May 29, 2018

TO COUNTY ASSESSORS AND INTERESTED PARTIES:

INTERESTED PARTIES PROCESS:
CHANGE IN OWNERSHIP - RESCISSION

Board staff has initiated a project to issue a Letter To Assessors to summarize the various written opinions by the Board of Equalization's Legal Department that address (1) a property owner's ability to rescind a recorded deed that triggered a reassessable change in ownership and (2) the property tax effect of such a rescission.

A copy of the draft Letter To Assessors is enclosed. Interested parties are encouraged to participate in the interested parties process for the above letter. Suggested revisions to the draft, in the form of alternative text, should be provided to Glenna Schultz at glenna.schultz@boe.ca.gov or mailed to the above address by July 31, 2018.

After reviewing comments received, it is anticipated that staff will meet with interested parties this fall to discuss comments received. All documents regarding this project will be posted to the BOE's website at www.boe.ca.gov/proptaxes/change-in-ownership-recissions.htm. If you have questions regarding this project, you may contact Ms. Schultz at 1-916-274-3362.

Sincerely,

/s/ David Yeung

David Yeung, Chief
County-Assessed Properties Division
Property Tax Department

DY:gs
Enclosure
CHANGE IN OWNERSHIP – RESCISSION

This letter summarizes the various written opinions by the Board of Equalization's Legal Department\(^1\) that address a property owner's ability to rescind a recorded deed that triggered a reassessable change in ownership, and the property tax effect of such a rescission.

A grant or quitclaim deed is a written instrument conveying or transferring title to real property; it is an executed conveyance and operates as a present transfer of the real property. Such a deed is not merely evidence of a gift or other grant; it is the gift or grant itself and, as a result, transfers or conveys the title of the property described to the grantee. A voluntary transfer is an executed contract,\(^2\) subject to all rules of law concerning contracts in general; except that a consideration is not necessary to its validity.\(^3\)

Therefore, since deeds are considered executed contracts and are generally subject to the laws concerning contracts, they are subject to the Civil Code, which sets forth grounds for which a contract may be rescinded.

Civil Code\(^4\) section 1688 provides that a contract is extinguished by its rescission. A contract may be rescinded either mutually if all the parties consent, or unilaterally under certain circumstances. Upon rescission, "the contract becomes a nullity; it and each of its terms and provisions cease to be subsisting or enforceable against the other party."\(^5\) Section 1691 explicitly requires the restoration of the parties to the status quo for unilateral rescission. Although the Civil Code contains no similar explicit requirement for mutual rescission, case law is supportive of a requirement to return the parties to the status quo for mutual rescission.\(^6\) Also, since a mutual rescission has the effect of nullifying the contract, it follows that the parties to an executed contract should return each other to the position they were in prior to the execution of that contract.

Agreement Between Parties

As noted above, a contract may be rescinded mutually under section 1689(a) if all the parties consent and if all parties are restored to their original position prior to the execution of the

\(^1\) Property Tax Annotations 220.0595, et seq.
\(^2\) An executed contract is one, the object of which is fully performed; all others are executory (Civil Code section 1661).
\(^3\) Civil Code section 1040; see also Estate of Stephens (2002) 28 Cal. 4th 665, 672 [a deed is an executed contract, subject to the rules applicable to contracts]; Johnston v. City of Los Angeles (1917) 176 Cal. 479, 485-486 [deeds must be read like any other contracts]; MacFarland v. Walker (1919) 40 Cal.App. 508, 512 [grants are to be interpreted as other contracts].
\(^4\) All statutory references in this letter are to the Civil Code unless otherwise specified.
\(^6\) See, for example, Green v. Darling (1925) 73 Cal.App. 700, 704 ("If the minds of the parties met on the proposition that they would rescind, it was not necessary that the defendant stipulate to return to the plaintiff the money which he had received, for the law requires him to do this as a consequence of having agreed that the contract be abrogated"); Dugan v. Phillips (1926) 77 Cal.App. 268, 278 ("upon a mutual rescission of a contract the law requires each party to restore whatever he has received under it"); Larsen v. Johannes (1970) 7 Cal.App.3d 491, 503 ("without rescission, and restoration of benefits received, a party may not avoid such a contract").
contract. For mutual rescissions, the Civil Code does not specify any particular grounds for rescission, so long as the parties to the contract consent to the rescission. The provisions of the Civil Code do not require a court order or approval for a contract rescission to be valid when the parties to a contract mutually agree to rescind.

Section 1689(b) provides that a contract may be unilaterally rescinded based on a specified variety of grounds. Thus, a unilateral rescission is limited to the reasons listed in Civil Code section 1689(b), which includes fraud, mistake, or duress. A mistake occurs when, among other things, there is a misapprehension of the law by all parties, all supposing that they knew and understood it, and all making substantially the same mistake as to the law.

**Reasonable Time/Accepting Benefits**

Section 1691 provides that, subject to section 1693, a party to the contract must, promptly upon discovering the facts which entitle him to rescind if he is free from duress, menace, undue influence or disability and is aware of his right to rescind, give notice of rescission to the party as to whom he rescinds and restore or offer to restore to the other party benefits received from the contract. Section 1693 states:

> When relief based upon rescission is claimed in an action or proceeding, such relief shall not be denied because of delay in giving notice of rescission unless such delay has been substantially prejudicial to the other party.

A party who has received benefits by reason of a contract that is subject to rescission and who in an action or proceeding seeks relief based upon rescission shall not be denied relief because of a delay in restoring or in tendering restoration of such benefits before judgment unless such delay has been substantially prejudicial to the other party; but the court may make a tender of restoration a condition of its judgment.

In addition, courts have opined that "the right to rescind must be exercised promptly" and "[w]hat is a reasonable time depends, as in other situations, upon the particular circumstances of the case."

For example, in *Osborne v. Cal-Am Financial Corp.* (1978) 80 Cal.App.3d 259, a buyer of property discovered that the seller misrepresented the subject property, and cancelled the escrow

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8 Civil Code section 1578, subd. (1).
9 Section 1693 states: "When relief based upon rescission is claimed in an action or proceeding, such relief shall not be denied because of delay in giving notice of rescission unless such delay has been substantially prejudicial to the other party." A party who has received benefits by reason of a contract that is subject to rescission and who in an action or proceeding seeks relief based upon rescission shall not be denied relief because of a delay in restoring or in tendering restoration of such benefits before judgment unless such delay has been substantially prejudicial to the other party; but the court may make a tender of restoration a condition of its judgment.
within 60 days. The court held that "[t]he buyer has a reasonable time to make his discovery and rescind, which was accomplished here within 60 days." On the other hand, in *Leeper v. Beltrami* (1959) 53 Cal.2d 195, the court held that the plaintiffs were barred from rescinding a contract to purchase land due to a two-year delay, providing, "[t]he failure to act promptly results in a waiver of the right to rescind."

Furthermore, in *Pearson Candy Co. v. Waits* (1946) 27 Cal.2d 615, where a party sought to rescind a contract on the grounds that it was coerced into signing it, the court stated that because the party accepted the benefits of the contract and failed to exercise its right to terminate the contract before the contract's renewal date, "any right that plaintiff might have had to rescind the contract was waived by its failure to give prompt notice of its election to rescind, by its adherence to the contract for several years, and by its failure to avail itself of its right to terminate it." Similarly, in *Neet v. Holmes* (1944) 25 Cal.2d 447, the court stated, "[w]aiver of a right to rescind will be presumed against a party who, having full knowledge of the circumstances which would warrant him in rescinding, nevertheless accepts and retains benefits accruing to him under the contract."

Therefore, while the Civil Code does not expressly specify a time frame for rescissions, case law has established that a rescission must be made within a reasonable time. What period of time is deemed "reasonable" should be determined on a case-by-case basis, taking into consideration whether the parties have availed themselves of the benefits under the contract.

**Restoration of Status Quo: Rescission or New Contract?**

Civil Code section 1691 also requires the party requesting rescission to "restore to the other party everything of value which he has received from him under the contract or offer to restore the same upon condition that the other party do likewise." (Emphasis added.) Notably, "the question of any sum not due under the contract calls for an adjudication of facts independent of the contract itself, and this does not come within the scope of section 1691 of the Civil Code." (*Dvorak v. Latimer* (1928) 91 Cal.App. 664 (*Dvorak*), 675.) In *Dvorak*, the vendee and vendor, under a contract for the sale or exchange of real property, entered into an additional agreement regarding real estate agent commissions, and advances that had been made to the vendee under that other agreement. The court held that "the vendee, upon rescinding the contract for purchase, is not obliged to offer restoration of a sum due under said independent agreement as a condition precedent to the right to maintain an action to enforce rescission." (*Id.* at p. 675). However, the court also noted that the equities between the parties had been properly adjusted, since the trial court had credited the vendor with the moneys, taxes, and other expenditures paid to the vendee in connection with the property. (*Ibid.*)

Thus, if the rescission agreement includes terms different from a return to the status quo, a question may arise as to whether a rescission or a new contract was effected. (See *Young v. New Pedrara Onyx Co.* (1920) 48 Cal.App. 1 [an agreement to rescind a stock transfer that included terms in addition to the return of the status quo is not a valid rescission, but rather a new contract].) Where the terms of the rescission are different from the original contract, the assessor can and should look at all considerations paid to determine whether the transaction is indeed a
rescission, or instead a buyback of the same property by the original seller under different terms. If a new contract was effected, a second change in ownership would occur upon the reconveyance of the property to the original seller.

4 Factors to Consider when Determining if a Rescission is Valid

By definition, and as a principle of logic, it follows that if a transfer meets the Civil Code requirements for a valid rescission, an assessor must accept the rescission as valid. However, an assessor has discretion to determine whether a transfer is, in fact, a valid rescission. If the parties to a contract to transfer real property have failed in fact to meet a requirement for rescission provided in the Civil Code, the assessor has the discretion to deny the rescission for property tax purposes.

For example, although the Civil Code provisions governing rescission were not specifically at issue, in Fashion Valley Mall v. County of San Diego (2009) 176 Cal.App.4th 871, the parties to a contract involving a transfer of real property attempted to effect a "reformation" of the agreement that was operative "... solely for property taxes." The parties specified that the contract, while "reformed" for property tax purposes, would remain in full force and effect for all other purposes, including income tax and securities purposes and commercial and real estate activities. The court considered the transaction to be a "sham" and "a mere fiction" that "cannot be given effect for the purposes of determining... property tax liability." Viewed in the context of the rescission requirements, we believe the parties in Fashion Valley Mall did not satisfy the requirements for a rescission; because the contract purported to be in effect for all purposes other than property tax purposes, the parties were not restored to their original positions.

We note, however, the difference between a "sham" rescission (i.e., one that is operative solely for property tax purposes), versus a valid rescission effected solely to achieve certain property tax consequences. The former, similar to Fashion Valley Mall, does not meet the requirement of restoring the contracting parties to their original positions and may be denied by the assessor for property tax purposes. The latter, however, if it satisfies the statutory requirements of a valid rescission, must be accepted by the assessor.

Civil Code section 1689, which lists the reasons for which a contract may be rescinded, does not limit rescissions to those not motivated by property tax benefits. In other words, if requirements for a valid rescission are met, the motive for rescinding a contract is inconsequential to its validity. Thus, for instance, if parties contract to transfer real property and subsequently discover that the transfer results in an unintended change in ownership, the parties may rescind the contract in order to avoid the change in ownership reassessment if all statutory requirements are met. In our view, a mutual rescission should be recognized if all parties to the transaction consent, all parties are restored to their original positions before the transfer, the rescission is made promptly and within a reasonable time (to be determined on a case-by-case basis) with consideration given to whether the parties have availed themselves of the benefits under the contract, and the rescission agreement does not include terms different from a return to the status quo. Conversely, if the parties to a contract or deed to transfer real property have failed in fact to
meet a requirement of rescission provided in the Civil Code, the assessor may deny the rescission for property tax purposes.

Of course, an assessor may request documentation to verify whether a rescission was valid and the parties were restored to the status quo. For example, an assessor might request copies of deeds, a declaration or other evidence from the parties that consideration was in fact restored, an explanation and description of the steps taken to effect the rescission, or tax returns that demonstrate income from the property in question was reported by the proper party.

**Effect Upon Property Taxes**

Once a transfer of real property is rescinded and the parties are placed in the same position they were in before the contract was executed, the value of the real property reverts to its previous adjusted base year value prior to the transfer. However, the liabilities established while the contract was in existence are not extinguished. Therefore, placing the parties in the position they held before the transfer will not result in a refund of taxes paid while the contract was in effect.

For example, if Party A transferred the subject property to Party B with the expectation or condition that Party B would immediately transfer the property to Party C, and due to a mutual mistake, all parties wished to rescind the two transfers within a reasonable amount of time, such rescissions may be acceptable, assuming all other requirements under the Civil Code are met. In that case, the rescission relates back to the formation of the contract and dissolves it as though it had never been made. Thus, once a contract for the transfer of real property is rescinded by mutual consent, the parties are placed in the same position they were in before the contract was executed, and the base year value of the real property reverts to its previous base year value with appropriate adjustments for inflation. No refund of taxes should be made by the county to the rescinding party while the transfer was in force. Therefore, if Party B and Party C mutually rescind their contract transferring the property from Party B to Party C, then ownership reverts to Party B, and the base year value of the property reverts to its base year value at the time of the original transfer from Party B to Party C. If Party A and Party B concurrently mutually rescind their contract to transfer the property from Party A to Party B, then ownership of the property subsequently reverts to Party A, and the base year value of the property reverts to its base year value as of the date of the original transfer from Party A to Party B. Thus, as a result of the two rescissions effected concurrently in this example, in our opinion, the county assessor should enroll the property at its factored base year value as of the original transfer from Party A to Party B, as of the date of the rescission, with appropriate adjustments for inflation. No refund of taxes should be made by the county assessor to the rescinding parties for the time during which the transfers were in force.

By contrast, however, if Party A, for example, transfers the property to Party B, who benefits from income or use of the property for an extended period of time, after which Party B transfers the property to Party C, in our opinion, it is no longer reasonable to rescind the original transfer between Party A and Party B. This is because Party B, after availing himself or herself of the benefits of the original property transfer and for failing to exercise his or her right to rescind
within a reasonable time, may be considered to have waived his or her right to rescind such transfer.