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Executive Director

July 31, 1996

Re:

Change in Ownership - Comparability of Replacement Property for Exclusion under Section 68 and Rule 462.5

Dear Mr. Elias:

This is in response to your letter of May 21, 1996 to the State Board of Equalization regarding the above matter. We also spoke briefly on June 27, 1996 and you provided additional information. Your clients, , have an appeal pending before the Board of Assessment Appeals scheduled for August 6, 1996; they are requesting that, pursuant to Revenue and Taxation Code section 68,[1] the base year value of the property be applied to the property purchased at . Both properties are in .

Because the replaced property (Walnut) has a higher market value than the replacement property (Orange), your clients wish to allocate a one-half portion of the replaced property to the replacement property. You have not identified a second replacement property.

Based on the facts and reasoning below, it is our opinion that the section 68 exclusion should apply to the replacement property and that a partial allocation is allowable.

LEGAL ANALYSIS

Revenue and Taxation Code sections 50 and 51 provide that the taxable value of real property is based on the base year value of the property. Properties purchased or changing ownership after the 1975 lien date are reassessed and base year

[1] All references to code sections are to the Revenue and Taxation Code unless otherwise noted.

values redetermined. "Change in ownership" is defined in section 60 which provides that a "change in ownership" means 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. Some transfers are excluded from consideration as changes in ownership. One such exclusion relates to the facts of this case.

The California Constitution, Article XIII A, Section 2(d) provides, in pertinent part:

> "For purposes of this section, the term, 'change in ownership' shall not include the acquisition of real property as a replacement for comparable property if the person acquiring the real property has been displaced from the property replaced by eminent domain proceedings, by acquisition by a public entity, or governmental action which has resulted in a judgment of inverse condemnation. The real property acquired shall be deemed comparable to the property replaced if it is similar in size, utility, and function, or if it conforms to state regulations defined by the Legislature governing the relocation of persons displaced by governmental actions...."

As enacted by the Legislature, section 68 implements Article XIII A, Section 2, subdivision (d); that statute similarly defines the term "change in ownership" and addresses matters other than the comparability of the acquired/replacement property to the original/replaced property. Property Tax Rule 462.5[2] (attached hereto) was promulgated by the State Board of Equalization to implement section 68 pursuant to its authority under Government Code section 15600.

Subdivision (c) of Rule 462.5 addresses the comparability requirement and provides that replacement property shall be deemed comparable to the replaced property if it is similar in size, utility, and function. As you have not raised other issues

[2] Property Tax Rules are set out in Title 18, California Code of Regulations.

related to this exclusion, we will focus our attention on the comparability question.

Comparability regarding function

You state that the original application pursuant to section 68 was denied because the replacement property was not considered "Like Kind". The difficulty in this case relates to the zoning and the actual use of the properties. The replaced property was zoned R-2; there was a small third unit which was out-of-compliance with the zoning. The replacement property is zoned R-1.

Rule 462.5, subdivision (c)(1) provides that property is similar <u>in function</u> if the replacement property is subject to similar governmental restrictions, such as zoning. Although R-1 and R-2 are different zoning restrictions, they appear comparable in that both relate to residential property in less than "multi-family" units. The rule requires only that the properties must be subject to "similar government restrictions", not identical ones. We have been of the view that whether zoning restrictions are "similar" is a question of fact for the assessor in each case, however.

A further issue is presented in this case because the replaced property is out of compliance with its R-2 zoning ordinance; there is a small third unit in use. The question in this regard is whether the variant use of the replaced property means that the property should be considered as something other than R-2. It is our opinion that zoning ordinances are the applicable standard for the purposes of Rule 462.5, subdivision (c)(1) and take precedence over actual use in instances as described herein; the replaced property is zoned R-2 and it is the R-2 zone designation that should be used for the purposes of Rule 462.5, subdivision (c)(1).

We have previously advised that the assessor should keep in mind the underlying intent of the constitutional provision cited above; it was designed to correct an inequity that may occur when a governmental agency forces a property owner to relocate to make way for a public project through eminent domain proceedings, public entity acquisition, or inverse condemnation. The displaced property owner should not be faced with the unpleasant

consequence of a tax increase after a government-caused relocation. Thus, the exclusion from change in ownership related to base year value was adopted. However, the constitutional provision was not intended to provide a benefit to the displaced owner; it was intended to compensate for a loss, and certain requirements and limitations were put in place.

Comparability regarding size and utility

Rule 462.5, subdivision (c)(2) states that both the size and utility of property are interrelated and associated with value. The value, i.e., full cash value, of the replaced and replacement properties differ in this case; the value of the replaced property is $257,500 and is higher than the $130,000 value of the replacement property identified herein. You ask whether a one-half allocation of the base year value of the replaced property can be made so that another replacement property acquired later can utilize the balance of the full cash value of the replaced property.

Phrased in a general way, the issue is whether the replacement property can consist of more than one appraisal unit, with the value of the replaced property being allocated to the different units for purposes of this exclusion. Our view has been that such allocations are allowable. The definition of "replacement property" under Rule 462.5, subdivision (b)(3) means "real property acquired to replace real property taken." Section 104 defines the term "real property" to include land and improvements and does not limit the term to mean a single unit of appraisal. Also, we note that the last example given in Rule 462.5, subdivision (c) recognizes multiple replacement properties. Thus, more than one appraisal unit may be used; if a subsequently acquired replacement property meets all the requirements of section 68 and Rule 462.5, the balance of the full cash value of the replaced property may be used.

Application of Rule 462.5

Subsections (d) through (h) of Rule 462.5 relate to other aspects of this exclusion, i.e., procedures for determining the adjusted base year value, ownership requirements, new construction required to make replacement property comparable, time limits for qualification, and administration. You have not

raised any question as to these aspects, and we will not address them except to note that the additional requirements must be met.

CONCLUSION

It is our opinion that based on the facts and law discussed herein, the exclusion set forth in section 68 and Rule 462.5 applies to the replacement property (Orange) and that a partial allocation of the value of the replaced property (Walnut) can be made.

The views expressed in this letter are, of course, only advisory in nature. They are not binding upon the assessor of any county. You may wish to consult the County assessor in order to confirm that the described property will be assessed in a manner consistent with the conclusions stated above.

Our intention is to provide timely, courteous and helpful responses to inquiries such as yours. Suggestions that help us to accomplish this goal are appreciated.

Sincerely,

Janet Saunders
Tax Counsel

JS:jd
precednt/emdomain/1996/96001.jd

Enclosure

cc: The Honorable
County Assessor

Mr. James Speed, MIC:63
Mr. Richard Johnson, MIC:64
Ms. Jennifer Willis, MIC:70

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Executive Director

January 25, 1995

The Honorable Robert C. Petersen
Santa Cruz County Assessor
Attn: Mr. Gary Hazelton, Director-Valuation
Government Center, 701 Ocean Street
Santa Cruz, CA 95060

In Re: Change in Ownership - Comparability of Replacement Property for Exclusion under Section 68 and Rule 462.5, subdivision (c).

Dear Mr. Hazelton:

This is in response to your November 8, 1994 letter to Mr. Richard Ochsner, requesting our opinion on the application of the exclusion from change in ownership for replacement property under Section 68 and Property Tax Rule 462.5 (Title 18 Cal. Code of Regs. 462.5) relative to a unique set of circumstances. The **original property** is described as follows:

1. Approximately 10.8 acres of a 28.87-acre parcel, known as the "G Property" in the City of San Jose was condemned in June 1990 by the State of California Department of Transportation for an extension of Highway 85 (a north-south freeway) in Santa Clara County.

(a) Zoned agricultural since 1940; improved with farm buildings and a two-family residence owned and occupied by the G family (hereinafter "owners");

(b) Approximately 13 acres was designated "Freeway Reserve" by the California Highway Commission in 1956/57; shown as part of Transportation Corridor on assessor's parcel maps, general plan, and zoning maps;

(c) Located on major arterial, Expressway, and in the proposed freeway extension; parcel originally larger, but owners sold 8 acres to regional shopping center in 1965;

(d) All development denied by county planning due to future highway extension, except for special use permit granted in April 1973, for golf driving range/school and golf shops (from which condemned portion was ultimately taken);

(e) Parcel annexed to City of in 1983, Williamson Act contract non-renewed in 1984; designated on city general plan as commercial/multi-family residential, but zoning continued agricultural;

(f) Owners leased and/or operated driving range and shops until State condemnation in 1990; State appraised value of $12,539,000 for property based on commercial/multi-family residential use; remaining 17 acres currently being rezoned to commercial.

2. The **replacement property** recently purchased by owners consists of approximately 17 acres and totals $12,293,614, and is described as follows:

(a) In County, three single family residences, one duplex, 4 commercial office buildings, one commercial property and one commercial land;

(b) In County, one residential condominium and one commercial office building;

(c) In County, one commercial land and building constructed;

(d) In County, one single family residence;

(e) In County, one commercial land; and

(f) In County, one commercial land.

Pursuant to Section 68 and as interpreted by Rule 462.5, subdivision (c), you question **whether the replacement properties may be deemed comparable as "similar in size, utility, and function" to the original property taken** by the state. Specifically, you have requested that we address the following:

1. Since the original property was under a Williamson Act Contract, how do the "restrictions" under Rule 462.5, subdivision (c) apply in this instance?

2. If the 10-acre original property was a golf driving range with a 1600 square foot building, how is it comparable to a 1.63 -acre replacement property in County with a 14,520 square foot office building?

3. How do the previous questions and answers apply to the replacement properties purchased in other counties?

Your questions pertain to the application of the standards for "comparable property" under Rule 462.5, subdivision (c), which states that replacement property shall be **deemed comparable** to the property replaced <u>if it is similar in size, utility, and function</u>. It is clear from Section 2 of Article XIIIA of the Constitution that a replacement property must meet **all three** comparability criteria to be considered "comparable." If the replacement property does **not** meet the comparability tests, any property that does not is subject to reappraisal. (Rule 462.5, subdivision (c)(3).)

Paragraph (1) under subdivision (c) states that property is **similar in function** if it is "subject to similar governmental restrictions as the condemned property, such as zoning." Paragraph (2) of subdivision (c) states that replacement property

is **similar in both size and utility** if it is, or is intended to be, used in the same manner as the taken property. The comparability standards are illustrated in the examples given in paragraph (3) of subdivision (c). These examples demonstrate that replacement property is similar in size and utility **only if** its actual or intended use is similar to the actual use of the taken property. Accordingly, the answers to your questions are explained in light of these examples and the language of subdivision (c).

Question 1. Since the original property was under a Williamson Act Contract, how do "government restrictions" under Rule 462.5, subdivision (c) apply in this instance?

The issue is whether the standard of "**similar governmental restrictions,**" in paragraph (1), subdivision (c), requires that where the original property is restricted under a Williamson Act Contract, the **replacement property** must also be so restricted.

The term "government restrictions" refers to a number of possible limitations placed upon the use of property by state and/or local government. The most obvious example is "zoning" as mentioned in paragraph (1). However, Williamson Act contracts, open space easements, special use permits, and general plan designations are other examples of such restrictions.

Moreover, the rule expressly states that the property must be subject to "**similar** government restrictions," **though not identical.** We have historically taken the position that whether restrictions are "**similar**" is a question of fact for the assessor in each case. Thus, facts demonstrating **similar** government restrictions in the instant case require that the replacement property need not exactly replicate the Williamson Act contract, freeway reservation, and special use permit restrictions characterizing the original property. However, what constitutes sufficient **similarity** of restrictions is a decision for the assessor based on an evaluation of all the facts.

We have advised in the past that the assessor should keep in mind the underlying intent of Proposition 3 (Section 2 of Article XIIIA of the Constitution), i.e., that Proposition 3 was designed to correct an inequity that occurs when a governmental agency forces a property owners to relocate to make way for a public project through eminent domain proceedings or inverse

condemnation. The displaced property owner should not be faced with the double penalty of a tax increase after a government-caused relocation. However, correcting such an inequity does **not** mean permitting the property owner to experience a "gain," since Proposition 3 was **not** intended to be a tax **benefit.** Thus, the displaced property owner is allowed to **replace** what he lost through eminent domain proceedings, (including replacement of the base year value) providing the replacement property is similar.

In determining similarity of the government restrictions on replacement property and the property taken, the primary question here is the nature of the restrictions on the original property. The owners claim that the controlling governmental restriction on the original property was the State's reservation of it as a **freeway**, and that but for the freeway reserve, they could have improved the property with commercial and multi-family development in compatibility with the general plan (notwithstanding the golf driving range). The Williamson Act Contract, they contend, was merely a means of reducing the property taxes while it was held for future condemnation, and was not indicative of **actual** use, a theory which tends to be substantiated by the fact that the Williamson Act Contract was not proposed or executed until 1973, **after** formal reservation of the property in the State Transportation Corridor.

The owners further contend that from 1956/57 (original date of freeway reservation) to the date of condemnation (June 1990), the County of and subsequently the City of prohibited the owners from any commercial and/or multi-family residential development on the property with the exception of the special use permit for the golf driving range and shops. Conversely, throughout the mid-1960's, and 1970's County rezoned and approved the development of numerous commercial complexes, multi-family housing units, and a large regional shopping center **immediately adjacent** to the owners' property, but refused to rezone owners' property. Heavy commercial and multi-family residential development was permitted to surround the owners' property during subsequent years, but was disallowed on owners' property, for the reason expressly stated in paragraph 18 of 1984 City of General Plan, as follows:

> When an area is designated as a proposed freeway of State transportation corridor and its dedication is not required by the City, that area has an alternate land

> use designation. Unless that alternate land use designation is specifically shown on the Land Use/Transportation Diagram, the alternative land use designation is the designation of the property which bounds the proposed corridor. If the proposed corridor is bounded by more than one designation, each designation applies to the centerline of such corridor. In the event land is subdivided with a future freeway or State transportation corridor, the recorded Parcel Map or subdivision Map shall show the corridor traversing the lots.

During the same time period, the alternate land use designation for the property under the general plan was **commercial/multi-family residential**, though the zoning remained agricultural. Thus, any rezoning and/or permanent development was denied the owners pending the freeway extension. However, the City of clearly anticipated high density development on the property once the freeway was constructed. This is also stated at the end of the same paragraph 18 in the general plan as follows:

> If a portion of the dedicated parcel remains outside the corridor, the City may permit that portion of the property bordering the corridor to be developed with a greater intensity if all of the following are met:
>
> 1. The subject property includes a portion of the parcel within the proposed corridor and a portion bordering it.
>
> 2. Both portions have the same alternate land use designation.
>
> 3. The development intensity permitted on the portion of property bordering the proposed corridor does not exceed the amount which would otherwise have been permitted on the entire parcel if dedication had not been accepted.

In furtherance of such anticipated future development, the City filed a Notice of Non-renewal of the Williamson Act Contract in 1984, even though the rezoning from agricultural to commercial/multi-family did not occur until the State took possession in 1990. And in 1992, the City approved the owners'

application for rezoning the remaining 17 acres (left from the condemnation), to commercial/multi-family. A further rezoning of the 17 acres to entirely commercial is pending at this time.

Recognizing that the owners' **use** of the property was dictated primarily by state and local government agencies whose key interest was limiting the state's ultimate cost of acquisition, and that it would be difficult, if not impossible, to locate replacement property which was similarly restricted, we are not in a position to evaluate all the facts. Certainly there is some evidence, at least, which indicates that the general plan land use designation, rather than the agricultural zoning, may be the most realistic and controlling governmental restriction for purposes of comparing similar government restrictions. However, your office may choose to apply the language requiring "similar governmental restrictions" to these facts in any manner you believe to be within the scope of the rule.

Similarity of government restrictions is a difficult comparison, even given a relatively simple set of facts. The matter is further complicated here in that the original property was subject to a restriction (the freeway reservation) unlikely to be considered **similar** to any other type of government restriction, and the replacement property appears to be subject to far **less land use** restrictions than the original property. The original property, as we have discussed, was one 10-acre parcel designated freeway reserve, zoned agricultural, general planned commercial/multi-family, and limited in use to a driving range, a 1600-square foot commercial building, and a two-family residence. The replacement property consists of 15 parcels on 17 acres in several different counties, none of which are designated right-of-way reserve, and none of which are zoned agricultural, or are otherwise limited in development or use. In fact, a large number of the replacement parcels are improved with office and commercial buildings, multi-family and single family residences, and one with a mobile home park.

In answer to your question, therefore, "similar governmental restrictions" under paragraph (1), subdivision (c) of Rule 462.5 does **not** require that the **replacement property** must be subject to the **identical** restrictions as original property. Rather, the replacement property must be **similarly** restricted or zoned, and several **dissimilar** government restrictions are apparent here. If you find convincing evidence that the agricultural status and zoning on all or part of the original property was **not** indicative

of the **actual** land use restriction (Williamson Act Contract and agricultural zoning), and that the true restrictions had, in reality, changed from agricultural to commercial/multi-family at the time of the City's annexation and general plan in 1983/84, then some similarity in government restrictions between the original property and the replacement property may be identified.

Question 2. If the 10-acre original property was a golf driving range with a 1600 square foot building, how is it comparable to a 1.63-acre replacement property in Santa Cruz County with a 14,520 square foot office building?

The answer to this question bears directly on the application of paragraph (2) of subdivision (c) which sets forth standards for comparability of **size and utility** of the original property and replacement property. Paragraph (2) states in pertinent part:

> (2) Both the size and utility of property are interrelated and associated with **value.** Property is similar in size and utility only to the extent that the replacement property is, or is intended to be, used in the same manner as the property taken (i.e., single-family residential and duplex, multi-family residential other than duplexes, commercial, industrial, agricultural, vacant, etc.) and its full cash value does not exceed 120 percent of the award or purchase price paid for the replaced property.

Sub-paragraph (A) states further that "A replacement property or any portion thereof used or intended to be used for a purpose substantially different than the use made of the replaced property, shall, to the extent of the dissimilar use be considered not similar in utility."

Based upon the foregoing, it is clear that size and utility are **interrelated and associated with value.** Thus, the term **"size"** does not refer to the physical dimensions of the property. Rather, the language attempts to clarify that the size and utility of the property relate to the size of the condemnation award. The test with regard to size and utility is one of similar use and value. That is, if the original property and the replacement property are not substantially different in use (applying the board classifications in the rule: i.e., single-

family residential and duplex, multi-family residential other than duplexes, commercial, etc.), and the full cash value does not exceed 120 percent of the award or purchase price paid for the replaced property, then the criteria of comparability in regard to size and utility are met. If you find that the portion of the original property with the 1600-square foot commercial building and driving range was in the same general use classification as the replacement property in County (a 14,520 square foot office building on 1.63 acres), and that the value standard is also met, then the replacement property may be comparable.

A greater problem from the standpoint of comparability under paragraph (2), exists where the owners seek to replace the original 1600-square foot commercial building with more than one replacement commercial building (four have been acquired) and two parcels of vacant commercial land. The owners argue, consistent with their contention discussed under Question 1, that **all** of the improvements existing on the replacement property could have, and most likely would have, been constructed on the original property had the original property not been withheld from development in the State transportation corridor. They contend that a 14,520 square foot office building is similar in size and utility to what could have been constructed on the original property. The obvious weakness in this argument, however, is that the language in the rule presumes that the comparison will be made based on **actual use** of the original property, **not** intended use. The rule allows for a finding based on **intended use** only with regard to the replacement property, not the original property (subparagraph (A), paragraph (2)).

Question 3. How do the previous questions and answers apply to the replacement properties purchased in other counties?

The definition of "replacement property" under Rule 462.5, subdivision (b)(3) means "real property acquired to replace real property taken." Section 104 defines the term as including both land and improvements. We have long recognized that neither the statute, Section 68, nor Rule 462.5, restrict the term "real property" to a single unit. Moreover, displaced owners may acquire replacement property in any county whose board of supervisors has authorized by local ordinance that the provisions of Sec.2, Art. XIIIA are applicable to persons with original property is outside that county.

The issue seems to be whether the replacement property can be divided into numerous appraisal units in several different counties. Clearly, nothing in the rule expressly says that you can do this. Based on the examples found in subdivision (c), however, we have concluded that there is an intent to permit segregation of the replacement property both on the basis of appraisal units and on the basis of land versus improvements. Thus, for purposes of determining comparability and the amount of relief, the test set forth in subdivision (c) can be applied in comparing improvement to improvement and land to land.

In order to accurately determine comparability in the instant case, the assessors in counties where the displaced owners have acquired replacement property, together with the County Assessor's Office, may need to jointly make such comparisons. Viewed as a whole, the compilation of all of the replacement properties (listed on "Reinvestment of 14611 Almaden Express.," attached) encompasses 4 office buildings, 2 commercial buildings (1 recently constructed), 1 duplex, 4 single family residences, and additional unimproved acreage zoned commercial. Although some of the parcels and/or improvements included within the replacement property may not be comparable to the original property and may be considered to have undergone a change in ownership, your offices, as well as the other assessors' offices affected may wish to approach the final determination of this matter from the same factual and procedural basis and jointly resolve the issues presented.

Our opinion is, of course, advisory only and is not binding on your office or on the assessor of any county. Our intention is to provide timely, courteous and helpful responses to inquires such as yours. Suggestions that help us to accomplish this objective are appreciated.

Sincerely,

Kristine Cazadd
Tax Counsel

KEC
cc: The Honorable
County Assessor