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January 30, 2008

The Honorable Gary E. Hazelton, Assessor-Recorder
County of Santa Cruz
701 Ocean Street, Room 130
Santa Cruz, CA 95060

Re: Claim for Base Year Value Transfer – Section 68, Eminent Domain

Dear Mr. Hazelton,

This is in response to your letter dated August 13, 2007, to Mr. Dean Kinnee, Chief, County-Assessed Properties Division, in which you requested a legal opinion as to whether a taxpayer who sold a property in Los Angeles County to a private entity under threat of eminent domain may transfer that base year value to a property located in Santa Cruz County under section[1] 68 of the Revenue and Taxation Code. We conclude that the Los Angeles County and Santa Cruz County properties are comparable properties within the meaning of section 68, but that there is insufficient evidence to prove that the taxpayer was displaced from the Los Angeles County property in the manner required by section 68.

Factual Background

The "original"(or "relinquished") property from which the transfer of base year value is being claimed is an undivided one-third interest in real property located in Los Angeles County that was co-owned by a "Family Trust" (1/3), an individual "JAB" (1/3), and the "Taxpayer" about whose claim you inquire (1/3).[2] The property was leased to a car dealership that wanted to purchase the property. The owners were unwilling to sell, but were willing to negotiate a new lease with the dealership. However, the Community Development Commission (Commission) sided with the dealership and its Executive Director sent the property owners a letter, dated May 5, 2006, advising them about the Commission's intent to initiate eminent domain proceedings to acquire the property and transfer it to one of several parties who appear to be the owners of the dealership, or affiliates thereof. As a result of the letter, the owners transferred the property to C P VII, L.P.

You enclosed a copy of the May 5, 2006 letter, which refers to the property as the "Property" and the co-owners, including the Taxpayer, as the "Seller," and states that:

[1] Section references are to the Revenue and Taxation Code unless otherwise indicated.
[2] We assume that the co-owners were tenants in common.

> The Commission desires to have the Property redeveloped in accordance with the Redevelopment Plan.
>
> The Commission seeks to induce Seller to transfer the Property, foregoing its rights under the California Redevelopment Law to be treated as an Owner Participant, on the understanding that were it not for Seller's agreement to sell the property voluntarily, the Commission would initiate the necessary actions to acquire the Property through the use of the eminent domain procedures (California Code [of] Civil Procedure[,] § 1230.10 *et seq.*).
>
> Further, the Commission understands that Seller will not engage in efforts to develop the Property itself on the understanding that, if it did not transfer the Property to Honda of , or its affiliates ("Buyer"), the Commission would initiate acquisition by eminent domain for transfer to the Buyer. Accordingly, Seller is entering into the sale of this property under threat of the exercise of eminent domain. While the Commission believes in good faith that Seller may use this letter as evidence of its entitlement to the tax deferral benefits in Internal Revenue Code section 1033, the Commission makes no guarantees as to the ultimate tax consequences of the proposed transaction and encourages Seller to consult with its own certified public accountant or other tax professional regarding this matter.

You also enclosed the August 2, 2006, grant deed the owners used to transfer the property to "C P VII, L.P., a California limited partnership" (referred to in your letter as "LP").

The Taxpayer has now contacted your office and indicated that the Taxpayer wishes to purchase a residential apartment complex located in Santa Cruz County (replacement property) with her proceeds from the transfer of her original property, and transfer the base year value of the original property to the replacement property.

Questions Presented

In your letter, you asked whether:

1. The Taxpayer can "purchase an apartment complex and qualify for a base year value transfer when the property taken was a car dealership? Investment property to investment property?"

2. "[T]he fact that the property was transferred directly from the sellers to Conant Properties negate[s] their right to a base year value transfer ([because a] public agency didn't take title [to] the property)?"

Law & Analysis

Section 60 defines a change in ownership as a transfer of a present interest in real property, including the beneficial use thereof, the value of which is substantially equal to the value of the fee interest. The first paragraph of section 68 provides that a change in ownership does not include:

> [T]he acquisition of real property as a replacement for comparable property if the person acquiring the real property has been displaced from property in this state by eminent domain proceedings, by acquisition by a public entity, or by governmental action which has resulted in a judgment of inverse condemnation.

The second paragraph of section 68 further provides that the adjusted base year value of the replacement property shall be the lower of:

(a) The fair market value of the property acquired; or
(b) The sum of the adjusted base year value of the property from which the person was displaced and the amount, if any, by which the full cash value of the property acquired exceeds 120 percent of the amount received by the person for the property from which the person was displaced.

We assume for purposes of this opinion that the adjusted base year value of the replacement property will be determined by the formula in subdivision (b), and that there is no dispute regarding the adjusted base year value of the acquired property.

Thus, as relevant to your inquiry, taxpayers may transfer the base year value of relinquished property to a newly acquired replacement property if:

- The relinquished and replacement properties are "comparable"; and
- The person is displaced from the relinquished property by eminent domain proceedings, acquisition by a public entity, or by governmental action which has resulted in a judgment of inverse condemnation.

Comparable Property Requirement

Property Tax Rule[3] (Rule) 462.500, subdivision (c), interprets section 68's comparable property requirement and provides that replacement property "shall be deemed comparable to the property taken if it is similar in size, utility, and function." Under subdivision (c)(3) of Rule 462.500, to the extent that a replacement property or any portion thereof, is not similar in size, function, and utility, the property undergoes a change in ownership.

Under subdivision (c)(1) of Rule 462.500, "[t]he size of property is associated with value, not physical characteristics." Specifically, "[p]roperty is similar in *size* if its full cash value does

[3] References to "Property Tax Rules" or "Rules" are section references to title 18 of the California Code of Regulations.

not exceed 120 percent of the award or purchase price paid for the property taken." (Emphasis added.) Under subdivision (c)(2) of Rule 462.500, "[p]roperty is similar in *function* and *utility* if the replacement property is or is intended to be used in the same manner as the property taken. Property is similar in function and utility if the property taken and the replacement property both fall into the same category." (Emphasis added.) The three categories are:

- Category A: Single-family residence or duplex.
- Category B: Commercial, investment, income, or vacant property. [4]
- Category C: Agricultural property.

"Single family residences and duplexes that are used as investment property may be considered income property [included in Category B] if sufficient proof is provided to the assessor. Proof may include, but is not limited to, rental or lease agreements, cancelled checks, income tax returns, or other investment records. If property does not fall within Category A or Category C, it falls within Category B." (Rule 462.500, subd. (c)(2).)

This means that property "held for productive use in a trade or business or held for investment . . . may be replaced with another property that is held for productive use in a trade or business or held for investment. The replacement property does not need to have the same zoning or use type as the property taken." (Letter to Assessors (LTA) 2005/007, *Property Tax Rule 462.500: Change in Ownership of Real Property Acquired to Replace Property Taken by Governmental Action or Eminent Domain Proceedings*, dated Jan. 14, 2005, p. 3.)

Displacement Requirement

Rule 462.500 also interprets section 68's "displacement requirement," which requires that a person be "displaced" from the relinquished property "by eminent domain proceedings, by acquisition by a public entity, or by governmental action which has resulted in a judgment of inverse condemnation." Rule 462.500 also describes the documents county assessors should consider proof of actual displacement. Subdivision (b)(4) of Rule 462.500 explains that a property owner must be "removed, expelled, or forced from property as a result of eminent domain proceedings, acquisition by a public entity in lieu of instituting eminent domain proceedings, or governmental action resulting in a judgment of inverse condemnation" in order to be considered "displaced" within the meaning of section 68.

Subdivision (h)(1)(A) of Rule 462.500 explains that proof of displacement by eminent domain proceedings includes a "certified recorded copy of the final order of condemnation, or, if the final order has not been issued, a certified recorded copy of the order for possession showing the effective date upon or after which the acquiring entity is authorized to take possession of the property taken." Subdivision (h)(1)(C) of Rule 462.500 explains that a "certified copy of a final judgment of inverse condemnation" is required to prove displacement by governmental action resulting in a judgment of inverse condemnation. Subdivision (h)(1)(B) of Rule 462.500 explains that proof of displacement by acquisition by a public entity in lieu of instituting eminent domain proceedings includes a "copy of a recorded deed showing acquisition by a public entity."

[4] Category B property may also include historically agricultural property that is "in transition" to another use. (Rule 462.500, subd. (c)(2).) However, it appears that neither the property taken nor the property acquired in this case are agricultural or transitional in nature.

In LTA 2005/007, the Board clarified that "acquisition by a public entity in lieu of instituting eminent domain proceedings" can include acquisition by an agent of a public entity and described specific documents that can be used to determine whether a person or entity listed as a grantee on a deed is acting as an agent authorized to acquire property on behalf of a public entity. LTA 2005/007 explains that:

> The question of whether the person whose name appears on a deed is the true owner of the property is a question of fact. Normally, the person whose name appears on the deed would be presumed to be the owner of the property in question. However, if one could prove that that person is merely acting as an agent of another, then the true owner of the property would be the agent's principal. Thus, a designated agent of a public entity authorized to acquire property in lieu of eminent domain may be considered to be the public entity within the meaning of Rule 462.500 if sufficient proof is provided to the assessor.
>
> (LTA 2005/007, p. 6.)

An agent is one who represents another in dealings with third persons. (Civ. Code, § 2295; 2 Witkin, Summary of Cal. Law (9th ed. 1987) Agency and Employment, § 3.) An agency may be actual or ostensible. (Civ. Code, § 2298.) "An agent may be authorized to do any acts which his principal might do" and agents will normally have the authority to "do everything necessary or proper and usual, in the ordinary course of business, for effecting the purpose of his agency." (Civ. Code, §§ 2304, 2319, respectively.) An actual agency is created when the agent is actually employed by the principal. (Civ. Code, § 2299.) "Both assent [to representation] and control are necessary predicates to establish an actual agency relationship." (v*an't Rood v. County of Santa Clara* (2003) 113 Cal.App.4th 549, 576.)

The existence of an agency relationship is a question of fact. (Witkin, *supra*, at § 37.) An agency may be created by precedent authorization or by the principal's subsequent ratification of the agent's actions. (Civ. Code, § 2307.) No consideration is necessary. (Civ. Code, § 2308.) "The principal must in some manner indicate that the agent is to act for him, and the agent must act or agree to act on his behalf and subject to his control." (*van't Rood, supra*, at p. 571.) "An oral authorization is sufficient for any purpose, except that an authority to enter into a contract required by law to be in writing can only be given by an instrument in writing." (Civ. Code, § 2309.) An agent's agreement to sell its principal's real property is invalid, unless the agent has written authority to make the sale. (Civ. Code, § 1624, subd. (a)(3).) An agent's agreement to purchase real estate on behalf of its principals in return for compensation or a commission is also invalid, unless the agency agreement is in writing. (Civ. Code, § 1624, subd. (a)(4).) However, uncompensated agents do not need written authorization to validly purchase real property on behalf of their principals. Declarations of the principal are admissible to prove the relation of agency. (Witkin, *supra*, § 38.) Proof of agency may be established by the acts of the parties, their oral and written communications, or by circumstantial evidence. (*van't Rood, supra,* at p. 573.)

As further explained on page six of LTA 2005/007, an "assessor may consider, but is not limited to, the following documents as proof that an agent is authorized to purchase property on behalf of the public entity:

- An official letter from the public entity on its letterhead addressed to the property owner identifying the representative as authorized to purchase property on behalf of the public entity, citing the resolution pursuant to which the public entity authorized the representative to act, and specifying the effective date of such authorization; or
- A copy of the minutes of the meeting in which the public entity authorized the representative to purchase [the] property on behalf of the public entity; or
- A copy of a resolution adopted by the public entity authorizing the representative to purchase property on behalf of the public entity[.]"

1. The Taxpayer May Transfer The Base Year Value Of Property Used As A Car Dealership To Property Used As An Apartment Complex Because Both Properties Qualify As Category B: Commercial, Investment, Income, Or Vacant Property, If All Other Requirements Are Met.

The Taxpayer's original property should be classified as Category B, commercial, investment, income, or vacant property for purposes of applying the comparable property requirements of section 68 and Rule 462.500. This is because the taxpayer held the original property for investment and the generation of income by leasing it to a car dealership; the taxpayer did not use the property as a Category A single family residence or duplex (that it not investment property) nor as Category C agricultural property, and Rule 462.500, subdivision (c) expressly states that: "[i]f property does not fall within Category A or Category C, it falls within Category B." The Taxpayer's replacement property, which is used as a residential apartment complex, should also be classified as Category B, commercial, investment, income, or vacant property, so long as: (1) the Taxpayer holds it for investment and the generation of income; (2) the residential apartment complex is not a duplex that the Taxpayer will use as a residence; and (3) the Taxpayer does not use the property for Category C agricultural purposes. Thus, the Taxpayer's original property and the Taxpayer's replacement property are comparable properties for purposes of applying the comparable property requirements of section 68 and Rule 462.500.

2. There Is Insufficient Evidence To Show That The Taxpayer Was Displaced By A Public Entity.

There were no eminent domain proceedings initiated against the Taxpayer; there was no judgment of inverse condemnation issued with regard to the Taxpayer's original property; and the taxpayer did not transfer her original property directly to a public entity. Instead, she transferred it to LP. A sale directly to a private party under threat of condemnation by a governmental entity is not sufficient to qualify for the base year value transfer under section 68. (See Property Tax Annotation 200.0370.) Therefore, the Taxpayer was not displaced from her original property by eminent domain proceedings or governmental action resulting in a judgment of inverse condemnation. The Taxpayer will only qualify for a base year value transfer under section 68 if she can establish that she was displaced from her original property because it was acquired by a public entity in lieu of initiating eminent domain proceedings and the acquisition

was accomplished through an indirect transfer to LP acting as the public entity's agent. However, there is insufficient evidence at this time to conclude that LP was acting as an agent of a public entity when it acquired the Taxpayer's original property.

The Commission's May 5, 2006, letter resembles the first type of agency document described on page six of LTA 2005/007. It is an official letter from a public entity on its letterhead and it is addressed to the property owner. The letter establishes that the public entity has authorized " Honda of , or its affiliates" to purchase the original property on the Commission's behalf, and the letter identifies " Honda of , or its affiliates" as the party to whom the Commission would transfer the original property for redevelopment purposes if the Commission acquired the property using its powers of eminent domain. However, the Commission's letter does not specifically identify a resolution under which " Honda of , or its affiliates" would have the power to exercise the Commission's authority to acquire the original property or the effective date of such authority as LTA 2005/007 recommends. Furthermore, the deed shows that the replacement property was transferred to LP and there is no documentary evidence establishing that the Commission intended to authorize LP to act as its agent by referring to " Honda of , or its affiliates" as its agent in the May 5, 2006, letter. If the Taxpayer can provide evidence establishing that LP and " Honda of , or its affiliates" are the same entity, or that the Commission otherwise authorized LP to act as its agent to acquire the Taxpayer's original property and the Taxpayer can cite the resolution granting such authority, then we would conclude that the original property had been acquired by a public entity within the meaning of section 68.

The views expressed in this letter are only advisory in nature; they represent the analysis of the Board's Legal Department based on present law and the facts set forth herein, and are not binding on any person or public entity.

Sincerely,

/s/ Carole Ruwart

Carole Ruwart
Tax Counsel III (Specialist)

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cc:	Mr. David Gau	MIC:63
	Mr. Dean Kinnee	MIC:64
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