the primary owner*, so that only a transfer by him will be a change in ownership and when it occurs the whole property will be reappraised. ...'" (*Leckie, 65 Cal.App.4th at p. 338*, first & second italics added.) By focusing on the primary owner, the assessor is not burdened with separately assessing different estates within the same property, such as having to reassess a transferred life estate separately from the remainder interest. The task force's "treatment of life estates was focused on those retained by the transferor, such as when a parent transfers the family home to his children, but retains the right to live there during his life. [Citation.] The task force explained, 'Transfers with a retained life estate are not ownership changes until the life tenant dies. *The life tenant has the dominant or primary interest under the "value* [**22] *equivalence" element of the general change in ownership definition*, and there is no transfer of the *present interest* in the property until the life tenant dies and the property vests in the remainder.'" (*Leckie, at p. 338*, first italics added.) Accordingly, the task force report expressly considered a life estate sufficiently equal in value to a fee interest to meet the change-of-ownership test.

**(6)** Moreover, as our division previously recognized in *Leckie*, *property tax rule 462.060(a)*, promulgated by the State Board of Equalization, provides: "The creation of a life estate in real property is a change in ownership at the time of transfer unless the instrument creating the life estate reserves such estate in the transferor or the transferor's spouse." (*Cal. Code Regs., tit. 18, § 462.060, subd. (a).*) This rule was adopted in August 1979 contemporaneously with *section 60*. "[A] contemporary administrative construction [*460] of a statute by the agency charged with its enforcement and interpretation, 'is entitled to great weight unless it is clearly erroneous or unauthorized.'" (*International Business Machines v. State Bd. of Equalization (1980) 26 Cal.3d 923, 930-931 [163 Cal. Rptr. 782, 609 P.2d 1].*) Accordingly, we perceive no [**23] reason to depart from our division's previous decision in *Leckie*.

Plaintiff also contends, however, that even if a life estate is substantially equal to a fee interest under the third prong of *section 60*, Wilson's interest had less value than a life estate because his interest was defeasible. Specifically, under the trust instrument, an income beneficiary's interest would lapse upon that beneficiary's attempt at assignment, mortgage or hypothecation of his or her interest, or attempt to attack or contest any provision of the trust. Plaintiff reasons, "The more or less probability that such an interest would be lost would merely affect the marketplace's estimate of its value."

Each of the conditions Phelps cited that may defeat the beneficiaries' interest in receiving income from the trust is completely under the beneficiaries' control. Accordingly, we believe the effect on the value of the beneficiaries' interests would not be sufficient to affect the operation of the value equivalency test under *section 60*.

Plaintiff also makes a purported appeal to "logic and common sense" by comparing the value of his annual income from the property, $ 77,548, with the value of the property, $ 27,740,000, [**24] and asking the court if these two values are equal. Of course, this is not a fair comparison because the fair market value of a property is virtually always a multiple of the income derived from it, and the $ 77,548 figure is only one-third of the income received from the property. The transfer of Wilson's one-third interest in the property did not result in a reassessment of the entire property, but only the third of it in which he had held an income interest. (See *§ 65.1* ["when an interest in a portion of real property is purchased or changes ownership, only the interest or portion transferred shall be reappraised"].)

Plaintiff asserts the trust receives no income from the restaurant and retail pads that were subleased by the property's lessee, and therefore the assessor should not have reassessed the parcels containing those pads. We disagree. Although the trust received no direct rent from those parcels, the parcels are part of the master lease from which it does derive income.

**(7)** We conclude the transfer of Wilson's interest as a trust beneficiary to the current beneficiaries constituted a change of ownership under *section 60*. Accordingly, we do not disturb the trial court's ruling [**25] denying plaintiff's request for writ of mandate. [*461]

IV

DISPOSITION

The judgment is affirmed. Respondent is entitled to its costs on appeal.

Rylaarsdam, Acting P. J., and Moore, J., concurred.

**AIR CHINA LIMITED, Plaintiff and Appellant, v. COUNTY OF SAN MATEO, Defendant and Respondent.**

**A120971**

**COURT OF APPEAL OF CALIFORNIA, FIRST APPELLATE DISTRICT, DIVISION FOUR**

*174 Cal. App. 4th 14*; *93 Cal. Rptr. 3d 893*; *2009 Cal. App. LEXIS 804*

**May 20, 2009, Filed**

**NOTICE:**

As modified June 16, 2009.

**SUBSEQUENT HISTORY:** Modified and rehearing denied by *Air China Limited v. County of San Mateo, 2009 Cal. App. LEXIS 958 (Cal. App. 1st Dist., June 16, 2009)*

**PRIOR HISTORY:** [***1]
Superior Court of San Mateo County, No. 460878, Marie S. Weiner, Judge.

**SUMMARY:**

CALIFORNIA OFFICIAL REPORTS SUMMARY

A Chinese airline commenced an action against a county, seeking a refund and a declaration that possessory interest taxes imposed against it were prohibited by the Agreement Between the Government of the United States of America and the Government of the People's Republic of China with Respect to Mutual Exemption from Taxation of Transportation Income of Shipping and Air Transport Enterprises (Tax Treaty). The trial court entered summary judgment in favor of the county, finding that the county's assessment and collection of taxes on the airline's leasehold possessory interests and landing rights at the San Francisco International Airport pursuant to *Rev. & Tax. Code, §§ 107* and *107.9*, was proper. (Superior Court of San Mateo County, No. 460878, Marie S. Weiner, Judge.)

The Court of Appeal affirmed the judgment. As a threshold matter, the court was satisfied, and the airline did not dispute, that its use of landing rights and leasehold improvements at the airport met the requirements of *Rev. & Tax. Code, § 107*. The court held that the Tax Treaty did not prohibit the county from taxing the airline's possessory interests in its use of landing and common terminal facilities at the airport. Nothing in the language of the treaty either applies to taxation of possessory interests or exempts air transportation enterprises from property taxation. The court concluded that the county's tax did not violate the internal revenue code or the Chicago Convention on International Civil Aviation, December 7, 1944, 61 Stat. 1180. The tax on possessory interests in the airline's landing rights and leasehold improvements was not a tax on gross income, but was in actuality a property tax. In assessing the taxes, the county gave no consideration to the airline's income or profits, and the taxes were based on the assessed value of the airline's leasehold interest and the value of its landing rights. *26 U.S.C. § 883* does not restrict the county from imposing a tax on these possessory interests. Contrary to the airline's argument, the taxes assessed were not fees infringing on the airline's right to land in the United States, but rather were taxes on its possessory interests in the airport's facilities. Thus, the Chicago Convention was not implicated. (Opinion by Rivera, J., with Ruvolo, P. J., and Reardon, J., concurring.) [*15]

**HEADNOTES**

CALIFORNIA OFFICIAL REPORTS HEADNOTES

**(1) Property Taxes § 4--Power to Tax--Counties--Possessory Interests--Shared Control of Property with Government.**--A county has the right to assess taxes on property within its jurisdiction (*Cal. Const., art. XIII, § 1*; *Rev. & Tax. Code, § 201*). Pursuant to *Rev. & Tax. Code, § 107*, the county may tax possessory interests in land or improvements if certain conditions are met. A possessory interest is 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 (*§ 107, subd. (a)*). In order for a possessory tax to be valid, the right of possession in the property must be independent, durable, and exclusive of rights held by others in the property. Taxation of possessory interests is rooted in the belief that the holder of a valuable use of public property that is tax exempt should contribute taxes to the public entity that makes its possession possible and provides a certain amount of exclusivity. Just as the shared use of property with others does not defeat the exclusivity requirement for taxability, but merely affects valuation of the taxable interest, similarly the shared control of property with government does not defeat the independence requirement, but merely affects the valuation of the taxable interest.

**(2) Property Taxes § 1--Possessory Interests--Shared Use of Property--Exclusivity Requirement.**--Shared use of property with others affects only the valuation of the possessory interest and does not defeat the exclusivity requirement of *Rev. & Tax. Code, § 107*.

**(3) Treaties § 1--Tax Treaty Between United States and China--Exemption of Income Taxes--Effect on Imposition of Property Taxes.**--The Agreement Between the Government of the United States of America and the Government of the People's Republic of China with Respect to Mutual Exemption from Taxation of Transportation Income of Shipping and Air Transport Enterprises (Tax Treaty) provides that income and profits of an enterprise of a contracting state from the operation of ships or aircraft in international traffic shall be taxable only in that contracting state. The Tax Treaty prohibits both the United States and the People's Republic of China from taxing the income or profits derived from airport transportation enterprises engaged in by one country's companies in the other country. It makes no mention of property taxes, and there is nothing in the language of the treaty that proscribes them. The Tax Treaty specifically exempts only taxation of transportation income of shipping and air transport enterprises. The Tax Treaty defines income and profits from the operation of ships and aircraft to include income and profits from the operation of passenger, cargo, or mail transportation service by the owner or charterer of an aircraft, and [*16] the sale of tickets related to that transportation. There is a provision exempting the People's Republic of China's residents from paying taxes in the United States on salaries derived from employment by the People's Republic of China enterprise as a crew member on an aircraft operated in international traffic. But there is no provision proscribing the imposition of property taxes. The legislative history of the Tax Treaty supports the interpretation that it was intended solely as an agreement to exempt income taxes.

**(4) Treaties § 3--Construction--International Tax Treaties--Language.**--Under the rules governing the interpretation of international tax treaties, the clear import of treaty language controls unless application of the words of the treaty according to their obvious meaning effects a result inconsistent with the intent or expectations of its signatories.

**(5) Aviation § 4--Airports--Tax Treaty Between United States and China--Effect on County's Imposition of Tax on Possessory Interests at California Airport.**--The plain language of the Agreement Between the Government of the United States of America and the Government of the People's Republic of China with Respect to Mutual Exemption from Taxation of Transportation Income of Shipping and Air Transport Enterprises afforded a Chinese airline no relief from a county's taxation of its possessory interests in its use of landing and common terminal facilities at the San Francisco International Airport.

[*Cal. Forms of Pleading and Practice (2009) ch. 540, Taxes and Assessments, § 540.426*.]

**(6) Aviation § 1--Taxation--Foreign Commerce--Home-port Doctrine.**--Taxation of airplanes engaged solely in commerce with foreign nations is vested exclusively at the home port of the airplanes. Under the home-port doctrine, no jurisdiction, other than that of the true domicile, may tax instrumentalities of communication engaged in foreign commerce. The home-port doctrine applies to foreign owned and foreign based and registered aircraft flown exclusively in foreign commerce having a single United States port.

**(7) Administrative Law § 10--Powers and Functions of Agencies--Administrative Construction and Interpretation of Laws--Deferential Review.**--Courts commonly give great credence to an agency's interpretation of the statutes and regulations it is charged with enforcing.

**(8) Corporations § 61--Taxation--Foreign Corporations--Gross Receipts Derived from Air Transportation.**--*Int. Rev. Code, § 883(a)(2)* exempts from taxation gross income derived by a corporation organized in a foreign country from the international operation of aircraft if such [*17] foreign country grants an equivalent exemption to corporations organized in the United States. Int. Rev. Code, § 1513(a) proscribes the imposition of state and local taxes on gross receipts derived from air transportation, because a property tax that is measured by gross receipts constitutes at least an indirect tax on the gross receipts of airlines.

**(9) Aviation § 1--Chicago Convention on International Civil Aviation.**--The Chicago Convention on International Civil Aviation, December 7, 1944, 61 Stat. 1180, provides that no fees, dues or other charges shall be imposed by any contracting state in respect solely of the right of transit over or entry into or exit from its territory of any aircraft of a contracting state of persons or property thereon (61 Stat. 1185).

**COUNSEL:** Wilson, Elser, Moskowitz, Edelman & Dicker, Stephen L. Nelson, George N. Tompkins, Jr., George N. Tompkins III and Margaret J. Elliott for Plaintiff and Appellant.

Michael P. Murphy, County Counsel, and Eugene Whitlock, Deputy County Counsel, for Defendant and Respondents.

**JUDGES:** Opinion by Rivera, J., with Ruvolo, P. J., and Reardon, J., concurring.

**OPINION BY:** Rivera

**OPINION**

[**895] **RIVERA, J.**--Air China Limited appeals from a summary judgment entered in favor of San Mateo County (the County) finding that the County's assessment and collection of taxes on Air China's leasehold possessory interests and landing rights at the San Francisco International Airport (Airport) pursuant to *California Revenue and Taxation Code* [1] *sections 107* and *107.9* was proper. Air China contends that a tax treaty between the United States and the People's Republic of China (PRC) prohibits the County from imposing taxes on its operations at the Airport, and that the taxes are contrary to the United States Internal Revenue Code and to the Chicago Convention on International Civil Aviation, December 7, 1944, 61 Stat. 1180, 1189 (the Chicago Convention). We affirm.

1 Unless otherwise indicated, all subsequent statutory [***2] references are to the California Revenue and Taxation Code.

**I. FACTUAL BACKGROUND**

The parties stipulated to the following facts: Air China is a corporation organized and existing under the laws of the PRC and is engaged exclusively in international air transportation serving various cities throughout the world [*18] including San Francisco. Air China operates aircraft out of the Airport and leases space there that it uses exclusively for its air transportation operations.

The United States and the PRC are parties to a tax treaty--"Agreement Between the Government of the United States of America and the Government of the People's Republic of China with Respect to Mutual Exemption from Taxation of Transportation Income of Shipping and Air Transport Enterprises" (Tax Treaty). The Tax Treaty exempts both the United States and the PRC from taxation by the other party for income and profits generated from the operation of aircraft in international air transportation.

Air China leases space from the Airport and makes payments for the use of the premises. Air China also pays landing fees for the right to land at the Airport. Since 2000, the County has imposed property taxes including possessory interest taxes on Air [***3] China's leasehold improvements, and landing rights at the Airport. Air China has paid these taxes under protest.

On October 21, 2002, California's State Board of Equalization (Board) issued an opinion letter in response to an inquiry by Air China concerning the Tax Treaty's tax exemption. The Board concluded that the County's imposition of any property tax on Air China's aircraft or other property [**896] including possessory interests was prohibited by the Tax Treaty.

In May 2006, Air China requested a refund of taxes under *section 5096*. The County did not issue a formal response to the request. In February 2007, Air China commenced this action seeking a refund and a declaration that the possessory interest taxes imposed are prohibited by the Tax Treaty. The parties subsequently filed motions for summary judgment based on the above stipulated facts. The court granted the County's motion, finding that the Tax Treaty did not prohibit imposition of taxes on Air China's possessory and leasehold interests and denied Air China's motion. This appeal followed.

**II. DISCUSSION**

A. *Standard of Review*

This appeal presents a question of law on stipulated facts. We therefore review the trial court's judgment [***4] de novo. (*MacIsaac v. Waste Management Collection & Recycling, Inc. (2005) 134 Cal.App.4th 1076, 1081-1082 [36 Cal. Rptr. 3d 650]*.)

B. *The County Has the Right to Tax Air China's Possessory Interests*

**(1)** The County has the right to assess taxes on property within its jurisdiction. (*Cal. Const., Art. XIII, § 1*; see also *Rev. & Tax. Code, § 201* [all [*19] property within the state is subject to taxation if not exempt under federal law or other state law].) Pursuant to *section 107*, the County may tax possessory interests in land or improvements if certain conditions are met. A possessory interest is a "[p]ossession 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." (*§ 107, subd. (a).*) In order for a possessory tax to be valid, the right of possession in the property must be independent, durable, and exclusive of rights held by others in the property. (*United Air Lines, Inc. v. County of San Diego (1991) 1 Cal.App.4th 418, 427, fn. 5 [2 Cal. Rptr. 2d 212]*; *Freeman v. County of Fresno (1981) 126 Cal.App.3d 459, 463 [178 Cal. Rptr. 764].*) "'[T]axation of possessory interests is rooted in the belief that "the holder of a valuable use of public property that is tax exempt should contribute [***5] taxes to the public entity which makes its possession possible and provides a certain amount of exclusivity." [Citations.]'" (*Korean Air Lines Co., Ltd. v. County of Los Angeles (2008) 162 Cal.App.4th 552, 560-561 [76 Cal. Rptr. 3d 26]* (*Korean Air Lines*), quoting *City of San Jose v. Carlson (1997) 57 Cal.App.4th 1348, 1352-1353 [67 Cal. Rptr. 2d 719].*)

Here, the County assesses a property tax based on Air China's possessory interests in the occupancy and use of the Airport's international terminal/customs space and facilities. The tax is based upon the value of rent Air China pays over the term of the lease. In determining the tax, the County gives no consideration to Air China's earnings or profits. Likewise, there is no consideration given to Air China's income in assessing the tax for its possessory interests in the landing rights at the Airport. This assessment is based on the value of Air China's right to use the airfield runways, taxiways, and appurtenant aircraft accessible facilities. The value of the landing rights is prescribed by statute in *section 107.9* and is calculated using Air China's prior year's annual aircraft landed weights, one-half of the applicable Airport landing fee rate, and the anticipated term and expense [***6] rate specified in the statute.

In *Korean Air Lines*, the court addressed the propriety of a county's imposition of a similar tax on a foreign airline's [**897] possessory interest in common airport terminal facilities. (*Korean Air Lines, supra, 162 Cal.App.4th at p. 558.*) The court determined that Korean Air's use of the federal inspection service area at the airport met the independent, exclusive and durable criteria to constitute a taxable possessory interest under *section 107, subdivision (a)*. "Just as the shared use of property with others does not defeat the exclusivity requirement for taxability, but merely affects valuation of the taxable interest [citation], similarly the shared control of property with government does not defeat the 'independence' requirement, but merely affects the valuation of the taxable interest." (*Korean Air Lines, at p. 569.*) The court concluded that the durability requirement was also met because [*20] Korean Air had the right to use the facilities pursuant to a lease for the period from 1992 through the 2001 date of its assessment appeal, a period sufficient to establish that its right was durable within the meaning of *section 107, subdivision (a)*. (*Korean Air Lines, at pp. 569-570.*)

**(2)** Here, [***7] the question of whether the County's tax on Air China's possessory interests in landing rights and leasehold improvements at the Airport meets the statutory requirements of *section 107* was not disputed in the trial court and is not before us. Air China, however, suggests in its reply brief that the County is prohibited from imposing any property taxes because it does not own any property at the Airport and its use of the terminal space, taxiways, and runways is not exclusive. While it does not make this argument in the context of the exclusivity requirement of *section 107*, it is well settled that shared use of property with others affects only the valuation of the possessory interest and does not defeat the exclusivity requirement of *section 107*. (*Korean Air Lines Co., supra, 162 Cal.App.4th at p. 569.*)

C. *The Tax Treaty Does Not Prohibit the County from Taxing Air China's Possessory Interests at the Airport*

Air China contends that the Tax Treaty prohibits the County from imposing any taxes on income and profits it derives from its air transportation operations to or from the United States. It argues that the County's taxation of its possessory interests in the use of landing and common terminal facilities violates the Tax Treaty.

**(3)** The Tax Treaty [***8] provides that "[i]ncome and profits of an enterprise of a Contracting State from the operation of ships or aircraft in international traffic shall be taxable only in that Contracting State." The Tax Treaty prohibits both the United States and the PRC from taxing the income or profits derived from airport transportation enterprises engaged in by one country's companies in the other country. It makes no mention of property taxes and there is nothing in the language of the treaty that proscribes them.

**(4)** The rules governing the interpretation of international tax treaties are established. "The clear import of treaty language controls unless 'application of the words of the treaty according to their obvious meaning effects a result inconsistent with the intent or expectations of its signatories.'" (*Sumitomo Shoji America, Inc. v. Avagliano (1982) 457 U.S. 176, 180 [72 L. Ed. 2d 765, 102 S. Ct. 2374]*, quoting *Maximov v. United States (1963) 373 U.S. 49, 54 [10 L. Ed. 2d 184, 83 S. Ct. 1054].*)

**(5)** Here, nothing in the language of the treaty either applies to taxation of possessory interests or exempts air transportation enterprises from property taxation. The Tax Treaty specifically exempts only "taxation of transportation [*21] income of shipping and air transport enterprises." [***9] The Tax Treaty defines income and profits from the operation of ships and aircraft to include income and profits from the operation [**898] of passenger, cargo, or mail transportation service by the owner or charterer of an aircraft, and the sale of tickets related to that transportation. And there is a provision exempting the PRC's residents from paying taxes in the United States on salaries derived from employment by the PRC enterprise as a crewmember on an aircraft operated in international traffic. But there is no provision proscribing the imposition of property taxes. The plain language of the treaty affords Air China no relief from the County's taxation of its possessory interests in its use of landing and common terminal facilities at the Airport.

The legislative history of the Tax Treaty supports our interpretation that the treaty was intended solely as an agreement to exempt income taxes. It states that the treaty was intended "to eliminate potential double taxation of certain income earned by enterprises and residents of either country from shipping and air transportation" and expressly notes that it is an "income tax agreement." (See Sen. Com. on Foreign Relations, Rep. on Shipping [***10] & Aircraft Tax Agreement with People's Republic of China (Treaty Doc. 97-24), Exec. Rep. No. 98-14, 1st Sess., pp. 1-2 (1983).) We have found nothing in the legislative history which reflects an intent to prevent imposition of local property taxes. The legislative history does contain language indicating that state and local governments have reciprocal rights to impose *income* taxes: "[I]f any state or locality of the United states imposes tax on PRC enterprises on income and profits from the operation of ships or aircraft in international traffic, then the People's Republic of China may impose any local surcharge on such income and profits of U.S. enterprises." (*Id.* at p. 6.) But there is no similar language pertaining to property taxes.

**(6)** Air China relies, primarily, on *Scandinavian Airlines System, Inc. v. County of Los Angeles (1961) 56 Cal.2d 11 [14 Cal. Rptr. 25, 363 P.2d 25]* (*Scandinavian Airlines*) as applicable precedent. The *Scandinavian Airlines* case addressed the issue of whether a county could impose property taxes on foreign owned airplanes flying exclusively in foreign commerce and using the Los Angeles airport infrequently as its sole United States terminal. The California Supreme Court determined that taxation of airplanes engaged [***11] solely in commerce with foreign nations is vested exclusively at the home port of the airplanes. (*Id. at pp. 35-36.*) Under the home-port doctrine, "no jurisdiction, other than that of the true domicile, may tax instrumentalities of communication engaged in foreign commerce." (*Id. at p. 32.*) The court determined that the home-port doctrine applied to foreign owned and foreign based and registered aircraft flown exclusively in foreign commerce having a single United States port. (*Id. at pp. 32-33.*) Further, the court held that the [*22] tax treaty between the United States and Sweden specifically prohibited income and property taxes on aircraft not registered in the taxing nation. (*Id. at p. 39.*)

Air China also relies on *Japan Line, Ltd. v. County of Los Angeles (1979) 441 U.S. 434, 451-452 [60 L. Ed. 2d 336, 99 S. Ct. 1813]* (*Japan Line*). There, the United States Supreme Court held that a property tax on a Japanese shipping line's cargo containers that were temporarily within the state but used exclusively in foreign commerce violated the commerce clause because the tax resulted in multiple taxation of instrumentalities of foreign commerce and prevented the United States from "'speaking with one voice'" in regulating foreign trade.

[**899] Neither [***12] *Scandinavian Airlines, supra, 56 Cal.2d 11*, nor *Japan Line, supra, 441 U.S. 434*, supports Air China's argument. The County's tax on Air China's possessory interests is not a tax on its aircraft as was the tax in *Scandinavian Airlines*, and it is not prohibited by the Tax Treaty. And, unlike the tax considered in *Japan Line*, there is no risk of multiple taxation because the property being taxed is fixed permanently within the County and not subject to taxation in any other location, including the PRC. Nor is there any evidence in the record that the County's taxation of possessory interests infringes on federal uniformity in this area. In short, we take the Tax Treaty at face value; had the parties wished to create an exemption from any and all types of taxation, they could have done so.

Air China urges us to defer to the Board's opinion letter of October 21, 2002, which purports to support Air China's argument that the Tax Treaty exempts Air China from the imposition of real property taxes. We decline to do so for three reasons.

First, it is not at all clear that the question posed to the Board was the same question posed either to the trial court or to this court. Conspicuously absent [***13] from the record is *any* copy of the letter from Air China to the Board requesting an opinion concerning its taxable status, while the record contains multiple copies of the Board's opinion letter in response to the phantom letter from Air China. The absence of Air China's letter is particularly salient because the Board's opinion letter seems to focus almost entirely on the question of the taxable status of Air China's *aircraft*, a question that is not before us. [2]

2 In its letter concluding that Air China was exempt from taxes, the Board begins by referring to *section 5331* (providing that *aircraft* owned by the United States or any foreign government, are exempt from personal property taxation), and then states that this statute "appears to provide a simple and clear answer to your inquiry if the *aircraft* are, in fact, owned by a foreign government." (Oct. 21, 2002 Board letter, italics added.) The Board then relies on the *Scandinavian Airlines* holding that "Los Angeles County was barred by international treaty from imposing property taxes on *aircraft*." (Oct. 21, 2002 Board letter, italics added.) The Board goes on to explain that taxes on *aircraft* of foreign countries generate a "strong possibility [***14] of a retaliatory tax" and "could jeopardize one of the purposes of the [Treaty] and subject the *aircraft* of U.S. carriers to a retaliatory tax." (*Ibid.*, italics added.) The Board concludes with its opinion that "the imposition of any property tax on aircraft and other property owned or leased by Air China, including possessory interests, is prohibited under the [Treaty]," and "[t]he ramifications of subjecting these *aircraft* to property taxation could have a significant impact on other states and would inhibit the federal government from speaking with one voice when regulating commercial relations with foreign governments." (*Ibid.*, italics added.)

The single, passing reference to a tax on (unidentified) "possessory interests" in the context of a letter that repeatedly refers to the taxable status of Air China's *aircraft*, strongly suggests that the Board was answering a different question than that posed in this lawsuit.

[*23]

**(7)** Second, assuming the Board's opinion did address the taxable status of Air China's leasehold interests in real property, it is not entitled to deference. Air China contends that we should defer to the opinion letter because the Board "possesses expertise and specific [***15] legislative authority to interpret legislation imposing property taxes." It is true the courts commonly give great credence to an agency's interpretation of the statutes and regulations it is charged with enforcing. (*Maples v. Kern County Assessment Appeals Bd. (2002) 96 Cal.App.4th 1007, 1015-1016* [**900] *[117 Cal. Rptr. 2d 663]* [judicial deference is given to an agency's "contemporaneous administrative construction of a regulation by the agency charged with its enforcement"]; *Ordlock v. Franchise Tax Bd. (2006) 38 Cal.4th 897, 910 [44 Cal. Rptr. 3d 212, 135 P.3d 628]* [courts afford "significant weight and respect to long-standing statutory construction ... by the agency charged with enforcement of the statute"]; *Yamaha Corp. of America v. State Bd. of Equalization (1998) 19 Cal.4th 1, 7 [78 Cal. Rptr. 2d 1, 960 P.2d 1031]* [Board's interpretations of tax law are entitled to the "consideration and respect" of courts].) As Air China readily concedes, however, the opinion is based on the Board's interpretation of the Tax Treaty, not any statute or regulation the Board is charged with enforcing.

Third, even if deference were due to the Board's opinion, we would reach the same conclusion on the merits. The letter acknowledged that the Tax Treaty exempted only the taxation of income and profits, [***16] and correctly summarized the holdings of *Scandinavian Airlines, supra, 56 Cal.2d 11*, and *Japan Line, supra, 441 U.S. 434* which proscribed taxation on foreign-owned aircraft and cargo containers ("instrumentalit[ies] of foreign commerce"). Under the circumstances, its conclusion (if any) that the tax exemption extended to property taxes on possessory interests in real property was erroneous, for the same reasons we rejected Air China's argument--it had no grounding in the express language of the Tax Treaty or the cited case law. [3]

3 The Board's opinion also ignored countervailing decisions holding that similar, locally imposed taxes did not violate federal policies or the commerce clause. (*Wardair Canada v. Florida Dept. of Revenue (1986) 477 U.S. 1, 9 [91 L. Ed. 2d 1, 106 S. Ct. 2369]* [sales tax on airplane fuel did not implicate foreign commerce clause nor threaten the ability of the federal government to "'speak with one voice' "]; *Itel Containers Int'l Corp. v. Huddleston (1993) 507 U.S. 60, 74-76 [122 L. Ed. 2d 421, 113 S. Ct. 1095]* [sales tax imposed on income from leases of international shipping containers does not impinge on federal authority or foreign policy].)

[*24]

D. [***17] *The County's Tax Does Not Violate the Internal Revenue Code or the Chicago Convention*

Air China argues that the County's taxation of its possessory interests in its landing rights and use of common terminal facilities at the Airport is an indirect tax on its income and, thus, contrary to *United States Internal Revenue Code section 883(a)(2)*.

**(8)** United States Internal Revenue Code *section 883(a)(2)* "exempt[s] from taxation ... [¶] ... [¶] [g]ross income derived by a corporation organized in a foreign country from the international operation of aircraft if such foreign country grants an equivalent exemption to corporations organized in the United States." Air China argues that the taxes on its possessory interests here are in effect indirect income taxes and thus preempted by the

United States Internal Revenue Code. It relies on *Aloha Airlines, Inc. v. Director of Taxation (1983) 464 U.S. 7, 10, 14-15 [78 L. Ed. 2d 10, 104 S. Ct. 291]*, where the United States Supreme Court invalidated a tax on an airline's gross income that was imposed as "'a means of taxing the personal property of the airline ... .'" The court determined that even though the tax was labeled as a personal property tax, it was not exempt under former [***18] section 1513(a) of title 49 of the United States Code, which proscribes the imposition of state and local taxes on gross receipts derived from air transportation, because "a property tax that is measured [**901] by gross receipts constitutes at least an 'indirect' tax on the gross receipts of airlines." (*Aloha Airlines, at pp. 13-14.*)

Here, the tax on possessory interests in Air China's landing rights and leasehold improvements is not a tax on gross income, but is in actuality a property tax. In assessing the taxes, the County gave no consideration to Air China's income or profits, and the taxes were based on the assessed value of Air China's leasehold interest and the value of its landing rights. *United States Internal Revenue Code section 883* does not restrict the County from imposing a tax on these possessory interests.

**(9)** Finally, Air China argues that the taxes imposed violate the Chicago Convention. The Chicago Convention provides that "[n]o fees, dues or other charges shall be imposed by any contracting State in respect solely of the right of transit over or entry into or exit from its territory of any aircraft of a contracting State of persons or property thereon." (Chicago Convention, [***19] 61 [*25] Stat. 1185.) Contrary to Air China's argument, the taxes assessed are not fees infringing on Air China's right to land in the United States, but rather are taxes on its possessory interests in the Airport's facilities. The Chicago Convention is not implicated.

## III. DISPOSITION

The judgment is affirmed.

Ruvolo, P. J., and Reardon, J., concurred.