

542.

PERMANENT LEASEHOLDS—APPRAISING INTERESTS OF LESSORS AND LESSEES—HOW COUNTY AUDITOR PROCEEDS—USE OF CAPITALIZATION METHOD.

SYLLABUS:

In appraising the interests of lessors and lessees in 99 year leases, renewable forever, the provisions of Section 5342 have no application, and the county auditor is required to proceed pursuant to the provisions of Section 5341 of the General Code. As one of the factors in determining the value of such interests for the purposes of the inheritance tax, the auditor may use the capitalization method, but his conclusion should, in each case, ultimately reflect the actual market value of the interests so appraised at the date of the accrual of the tax.

COLUMBUS, OHIO, June 19, 1929.

The Tax Commission of Ohio, Columbus, Ohio.

GENTLEMEN:—This will acknowledge receipt of your recent communication as follows:

“The Tax Commission of Ohio has for several years been following a rule in valuing lessors’ and lessees’ interests in 99 year leases renewable forever, that such interests should be appraised by capitalizing the annual rentals at five per cent. This ruling was predicated upon Section 5342 of the General Code.

It has been decided recently in several cases, with which you are familiar, that the five per cent rate does not control and that the respective interests should be appraised at their actual worth and not according to any fixed rate of per cent.

The Commission is desirous of having an opinion from your department in view of the recent decisions with respect to the valuation of lessors’ and lessees’ interests in 99 year leases, that is to say whether or not such interests shall be valued by capitalizing the rentals at five per cent, or by appraising the property for inheritance tax purposes by some other method of valuation.”

The method of appraisal for inheritance tax purposes has, as you say, been to capitalize the average rentals payable under perpetual leases, at five per cent, following the provisions of Section 5342, General Code. Doubt has been thrown upon the propriety of this method by reason of several recent cases in which this method has been rejected by the courts, although it may be said, at this time, there is no decisive adjudication of our Supreme Court which may be pointed out as dispositive of the question.

Section 5342 of the General Code provides in part as follows:

“The value of a future or limited estate, income, interest or annuity for any life or lives in being, or of any dower interest or other estate or interest upon which any estate or interest the succession to which is taxable under this chapter is limited, shall be determined by the rule, method and standard of mortality and value employed by the superintendent of insurance in ascertaining the value of annuities for the determination of liabilities of life insurance companies, except that the rate of interest shall be five per centum per annum.”

The solution to your question depends upon whether the interests concerning which you inquire, are comprehended within any of the descriptive terms found in this section. If they do not, then, in order to ascertain the value of such interests for taxation, the method prescribed by Section 5341 of the General Code must be followed, which section will be hereinafter quoted.

Doubtless the practice which now is being followed had its origin, at least in part, by reason of the decision of the Supreme Court in the case of *Ralston Steel Car Company vs. Ralston*, 112 O. S. 306. In that case, the owner of a lease of real estate for 99 years, renewable forever, was held to have a freehold estate subject to the laws of descent as an estate in fee, which estate was subject to dower.

The court further fixed the method of determining the value of the dower right in such lease, as stated in the third branch of the syllabus:

“Where such interest in real estate is subjected to sale by an administrator in a proceeding to sell real estate to pay debts of the decedent, the value of a widow’s dower is properly payable to her in money out of the proceeds of such sale, and the reasonable value of such dower is the present value of one-third of the proceeds of such sale computed in accordance with her expectancy of life under the mortality tables.”

The court, speaking of the interest of the lessor, says on page 309:

“So long as all of the conditions of the lease were faithfully observed, the only rights which the owner of the fee could lawfully claim were those of receiving the stipulated rent and the further right to claim a forfeiture in the event of non-performance of the conditions, including the payment of rent.”

The court very properly concludes that the right of the lessor amounts substantially only to the right to receive the stipulated rent, together with a lien therefor, and the right to claim a forfeiture. In substance, therefore, the lessor’s interest becomes merely income, and superficially, it would appear that the lessor’s interest would come within the descriptive terms used in Section 5342, *supra*.

In my opinion, however, this conclusion is not warranted by the terms of the section. Taking the section as a whole, it is quite apparent that the interests therein described are all of the character which are dependent upon the continued existence of a person or persons. You will observe that the phrase “for any life or lives in being” follows immediately after the word “annuity.” It may be argued that this phrase is a qualification solely of the word “annuity,” but this does not appear to me to be the correct conclusion. This modifying phrase applies alike to the other descriptive words, “estate, income, interest” and each of these interests so denominated must be for a life or lives in being before the section has any application.

This conclusion may be reached solely from rules of proper construction, but it is re-enforced by the remaining portion of the section. You will observe that the value of these various interests is to be determined “by the rule, method and standard of mortality and value employed by the superintendent of insurance in ascertaining the value of annuities,” etc. Quite obviously mortality tables are only called into use in determining the value of things held during the period of a life or lives alone, and value of that dower interest should be determined in accordance with the expectancy of which is not dependent upon human life.

I have accordingly reached the conclusion that all of the interests described in Section 5342 of the Code are dependent for either their origin or their extinction upon a life or lives in being, for to such kind of interests only would the use of mortality tables be appropriate.

The most casual discussion of the attributes and characteristics of the interests of both lessors and lessees in 99 year leases, renewable forever, will disclose that Section 5342 can have no application. The interests are neither terminable, nor do they originate upon the death of any person or persons now living. The interest of each party to the lease continues as property after death, and as pointed out by the court in the Ralston case, *supra*, is an estate in fee, subject to the laws of inheritance and to dower. The impropriety of applying mortality tables in determining the value of these interests for purposes of inheritance tax, as a general rule, is quite clear, except where, as in the Ralston case, an interest in the interest is dependent upon life. There the court was dealing with a dower interest in the lessee's property right in the lease, and quite properly it was held that, where the property was sold, the value of that dower interest should be determined in accordance with the expectancy of life of the widow under the mortality tables.

Based upon the foregoing, I have reached the conclusion that the valuation of the interests of lessors and lessees in 99 year leases, renewable forever, cannot be made under the provisions of Section 5342 of the General Code.

It follows that the appraisal must be accomplished in the ordinary way which is set forth in Section 5341, General Code, which provides in part as follows:

"The county auditor shall be the inheritance tax appraiser for his county. The probate court, upon its own motion may, or upon the application of any interested person, including the tax commission of Ohio, shall by order direct the county auditor to fix the actual market value of any property the succession to which is subject to the tax levied by this subdivision of this chapter. Such auditor shall forthwith give notice by mail to all persons known to him to have a claim or interest in the property to be appraised, including the tax commission of Ohio, and to such persons as the probate court may by order direct, of the time and place when he will appraise such property. He shall at such time and place appraise the same at its actual market value as of the date of the accrual of the tax, except as hereinafter provided, and subject to the rules hereinafter prescribed. Such county auditor for such purpose is hereby authorized to issue subpoenas and to compel the attendance of witnesses and the production of books and papers before him, and to examine such witnesses under oath concerning such property, the value thereof, and the nature and circumstances of the succession. Disobedience of such subpoena, or refusal to testify on such examination shall be punished as a contempt of the probate court. The county auditor shall report his findings in writing, together with the depositions of the witnesses examined, and such other facts in relation thereto as the probate court may order. Such report shall be made in duplicate; one copy thereof shall be filed with the probate court, and the other with the tax commission of Ohio."

Accordingly the county auditor should appraise these interests at their actual market value as of the date of the accrual of the tax and in so doing he is required to take into consideration every fact and circumstance bearing upon the question of value. To aid in reaching his conclusion he may compel the attendance of witnesses and the production of books and papers.

It is not my intention to leave the impression that the county auditor cannot give any consideration at all to a value arrived at by the capitalization method. In the case of income property this method is too generally used to warrant an arbitrary disregard thereof in arriving at value. Under many circumstances this method may be the fairest and most accurate method of reaching a conclusion. All that I intend to say is that it is improper arbitrarily to fix the valuation of the interests of the

lessors and lessees in 99 year leases, renewable forever, by the capitalization method at a fixed percentage, irrespective of other conditions reflecting upon the value. Furthermore, economic conditions may demand, even though the capitalization method be used, that some different percentage be applied, rather than the five per centum mentioned in Section 5342 of the Code.

The foregoing discussion has been based primarily upon the statute itself. As you are well aware, the courts at the present time are in considerable conflict upon the question you present. In view of this conflict I have felt free to express my views upon the proper interpretation of Section 5342 of the Code, and suggest that you be governed accordingly unless and until a decision of the Supreme Court is rendered to the contrary.

Summarizing my conclusions and in specific answer to your inquiry, I am of the opinion that, in appraising the interests of the lessors and lessees in 99 year leases, renewable forever, the provisions of Section 5342 have no application, and the county auditor is required to proceed pursuant to the provisions of Section 5341 of the Code. As one of the factors in determining the value of such interests for the purposes of the inheritance tax, the auditor may use the capitalization method, but his conclusion should, in each case, ultimately reflect the actual market value of the interests so appraised at the date of the accrual of the tax.

Respectfully,
GILBERT BETTMAN,
Attorney General.