220.0346 **Leases.** The transfer by a lessor of its interest in a lease with a remaining term of 35 years or more to the lessee or another party is not a change in ownership. Likewise the transfer by the lessee of its interest in the lease only on the condition that the lessor immediately convey free and clear title back to the lessee would not be a change of ownership. The lessee would retain the present beneficial use of the property and the lessor's conveyance would be of bare legal title only. C 12/16/93.

STATE OF CALIFORNIA

STATE BOARD OF EQUALIZATION
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December 16, 1993

Re: Tax Status, Deepwell Ranch, Palm Springs, California

Dear I

This is in response to your letter of October 29, 1993 to Mr. Richard H. Ochsner in which you request our opinion as to whether a "change in ownership" for property tax purposes would occur under the following facts and proposed transactions described in your letter.

The facts, as we understand them are as follows:

Deepwell Ranch is a Planned Unit Development located in Palm Springs, California. Deepwell Ranch apparently was developed into individual lots by Deep Well Development Company, the lessee under a Master Lease Agreement, a memorandum of which was recorded in 1969. The City of Palm Springs Tract Maps creating the individual lots contained conditions requiring that the lots could only be leased and not sold. Therefore, Although the homes located on the lots were sold, the underlying lot was leased rather than sold to the purchaser.

In 1972, Deep Well Development Company subleased the lot under your current home in Deepwell Ranch to Textured Coatings of America, a California corporation for a term continuing until July 31, 2034. This sublease was later assigned to you and your wife by the prior sublessee. For purposes of this letter, we will assume that all the homeowners in Deepwell Ranch also have a leasehold interest in their lots in excess of 35 years.

In 1977, the original lessors quitclaimed their interest in the entire property and assigned the Master Lease to Deepwell Ranch Homeowners' Association, a California nonprofit corporation (the "Association"). It is your understanding that since 1977, Deepwell Ranch homeowners have not paid any rent to anyone under the leases. For purposes of letter, we will assume that the Association holds all interests in the property except those held by the sublessees.

The County of Riverside assesses each parcel (the lot and residence) in Deepwell Ranch individually to the homeowner and not to the Association.

The City of Palm Springs has recently enacted an ordinance which will allow the restriction regarding sales of lots to be removed and if desired, the conversion of the leasehold interests of the homeowners in their lots to fee simple ownership. The contemplated means of accomplishing this conversion is for each homeowner to quitclaim his or her interests in the property to the Association and for the Association to then grant title to the homeowner so that the homeowner then has legal title to the lot. We will assume for purposes of this letter that any quitclaim from the homeowners to the Association includes the homeowner's right, title and interest in the lot as well as any improvements on the lot.

Your question is whether this will result in a "change in ownership" for property tax purposes which would require a reassessment of the property at current market value.

Revenue and Taxation Code[1] section 60 defines "change in ownership" to mean "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."

Section 61 lists several specific statutory examples of transactions which constitute a change in ownership as defined in section 60. Subdivision (c) of section 61 sets forth the rules with respect to leases and includes as a change in ownership:

(1) The creation of a leasehold interest in taxable real property for a term of 35 years or more (including renewal

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

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

The Board has interpreted the foregoing provisions in Property Tax Rule 462, subdivision (f), which provides in relevant part:

(1) The following transfers of either the lessee's interest or the lessor's interest in taxable real property constitute a change in ownership of such real property:

(A) Lessee's Interest:

(i) the creation of a leasehold interest in real property for a term of 35 years or more.

(ii) the transfer, sublease, or assignment of a leasehold interest with a remaining term of 35 years or more.

(iii) the termination of a leasehold interest which had an original term of 35 years or more.

(B) Lessor's Interest:

. . .

(2) The following transfers of either the lessee's interest or the lessor's interest in taxable real property do not constitute a change in ownership of such real property.

(A) Lessee's interest:

. . .

(B) Lessor's interest:

(i) <u>The transfer of a lessor's interest in real property subject to a lease with a remaining term of 35 years or more, whether to the lessee or another party.</u> (Emphasis added.)

(3) Once a change in ownership of taxable real property subject to a lease has been deemed to have occurred, the entire property subject to the lease is reappraised (i.e., the value of both the lessee's interest and the reversion).

Under the foregoing rules, it is clear that when a homeowner quitclaims his or her interest in the property to the Association, there is a transfer of a leasehold interest with a remaining term of 35 years or more. Also, there would be a merger of the lessee's and lessor's interest which would result in a termination of a leasehold interest which had an original term of 35 years or more. Such a transfer by a homeowner to the Association would therefore result in a change in ownership of the leased lot under section 61, subdivision (c). There would also be a change in ownership of the residence under section 60. Similarly, the transfer back to the homeowner by the Association would constitute another change in ownership under section 60.

It is not clear from your letter why it is necessary for the homeowners to first quitclaim to the Association before the Association conveys its interest to the homeowners. Since we assume that the Association has all the rights in the property except those held by the homeowners including the legal title, it would seem that a conveyance from the Association to the homeowners would be sufficient without first having the homeowners quitclaim to the Association. If that were done, i.e., a conveyance by the Association to the homeowners without the homeowners first quitclaiming to the Association, there would be no change in ownership because such transfer would be a "transfer of a lessor's interest in real property to subject to a lease with a remaining term of 35 years or more, whether to the lessee or another party." (See above Property Tax Rule 462(f)(2)(B)(i).) This rule is an exception to the general rule that the termination of a lease with an original term of more than 35 years is a change in ownership.

If, however, there is no other alternative to having the homeowners quitclaim to the Association before the Association conveys legal title to the homeowners, it may nevertheless be possible to argue that no change in ownership would occur.

In enacting section 61, subdivision (c), the Legislature intended that it would be a concrete example of the basic definition of change in ownership contained in section 60 and was particularly concerned that this and other statutory examples set forth in sections 61 and 62 be consistent with the general three part test. (*Howard v. County of Amador* (1990) 220 Cal.App.3d

962, 974.) Thus, in order for a change in ownership to occur under section 60 or section 61, subdivision (c), there are three requirements: (i) a transfer of a present interest in real property; (2) the interest must include the beneficial use of the property; and (3) the interest transferred must be substantially equivalent to the value of the fee interest.

Prior to any transfer by the homeowners to the Association, the homeowners have the present beneficial use of the property and their interest, having a remaining term in excess of 35 years, is clearly substantially equivalent to the value of the fee interest. (*Pacific Southwest Realty Co. v. County of Los Angeles* (1991) 1 Cal. 4th 155, 165.)

If the arrangement between the homeowners and the Association were such that the quitclaim from the homeowners to the Association were subject to an obligation on the part of the Association to immediately convey fee title to the homeowners, we believe it could be validly argued that the Association received no right to the present beneficial use of the property and that therefore, no change in ownership occurred under sections 60 or 61, subdivision (c). Similarly, under such circumstances, the conveyance by the Association to the homeowners would not constitute a change in ownership under section 60 because it would not convey present beneficial use of the property which remained with the homeowners. Essentially, the conveyance by the Association in that instance would, in our view, be of the bare legal title only and such a transfer does not constitute a change in ownership. (*Parkmerced Co. v. San Francisco* (1983) 149 Cal.App.3d 1091.)

As the California Supreme Court stated in *Pacific Southwest Realty v. County of Los Angeles,* supra, 1 Cal.4th at p. 167, "the Legislature intended to find a change in ownership when the primary economic value of the land is transferred from one person or entity to another." We don't believe that would occur under section 61, subdivision (c), or section 60 where any quitclaim by the homeowners to the Association is subject to the Association's obligation to immediately convey title to the homeowners.

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 Riverside 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.

Very truly yours,

Eric F. Eisenlauer

Eric F. Eisenlauer
Staff Counsel III

EFE:ba

cc: Mr. Larry Ward
Riverside County Assessor's Office

Mr. John Hagerty - MIC:63
Mr. Verne Walton - MIC:64

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