STATE OF CALIFORNIA

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September 29, 1999

Honorable Gerald D. Cochran, Assessor
County of Del Norte
482 G Street
Crescent City, CA 95531

Attention:

Re: *SS Brother Jonathan* Marine Salvage Permit

Dear Mr. :

This is in response to your letter of July 6, 1999 in which you request our opinion on two questions regarding the Marine Salvage Permit issued to , Inc. to conduct salvage operations on the *SS Brother Johathan*. The two questions are set forth below:

1. Does a legitimate taxable possessory interest exist?

2. Can the 20% of "Net Recovery Value" be considered an economic rent?

As to the first question – and as we discussed over the telephone -- the submitted materials raise an issue as to whether or not the submerged land is within the territorial boundaries of your county. If the salvage site is outside your county's boundaries, then there is a jurisdictional problem with your proposed assessment. If, however, the salvage site or a part of it is within your county's jurisdiction, then, in my opinion, the salvage permit creates a taxable possessory interest in favor of the permittee. As to the second question, subject to the terms and conditions of Board Property Tax Rule 8, such percentage rents or royalties to be paid to the State in consideration of the permitted use of the property can be considered to be economic rents under an income approach to value. In this case, however, there is a problem: under these unique facts, what ultimate net return would a well-informed buyer anticipate receiving as of the lien date? As indicated below, there is no easy answer to this difficult appraisal problem. If you believe that it would be economically justified, however, this is the type of situation that often can benefit from both expert advice and expert testimony.

Underlying Facts

On June 16, 1999 the California State Lands Commission issued a Marine Salvage Permit to , Inc. The terms of the permit are as follow:

1. **Area:** "The area is on State submerged land within the Pacific Ocean approximately four nautical miles from Point St. George and Crescent City, Del Norte County, California."

2. **Use:** "Permittee will conduct salvage operation on the *SS Brother Jonathan*, sunk in 1865 and resting on state submerged lands. Salvage operations will be conducted under the terms of the permit and in accord with the research design submitted by , Inc. as approved by the Commission."

3. **Term: "**One (1) year commencing upon issuance, and renewable for additional one year periods upon request to , Inc., with evidence of substantial compliance with the terms of the permit including due diligence in pursuit of recovery work."

4. **Consideration: "**Permittee and the State shall share the net recovery value as defined in the permit on a 80/20 % basis."

5. **Pre-Permit Salvage Operations:** " , Inc. (hereafter DSR) has been conducting salvage operations on the *Brother Jonathan* since 1995 as exclusive Salvor under an order of the United States District Court for the Northern District of California. The location of the gold has increased interest in the site and the risk of pillage and damage by other persons. To minimize that risk, DSR will be permitted to continue to conduct salvage operations under the terms of this permit to recover and remove items of value from the wreck."

6. **Compliance with Law and Permit:** The permittee shall comply with all laws and permit requirements. The State may inspect and monitor the permittee's activities. Disputes will be submitted to the state courts for resolution.

7. **Intellectual Property:** All intellectual property created by the permittee shall remain the exclusive property of the permittee.

Law and Analysis

Question No. 1: Does a legitimate taxable possessory interest exist?

In reviewing the documents enclosed with your letter, the first question that arises is as to the jurisdiction of Del Norte County. Under state law, California' territorial boundaries extend three nautical miles beyond the outermost islands, reefs, and rocks, and include all waters between those islands and the coast. (Cal. Const., art. III, § 2; Gov. Code §170, 171; *Tidewater Marine Western, Inc. et al. v. Victoria L. Bradshaw* (1996) 14 Cal.4th 557, 564-565.) The federal Submerged Lands Act (43 U.S.C. §1301 et seq.), defines California's boundaries as extending three geographical miles seaward of the low-water line. The ownership of the underwater lands located within those boundaries was transferred to California via such act.[1] Section 23144 of the Government Code provides that the boundaries of Del Norte County run "three miles from [the] ocean shore." The salvage permit, on the other hand, permits salvage operations on submerged lands "four nautical miles" from a point on the coast. Thus, the initial question that arises is this: Is the salvage site wholly or partically within the boundaries of Del Norte County? If this factual question cannot be answered in the affirmative, there is a jurisdictional problem.

Assuming that no such jurisdictional problem exists in this case, I return to the question of whether or not a taxable possessory interest is created by the permit.[2] The fact that the permit addresses the use of a defined area of the ocean and the submerged lands thereunder does not necessarily present a problem. Board Property Tax Rule 20(c)(1) defines "real property" to include not only land (presumably including submerged land) but also "public waters such as tidelands and navigable waters and waterways." Furthermore, in *Scott-Free River Expeditions v. El Dorado* (1988) 203 Cal.App.3d 896, 904 the court held that the right to use water may constitute a taxable possessory interest.

As you know, subdivision (a) of section 107 of the Revenue and Taxation Code defines "possessory interests" to mean the "possession of, claim to, or right to the possession of land or improvements that is independent, durable, and exclusive of rights held by others in the property, except when coupled with ownership of the land or improvements in the same person." For purposes of subdivision (a):

> "Independent" means the ability to exercise authority and exert control over the management or operation of the property or improvements, separate and apart from the policies, statutes, ordinances, rules, and regulations of the public owner of the property or improvements. A possession or use is independent if the possession or operation of the property is sufficiently autonomous to constitute more than a mere agency.

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[1] Since the State has issued the permit, presumably the salvage operations or some of them must be taking place within the jurisdictional range of California.

[2] Although I was not given a copy of the referenced court judgment under which the pre-permit salvage operations were conducted, it is possible that a taxable possessory interest could be found for such activities under either "right to occupy and use" or "actual occupancy and use" theories.

Consistent therewith, pursuant to subdivision (a) of Board Property Tax Rule 20, a taxable possessory interest must be independent, durable, exclusive, and, in addition, provide a private benefit to the possessor. In this case, the permitted property use is not only durable but exclusive as well. And there is no question but there is a potential private benefit to the permittee. Thus, the only apparent potential problem is with the "independence" requirement. Subdivision (c)(5) of Rule 20 provides, in pertinent part, as follows:

> "Independent" means a possession, or a right or claim to possession, if the possession or operation of the real property is sufficiently autonomous to constitute more than a mere agency. To be "sufficiently autonomous" to constitute more than a mere agency, the possessor must have the right and ability to exercise significant authority and control over the management or operation of the real property, separate and apart from the policies, statutes, ordinances, rules and regulations of the public owner of the real property. (Emphasis added.)

An agent is one who represents another in dealings with third persons. (Civ.Code §2295; Witkin 2 Summary of California Law, 9th Ed., "Agency and Employment," §3.) The existence of an agency relationship is a question of fact. (Witkin, *supra* at §37.) Furthermore, "whether an agency relationship has been created or exists is determined by the relation of the parties as they in fact exist by agreement or acts and the primary right of control is particularly persuasive. (Emphasis added.)" (*Pagan v. Spencer* (1951) 104 Cal.App.2d 588-592-593.) Commentators indicate that other factors to consider in determining if an independent contractor is acting as an agent include: (i) whether the principal and agent are engaged in distinct occupations; (ii) the skill required to perform the agent's work; (iii) whether the principal supplies the workplace; (iv) whether the work is part of the principal's regular business; and (v) whether the parties intended to create an agency relationship. (See Witkin, *supra*.) In this case, these factors indicate that the permittee was not the agent of the State. For example, the permittee is engaged in a highly skilled and very unique enterprise as to which the State has no expertise or experience; and there is certainly no indication in the documents of a mutual intent that the permittee be the agent of the State. In fact, the permittee had to obtain a court order in order to commence salvage operations in the first place.

Furthermore, while the permit gives the State the right to exercise some controls over the permittee's salvage operations in order to protect the public's interest in the historical wreck and its contents, the actual control of the operations – particularly on a day-to-day basis – clearly rests with the permittee. In the recent case of *City of San Jose v. Carlson* (1997) 57 Cal.App.4th 1348, contract conditions much more intrusive and detailed than those present in the salvage permit were found not to be "so 'severe' as to constitute an agency relationship." (*Id.* at p. 1358.) As stated in *Stadium Concessions, Inc. v. City of Los Angeles* (1976) 60 Cal.App.3d 215, 225: "The governmental body that contracted with [the user] has the responsibility to safeguard the use of public property, and would be remiss if it did not retain ultimate control over such use, by grantees as well as by the public."

In *Pacific Grove-Asilomar Operating Corporation v. County of Monterey* (1974) 43 Cal.App.3d 675, on the other hand, independence was found lacking because every aspect of the nonprofit corporation's use was controlled by the public entity and the nonprofit corporation derived no private benefit from its operations. Clearly, the instant facts are distinguishable from those present in *Pacific Grove-Asilomar*.

Thus, based upon the given facts, I conclude that, in carrying out the salvage operations, the permittee will not merely be acting as the agent of the State. Therefore, subject to the above-referenced concerns relating to the potential jurisdiction problem, it is my opinion that the salvage permit does, in fact, create a taxable possessory interest in favor of the permittee under the terms of section 107 and Rule 20.

Question 2: Can the 20% of "Net Recovery Value" be considered an economic rent?

The answer is a conditional yes. The twenty- percent of the net recovery value to be paid to the State as consideration for issuance of the salvage permit can be considered to be the rent or royalty paid by the permittee for the designated use of the property during the term of possession. Under Board Property Tax Rule 8, "The Income Approach to Value," such "recently negotiated rents" should be used in estimating the "future income if, in the opinion of the appraiser, they are reasonably indicative of the income the property will produce in its highest and best use under prudent management." (Board Property Tax Rule 8(e).) In fact, "[i]ncome derived from rental of properties" is preferred to "income derived from their operation since income derived from operation is the more likely to be influenced by managerial skills and may arise in part from nontaxable property or other sources." (*Id*.)

Nevertheless, in this case, a problem exists: how to estimate the anticipated aggregate or average annual percentage rentals or royalties from the salvage operations over the anticipated term of possession? In other words, under these unique facts, what "net return" would "a reasonably well informed owner and reasonably well informed buyers . . . anticipate on the valuation date that the taxable property existing on that date will yield under prudent management and subject to such legally enforceable restrictions as such persons may foresee as of that date"? (Board Property Tax Rule 8(c).)

Obviously, I cannot provide an easy answer for this difficult appraisal problem. But I can make one recommendation: if you believe that it is worth the cost, this is the type of case in which it would be extremely helpful to have the advantage of both expert advice and expert testimony. An expert in salvage operations would be in a better position than a real property appraiser to offer an opinion as to what "net return" a well-informed buyer would anticipate receiving from the salvage operations as of a given valuation date.

If you have any further questions or comments – or if you obtain any additional information – please do not hesitate to call me at (916) 324-6593. The views expressed in this letter are, of course, only advisory in nature; they represent the analysis of the legal staff of the Board based on present law and the facts set forth herein, and are not binding on any person or public entity.

Very truly yours,

/s/ Robert W. Lambert

Robert W. Lambert
Senior Tax Counsel

RWL:jd
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cc: Mr. Dick Johnson – MIC:63
Mr. David Gau – MIC:64
County Property Taxes Division – MIC:62
Ms. Jennifer Willis – MIC:70