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JAMES E. SPEED
Executive Director

May 23, 2001

RE: ***The Taxability of Possessory Interests Held by Vendors at Fairgrounds.***

Dear Mr.

This is in reply to your letter dated August 29, 2000 to the California Department of Veterans Affairs regarding the taxability of possessory interests to veterans renting space for peddling or vending goods at county fairgrounds and the State Fair. You question the validity of the assessment of property tax in light of the exemption provided to veterans by Business and Professions Code section 16102. Please excuse the delay in responding. Your letter was forwarded to the State Board of Equalization on January 9, 2001 because the Board is the agency which oversees the administration of the property tax.

As discussed further below, it is our opinion that the private rental of space at county fairgrounds or the State Fair creates a taxable possessory interest absent any exclusion or exemption. Since Business and Professions Code section 16102 is a limitation on local business licensing, rather than an exemption from property tax, this statute has no effect on an assessor's authority to assess property taxes on any possessory interest under the California Constitution and the Revenue and Taxation Code. Therefore, a vendor, even though a veteran, can be subject to the assessment of property taxes due to his rental and use of a taxable possessory interest at the State Fair.

Law and Analysis

Article XIII, section 1 of the California Constitution provides that all property is taxable unless otherwise provided by the laws of the United States or the California Constitution. Possessory interests in lands are deemed to be real property for purposes of property taxation. Forster Shipbuilding Co. v. County of Los Angeles (1960) 54 Cal.2d 450, 455. In addition, Revenue and Taxation Code section 104¹ classifies the right to use or possess land as real property and section 107 defines "possessory interests" in pertinent part as the "[p]ossession 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."

Property Tax Rule 20, one of the Property Tax Rules interpreting section 107, provides in part that:

¹ Unless otherwise indicated, all statutory references are to the Revenue and Taxation Code.

- (a) **POSSESSORY INTERESTS.** "Possessory interests" are interests in real property that exist as a result of:
- (1) A possession of real property that is independent, durable, and exclusive of rights held by others in the real property, and that provides a private benefit to the possessor, except when coupled with ownership of a fee simple or life estate in the real property in the same person; or
 - (2) A right to the possession of real property, or a claim to a right to the possession of real property, that is independent, durable, and exclusive of rights held by others in the real property, and that provides a private benefit to the possessor, except when coupled with ownership of a fee simple or life estate in the real property in the same person; or
 - (3) Taxable improvements on tax-exempt land.
- (b) **TAXABLE POSSESSORY INTERESTS.** "Taxable possessory interests" are possessory interests in publicly-owned real property. . . .

The rationale behind the taxation of possessory interests is that "[t]hese possessions . . . are recognized as a species of property subsisting in the hands of the citizen. It is not the land itself, nor the title to the land . . . It is not the pre-emption right, but is the possession and valuable use of the land subsisting in the citizen. Why should it not contribute its proper share, according to the value of the interest, . . . of the taxes necessary to sustain the Government which recognizes and protects it?" People v. Shearer (1866) 30 Cal. 645, 657.

The Court of Appeal in Scott-Free River Expeditions, Inc. v. County of El Dorado, (1988) 203 Cal.App.3d 896, 903, summarizes the approach taken by the courts in analyzing possessory interests:

In light of the decisional law which more than a century ago recognized the concept of a possessory interest tax, coupled with the broad statutory language defining possessory interests, a valuable and taxable possessory interest may be found in virtually any situation where a private citizen is allowed to use public property for personal gain.

Consistent with the above, you acknowledge that the concept of taxing possessory interests is recognized under California law and that the lessee-business owner, not the government, is responsible for the taxes. You object, however, to the method of determining the value of concessionaires' possessory interests at fairs and to not receiving an exemption from possessory interest tax as a qualifying veteran under Business and Professions Code section 16102.

THE VALUATION OF POSSESSORY INTERESTS

Property Tax Rule 25, subsection (b) provides in part for the valuation of taxable possessory interests by use of:

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The "income approach" wherein the possessory interest is valued either directly by capitalizing all future net income that the possessory interest is capable of generating under typical management during the estimated term of possession, or indirectly by first capitalizing the net income to estimate the value of the possessor's rights as if perpetual and then deducting the present worth of those rights for the period subsequent to the term of the possessory interest.

The direct income method is preferred over the indirect method when the remaining economic life of wasting assets does not exceed the estimated term of possession or when a constant income stream is projected. The indirect income method is preferred when the remaining economic life of wasting assets exceeds the estimated term of possession.

The direct income approach mentioned above appears to be the valuation method used by the assessor in your case. The particular income method used should be applied as circumstance demand, based on sound appraisal judgment.

When applying the income approach, the use of contract rent (e.g., rent to the lessor) should only be used for valuation purposes if the contract rent provides good evidence of economic rent. Property Tax Rule 8, subsection (e) states in part that

Recently derived income and recently negotiated rents . . . (plus any taxes paid on the property by the lessee) of the subject property and comparable properties 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

Property Tax Rule 25, subsection (b) continues, stating

The net income to be capitalized is either the imputed economic rent, which may be estimated by reference to rentals recently negotiated in a competitive market or, if such evidence is inadequate, by reference to the anticipated gross income of a typical operator of the property subject to the possessory interest, less costs of goods sold and typical management and other operating expenses [Emphasis added.]

We are assuming in the present situation that the "net income to be capitalized" is based upon contract rent for the use of the fairground space. Based on your letter, contract rent is being used as an indicator of economic rent. As the valuation of a possessory interest involves the valuation of a unique interest in publicly-owned property (such as a fairground), contract rent (e.g., rent to the lessor) can act as good evidence of the economic rent of this type of property interest and is a reasonable method for valuing a possessory interest under the income approach. Such a valuation could be subject to appeal, however, if the contract rent was not reflective of the economic rent of the possessory interest.

You state that your contract rent is based on your gross sales less sales tax and is higher than your sales. If you believe that the assessor's office has miscalculated the value or that the

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contract rent includes other items that are not taxable (i.e., appurtenant privileges such as parking areas, landscaping amenities, police protection, waste hauling services, etc.), you may file an application for a reduced assessment, requesting that the local assessment appeals board reduce the value of your concession stand. For example, the assessor may have used incorrect sales information for your stand, made improper adjustments for operating expenses, or otherwise miscalculated the value of the interest. Any of these errors mentioned would be the basis for applying for a reduced assessment.

THE AVAILABILITY OF AN EXEMPTION
FROM THE POSSESSORY INTEREST TAX

Sections 3 and 4 of Article XIII of the California Constitution provide that certain properties or uses of property are exempt from property taxation. Such exemptions include property owned by the State and property owned by local governments. (Article XIII, section 3.) However, as noted in the discussion above, a taxable possessory interest can be created by an interest held in publicly-owned real property.

Assuming that a taxable possessory interest was created by the lease of space, you believe that Business and Professions Code section 16102 provides an exemption for veterans while vending, peddling, or hawking any goods. The language in section 16102 states

Every soldier, sailor or marine of the United States who has received an honorable discharge or a release from active duty under honorable conditions from such service may hawk, peddle and vend any goods, wares or merchandise owned by him, except spirituous, malt, vinous or other intoxicating liquor, without payment of any license, tax or fee whatsoever, whether municipal, county or State, and the board of supervisors shall issue to such soldier, sailor or marine, without cost, a license therefor.

As explained by the Court of Appeal in Brooks v. County of Santa Clara, (1987) 191 Cal.App.3d 750, however, this language applies only to business license fees, not to other forms of taxes or fees. On pages 755-756, the court notes that

Section 16102 is one of a series of Business and Professions Code provisions for business licensing at the local level. Sections 16100 through 16104 provide, more specifically, for licensing by counties: Section 16100 authorizes general business licensing by boards of supervisors . . . Section 16101 permits counties to license . . . "for the purpose of revenue." . . .

* * *

Patently the thrust of section 16102 is not to exempt veterans from local *regulation*, but rather to enable specified veterans to engage in specified kinds of business without being required to *pay*. The last several words of the section make clear the Legislature's assumption that the veteran must have a license, but also its intent that he or she should receive it "without cost," consistent with the antecedent provision that the veteran should be

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permitted to do business "without payment of any license, tax or fee whatsoever" [Underlines added.]

Besides authorizing licenses at the local level, Business and Professions Code sections 16100 and 16101, this portion of the Business and Professions Code (i.e., Chapter 2 (Licensing by Counties) of Part 1 (Licensing of Revenue and Regulations) of Division 7 (General Business Regulations)) provides for a variety of exemptions from business licensing fees, including exemptions for nonprofit organizations (subdivision (b) of section 16100), café musicians (section 16100.5), veterans (section 16102), and wholesale salesmen (section 16103). As such, this Chapter of the Business and Professions Code authorizes counties to impose business licenses and sets limitations and exemptions for parties exempt from such licensing. In other words, as characterized by the Court of Appeal in Brooks v. County of Santa Clara, this Chapter of the Business and Professions Code allows counties to impose "business licensing at the local level."

Thus, the exemption from business licensing fees is specifically limited only to such fees and costs and does not extend to either real or personal property taxes. Property taxes are authorized and imposed by the California Constitution and are not subject to, nor can be limited by, local regulation. Since Business and Professions Code section 16102 is a limitation on local business licensing, this statute has no effect on an assessor's authority to assess property taxes under the California Constitution and the Revenue and Taxation Code. Therefore, a vendor, even though a veteran, can be subject to the assessment of property taxes due to his rental and use of a taxable possessory interest at the State Fair.

The views expressed in this letter are advisory in nature only; 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. You may wish to contact the Sacramento County Assessor's Office to ascertain whether it is in agreement with the analysis and conclusions set forth herein.

Very truly yours,

/s/ Anthony Epolite

Anthony Epolite
Tax Counsel

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