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April 9, 2014

The Honorable Jerome Horton, Chairman
Members of the Board of Equalization
450 N Street
Sacramento, CA 95814

Re: Proposed LTA Concerning Property Tax Rule 21(d)

Dear Chairman Horton and Members of the Board:

I am writing on behalf of the Council On State Taxation ("COST") to express our support and appreciation for the Board's proposed Letter To Assessors ("LTA") providing guidance regarding taxable possessory interests ("TPIs").

As the Board has discovered through the assessment practices surveys, county assessors have been inconsistently applying Rule 21, Assessor Handbook 510, and governing judicial authority applicable to TPIs since adoption of the Rule. Without this LTA, the lack of uniformity in appraisal and assessment of TPIs will persist, subjecting some taxpayers to non-uniform assessment and substantially increasing costs of administration for both taxpayers and counties.

As noted in the LTA, the current confusion stems largely from the inapposite reading of the Court of Appeal decision in *Charter Communications Properties, LLC v. County of San Luis Obispo*, 198 Cal.App.4th 1089 (2011) ("Charter"). As noted by the Court of Appeal in *California State Teachers' Retirement System v. County of Los Angeles* (2013) 216 Cal.App.4th 41, publicly owned real property is exempt from taxation (see Cal. Const., art. XIII, §3). (*Id.* at 55.) The bundle of rights that constitute a possessory interest in public lands when held by private parties, however, is a taxable property interest (see Cal. Const., art. XIII, § 1; Rev. & Tax Code § 107). (*Id.* at 55-56.) Like all real property, TPIs are taxable at fair market value – no more and no less.

Ascertaining the fair market value of the real property right constituting a taxable possessory interest consistent with Rule 21(b) demands identification of the reasonably anticipated term of possession.

‘[T]he cardinal feature of a taxable possessory interest is that it is an interest of finite duration. At some future date, the interest of the private possessor will terminate, and possession of the property will revert to the public owner.’ (Handbook, *supra*, at p. 21.) Therefore, ‘[w]hen valuing a taxable possessory interest, the appraiser must determine a term of possession for the interest.... The term of possession also affects the value of a taxable possessory interest. All else being equal, the longer the term of possession, the higher the value of the possessory interest. (*Ibid.*)’ (*CalSTRS*, at 57.)

As the LTA identifies, ascertaining the correct reasonably anticipated term of possession under Rule 21(d) is critical to ensure that the right in real property constituting a taxable possessory interest is appraised and subject to tax exclusive of any reversionary rights held by the public entity.

Precise ascertainment of the reasonably anticipated term of possession ensures that a TPI's base year value is correctly appraised and property taxes are legal throughout the term of possession. This will ensure that several constitutionally based requirements are adhered to so that the appraisal assesses a TPI at full cash value and intangible value is not included in the valuation. Rule 21(d) provides for precise ascertainment of the reasonably anticipated term of possession depending on the term in a lease, franchise, or other conveyance of public land creating a TPI to ensure that the appraisal method results in a value that is consistent with the Constitutional requirement to tax property at fair market value.

To do otherwise would, as the Court discovered in *CalSTRS*, produce the unconstitutional taxation of public property. Consequently, Rule 21 and AH 510 identify specific rules for ascertain the reasonably anticipate term of possession.

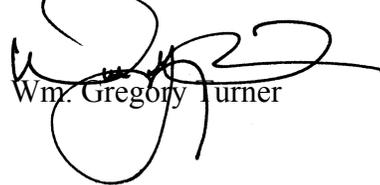
Unfortunately, some counties have read the Court of Appeal decision in *Charter* in a manner that is inconsistent with the overarching regulatory, statutory, and judicial framework for the assessment of TPIs. As noted in the LTA, while the Court of Appeal in *Charter* found substantial evidence to support the AAB’s factual conclusion of a modification to the stated term of possession at issue there, the opinion provides no guidance or legal authority that might be useful for an objective determination that a public owner and taxpayer have modified the stated term of possession. Indeed, *Charter* is simply inapposite with regard to well-established California law concerning modifications of an interest in publically owned real property (See Civ. Code §§ 1091, 1624; Civ. Proc. Code § 1971; Govt. Code §§ 11120-11132, and §§ 54950-54963). The LTA embraces that law: “As a matter of law, *American Airlines*, AH 510, and Rule 21(d)(1) provide the authoritative guidance that county assessors and AABs must look to when making such a determination. Any reading of *Charter* that is inconsistent with the advice given in this LTA should be disregarded.”

If an assessor's appraisal of a TPI is contested, an AAB must determine if there is clear and convincing evidence that the public owner and private possessor have modified the stated term. When making this determination, the Board interprets Rule 21(d)(1) to require these principles be followed:

1. As a matter of law, the public owner and private possessor must have modified the right to possess the land in a manner that is legally cognizable under contract law principles (e.g., promissory estoppel, quasi-contract, breach of contract, a writing consistent with the statute of frauds, implied contract, detrimental reliance, etc.).
2. No party can prove by clear and convincing evidence that a modification has taken place under Rule 21(d)(1), when either party's agreement to the asserted modification constitutes an ultra vires act that renders the modification void ab initio (i.e., an unenforceable act that is invalid from the outset because it is beyond the scope of powers of the parties under applicable local, state or federal laws).
3. Unless allowed by the statutory scheme, the reasonably anticipated term of possession may never exceed a limit placed on the occupancy of public land by the Legislature.

The guidance offered by this LTA on the application of Rule 21 and AH 510 is well grounded in judicial and statutory authority as well as the Board's longstanding application of that authority. This LTA will ensure the proper and equalized assessment of TPIs through the uniform application of the appropriate standards applicable for determining when a modification to a stated term of possession occurs such that the initial stated term is no longer the "reasonably anticipated term of possession."

Cordially,



Wm. Gregory Turner

CC:
Marcy Jo Mandel, Deputy Controller
Cynthia Bridges, Executive Director
Randy Ferris, Chief Counsel
David J. Gau, Deputy Director Property and Special Taxes