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April 4, 2011

Honorable Kristen Spears
 Placer County Assessor
 Attn:
 2980 Richardson Drive
 Auburn, CA 95603-2640

**Re: Request for Review and Opinion – Solar Power Taxable Possessory Interests
 Assignment No.: 10-262**

Dear Ms. _____ :

This is in response to your October 13, 2010 letter to Assistant Chief Counsel Randy Ferris wherein you requested our opinion regarding the change in ownership consequences of several agreements and certificates involving Placer County and three private companies. As explained below, it is our opinion that two of the transactions created taxable possessory interests and that an assignment of a taxable possessory interest may also have occurred.

Facts

Your letter asks whether the transactions described in the following documents constituted changes in ownership under Revenue and Taxation Code¹ section 60:

- Ground Lease dated March 28, 2007, between Placer County and S _____, Inc.
- Addendum to the Ground Lease dated July 2007.
- Termination of Ground Lease on October 17, 2007.
- Land Lease between Placer County and S _____, Inc.
- Power Purchase Agreement between Placer County and S _____, Inc.
- Certificate as to Purchase Power Agreement, executed by Placer County on April 29, 2008.
- Estoppel Certificate, executed by Placer County on April 29, 2008.

Law

Section 60 defines "change in ownership" as 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." Specific examples of changes in ownership are set forth in section 61 which provides in relevant part:

¹ All "section" references are to the California Revenue and Taxation Code, unless otherwise indicated.

Except as otherwise provided in Section 62, change in ownership includes, but is not limited to:

* * *

(b) The creation, renewal, extension, or assignment of a taxable possessory interest in tax exempt real property for any term. For purposes of this subdivision:

* * *

(3) 'Assignment' of a possessory interest means the transfer of all rights held by a transferor in a possessory interest.

Property Tax Rule² (Rule) 20, subdivision (a), which interprets section 107, defines a possessory interest as:

A possession [or right to 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.

Rule 20, subdivision (b) defines taxable possessory interests as "possessory interests in publicly-owned real property." A taxable possessory interest also includes "taxable improvements on tax-exempt land." (Rev. & Tax. Code, § 107, subd. (b); Rule 21, subd. (a)(3).)

Analysis

1. Ground Lease dated March 28, 2007, between Placer County and S , Inc.

On March 28, 2007, Placer County (County or Lessor) entered into an agreement (the Ground Lease) to lease county-owned real property to S , Inc. (S or Lessee). The terms of the Ground Lease required Lessee to design, install, own and operate a photovoltaic power plant (plant or Solar System) on county-owned land (Premises). (Ground Lease, sections 2.1, 3, 8, 11, 15, and 18.2.) In return, Placer County agreed to purchase the electricity generated by the plant from Lessee. (Ground Lease, section 9.) The term of the contract was 10 years from the beginning of the operation of the plant. (Ground Lease, section 4.1.) The County agreed to purchase the plant with annual payments of \$50,000 over the 10 year contract term. (Ground Lease, section 6.)

Section 61, subdivision (b) provides that the creation of a taxable possessory interest in tax exempt real property for any term constitutes a change in ownership. A taxable possessory interest is a possession or right to possession of publicly-owned 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." (Rule 20, subd. (a); see also Rev. & Tax. Code, § 107, subd. (a).) A taxable possessory interest also includes "taxable improvements on tax-exempt land." (Rev. & Tax. Code, § 107, subd. (b); Rule 20, subd. (a)(3).)

The rights to install, own and operate a power plant on the Premises and to sell electricity to the County provide a benefit³ to Lessee, a private entity, and Lessee does not own the

² Cal. Code Regs., tit. 18, § 462.180. All Rule references are sections to title 18 of the California Code of Regulations.

Premises; therefore whether a taxable possessory interest was created in the Premises depends on whether Lessee's possession of the Premises is independent, durable and exclusive of rights held by others in the Premises.

Independent

Rule 20, subdivision (c)(5) provides that:

'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.

As specified in section 8.11 of the Ground Lease, "LESSEE shall at its sole cost and expense design, build, own and operate the Solar System in compliance with the Project Design, Project Schedule and Specifications," and pursuant to section 3.1 of the Ground Lease, Lessee has "the right to occupy and use the Premises for the sole purpose of constructing, installing, removing, replacing, modifying, maintaining, and operating the Solar System. . ." Pursuant to section 2.2, the County reserved "the right to construct or reconstruct facilities and appurtenances in, upon, over, under, across and along the Premises and in connection therewith, the right to grant or convey to others easement rights and interests to the Premises; provided such rights and interests do not unreasonably interfere with LESSEE's operations." In other words, Lessee has significant authority and control over the Premises to install and operate the plant, and the county's use of the Premises is limited in that it may not interfere with those operations. Therefore, Lessee's possession of the property is independent within the meaning of Rule 20.

Durable

Rule 20, subdivision (c)(6) provides that:

'Durable' means for a determinable period with a reasonable certainty that the possession of the real property by the possessor, or the possessor's right or claim with respect to the possession of the real property will continue for that period.

Section 4.1 of the Ground Lease provides that "the term of this Lease shall commence on the Effective Date and shall terminate ten (10) years after the Solar System Firm Operation Date unless terminated early as elsewhere provided in this Lease." Since the Ground Lease sets forth a determinable period (10 years) for the possessory interest, Lessee's interest is durable within the meaning of Rule 20.

³ A "private benefit" includes the "opportunity to make a profit," as well as a "private or economic benefit that is not shared by the general public." (Rule 20, subd. (c)(8).)

Exclusive

Rule 20, subdivision (c)(7) provides:

'Exclusive of rights held by others in the real property' means the enjoyment of an exclusive use of real property, or a right or claim to the enjoyment of an exclusive use together with the ability to exclude from possession by means of legal process others who may interfere with that enjoyment.

Exclusive use can include the concurrent use of real property, not amounting to co-tenancy or co-ownership, that is a "primary or prevailing right" to use the property, or where persons make qualitatively different uses of the same property. (Rule 20, subd. (c)(7)(A)(3)-(4). See also *Vanguard Car Rental USA, Inc. v. County of San Mateo* (2010) 181 Cal.App.4th 1316, *Air China Ltd. v. County of San Mateo* (2009) 174 Cal.App.4th 14, and *Korean Air Lines Co., Ltd. v. County of Los Angeles* (2008) 162 Cal.App.4th 552.) In this case, the County may also use the Premises, and grant use and access rights to others, but only if in doing so it does not interfere with Lessee's operation of the plant. (Ground Lease, sections 2.2 and 3.1, *supra*.) Therefore, Lessee has a primary or prevailing right to the use of the Premises as described in Rule 20, subdivision (c)(7)(A)(3), and the uses of the Premises by others appear to be limited to those that are qualitatively different from owning and operating a solar power plant, and therefore Lessee's use of the Premises is exclusive within the meaning of Rule 20.

Based on the foregoing, it is our opinion that the Ground Lease created a taxable possessory interest in the Premises in that Lessee received a possession of publicly-owned real property that was independent, durable, and exclusive of rights held by others in that real property, and that provides a private benefit to the possessor. As such, the creation of the interest was a change in ownership of the Premises pursuant to section 61, subdivision (b).

With respect to the plant, Property Tax Rule 20, subdivision (a)(3) provides that possessory interests include "taxable improvements on tax-exempt land." Assessors' Handbook 510 *Assessment of Taxable Possessory Interests* (December 2002) (hereinafter AH 510), states on page 6 that:

The rule then states that a possessory interest includes 'taxable improvements on tax-exempt land.' This refers to privately owned improvements constructed or owned by the possessor (i.e., not the public owner) on the land subject to the taxable possessory interest. According to this provision a possessory interest includes all improvements constructed pursuant to a possessory interest in land that become the property of the public owner at the termination of the possession, whether the improvements are constructed at the possessor's or the public owner's expense. However, improvements owned by the possessor that do not become the property of the public owner at the end of the term of possession fail the ownership test of Rule 20(a)(1) and, thus, are not taxable possessory interests.

There is no possessory interest in improvements located on tax-exempt land if the lessee retains fee simple or life estate ownership of the improvements, or if the lessee is required to remove the improvements at the end of the lease. (Property Tax Annotation 660.0120 (9/27/84).) Section 15 of the Ground Lease provides that:

Subject to the rights provided to COUNTY pursuant to other terms hereof, the Solar System and all alterations, additions, improvements or installations made thereto by LESSEE and all LESSEE property used in connection with the installation, operation and maintenance of the Solar System is, and shall remain, the personal property of LESSEE ('LESSEE Property'). In no event shall any LESSEE Property be deemed to be a fixture, nor shall COUNTY, nor anyone claiming by, through, or under COUNTY (including by not limited to any present or future mortgagee of the Facility or the Premises) have any rights in or to the LESSEE Property at any time except as otherwise provided herein.

Section 18.2 of the Ground Lease provides that "except for the right of purchase the Solar System as provided for in this Agreement, COUNTY acknowledges that it has no interest in the Solar System." Section 20.1 of the Ground Lease requires Lessee to remove the Plant from the Premises and return the Premises to its pre-installation condition. Thus, Lessee did not have a possessory interest in the plant because it retained fee simple ownership until the county made the ten years of payments.

2. Addendum to the Ground Lease dated July 2007.

In July, 2007,⁴ Placer County and Lessee agreed to amend the Ground Lease by "Addendum No. 1. To Energy Service Contract and Ground Lease" (Addendum). The Addendum deleted section 6 of the Ground Lease, which stated that the County agreed to purchase the plant over the term of the lease, and pursuant to the Addendum Lessee granted to the County an option to purchase the plant at any time beginning after the ninth year of the lease and prior to the end of the tenth year.

In this case, the Addendum replaced the ten-year payment purchase agreement with the County's option to purchase the plant. Until the County exercises the option to purchase, Lessee was the fee owner of the plant (if and when the plant was constructed) and by definition did not have a possessory interest therein.

3. Termination of Ground Lease on October 17, 2007

On October 17, 2007, Placer County and Lessee executed a document terminating the Ground Lease. This effectively terminated Lessee's possessory interest in the Premises and any possessory interest it might have had in the plant. Since possession of the Premises and the plant returned to the County, a tax-exempt entity, the property is exempt from taxation. (Cal. Const. art XIII, § 3, subd. (b).)

4. Land Lease and Power Purchase Agreement between Placer County and Partners, Inc.

In October 2007,⁵ Placer County (County or Landlord) entered into a Power Purchase Agreement (PPA) and an agreement (the Land Lease) to lease County-owned real property to Partners, Inc. (Tenant). The terms of the Land Lease required Tenant to construct, own and operate a solar energy facility (plant or SEF) on County-owned land

⁴ We were given an executed but undated copy of the Addendum.

⁵ According to the Estoppel Certificate and the Certificate as to Power Purchase Agreement, *infra.*, the Land Lease and PPA were entered into effective October 18, 2007.

(Premises). (Land Lease, section 5.) In return, Placer County agreed to purchase the electricity generated by the SEF from Tenant. (PPA, section 3.) The term of the PPA is 10 years from the beginning of the operation of the SEF. (PPA, section 2.1) The term of the Land Lease "coincides" with the term of the PPA. (Land Lease, section 4.) The County has no ownership interest in the SEF or any other Tenant property, and Tenant is required to remove the SEF at the end of the term of the lease. (Land Lease, sections 6 and 10.)

As above, since the right to operate a solar energy facility on County-owned land and sell electricity to the County is a benefit to Tenant, and Tenant does not own the Premises, whether or not Tenant has a taxable possessory interest depends on whether its possession of the Premises is independent, durable and exclusive of rights held by others in the real property.

Independent

Section 5, subdivision (a) of the Land Lease provides, "Tenant shall use the Premises for the sole purpose of installation, construction, operation, maintenance, repair, improvement, replacement, and removal of the SEF and uses incidental thereto . . ." Section 5, subdivision (b) provides that "At all times during the Term, Tenant shall have the exclusive right to occupy the Premises and the exclusive and continuous right to direct sunlight for operation of the SEF. . . . Any such use, lease or easement entered into after the Effective Date of this Lease shall expressly provide it is are [sic] subject and subordinate in all respects to this Lease and to the rights of Tenant hereunder." It also provides that Tenant is entitled to specific performance of these rights. Section 6, subdivision (a) of the Land Lease provides, "Tenant shall have the right at any time and from time to time to repair, replace, remove, improve, enhance, relocate or replace the SEF and other SEF assets . . ." Based on these provisions, Tenant has significant authority to install, operate and maintain the SEF on the Premises, and its possession of the Premises is sufficiently autonomous as to be independent within the meaning of Rule 20.

Durable

"The term of this Lease (the '*Term*') shall coincide with the term of the PPA." (Land Lease, section 4.) "The initial term of this PPA (the '*Initial Term*') shall commence on the Effective Date and shall be in effect until 00:00 hours Pacific Time on the tenth (10th) anniversary of the Commercial Operation Date." (PPA, section 2.1.) Since the Land Lease sets forth a determinable period (10 years) for the possessory interest, Tenant's interest is durable within the meaning of Rule 20.

Exclusive

With regards to exclusivity, section 5, subdivision (b) of the Land Lease states:

Landlord reserves the right to use the remainder of the Property for any other purpose, or to grant easements or leases in favor of third persons for any other lawful purpose permitted under applicable law, so long as any such uses, easements or leases or the construction of buildings or other improvements on the remainder of the Property or the use of the Property for agricultural purposes (including the planting of trees, vines or other crops), does not cast shadows, block or restrict access to direct sunlight or otherwise interfere with any of

Tenant's rights under this Lease or the construction, use or operation of the SEF to generate Energy in accordance with the requirements of the PPA.

In our opinion, because the County's concurrent use of the property may not interfere with Tenant's use of the property, Tenant has a primary or prevailing right as described in Rule 20, subdivision (c)(7)(A)(3) and its possession of the property is exclusive of rights held by others in the real property.

Under the terms of the Land Lease, Tenant received the right to build and operate a solar energy facility on county-owned property. As explained above, Tenant's possession of the county-owned land subject to the lease is independent, durable, and exclusive of rights held by others in the real property, and provides a private benefit to the possessor. As such the creation of the possessory interest in the land was a change in ownership pursuant to section 61, subdivision (b).

With respect to the SEF, Section 6, subdivision (b) of the Land Lease provides that:

Landlord shall have no ownership or other interest in the SEF or any SEF Assets or other equipment or personal property of Tenant installed on the Premises and Tenant may remove all or any portion of the SEF or any SEF Assets at any time and from time to time as further provided in the PPA.

Section 10 of the Land Lease requires Tenant to remove the SEF and related property from the Premises upon the termination or expiration of the PPA, and again acknowledges Tenant's ownership of the SEF and related property. Under Article 12 of the PPA, the County has the option to purchase the SEF under specified conditions, but otherwise, under Article 2.1, subdivision (c), Tenant is required to remove the SEF at the expiration of the term of the PPA. Thus, the County has no ownership interest in the SEF. Tenant is the owner of the SEF and therefore does not have a possessory interest therein. (Rule 20, subd. (a).)

5. Certificate as to Power Purchase Agreement and Estoppel Certificate, executed by Placer County on April 29, 2008.

On April 29, 2008, Placer County executed a Certificate as to Power Purchase Agreement. This document stated that "[Placer County] has been informed that Macquarie Holdings (USA), Inc. . . . and [Tenant], are parties to an asset purchase agreement, whereby Buyer agreed to purchase, and [Tenant] agreed to sell, certain assets (including the PPA) of [Tenant]." The Certificate states that the PPA remains in effect and that Tenant owns title to the SEF. It states that the County acknowledges and consents to the assignment of the PPA from Tenant to Macquarie.

On April 29, 2008, Placer County executed an Estoppel Certificate which states that "[Placer County] has been informed that Macquarie Holdings (USA), Inc. . . . and [Tenant], are parties to an asset purchase agreement, whereby Buyer agreed to purchase, and [Tenant] agreed to sell, certain assets (including the Lease) of [Tenant]." The Estoppel Certificate further states that the Land Lease remains in effect and that the County consents to the assignment of the Land Lease to Macquarie and the assumption of the Land Lease by Macquarie from Tenant.

Section 61, subdivision (b), provides that the assignment of a taxable possessory interest is a change in ownership. An assignment of a possessory interest is "the transfer of all rights held by a transferor in a possessory interest." (Rev. & Tax. Code, § 61, sub. (b)(3).) Therefore, if Tenant transferred its rights set forth in the Land Lease to Macquarie, then a change in ownership of the possessory interest occurred. However, the above documents merely acknowledge that the County has been informed that the assignment has occurred; they do not themselves represent the transfer. It is our opinion that your office should confirm that the assignment did actually occur before processing the change in ownership of the taxable possessory interest.

As explained above, Tenant did not have a taxable possessory interest in the SEF, if constructed, and according to paragraph 6 of the Certificate as to Power Purchase Agreement, as of October 18, 2007 Tenant still held title to the SEF. Because the Estoppel Certificate and the Certificate as to Power Purchase Agreement do not clearly state whether the SEF is being purchased by Macquarie, it is unclear whether the assignment described in those documents would result in the reassessment of the SEF. (AH 510, p. 6.) If Tenant still holds title to the SEF, then no change in ownership occurred. If, on the other hand, title to the SEF was transferred to Macquarie, or another entity, then the SEF should have been reassessed pursuant to section 60, unless an exclusion applied.

The views expressed in this letter are 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.

Sincerely,

/s/ Daniel Paul

Daniel Paul
Tax Counsel

DMP:yg

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cc: Mr. David Gau MIC:63
Mr. Dean Kinnee MIC:64
Mr. Todd Gilman MIC:70