

M e m o r a n d u m

To: Mr. Dean R. Kinnee, Chief (MIC: 64)
County-Assessed Properties Division

Date: April 29, 2009

From: Kiren Kaur Chohan
Tax Counsel III

Subject: *Rule 462.500 – Award Price, Base Year Transfer Allowance
(Real Property Taken by Governmental Action or Eminent Domain)
Assignment No. 08-217*

This is in response to your memorandum of October 15, 2008 based on the following facts:

Taxpayer Z owns Parcel A. The City wants to put in a new freeway interchange, part of which will pass over a portion of Parcel A. The parties end up in court for eminent domain proceedings. The result is that the City receives (1) fee simple interest in a portion of Parcel A, (2) a permanent public utility easement over another portion of Parcel A, and (3) a temporary construction easement over a different portion of Parcel A. The taxpayer keeps the remainder of Parcel A. The monetary award paid by the government entity to the property owner is \$2,476,000. Of this amount, \$2,112,374 is the amount paid for the fee simple interest for a portion of Parcel A, \$80,238 for the permanent utility easement, and \$127,637 for the temporary construction easement. The remaining amount was for interest and court costs.

Itemized Breakdown:

1. Fee simple of property	\$2,112,374
2. Permanent utility easement	80,238
3. Temporary construction easement	127,637
4. Interest and court costs (other amount)	<u>155,751</u>
Total	<u>\$2,476,000</u>

You presented the following questions related to the foregoing scenario:

Question 1: Are either of the easements part of "property taken"?

Question 2: For the purpose of the base year transfer value comparison, should the money paid for interests other than the portion of Parcel A be excluded?

Question 3: If it turns out that only part of the monetary award is for the real property interests, and the rest is for other non-realty items such as interest and court costs, should those other costs be excluded and only the portion of the award that is directly tied to the real estate interests be used to calculate the base year transfer allowance?

As discussed in detail below, our answers to your questions are as follows:

Answer 1: Neither easement is considered to be "property taken."

Answer 2: For purposes of determining the base year transfer value comparison, only the amount paid for the taxpayer's fee simple interest in the real property (i.e., "property taken") should be considered as the award or purchase price paid for property taken; and any amounts received for others types of interests in the property should be excluded.

Answer 3: As stated above in answer to question 2, only the portion of the award that was paid for the fee simple interest in taxpayer's real property (i.e., the fee simple interest in Parcel A) should be considered for purposes of determining the base year transfer allowance. Based on the information provided, this amount is \$2,112,374.

Analysis

Article XIII A, section 2 of the California Constitution requires the reassessment of real property upon a "change in ownership."

Revenue and Taxation Code¹ section 68 provides that the term "change in ownership" shall not include the acquisition of real property as a replacement for comparable property if the person acquiring the real property has been displaced from property in this state by eminent domain proceedings, by acquisition by a public entity, or by governmental action which has resulted in a judgment of inverse condemnation.

Property Tax Rule² 462.500, the regulation that interprets and implements section 68, states in subdivision (a) that the term "change in ownership" shall not include the acquisition of comparable real property as replacement for property taken if the person acquiring the replacement real property has been displaced from the property by eminent domain. Subdivisions (b)(1) and (5) provide that "property taken" is real property, which includes land, land improvements, living improvements, manufactured homes, and fixed machinery and equipment, which is taken or acquired as provided in subdivision (a).

With respect to your first question of whether easements constitute property taken for purposes of section 68 and Rule 462.500, we note that an easement is an interest in the land of another, which entitles the holder of the easement to limited use or enjoyment of the other's land; and thus it is not an estate of land. (12 Witkin Sum. Cal. Law Real Property § 382(1).) Here, we are concerned with two types of easements, a permanent public utility easement and a temporary construction easement.

In our annotations, we have noted that an easement is an interest in real property, the transfer of which *may* constitute a change in ownership, but that easements are generally not the equivalent of a fee simple estate and there is generally no change in ownership upon a transfer or acquisition of an easement under section 60. (See Annotations 220.0160 through 220.0165.) (One exception was noted in Annotation 220.0160, where we concluded that the creation of a "conservation easement" conveying all rights and interest in the property except legal title, exclusive in perpetuity, and running with and burdening title to the property constituted a change in ownership under section 60.) However, for purposes of determining whether property is "taken" under section 68, even though an interest in real property may constitute a change in ownership for reassessment purposes under section 60, if the interest taken or acquired does not represent

¹ All further statutory references are to the Revenue and Taxation Code unless otherwise specified.

² All references to Property Tax Rule or Rule are to title 18 of the California Code of Regulations.

"ownership" of the property it would not be eligible for relief under section 68 (either as property taken, or as replacement property).

In Rule 462.500, subdivision (e), "Owner" is defined as *the fee owner or life estate owner* of the real property taken and specifically excludes lessees, unless a lessee owns improvements located on land owned by another. In Annotation 200.0357, we interpreted Rule 462.500 as requiring ownership both of "property taken"³ and "replacement property" in order for exclusion from change in ownership provided in Article XIII A, section 2(d), section 68 and Rule 462.500 to be available to a taxpayer. We further concluded that while leases of taxable real property for terms of 35 years or more are changes in ownership for purposes of reassessment (sections 60 and 61, subdivision (c)), leases of such property do not convey ownership thereof under real property law, as leases only convey certain rights such as possession and use of the property. Thus, we concluded that leases of real property for terms of 35 years or more do not qualify for relief under section 68.

Based on the foregoing, we understand the general rule to be that relief is only available under section 68 when the owner's fee simple or life estate interest in real property has been taken by eminent domain, and when a fee simple or life estate interest in replacement property has been acquired; and relief is *not* available under this section where lesser interests in the taxpayer's property have been taken or when lesser interests in real property are acquired. In both cases here, the taxpayer retains the ownership interest in the real property that is subject to the easements, and thus we find that the easements do not qualify as "property taken" under section 68.

Your second and third questions pertain to the base year value of replacement property, which is discussed in subdivision (d) of Rule 462.500, and provides that the full cash value of the comparable replacement property should be compared to the award or purchase price for the property taken. "Award or purchase price" is defined as the amount paid for "property taken" and shall not include amounts paid for any thing other than the replaced property. (Rule 462.500, subd. (b)(3).) By definition then, the amount paid for the easements, court costs and interests are not amounts paid for the "property taken," and thus are not properly included in the "award or purchase price." In sum, for purpose of determining the base year value of replacement property, the amount paid for property taken is the amount received by the owner for their fee simple interest in the real property taken by eminent domain; and only that portion of the award that is directly related to the property taken should be used to determine the base year transfer allowance. Based on the information provided to us, the property taken by eminent domain is the taxpayer's fee simple interest in a portion of Parcel A, and the award or purchase price paid for this property is \$2,112,374.

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cc: Mr. Ramon Hirsig MIC: 73
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Mr. Randy Ferris MIC: 82
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³ Rule 462.500 was amended in 2004 to delete the definition of "replaced property," and revise the definition of "property taken." Prior to the amendment, "replaced property" was defined as "real property taken." Thus, the definition of "replaced property" as used in this annotation is essentially that of "property taken," with which we are concerned here.