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Ad Valorem Tax Status of a Private Lessee's Interest in Publicly Owned Property: Taxability of Possessory Interests in Industrial Projects under the New Mexico Industrial Revenue Bond Act

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AD VALOREM TAX STATUS OF A PRIVATE LESSEE'S INTEREST IN PUBLICLY OWNED PROPERTY: TAXABILITY OF POSSESSORY INTERESTS IN INDUSTRIAL PROJECTS UNDER THE NEW MEXICO INDUSTRIAL REVENUE BOND ACT

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The primary purpose of this study is to seek an answer to the question whether a private lessee's interest in an industrial "project," acquired by a New Mexico municipality and purportedly leased to such private lessee pursuant to the New Mexico Industrial Revenue Bond Act,[1] is subject to ad valorem taxation by the state of New Mexico or its political subdivisions. Any conclusions reached with respect to the primary question may, however, have application to the ad valorem tax status of other private leaseholds and similar possessory interests in property the reversion of which is vested in the United States, the state of New Mexico or one or more of its political subdivisions.[2]

The seemingly narrow scope of the inquiry belies somewhat the potential importance of any conclusions which may be reached. Certainly as a minimum they could have a material bearing on the breadth of the property tax base in the jurisdiction affected, and possibly on the efficacy and appeal of industrial revenue bond financing for new, expanding or relocating business enterprises.

THE LEGAL AND FACTUAL SETTING AND A SUMMARY OF THE ISSUES

A. Purpose and Operation of the Industrial Revenue Bond Act

The purposes of the Industrial Revenue Bond Act are perhaps best expressed by pertinent provisions of the Act itself:

> 14-31-2. Legislative intent.–It is the intent of the legislature to authorize muncipalities to acquire, own, lease or sell projects for the purpose of promoting industry and trade by inducing manufacturing, industrial and commercial enterprises to locate or expand in this state, promoting the use of the agricultural products and natural resources of this state, and promoting a sound and proper

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1. N.M. Stat. Ann. §§ 14-31-1 to -13 (Repl. 1968, Supp. 1971).

2. When ownership of the entire property is thus divided between a private lessee and a public lessor, the lessee is hereafter sometimes described as having a possessory or leasehold interest in "publicly owned property" although the public entity obviously owns only the reversion in fee.

> balance in this state between agriculture, commerce and industry. It is intended that each project be self-liquidating. It is not intended hereby to authorize any municipality itself to operate any manufacturing, industrial or commercial enterprise.
>
> 14-31-2.1. Additional legislative intent.–It is, further, the legislative intent that the industrial Revenue Bond Act [14-31-1 to 14-31-13] authorize municipalities to acquire, own, lease or sell projects for the purpose of promoting the local economy by inducing private institutions of higher education to locate or expand in this state. It is not intended hereby to authorize any municipality itself to operate any private institution of higher education.

The term "project" is very broadly defined,[3] but for present purposes can be considered to include any land, building or other improvements and all machinery and equipment and other personal properties deemed necessary for the conduct of the business enterprise.

To carry out the purposes of the Act, the municipality is authorized or required:

(1) to acquire the project by construction, purchase, gift or lease;

(2) to sell, lease or otherwise dispose of the project (presumably to a private corporation which will operate the project for profit) under an agreement conditioned upon completion of the project and providing for such rentals or payments as will be sufficient to pay the bond principal and interest, provide any reserves deemed advisable and pay repairs and insurance if not paid by the lessee; and

(3) to issue revenue bonds to defray all acquisition and related costs, such bonds and interest thereon to be payable solely out of revenue derived from the project, and to be secured by a pledge of such income and perhaps by a mortgage covering all or part of the project.[4]

The most significant feature of the above-described financing plan is that the revenue bonds are not a general obligation of the municipality; neither are they a charge against the municipality's general credit or its taxing powers.[5] Accordingly, in *Village of Deming v. Hosdreg Company*,[6] the New Mexico Supreme Court

3. N.M. Stat. Ann. § 14-31-1(B) (Supp. 1971).
4. N.M. Stat. Ann. § 14-31-3 to -6 (Repl. 1968).
5. N.M. Stat. Ann. § 14-31-4 (Repl. 1968).
6. 62 N.M. 18, 303 P.2d 920 (1956).

sustained the validity of the Act against the contentions that it violated both the constitutional debt limitations[7] and the constitutional prohibition against making "any donation to or in aid of any . . . private corporation."[8]

B. A Typical Industrial Revenue Bond Financing Transaction

Although undoubtedly more complex in actual practice, the principal features of a fairly typical industrial revenue bond financing arrangement might be described as follows for a hypothetical "project" acquired by the City of Albuquerque (City) for the use of Expando, Inc. (Expando):[9]

> (1) City enters into certain arrangements with Expando to induce Expando to locate in the immediate Albuquerque area. The arrangements are embodied in: (a) a letter agreement outlining the proposed transactions, (b) a "Contract of Purchase," (c) a "Trust Indenture," and (d) a "Lease Agreement and Option to Purchase."
>
> (2) The letter agreement provides for the acquisition of land and the construction and equipping of an industrial plant thereon according to Expando's specifications, either by Expando or by City. If Expando assumes responsibility for acquisition of the project, then Expando and City agree that they will simultaneously enter into a "Contract of Purchase," whereby Expando would agree to "sell" and City would agree to "buy" the project for a price equal to its cost, but not in excess of the net proceeds from the sale of the bonds discussed below. If City assumes responsibility for acquiring the project, then Expando would agree to reimburse City for any costs in excess of the net proceeds from sale of the bonds.
>
> (3) City will obtain funds to finance the purchase or construction of the project by issuing industrial revenue bonds, secured by and payable solely from the proceeds derived from leasing the project as described below. To provide for issuance of the bonds, disbursement of the net

7. N.M. Const. art. 9, § 12.
8. N.M. Const. art. 9, § 14.
9. The transaction described is not one actually consummated in New Mexico but rather is patterned after one described in a ruling by the U.S. Internal Revenue Service. Rev. Rul. 68-590, 1968-2 Cum. Bull. 66. Nevertheless, it is similar in all material respects to industrial bond financing transactions actually carried out in New Mexico with the exception that in many if not all of the New Mexico transactions the lessee of the project does not have an option to renew its lease.

proceeds, and security for payment of bond interest and principal, City will execute a Trust Indenture appointing a trustee for the bondholders. The trustee will receive the net proceeds from the sale of the bonds and use the funds to pay for the purchase or construction of the project, as the case may be. If the net proceeds from sale of the bonds are not sufficient to cover the cost of the project, Expando will agree to make up the difference; and if the net proceeds exceed such cost, the trustee is to retain such excess and apply it to payment of bond interest and principal.

(4) The last maturity date of the bonds will coincide with the end of the initial lease term provided in the "Lease Agreement and Option to Purchase." Under the terms of the "Trust Indenture," the trustee will be given a deed of trust to the project subject to the "Lease Agreement and Option to Purchase." City also will assign the basic lease rentals to the trustee as security for payment of bond interest and principal.

(5) Simultaneously with the other agreements, City and Expando will enter into a "Lease Agreement and Option to Purchase," whereby City will agree to "lease" the project to Expando for an initial lease term of 20 years, which is substantially shorter than the useful life of the project. Expando will assume an unconditional obligation to make periodic payments, called "basic rental," during the initial lease term in an amount sufficient to cover payment in full of bond interest and principal. The basic rental will be payable directly to the trustee, and will be adjustable to take into consideration any excess of the net proceeds from sale of the bonds over the cost of the project and certain other contingencies. Expando will be given options to renew for renewal terms which, when added to the initial lease term, aggregate 99 years. The basic rent during the renewal period will be nominal. Expando will also be given an option to purchase the project for a nominal amount at the end of the initial lease term (or at any time during the renewal terms), or earlier upon prepayment of the basic rental.

(6) Expando will agree to pay, as additional rent, all utility charges, taxes, assessments, casualty and liability

insurance premiums, and any other expenses or charges relating to the use, operation, maintenance, occupancy and upkeep of the project.

(7) The "Lease Agreement and Option to Purchase" and "Trust Indenture" will contain provisions relating to damage to or condemnation of the project or default by Expando. The substance of the provisions would make Expando entitled to any excess of insurance, condemnation or foreclosure sale proceeds over the remaining basic rentals and liable for any deficiency.

Assuming, for purposes of discussion, that a transaction containing these principal features is entered into between the City of Albuquerque and a hypothetical corporation named Expando, Inc., the factual pattern thus established provides a framework within which to identify and discuss the legal and policy issues presented.

C. *Summary of the Issues*

As already indicated, the ultimate issue is whether Expando, Inc., the purported lessee of an industrial project acquired by the City of Albuquerque pursuant to New Mexico's Industrial Revenue Bond Act, has an interest which is or should be subject to ad valorem taxation. For purposes of analysis and discussion, however, the inquiry can logically be divided into several subsidiary issues.

The possibility exists at the outset that the transaction which purports to create a relationship of landlord and tenant should in fact and in law be deemed to create a relationship of vendor and vendee, with the result that Expando may be considered the owner of the project for ad valorem tax purposes.

Alternatively, the transaction might be analyzed on the assumption that the true nature of the relationship between the City and Expando is one of lessor-lessee. Under such assumption, does Expando's leasehold interest constitute property subject to ad valorem taxation, or is such interest merely a part of the larger "project" which is exempt from ad valorem taxation as "property of" the City under article 8, § 3, of the Constitution of New Mexico? If a private lessee's interest in publicly owned property is properly subject to ad valorem taxation under New Mexico law, two important collateral questions must be resolved. The first is how to value the lessee's interest, *i.e.*, will the proper valuation method be likely to produce a significant assessed value or, in many cases, perhaps only a nominal assessed value (due to allowance of a deduction for rentals reserved under the lease for the remainder of the term)? And if there is a significant assessed value remaining to be taxed, a second question arises as to the remedies available to the citizen desiring to secure enforcement of the law by taxing jurisdiction(s) which today, for whatever reason, are permitting possessory leasehold interests such as Expando's to escape taxation entirely.

If, on the other hand, one were to conclude that present New Mexico law is not sufficiently broad to reach the private lessee's possessory interest in publicly owned property, a question remains whether the New Mexico tax statutes can and should be amended to permit this result. What legal and policy considerations would be involved?

These, then, are the issues which will be confronted and, hopefully, resolved in the remainder of this paper.

FORM VS. SUBSTANCE–A LEASE OR A SALE?

Perhaps more in the field of federal taxation than in any other field of law the principle is established that the courts will look through the formalities of a transaction to determine its true economic substance or reality.[10] Application of this principle is often occasioned by the necessity of distinguishing between a lease and a conditional or an installment sale. Accordingly, in Revenue Ruling 55-540 [11] the Internal Revenue Service issued guidelines for determining whether a particular transaction should be characterized as a lease or a contract of purchase and sale. The existence of the following factors, among others, were held in the ruling to be indicative of a purchase and sale rather than a lease:

> (1) If the lessee will acquire title to the property upon payment of a stated amount of "rentals" which under the contract he is required to make.
>
> (2) If the total amount which the lessee is required to

10. Helvering v. Lazarus & Co., 308 U.S. 252 (1939); Gregory v. Helvering, 293 U.S. 465 (1935). In the Lazarus case the U.S. Supreme Court affiirmed findings of the trial court that an instrument purporting to convey legal ownership was in reality given and accepted as security for a loan; that "rent" stipulated in a 99-year "lease" was intended as interest; and that a "depreciation fund" required by the instrument represented an amortization fund, designed to pay off the loan over a period of years.

11. 1955-2 Cum. Bull 39.

pay for a relatively short period of use is an inordinately large proportion of the total sum required to be paid to secure transfer of title to the property.

(3) If the property may be acquired under a purchase option at a price which is nominal in relation to the probable value of the property at the time the option is exercised, or is a relatively small amount when compared with the total contract payments required to be made.

The ruling further declares that a transaction will be presumed to be a conditional sales contract if the total rental payments plus any option price approximates what would have been the original purchase price of the property plus carrying charges had the property been sold in the first instance.

The existence of most of the above enumerated factors in the hypothetical Expando, Inc. transaction is readily apparent. One should not be surprised to learn, therefore, that in a virtually identical transaction the Internal Revenue Service ruled that the corporate "lessee" should be considered the owner of the project for federal income tax purposes, reasoning as follows:

> The substance of the agreements between the corporation and the political subdivision, when viewed in their entirety, is clearly that of a financing arrangement. The letter agreement, the "Contract of Purchase," the "Lease Agreement and Option to Purchase," and the "Trust Indenture," although in the form of a sale and leaseback (or a lease), are security devices for the protection of the bondholders who provided the financing for the project.
>
> The corporation has all the burdens and benefits of ownership. The corporation is obligated to repay the principal cost of the project plus interest in the form of basic rentals. It is also obligated to pay the normal costs of operating the project plus the financing expenses in the form of additional rent. In the event of default, casualty, or condemnation, the corporation has the same substantive rights and obligations as a mortgagor. It is clear that the parties intend legal title to the project to pass to the corporation. The existence of an option to renew does not negate this intent since rental during any renewal periods is nominal and the corporation still retains the right to acquire legal title upon payment of a nominal sum.
>
> The political subdivision assumes no risk of loss regarding the project and has no opportunity of gain.[12]

In reaching its conclusion, the Internal Revenue Service relied in

12. Rev. Rul. 68-590, *supra* note 9, at 68.

part upon *Oesterreich v. Commissioner,*[13] a leading case in which the issue was whether a certain agreement was a lease or a contract for the sale of land. The instrument, denominated a "lease," provided that at the end of the 68-year term the "lessee" could acquire the premises, likely to then be of substantial value, for the token consideration of $10. Based largely on this factor, the Court of Appeals for the Ninth Circuit concluded as a matter of law that the "lessee" was acquiring title to the premises and, accordingly, was not entitled to treat its payments as rentals currently deductible in computing taxable income.

A similar issue arises under New Mexico's Gross Receipts and Compensating Tax Act,[14] namely, whether a particular transaction is a lease, on the one hand, or a sale or security agreement, on the other. The regulations issued by the Bureau of Revenue include the following among the indicia of a sale or security agreement:[15]

> 1. The agreement provides that upon compliance with its terms the lessee-buyer automatically becomes the owner of the property or the lessee-buyer has the option to purchase the property without additional consideration or with nominal consideration.
>
> 2. The payments made by the lessee-buyer to the lessor-seller are determined by the cost of the equipment selected by the lessee-buyer plus an interest charge added by the lessor-seller.

These regulations reflect the holdings in recent decisions of the New Mexico Supreme Court, which have stressed that "the character of the instrument is not to be determined by its form, but from the intention of the parties as shown by the contents of the instrument."[16] In the *Rust Tractor Company* case,[17] that Court concluded that the instrument in question created a security interest rather than a lease because:

> The agreement provides that upon full payment of the rentals the lessee will become the owner of the property with no other or

13. 226 F.2d 798 (9th Cir. 1955); *accord,* M & W Gear Company v. Commissioner, 446 F.2d 844 (7th Cir. 1971). *But see* Breece Veneer & Panel Co. v. Commissioner, 232 F.2d 319 (7th Cir. 1956).

14. N.M. Stat. Ann. §§ 72-16A-1 to 72-16A-19 (Supp. 1971).

15. G. R. Regulation 3(J):3, N.M. Bureau of Rev. Regs. 24; *cf.* G. R. Regulation 3, N.M. Bureau of Rev. Regs. 7.

16. Transamerica Leasing Corp. v. Bureau of Revenue, 80 N.M. 48, 51-52, 450 P.2d 934, 937-38 (1969).

17. Rust Tractor Company v. Bureau of Revenue, 82 N.M. 82, 475 P.2d 779 (1970).

> further consideration. This provision introduces an element under which an equity interest in the property is being created in the lessee through the payment of rentals. In accordance with the undisputed facts and the language of the agreements the parties are deemed as a matter of law to have intended the lease as one creating a security interest within the meaning of the Uniform Commercial Code.[18]

The principles enunciated and applied in the New Mexico and federal tax cases are consistent with the general law as applied in other jurisdictions. The case of *Marine Midland Trust Co. v. Village of Waverly*[19] is an ideal and unique illustration in that it involved facts which were the reverse of those in the fictitious Expando-City of Albuquerque transaction, i.e., a private organization was the "lessor" and a municipality was the "lessee." The Waverly Chamber of Commerce purported to lease certain land to the Village of Waverly for use as a "public parking lot" for a period of twenty years, with an option in the Village to purchase the land at the end of the twenty-year term for the consideration of one dollar. In effect characterizing the arrangement as an attempt to evade municipal debt limitation provisions by subterfuge, the New York court found a purchase and sale.

> By no stretch of the imagination can this Court conceive of the Village not exercising the option for this nominal amount. The inescapable conclusion reached is that the consideration of $1.00 stated therein is no reflection of the reasonable value of the property. This entire arrangement was nothing more than a means of financing the purchase of the premises by paying monthly installments for twenty years, at the end of which the property was to be deeded to the defendant Village. (38 Am.Juris. Municipal Corporations, § 467, p. 149; 71 A.L.R. 1318, 1326 (1931); 145 A.L.R. 1362, 1367 (1943).[20]

By the same token, the conclusion seems inescapable that Expando, Inc. is a purchaser masquerading as a lessee and, as such, should be considered the owner of the project for ad valorem tax purposes, giving full effect to the substance of the arrangements between the parties.

But what if the New Mexico courts were to hold that Expando is a bona fide lessee? Or what if the lease contains no indicia of purchase and sale? Does exemption from ad valorem tax follow

18. *Id.* at 84-85, 475 P.2d at 781-82.

19. 42 Misc. 2d 704, 248 N.Y.S.2d 729 (1963), *aff'd* 21 App. Div.2d 753, 251 N.Y.S.2d 937 (1964).

20. *Id.* at 731, 42 Misc.2d at 706.

as a matter of course, or does the private lessee have an interest which can and should be taxed?

TAXABILITY OF PRIVATE LESSEE'S SEPARATE LEASEHOLD INTEREST

Our primary concern is with a specific facet of the broader ad valorem tax exemption problem as related to lessees of property—the case where property otherwise exempt, because title is held by a municipality, has been made available for use by a private corporation in a business conducted for profit, pursuant to the provisions of New Mexico's Industrial Revenue Bond Act. In the interest of clarity, however, the analysis will proceed in two steps—from the general to the particular—by first determining the proper ad valorem tax treatment of private lessees' interests in publicly owned property in the absence of any specific statutory provision and then examining the effect, if any, of specific provisions of the Industrial Revenue Bond Act.

A. Tax Status of Private Lessee's Interest in Absence of Specific Statute

1. New Mexico Constitutional and Statutory Provisions.

The Constitution of New Mexico provides that "[t]axes levied upon tangible property shall be in proportion to the value thereof, and taxes shall be equal and uniform upon subjects of taxation of the same class. . . ."[21] Thereafter, it prescribes that certain property shall be exempt from taxation, including "property of the United States, the state and all counties, towns and school districts,"[22] and it authorizes the legislature to exempt certain additional property of heads of families and veterans.[23] The legal effect of these constitutional provisions has been summarized by the New Mexico Supreme Court as follows:

> It is the policy of this State, expressed in its Constitution, that tangible property must be taxed unless specifically exempt by the Constitution, or by legislative act authorized by the Constitution. State ex rel. Attorney General v. State Tax Comm., 40 N.M. 299, 58 P.2d 1204. Certain property is exempt from taxation by Sec. 3 of Art. 8 of the State Constitution. By Sec. 5 of Art. 8 the legislature may exempt other specific property from taxation. *All other*

21. Art. 8, § 1.
22. Art. 8, § 3.
23. Art. 8, § 5.

tangible property is required by the Constitution to be taxed. (Emphasis added.)[24]

Consistent with these constitutional requirements, the New Mexico legislature has acted to impose a property tax stating that, "Unless otherwise imposed by law, there is imposed a property tax upon all tangible property in the state except that exempted by the Constitution or by existing law."[25] Municipalities are authorized to levy taxes by the following statutory provision:

> The city council or board of trustees of any city, town or village, shall have power and authority to levy taxes upon taxable property within the limits of such city, town or village, subject to taxation for state or county purposes, in accordance with the laws of the state.[26]

The foregoing constitutional and statutory provisions leave two important questions to be answered in determining the ad valorem tax status of Expando, Inc.'s leasehold interest:

(1) Does the fact that the City of Albuquerque has legal title to, and a reversion in, the project preclude the taxation of Expando's interest as its separate property?

(2) Is Expando's leasehold interest tangible property?

Answers to these questions will first be sought in the New Mexico cases and Attorney General's opinions, and then in the cases arising in other jurisdictions.

2. New Mexico Authorities

The leading and virtually the only New Mexico case concerning the tax status of a private leasehold interest in publicly owned property is *Kirtland Heights, Inc. v. Board of County Commissioners of Bernalillo County,*[27] wherein the Supreme Court of New Mexico held that a private corporation's interest in federal

24. Town of Atrisco v. Monahan, 56 N.M. 70, 77, 240 P.2d 216, 220 (1952). There is at least substantial doubt whether the legislature has power to exempt any property from ad valorem taxation other than as specifically authorized in N.M. Const., art. 8, § 5. Exemptions enumerated in the Constitution were held to be the only exemptions which the legislature had power or authority to grant in Att'y Gen. Op. No. 2086, 1917-18 Rep. of Att'y Gen. 153 (1918); Att'y Gen. Op. No. 69-137, 1968-69 Rep. of Att'y Gen. 221. *See* Oden Buick Co. v. Roehl, 36 N.M. 293, 13 P.2d 1093 (1932); Albuquerque Alumnae Ass'n of Kappa Kappa Gamma Fraternity v. Tierney, 37 N.M. 156, 20 P.2d 267 (1933); State *ex rel.* Attorney General v. State Tax Comm., 40 N.M. 299, 58 P.2d 1204 (1936).

25. N.M. Stat. Ann. § 72-25-4 (Supp. 1971). The quoted provision is part of the Property Appraisal Department Act. N.M. Session Laws, Ch.31., at 85 (1970). The Act also repealed § 72-1-1. N. Mex. Session Laws, Ch. 31, §§ 3, 22 at 86 and 105 (1970). The effect presumably intended, of this change is to exempt all intangible property in New Mexico from ad valorem taxation. One practical consequence is discussed *infra* note 60.

26. N.M. Stat. Ann. §72-4-1 (Repl. 1961).

27. 64 N.M. 179, 326 P.2d 672 (1958).

land comprising a part of Kirtland Air Force Base, which the corporation had leased to construct a housing project thereon, was subject to state and local taxation. After first noting that Congress had given its consent to local authorities to tax such a lessee's interest,[28] the Court held that "the immunity granted the Federal Government by Article VIII, § 3 and Article XXI, § 2, New Mexico Constitution, clearly is not available to appellee. It is *his interest* that is subject to taxation." (Emphasis added).[29] The Court then responded to the lessee-taxpayer's objection that New Mexico has no statute subjecting such an interest to local taxation with the following brief statement: "There is a ready answer. All property, real, personal and intangible, is subject to taxation, unless specifically exempted."[30]

The *Kirtland* case is something less than an ideal precedent, however, for two reasons. The case is weak for lack of a thoroughly reasoned opinion concerning the nature of the lessee's interest and the legal justification for subjecting such interest to taxation despite the absence of any separate tax on the lessee in cases where the *lessor* is also a private individual or corporation. Moreover, § 72-1-1 of the New Mexico statutes, cited by the Court, has been repealed and § 72-25-4 has been enacted apparently to serve in its stead. Under the latter provision only tangible property is subject to ad valorem taxation unless otherwise provided by law. Neither the *Kirtland* case nor any other New Mexico case seems to have dealt with the question whether the interest of the lessee would be classified as tangible or intangible property.[31]

Research fails to disclose any authority in New Mexico which would preclude separate taxation of the lessee's interest. Moreover, mineral interests in lands which have been severed from the remaining interest, both surface and subsurface, have been held separately taxable to the owner thereof despite the absence of a statute requiring mineral rights to be separately assessed.[32]

28. On the question of the effect of intergovernmental tax immunity, *see* discussion *infra* beginning at 168.

29. 64 N.M. at 182, 326 P.2d at 673-74.

30. *Id.*

31. *See* discussion of this question *infra* beginning at 154.

32. Sims v. Vosburg, 43 N.M. 255, 91 P.2d 434 (1939); to the same effect for timber lands, *see* Att'y Gen. Op. No. 2389, 1918-19 Rep. of Att'y Gen. 76 (1919).

The only other indication of the probable attitude of the Supreme Court of New Mexico is in the Court's description of the nature of a lease contained in a case unrelated to matters of taxation:

> During the life of a lease the lessee holds an outstanding leasehold estate in the

The New Mexico Attorney General has had occasion over the years to rule upon the taxability of leaseholds and other separate interests in property, with varying and not entirely consistent results. The following is a quotation from an opinion rendered in 1946:

> Personal property of individuals, and leasehold interests are not exempt from taxation, although the leasehold interest ordinarily is taxed to the owner of the fee, rather than to the lessee. However, a different rule applies where the fee is owned by the public, and the great weight of authority is that the leasehold interest, whatever it may be, including any improvements, is subject to taxation.[33]

Inexplicably, the opinion proceeds to the conclusion that improvements upon lots or tracts of land leased from the federal government are subject to taxation but does not discuss the status of the lessee's interest in the land itself.

More recently the Attorney General was asked for an opinion whether a member of the faculty of New Mexico Highlands University is required to pay ad valorem taxes on his long-term leasehold interest in land leased from the University. In his opinion the Attorney General concluded that land owned by the University is state land; that exemption of state land from taxation is based on ownership, not use; and, accordingly, that the land leased to the faculty member (but not the improvements erected by him) is constitutionally exempt from ad valorem taxation.[34] The *Kirtland* case was disposed of in the opinion by a *non sequitur* to the effect that "the New Mexico Supreme Court permitted taxation of residential property leased from the United States only after first fiinding that the federal government had waived the tax-exempt status of the land." Absent federal ownership, as in the Highlands University ruling, the *Kirtland* case should have been regarded as persuasive authority for denying the faculty member tax exemption on his leasehold interest regardless of the ownership of the fee interest (reversion) by Highlands University.

> premises, which for all practical purposes is equivalent to absolute ownership. . . .
> The estate of the lessor during such time is limited to his reversionary interest which ripens into perfect title at the expiration of the lease. (citations omitted) Tri-Bullion Corp. v. American Smelting & Refining Co., 58 N.M. 787, 794, 277 P.2d 293, 297, (1954).

One might infer from the above quoted language that a leasehold would be regarded as a substantial tangible property right.

33. Att'y Gen. Op. No 4888, 1945-46 Rep. of Att'y Gen. 217 (1946).

34. Att'y Gen. Op. No. 70-24, March 3, 1970. *See* further discussion of this opinion *infra* at 173.

The weight of authority in New Mexico seems inconclusive either for or against the validity of imposing an ad valorem tax on Expando's leasehold interest. Resort to other authorities may provide more enlightenment.

3. *Authorities Outside of New Mexico: Separability of Private Interest*

In a substantial majority of jurisdictions, the rule seems to have been early established that if land or other property owned in fee by governmental bodies or other tax exempt institutions is leased to a private party, the private lessee's interest may be taxed separately to him even if there is no specific statutory provision for separate assessment of leasehold interests and despite the usual practice, when both the leasehold and reversion are privately held, of including the leasehold estate in the assessment against the owner of the fee.[35]

The issue arose with respect to the interest of the occupant of a mining claim in land owned by the United States in the early California case of *California v. Moore.*[36] After noting that the interest of the possessor of a mining claim was property, the court disposed of the tax issue with the following analysis:

> The term "property in lands" is not confined to title in fee, but is sufficiently comprehensive to include any usufructuary interest, whether it be a leasehold or a mere right of possession. Several persons may have, in the same land, a property which is subject to taxation, and it is not perceived that the fact that the property of the Government is exempt from taxation, affects the right to tax the interest which private individuals have acquired in the same property. Exemption from taxation is a privilege of the Government not an incident to the property.
>
> In the hands of the Government, the lands are exempt, but the moment the title vests in a private individual, it becomes liable to the burdens which are imposed on other property of like character. If the acquisition of the fee by a private person subjects the property to taxation, it follows that the acquisition of a lesser estate would equally subject such estate.[37]

Similarly, the Supreme Court of Washington concluded that the leasehold interest in certain Seattle tidelands leased from the

35. Annot., 23 A.L.R. 248 (1923).

36. 12 Cal. 56 (1859).

37. *Id.* at 70-71. Other early cases to the same effect are People v. Shearer, 30 Cal. 645 (1866) (possessory interest in agricultural lands owned by the U.S.) and Garland County v. Gaines, 56 Ark. 227, 19 S.W. 602 (1892) (lessee's interest in land leased from the United States).

State of Washington was subject to county ad valorem taxes despite a provision in the state constitution exempting "property of the United States and of the state, counties, school districts and other municipal corporations." The court reasoned:

> As soon as title passes from the state, the land becomes private, and no longer public, property. When a lease is given by the state to an individual or private corporation, the lessee thereby obtains for his or its private use certain rights and privileges in, to and upon such real estate. These rights and privileges constitute private property over which the lessee has, and may exercise, absolute dominion and ownership within the limitations of his or its lease. Why as such property it should not be subject to the general rule of taxation we conceive of no reason.[38]

In another case involving taxability of leaseholds in city-owned tidelands in the state of Washington, the Supreme Court of the United States upheld the assessment against the contention that statutes enacted subsequent to execution of the leases, authorizing assessment of the leaseholds for local improvements, impaired the obligation of the lease contract in violation of the federal constitution.[39] The Court, speaking through Mr. Justice Holmes, said:

> [I]n ordinary cases the whole property is taxed and which party shall bear the burden is not a matter of public concern. But when the State makes the lease, the supposed obligation would be an obligation not to tax—a restriction of public import not lightly to be imposed. . . . It is urged that to deny the State's obligation discriminates unconstitutionally against this class of lessees, since all others are free from the burden. But that is not true. Whether landlord or tenant shall pay a tax is a matter of private arrangement, and the practice one way or the other has no bearing on the matter. The argument from inequality really works the other way. *If these leaseholds are not taxable, they are a favored class of property; for ordinarily leaseholds are taxed even if they are lumped and included in the value of the fee. When an interest in land, whether freehold or for years is severed from the public domain and put into private hands, the natural implication is that it goes there with the ordinary incidents of private property and therefore is subject to being taxed.* (Emphasis added; citations omitted).[40]

On facts similar to those in *Trimble v. Seattle*, the Supreme Court of California sustained the taxability of the leasehold interest, observing that "[t]he principle that a possessory right in

38. Moeller v. Gormley, 44 Wash. 465 468-69, 87 P.507, 508 (1906).
39. Trimble v. Seattle, 231 U.S. 683 (1914).
40. *Id.* at 689-90.

public land is private property, and that it may be assessed for purposes of taxation to the person in possession, although in point of law he may have no right as against the state or government owning the land, has long been settled in this state."[41] Moreover, the court acknowledged that no California statute specifically provided for separate assessments of leasehold and reversion, noting that the usual procedure had been to assess the entire value of the land to the owner of the reversion. Nevertheless, according to the court, a different result should follow when the reversion is exempt from taxation because owned by the state:

> In such a case it cannot be said that the private property right of the lessee is taxed through the medium of the taxation of the interest of the owner. Still less can it properly be said that because the interest of the state is not taxable, the private owner of a leasehold interest should be exempt from paying taxes upon the property that is owned by him.[42]

Results consistent with those reached in the cases heretofore discussed have been reached in several more recent cases in other jurisdictions.[43] The case of *Iron County v. State Tax Commission,*[44] decided by the Supreme Court of Missouri in the latter part of 1968, is an excellent illustration of the prevailing judicial attitude in that (1) the taxpayer was the lessee of a manufacturing and industrial plant acquired by a municipality pursuant to Missouri's Industrial Development Act with the proceeds of an issue of industrial revenue bonds; (2) the constitutional and statutory provisions involved were not significantly different from New Mexico's; and (3) the court's opinion contains a rather thorough analysis and discussion of this area of the law.

A principal issue in the *Iron County* case was whether the County could tax a leasehold interest of the Ruberoid Company in a manufacturing and industrial plant owned in fee by the City of Annapolis, Missouri. The details of the financing transaction were much like those described in the hypothetical Expando, Inc.-City of Albuquerque transaction: a project financed by the

41. San Pedro. L.A. & S.L.R. Co. v. City of Los Angeles, 180 Cal. 18, 20, 179 P. 393, 395 (1919).

42. *Id.* at 23, 179 P. at 395.

43. Iron County v. State Tax Comm. 437 S.W.2d 665 (Mo. 1968); People v. American Airlines, Inc., 39 Ill. 2d 11, 233 N.E.2d 568 (1967); Delta Air Lines, Inc. v. Coleman, 219 Ga. 12, 131 S.E.2d 768; *cf.* Clark-Kunzl Company v. Williams, 78 Wash.2d 59, 469 P.2d 874 (1970).

44. 437 S.W.2d 665 (Mo. 1968).

issuance of industrial revenue bonds; a 20-year lease with fifteen successive 5-year renewal options, with rental payments calculated and pledged to pay interest and principal of the bonds over the same twenty-year period; and nominal rentals during any lease renewal term together with an option in Ruberoid to purchase the leased facility for a price equal to the unpaid principal and interest on the bonds, or for a nominal price once the bonds were paid off.

The applicable portion of article X, § 6 of the Missouri Constitution provided that "all property, real and personal, of the state, counties and other political subdivisions . . . shall be exempt from taxation; . . . all laws exempting from taxation property other than the property enumerated in this article, shall be void." Consistent with the foregoing, the Missouri statutes provided exemption from taxation for "(2) Lands and any other property belonging to any city, county or other political subdivision in this state."[45] Moreover, in its opinion in the *Iron County* case the court quoted from an earlier opinion to the effect that in Missouri "all property except such as is exempted by the Constitution and the statutes enacted pursuant thereto, is subject to taxation."[46]

The Missouri Supreme Court concluded that the exemption from taxation accorded government property does not extend to a privately owned leasehold interest in that property. In so doing, the court cited and relied upon one of its earlier cases in which land, the fee title to which was vested in the federal government but which was leased for the purpose of constructing housing thereon for renting to military personnel, was taxable to the extent of the value of the private lessee's interest.[47] The court also discussed with approval several cases from other jurisdictions, including some heretofore discussed in this paper, concluding that "the majority rule . . . is the correct rule and, under our constitutional and statutory provisions, is the one we should follow."[48]

However, the cases do not uniformly support separate taxation of the private leasehold interest in public property. The reasoning

45. Mo. Ann. Stat. § 137.100(2) (Vernon 1952).

46. 437 S.W.2d at 668, quoting from State *ex rel.* Ziegenheim v. Mission Free School, 162 Mo. 332, 337, 62 S.W. 998, 999 (1901).

47. State *ex rel.* Benson v. Personnel Housing, Inc., 300 S.W.2d 506 (Mo. 1957).

48. 437 S.W.2d at 671.

of a typical minority jurisdiction was well expressed in *Aberg v. Moe*[49] as follows:

> If a lease creates a separable taxable interest in the lessee in one case it does in all cases. The fact that the fee is exempt in one case and not in another does not change the nature of the lessee's interest. A holding to that effect would involve a complete reversal of the public policy of this state throughout its history, and if a change of that kind is to be brought about it should be done by legislative action, not by a judicial holding to fit a particular case.[50]

Thus, when both the owner of the leasehold and the owner of the reversion are private persons, the practice in most jurisdictions is to assess the owner of the reversion for the value of the entire property. Those jurisdictions which adhere to the minority view generally refuse to alter this rule of unitary assessment (or non-assessment) merely because the owner of the reversion is a governmental body or other exempt entity. Typically, the court, while acknowledging the power of the legislature to provide for taxation of leaseholds of this nature, will conclude that in the absence of express statutory provision such leaseholds are not subject to taxation.[51]

If New Mexico were to adopt the minority view–refusing to sustain a tax on the private lessee's separate leasehold interest in the absence of express statutory authority–the characterization of the lessee's interest as either tangible property or intangible property would become extremely important. If such interest were to be considered tangible property, denial of the exemption by legislative action would seem to be impossible because the granting or denial of exemptions with respect to tangible property, other than as provided in the New Mexico Constitution, is probably beyond the power of the legislature.[52] If, on the other hand, the lessee's interest were considered intangible property, the legislature would have power to adopt the majority rule should it choose to do so, reversing for the future, any judicial authority to the contrary. Therefore, the nature of the lessee's interest is appropriately the next topic for consideration, absent any clear authority on the question under New Mexico law.

49. 198 Wis. 349, 224 N.W. 132 (1929).
50. *Id.* at 359, 224 N.W. at 136.
51. Maricopa County v. Fox Riverside Theatre Corp., 57 Ariz. 407, 114 P.2d 245 (1941); State v. West Point Development Corporation, 280 Ala. 100, 190 So.2d 535 (1966).
52. Cases cited *supra* note 24.

4. *Authorities Outside of New Mexico: Tangible Nature of Lessee's Interest.*

To most lawyers, the term "intangible property" readily calls to mind such items as stocks, bonds, goodwill, franchises, patents, copyrights, and receivables and other choses in action; whereas the term "tangible property" usually causes the lawyer to think of land, buildings, machinery and equipment and other things of physical substance. But the delineation of these terms doubtless becomes less apparent when confronted with the necessity of characterizing a leasehold interest. Is a leasehold interest tangible property or intangible property? The cases on the point seem to be few and uncertain in result. The law in this area is elusive, conceptualistic and complex, and has been strongly influenced by early historical developments in the common law.

Perhaps it would be well at the outset to note that for purposes of discussion the terms "corporeal" and "incorporeal" will be used interchangeably with "tangible" and "intangible," respectively, in the belief that such terms are used synonymously in the law[53] and because the former terms are more likely to be used by many of the best known and recognized authorities in the field of property law.

Although there is some authority to the contrary,[54] the sounder view seems to be that a leasehold interest, e.g., an estate for years, is a corporeal, and hence a tangible, interest in property.[55] The Restatement of Property describes the proper distinction as follows:

> As the law has developed, corporeal interests are, in general, coincident with possessory interests; incorporeal interests with non-possessory interests. The possessory interests denote a wider range of dominion than do the non-possessory. It is natural, therefore, to attach more importance to the ownership of corporeal, or possessory, interests than to that of incorporeal, or non-possessory, interests.[56]

The Restatement also describes a reason for some of the confusion and difficulty in drawing this distinction:

53. The noun "intangible," for example, is defined as "an asset (as goodwill or a patent right) that is not corporeal." Webster's Third New International Dictionary 1173 (Unabridged 1961).

54. *See*, e.g., 3 G. Thompson, Thompson on Real Property, § 1017, 10 & n. 62 (1959 Repl.) *citing* Greene Line Terminal Co. v. Martin, 122 W. Va. 483, 10 S.E.2d 901 (1940).

55. W. Burby, Handbook of the Law of Real Property § 45 at 116-17 (3rd ed. 1965); Cribbet, Fritz & Johnson, Cases and Materials on Property 336 (2d ed. 1966).

56. § 473, comment a at 2968 (1944). For the historical development of the law in this area, *see* § 467, comment g at 2954.

> Since interests are merely aggregates of legal relations they are in their nature incorporeal, whether possessory or not. But, despite criticism which may properly be made with respect to the connotations of the words "incorporeal" and "corporeal," the classification of interests into incorporeal and corporeal corresponds to a fundamental difference between non-possessory and possessory interests and is therefore a useful one.[57]

The Restatement's characterization of possessory interests as corporeal interests is not peculiar to American law but rather is consistent with the classification of interests in land under English law. Bigelow affirms this as follows:

> Up to the present time, in discussing the nature of the interests or estates that might be created in land, the discussion has been confined to a consideration of the larger or smaller group of rights that might be had by the person in the occupation of the land, whether this occupation be technically described as seisin of a freehold estate or possession of a nonfreehold estate, and whether the group of rights was the complete group embraced in the term fee simple or the comparatively limited group of rights embraced in the idea of a tenancy for years. Regardless of these variations, the rights have always been those relating to the physical occupation of the land. Rights of this nature are technically classified under the English law as corporeal rights.[58]

Bigelow also makes the same criticism as the Restatement to the effect that the terminology, "corporeal" and "incorporeal," is not really sound, and the distinction might more accurately be expressed as a distinction between possessory and non-possessory rights. But he also observes that the terminology is firmly established in the English legal vocabulary. Finally, Bigelow concludes his discussion by describing two different classes of incorporeal rights:

> Incorporeal rights may be divided into two different classes. There are, first, those that may ultimately develop into corporeal or complete possessory interests. Such is the nature of A's interest where he has leased to B for a term of years. During the continuance of B's lease, A's interest is incorporeal or non-possessory. At the end of the term his interest will once more become possessory. The second group of nonpossessory rights is those which do not have this characteristic. The right of way or the right to rent mentioned above are sufficient illustrations of this species of incorporeal rights. Rights of this second sort are grouped by Blackstone under the head of incorporeal hereditaments, and will

57. § 450, comment c at 2903-04.
58. H. Bigelow, Cases on Rights in Land 41 (3rd ed. 1945).

be discussed in detail later on. For the present we shall confine ourselves to the first group of incorporeal rights.[59]

The authority seems clear, therefore, that a leasehold interest is corporeal, or tangible property, and that the New Mexico Supreme Court, if called upon to decide in the case of Expando, Inc., would so hold.[60]

5. *Summary.*

Absent specific statutory provisions to the contrary, a New Mexico court reasonably and probably would hold that (1) a private lessee's interest in publicly owned property may be taxed separately to the lessee even without benefit of a statute specifically prescribing such treatment, and (2) such private lessee's interest qualifies as tangible property and, therefore, is not exempt from ad valorem taxation. Accordingly, Expando, Inc.'s leasehold interest can and should be taxed unless validly exempted by specific provision in New Mexico's Industrial Revenue Bond Act. Does the Act provide for such exemption?

B. Tax Status of Private Lessee's Interest Under New Mexico's Industrial Revenue Bond Act

No consideration whatever has thus far been given to the provisions of the Industrial Revenue Bond Act itself in determining the tax status of the private lessee's interest. Not surprisingly, perhaps, the Act does purport to provide certain tax exemptions as follows:

> 14-31-11. Exemption from taxation.—The bonds authorized by sections 14-31-1 through 14-31-13 New Mexico Statutes Annotated, 1953 Compilation, and the income from said bonds, all mortgages or other security instrument executed as security for said bonds, *all lease agreements made pursuant to the provisions hereof,* and revenue derived from any lease or sale by the municipality thereof shall be exempt from all taxation by the state of New Mexico, or any subdivision thereof. (Emphasis added.)

The italicized phrase, *"all lease agreements made pursuant to the provisions hereof,"* would seem to be the only provision relevant

59. *Id.* at 42.

60. Although not directly relevant to the principal issue under discussion, it is of interest and perhaps of some importance to note that the reversion is nonpossessory, hence incorporeal or intangible. Since intangible property is no longer subject to taxation in New Mexico (*see supra* note 25 and accompanying text) a private lessor's reversion in property leased, for example, to the City of Albuquerque, or to Bernalillo County, or to the State of New Mexico, would be exempt from ad valorem taxation. One might speculate as to whether the law is being so administered.

to the present inquiry. To what does the phrase refer? Lease agreements in the hands of the lessor-City? In the hands of the lessee-Expando, Inc.? Does the exemption extend only to the agreements themselves, or to the valuable rights and interests created thereunder? Is the language broad enough to be construed to apply to Expando's possessory leasehold estate?

The statutory language appears to be sufficiently ambiguous to warrant resort to the title of the Act for any assistance it might afford in determining legislative intent.[61] Among numerous other purposes, the title to the statute as originally enacted in 1955 recited the purpose "To exempt from taxation such properties [the project] and the revenue from the lease and sale thereof, such bonds and the income therefrom, all mortgages executed as security therefore and all lease agreements made hereunder."[62] Many questions could be raised concerning the scope of the exemption provision in light of this recital of purpose in the title, but only those which are material to the present inquiry will be discussed.

Peculiarly, the title of the Act expresses an intention to provide exemption from taxation for the "properties" comprising the industrial project, whereas the text of the statute itself is silent on this point. To regard the reference to "properties" as mere surplusage would seem rather difficult. On the other hand, if not so regarded, the effect of reading such language into the statute would be to broaden or extend the effect of the Act, which is generally not an acceptable method of statutory construction.[63]

A tax exemption provision, insofar as it relates to either the properties or the lease agreements, is meaningless as far as the City is concerned, because tax exemption for its property has already been clearly provided for in the New Mexico Constitution. Instead, one gets the subjective feeling that the legislature must have intended that the exemption benefits be extended to the private party to the transaction–in our case, the private lessee, Expando, Inc. The statute might conceivably be construed to give effect to such intent if the property to be exempted were intangible property. However, when the property is of a tangible nature, such as Expando's possessory leasehold interest, tax

61. State v. Richardson, 48 N.M. 544, 154 P.2d 224 (1944); Harriet v. Lusk, 63 N.M. 383, 320 P.2d 738 (1958).

62. N. Mex. Sess. Laws, Ch. 234 at 591 (1955).

63. 1 J. Sutherland, Statutory Construction § 1709, at 300 (3rd ed. 1943).

exemption would seem to be beyond the power of the legislature to grant. *All* tangible property *must* be taxed unless exempted by the Constitution or by legislation authorized by the Constitution.[64] The private lessee's interest is not exempted by the Constitution because it is not "property of the United States, the state and all counties, towns and school districts;"[65] and it may not be granted exemption by the legislature because it is not the type of property (property of heads of families and veterans) which the legislature is authorized to exempt.[66]

Confronted with the necessity of interpreting this exemption provision, a New Mexico court would seem to have no choice but to read it out of the Act as invalid, or to construe it as having no application to the private lessee's leasehold interest. The New Mexico Supreme Court chose the latter approach in *Village of Deming v. Hosdreg Company,*[67] the only case in which it has confronted the issue. The Court, in speaking of the exemption provisions of the Act, noted that "[t]here is nothing in the act exempting the defendant [lessee] from ad valorem taxes on its leasehold interest, raw materials, stock and equipment."[68] Justifying its position further, the court asserted, "we do not have to resort to strained construction to see in the questioned act a mere legislative effort to vitalize and render effective an exemption contained in the Constitution, itself, in favor of one of its political subdivisions."[69] The authority of the case is weakened only because the court was not called upon to decide, and did not decide, that the private lessee's interest was subject to ad valorem tax, but only that the Act did not exempt such interest.

The conclusion seems inescapable that, notwithstanding provisions in the text and title of the Industrial Revenue Bond Act indicating a possible contrary intent, Expando's leasehold interest may not excape ad valorem taxation under the exemption provisions of the Act.[70]

64. Cases cited note 24 *supra.*
65. N.M. Const. art. 8, § 3.
66. N.M. Const. art. 8, § 5.
67. 62 N.M. 18, 303 P.2d 920 (1956). The latter approach is more consistent with the principle that statutes should be upheld if they can be construed to give a sensible effect and render them of binding force. Gallegos v. Ortiz, 28 N.M. 598, 216 P. 502 (1923).
68. 62 N.M. at 34, 303 P.2d at 931.
69. *Id.*
70. The private lessee's interest is clearly excluded from the exemption provisions of the Utah Industrial Facilities Development Act. Utah Stat. Ann. § 11-17-17 (Supp. 1971); Allen v. Tooele County, 21 Utah 2d 383, 445 P.2d 994 (1968).

VALUATION OF LEASEHOLD INTERESTS

Having concluded that a private lessee's interest in publicly owned property is taxable in New Mexico, the standards to be applied in determining a value for such interest must be ascertained.[71] The New Mexico Constitution and statutes speak in terms of "value," "cash value," and "full actual value" as the starting point in arriving at the assessed value for tax purposes.[72] Such terms have been held to set a standard of "market value," meaning "the price that property would bring to its owner if it were offered for sale on an open market under conditions in which neither buyer nor seller could take advantage of the exigencies of the other."[73]

The "fair market value" standard of valuation for ad valorem tax purposes is widely if not universally accepted in the United States. In the case of leasehold interests, however, the inquiry may not stop here. One must ask: The fair market value of what? Is it the full value of the leasehold or the value of the lessee's "equity" in the leasehold? Or, to put the question another way, is it the present value of the right to the use and possession of the property for the unexpired term of the lease, or is it that value less the present value of rentals applicable to such unexpired term? The courts have not been consistent in their answers to this question.

In some jurisdictions only the "bonus value," or the lessee's "equity," in the lease is considered assessable. This view is exemplified by *St. Louis County v. State Tax Commission*,[74] a Missouri case in which several airlines contested the values placed by St. Louis County on their leased space at the St. Louis airport. Experts testified on behalf of the airlines to the effect that "the value of a leasehold interest is the present worth of the rental saving where the contractual rent is less than the fair market value of the leased premises" and, under such test, the leases had no value because the contract rentals exceeded the fair rental value. The Missouri Supreme Court, on appeal by the County, concurred in this valuation approach. In reaching its

71. The methods or techniques to be employed by the assessor in the actual valuation process, once the applicable standards have been ascertained, are beyond the scope of this paper.

72. N.M. Const. art. 8, § 1; N.M. Stat. Ann., §§ 72-1-3, 72-2-2, -3 (Supp. 1971).

73. DeLuz Homes v. County of San Diego, 45 Cal. 2d 546, 562, 290 P.2d 544, 554 (1955); Hardin v. State Tax Comm., 78 N.M. 477, 432 P.2d 833 (1967).

74. 406 S.W.2d 644 (Mo. 1966).

decision, the court relied on a condemnation case[75] in which the issue was the compensation to be paid to a tenant in an eminent domain proceeding. By way of contrast, the Illinois Supreme Court, when confronted by a taxpayer's similar reliance on a condemnation case, acknowledged that the concept of fair market value does not depend upon the kind of proceeding in which such value is being determined, but pointed out that the concept does depend on what is being valued. The Illinois court drew a distinction between a condemnation case, in which the interest being valued is the equity of the lessee in a lease which has been abrogated, and an ad valorem tax case, in which the interest being valued is the right to occupy and use the leased property until the expiration of the lease.[76] The distinction seems to be a valid one and suggests that reliance upon valuations arrived at in eminent domain proceedings is misplaced.

At one time the California Supreme Court endorsed the concept of "bonus value" as the measure of the lessee's interest in cases wherein the assessor had employed the capitalization of income method of valuing the leasehold interest.[77] Mechanically, the assessor's approach was to determine the present value of net income expected to be earned over the remainder of the lease term and, in arriving at net income, to allow deductions for rent remaining to be paid and amortization of the cost of improvements made by the lessee which would pass to the lessor upon expiration of the lease. One writer has justified this practice by adopting the definition of a "leased fee" as "[t]he right to receive the agreed rental payments during the term of the lease, and, in addition, the right to receive back the *fee title* unencumbered with the lease at the end of the term," and by defining the "leasehold estate" as "[t]he right to receive all the benefits that may derive *after the rent to the lessor.*"[78] Under these definitions, of course, the lessee's interest will have value only when there is an excess of fair rental value (or economic rentals) over contract rentals, or a "bonus value."

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75. Land Clearance for Redevelopment Corporation v. Doernhoefer, 389 S.W.2d 780 (Mo. 1965).

76. People *ex rel.* Korzen v. American Airlines, Inc., 39 Ill.2d 11, 233 N.E.2d 568 (1967).

77. Hammond Lumber Co. v. County of Los Angeles, 104 Cal. App. 235, 285 P. 896 (1930); Blinn Lumber Co. v. County of Los Angeles, 216 Cal. 474, 14 P.2d 512 (1932).

78. Ricks, *Possessory Interests in Publicly Owned Property: Improperly Assessed,* 20 Nat'l Tax J. 347, 348 (1967), quoting, with approval, H. Babcock, *Valuation Principles and Procedures,* Los Angeles, California (unpublished manuscript 1967).

Another author has analyzed this approach as follows:

> According to this conception of ownership, the lessor remains the sole owner of the property. In leasing the property he is, in effect, simply using it for the production of income. If the rental is a fair rental, the value of the property to the lessor is unaffected. In such a case the existence of a lease neither adds to nor detracts from the value of the property and hence there is no remaining value to be attributed to the lease. If the rental is excessive as of the valuation date, the property will have a greater value on that account than it would otherwise have, and as a result, the lease, in effect, has a minus value. If the rental is inadequate, the value of the property to the lessor is decreased and in such a case some value may be assigned to the lease. Where the rental is inadequate the lessee presumably could find someone who would take over the lease, assume the obligation to pay rent, and pay a bonus or premium to the lessee for the assignment.[79]

Both that author and the better reasoned cases point out the difficulty with this position. "What is being taxed is the value of the leasehold, in the sense of the price for which it can be sold, not the value of the leasehold *to the tenant,* in the sense of the profit that the tenant can make upon a sale of the lease."[80] As an Illinois court observed in a very early case,

> A person having property in possession is assessed for its full value, although he may at the time be indebted for it. A man pays as much tax on a farm that is under mortgage as does his neighbor on a farm equally valuable and free from encumbrance.[81]

Thus, property is taxable at its value without regard to the owner's equity, and without regard to the amount of rent he has paid or agreed to pay. "It would be anomalous to hold that a possessory interest has no value merely because the lessee has agreed to pay what it is worth."[82]

In *Texas Company v. County of Los Angeles,*[83] the taxpayers contended that an unconstitutional tax on the city's tax-exempt property would be imposed if rent were not allowed as a deduction in valuing the private lessee's interest–a tax measured by the amount which the city would have to reduce its rents, in order to compete with private lessors, if its lessees were required

79. Keesling, *Property Taxation of Leases and Other Limited Interests,* 47 Calif. L. Rev. 470, 483 (1959).

80. People *ex rel.* Kucharski v. Trans World Airlines, Inc., 43 Ill.2d 174, 176, 251 N.E.2d 225, 226 (1969).

81. People v. Rhodes, 15 Ill. 304, 306 (1853).

82. Texas Company v. County of Los Angeles, 52 Cal. 2d 55, 62, 338 P.2d 440, 444 (1959).

83. 52 Cal. 2d 55, 338 P.2d 440 (1959).

to pay tax on the full value of their leasehold interests. In rejecting this argument, Justice Traynor persuasively summed up the case for taxing the private lessee's interest at its full value:

> When the city leases its land, however, it does not merely use it. It creates valuable privately-held possessory interests, and there is no reason why the owners of such interests should not pay taxes on them just as lessees of private property do through increased rents. Their use is not public, but private, and as such should carry its share of the tax burden. Moreover, the city does not lose its tax exemption by leasing its land. The reversion is not taxed, for it is only the value of the use for the unexpired term of the lease that is assessed. Thus, whereas lessees of private property indirectly pay taxes through increased rent on the full value of the land including the lessor's reversion, the city's lessees pay taxes only on the value of the possessory interests granted to them by the city. The city retains the full benefit of its tax exemption on the interest it has retained. The city is not afforded a competitive advantage over private owners when it sells the fee, for the land is taxable to its new private owner whatever its source. Similarly, the city is not entitled to a competitive advantage over private lessors when it sells lesser interests carved out of the public domain. Of course the city would be able to charge higher rents if it could extend the mantle of its tax exemption over the private interests it creates in its lands, but since it is only its own property that is tax exempt, it is not entitled to that advantage. Since the tax is on the private interest alone, it is immaterial that the denial of that competitive advantage might be an economic burden on the city.[84]

If, as suggested herein, the lessee's right to the use and possession of the leased property for the remainder of the lease term is the proper item to be valued for ad valorem taxes, it follows that the value of such right will decline ratably with the expiration of the lease term. The volume of revenue flowing from this source will, of course, also decline proportionately as the lease expires.

One important aspect of the valuation problem remains for consideration. No consideration whatever has been given to any renewal or purchase options which may have been granted to the lessee by the terms of the lease. Even the Missouri Supreme Court, which follows the "bonus value" rule in valuing leaseholds, acknowledged in its *Iron County* opinion that an option in the lessee to buy the property at a nominal price, upon expiration of the lease or complete retirement of the industrial revenue

84. *Id.* at 63-64, 338 P.2d at 444.

bonds, would materially affect the valuation. The court reasoned as follows:

> This option obviously is a valuable right. . . . The leasehold with such an option to purchase clearly is more valuable than one without. Absent the right to purchase, rental payments were rent, and nothing else, and at the end of the lease period the rental payments would have purchased merely a right of possession and use. With the option to purchase, lessee had the right to apply almost all of the rental payments to a purchase on the basis of cost to the owner (City).[85]

As in the case of Expando, Inc., whenever the lessee can obtain full use, possession and enjoyment of the leased property for substantially its entire useful life merely by exercising a renewal option at a nominal rental, or a purchase option at nominal price, the purported "leasehold" more appropriately should be assigned a value equal to the value of the entire project, leaving little or no value for the City's reversion, the value of which is obviously illusory in any event.

In no event, however, should a deduction be allowed for rentals attributable to the remainder of the lease term.

POLICY CONSIDERATIONS

The merits and demerits of industrial revenue bonds as a method of inducing and financing the location of new or expanded industry in New Mexico are beyond the intended scope of this paper,[86] although one might well question how far the benefits sought have actually been obtained.[87] Since the

85. Iron County v. State Tax Comm., 437 S.W.2d 665, 673 (Mo. 1968).

86. On this subject generally, *see* Advisory Commission on Intergovernmental Relations, Industrial Development Bond Financing (1963); C. Harriss, Handbook of State and Local Government Finance (Tax Foundation, Inc. 1968); Mumford, *The Past, Present and Future of Industrial Development Bonds,* 1 The Urban Lawyer 147 (1969); Beck, *The 1965 Maine Municipal, Industrial and Recreational Obligations Act,* 18 Me. L. Rev. 25 (1966); Abbey, *Municipal Industrial Development Bonds,* 19 Vand. L. Rev. 25 (1965); Pinsky, *State Constitutional Limitations on Public Industrial Financing: An Historical and Economic Approach,* 111 Pa. L. Rev. 265 (1963); Armstrong, *"Municipal Inducements"–The New Mexico Commercial and Industrial Project Revenue Bond Act,* 48 Calif. L. Rev. 58 (1960); Note *Incentives to Industrial Location: The Municipal Industrial Bond Plans,* 66 Harv. L. Rev. 898 (1953).

For developments concerning the federal tax treatment of industrial revenue bonds and the interest theron, see Ritter, *Federal Income Tax Treatment of Municipal Oligations: Industrial Development Bonds,* 25 The Tax Lawyer 511 (1972); McDaniel, *Federal Income Taxation of Industrial Bonds: The Public Interest,* 1 The Urban Lawyer 157 (1969); Spiegel, *Financing Private Ventures With Tax-Exempt Bonds: A Developing "Truckhole" in the Tax Law,* 17 Stan. L. Rev. 224 (1965).

87. The benefits sought, as expressed in the statute, are the location or expansion of industry in the state, the promotion of the use of agricultural products and natural resources of the state and the promotion of a sound and proper balance in the state between agriculture, commerce and

validity of New Mexico's Industrial Revenue Bond Act has been sustained,[88] any change in policy would be up to the Legislature. As a practical matter, however, a legislative change may now be too late because of the pressure of interstate competition.[89]

Evaluation of an ad valorem tax exemption as an inducement to industrial location remains an appropriate and timely topic for discussion. Although the exemption presently being accorded lessees of industrial projects has already been shown to be of doubtful legality and perhaps even beyond the power of the legislature to grant, such exemption could be authorized by constitutional amendment, if necessary, if it can be justified as a matter of sound public policy.

The value of tax exemptions as an incentive device has been extensively and exhaustively debated and discussed.[90] The benefits sought to be obtained are clear, and are substantially the same as from the use of industrial revenue bond financing: increased employment, higher income, more spending power, more prosperous economy and increased property values, tax base and tax revenues.

What, then, are the objections to tax exemptions? The Advisory Commission on Intergovernmental Relations has this to say about property tax exemptions in general:

> The seemingly endless process of narrowing the property tax base has progressed so far, and in such diverse directions, as to

industry. N.M. Stat. Ann. § 14-31-2 (Repl. 1968). Against these benefits must be weighed some or all of the following costs: (1) self defeating competition for industry among the states and municipalities, (2) impairment of normal competitive business relationships among competing firms, (3) increased borrowing costs for municipalities generally, and (4) in some cases, a narrowing of the ad valorem tax base with consequent impaired fiscal strength of local governments.

88. Village of Deming v. Hosdreg Company, 62 N.M. 18, 303 P.2d 920 (1956).

89. Many states have enacted industrial revenue bond statutes as a defensive measure, to prevent the pirating of industry. Now that so many states have adopted such measures, no state can very well repeal its statute and accept the consequent loss of competitive position—assuming one accepts the premise that economic growth is a desirable goal.

90. *See* Advisory Commission on Intergovernmental Relations, State-Local Taxation and Industrial Location (1967); I Advisory Commission on Intergovernmental Relations, The Role of the States in Strengthening the Property Tax (1963); A. Balk, The Free List (1971); The Property Tax: Problems and Potentials (Tax Inst. of America 1967); Property Taxation—U.S.A. (1967); Symposium on Tax Incentives (Tax Institute of America, 1969); Jones, *Taxation and Industrial Location*, 23 New Mexico Business, No. 6, 1 (1970); Stober & Falk, *Property Tax Exemption: An Inefficient Subsidy to Industry*, 20 Nat'l Tax J. 386 (1967); Bridges, *State and Local Inducements for Industry*, 18 Nat'l Tax J. 1 and 175 (1965); Gray, *Industrial Development Subsidies and Efficiency in Resource Allocation*, 17 Nat'l Tax J. 164 (1964); Due, *Studies of State-Local Tax Influences on Location of Industry*, 14 Nat'l Tax J. 163 (1961); Note, *Legal Limitations on Public Inducements to Industrial Location*, 59 Colum. L. Rev. 618 (1959); Note, *Municipal Inducements to Private Industry*, 40 Minn. L. Rev. 681 (1956).

> necessitate some forthright determination not only of where it should stop but how much of it should be repealed. Step by step, exemptions place heavier burdens on those still required to pay, or reduce the responsibility of local governments by inducing them to depend increasingly on fiscal aid. . . .
>
> The questions and criticisms raised . . . are directed to the perennial give-away system that is confusing tax administration, frittering away the tax base, and unequally burdening local governments by yielding to special pressure groups, by shifting the tax burden without due regard for equity and justice, by the reckless misuse of exemptions for purposes which, while they may be desirable, could be better accomplished by other means, and by the piling up of concealed subsidies with little regard to their mounting cost and its effect on the local governments and the narrowing group of full-time taxpayers.[91]

And, on the specific subject of subisdy exemptions to industry, the Commission concluded:

> The immediate effect of such subsidies is to benefit the recipient; however, they also harm competitors, place a burden on the taxpayers who have to carry the tax from which the beneficiary has been freed, and promote interstate tax warfare that endangers the development of fair and adequate systems generally. There is some doubt, moreover, that there is sufficient long-term benefit to the economy of the State to justify the cost imposed on the taxpayers and the possible hardship to non-subsidized industry.[92]

One need look no further than to our own highly respected former Commissioner of Revenue, Franklin Jones, for confirmation of the foregoing criticisms and conclusions. Writing in the June 1970 issue of New Mexico Business, Mr. Jones impliedly endorsed the findings of certain studies as to the relatively low level of importance to management of taxes in the selection of a location for a new industrial establishment.[93] He observed that management is too sophisticated to be strongly attracted by tax incentives, recognizing as it does that low taxes probably mean a low level of government services and that the tax "break" must be paid for by someone and perhaps ultimately, when the "honeymoon" is over, by the firm receiving the break.[94] Far more important than either the tax rate or the total tax bill, according to Mr. Jones, is tax stability, an attribute made possible only by a

91. 1 Advisory Commission on Intergovernmental Relations, The Role of the States in Strengthening the Property Tax 77-78, 87 (1963).

92. *Id.* at 80.

93. Jones, *Taxation and Industrial Location*, 23 New Mexico Business, No. 6, 1 (1970).

94. *Id.* at 2.

sufficiently broad tax base, properly defined statutes and efficiency in tax administration and enforcement. As for his personal views on tax-incentive programs, Mr. Jones said:

> A major problem with the use of tax-incentive programs is that, if such programs are to be meaningful to industry, substantial state revenues will be lost. Also, since such programs affect either tax rates or the tax base, it is difficult to determine the amount of revenue that is lost. A direct subsidy usually involves a specific amount that is given to an industry. I would, therefore, prefer—as a matter of fiscal management—that New Mexico collect the tax and then give an outright subsidy. Control can be maintained over the costs of a subsidy. That control is lost when tax incentives are used. The objection to this approach is that the New Mexico Constitution prohibits any and all subsidies to private enterprise. Tax incentives, on the other hand, are not expressly prohibited. Despite the fact that tax incentives technically *may be* allowed by the New Mexico Constitution, my position is that since we cannot give subsidies we probably should not allow tax incentives. In my opinion, and most tax experts agree, a tax-incentive program is simply one form of subsidy.[95]

Mr. Jones undoubtedly has in mind tax incentives explicitly provided by statute in referring to the difficulty of determining the amount of revenue lost. Consider the much lower level of visibility of the exemptions accorded lessees of industrial projects, exemptions of which most members of the public, and indeed probably most members of the legislature, are not even aware.

Another and final aspect of the exemption accorded lessees of industrial revenue bond projects, as well as other lessees of publicly owned property, is often overlooked—the inequity created among the tax jurisdictions competing for their fair shares of the ad valorem tax revenue. If, for example, the Expando, Inc. industrial project is "owned" by the City of Albuquerque, and is therefore exempt from ad valorem taxation, what happens to the ad valorem tax base available for taxation by Bernalillo County, or by the Albuquerque Public Schools, or by the State of New Mexico? The action of the City, in effect acting as a conduit for the acquisition by Expando of its industrial plant and equipment, effectively removes such plant and equipment not only from the tax rolls of the City but also from the tax rolls of every other jurisdiction which would otherwise have power to tax the property. The other taxing

95. *Id.*

jurisdictions are thus being forced to subsidize the City, and by the unilateral action of the party (the City) receiving all of the benefit.

TAXATION OF LESSEES OF PUBLICLY OWNED PROPERTY OTHER THAN INDUSTRIAL REVENUE BOND PROJECTS

Our inquiry has heretofore been directed for the most part to the taxability of lessees of industrial revenue bond projects. Apart from the possibility of tax exemption under specific provisions of the New Mexico Industrial Revenue Bond Act, however, the legal analysis and case authority equally support the taxability of other lessees of publicly owned property. No effort will be made to identify all possible types of taxable leaseholds or similar possessory interests,[96] but certain major categories merit discussion.

A. *Possessory Interests in Property Owned by the Federal Government*

Lessees of property owned by the United States government probably comprise the majority of lessees of publicly owned property in New Mexico.[97] Among the Government properties under lease, some of the most common would be military housing projects, grazing lands, national forest lands, mineral properties and defense, nuclear and space oriented plants and facilities. The ad valorem tax status of possessory interests in these properties is complicated somewhat by the fact of federal government ownership of the reversion, which gives rise to the following questions:

(1) Does the doctrine of inter-governmental tax immunity affect the tax treatment of the lessee's interest?

(2) What is the measure of value of the lessee's interest?

96. The exemption issues discussed in this paper are but part of the much larger problem of tax-exempt property in general, a subject explored in depth in A. Balk, The Free List (1971). Among the many examples of totally tax-exempt property described by Balk are the following: the Houston Astrodome, leased by Harris County, Texas to Roy Hofheinz's Houston Sports Association for 40 years; the Massachusetts Port Authority's Logan International Hotel (at Boston's Logan International Airport) leased to Hotel Corporation of America; the New York Port Authority's new World Trade Center; the University of Michigan's Willow Run Airport; and Greenville, Alabama's Holiday Inn. A. Balk, *supra*, at 57-59, 63, 98.

The revenue loss attributable to the exemption of federal and state owned property may be reduced or eliminated, usually either by payments in lieu of taxes, waiver of immunity or sharing of revenues from the exempt property. J. Hellerstein, State and Local Taxation 690 (3rd ed. 1969); O'Bannon, *Payments from Tax-Exempt Property*, Property Taxation—U.S.A. 187 (1967).

97. Federal land holdings comprise approximately one-third of the total land area of the United States and slightly more than one-third of the total land area of New Mexico. Balk, The Free List, appendix at 210-12 (1971), citing General Services Administration, Inventory Report on Real Property Owned by the United States Throughout the World, as of June 30, 1968.

(3) What effect, if any, must be given to the fact that the leased property is situated in an area of exclusive federal jurisdiction?

Each of these questions has been the subject of careful judicial scrutiny.

1. The Effect of Intergovernmental Tax Immunity.

Over the years the U.S. Supreme Court has curtailed sharply the doctrine of intergovernmental tax immunity,[98] but the principle that property of the federal government itself is not subject to any form of state or local taxation, in the absence of Congressional consent, has continued without change.[99] "The distinction between taxation of private interests and taxation of government interests, although sometimes difficult to define, is fundamental in application of the immunity doctrine as developed in this country."[100] Thus, the rule as applied to the taxation of private interests was stated by Justice Black in *United States v. City of Detroit* as follows:

> At the same time it is well settled that the Government's constitutional immunity does not shield private parties with whom it does business from state taxes imposed on them merely because part or all of the financial burden of the tax eventually falls on the Government.[101]

In the *City of Detroit* case, the United States owned an industrial plant in Detroit, part of which it leased to the Borg-Warner Corporation for use in a private manufacturing business. The court sustained a tax assessed by the City of Detroit on Borg-Warner's possessory interest in the property pursuant to a Michigan statute despite the fact that the tax was measured by the full value of the property, not just the value of the possessory interest. In his dissenting opinion, Justice Whitaker, joined by Justice Burton, while objecting strenuously to the use of the value of the entire property to measure the tax, made it very clear that he would have voted with the majority if there had been a segregation of the value of the leasehold estate from the value of the government's reversion.

98. United States v. City of Detroit, 355 U.S. 466 (1958); United States v. Township of Muskegon, 355 U.S. 484 (1958); City of Detroit v. Murray Corporation, 355 U.S. 489 (1958). Alabama v. King & Boozer, 314 U.S. 1 (1941); James v. Dravo Contracting Co, 302 U.S. 134 (1937.

99. United States v. Allegheny County, 322 U.S. 174 (1944).

100. *Id.* at 186.

101. 355 U.S. 466, 469 (1958).

> By the lease, the Government, in exercise of its right to use, and to let the use of, its property, carved from its fee a subservient leasehold estate and vested the same in the lessee. That leasehold estate was private local property of the lessee and, therefore, was subject to state regulation, and, hence, to ad valorem or privilege of use taxation by the State, in such measure as is not unequal, unreasonable or confiscatory—on the basis of the value of the leasehold being taxed or used as the measure of the tax. (footnote omitted)[102]

More recently, some state courts have made it clear that when the issue is the taxability of the private lessee's interest the question of intergovernmental tax immunity is not involved. In *Rummel v. Musgrave,*[103] for example, lessees of producing uranium lands owned by the United States were held subject to ad valorem tax. The Colorado Supreme Court's analysis and conclusion would seem appropriate for adoption by the courts of any jurisdiction, including New Mexico, where the issue is presented:

> The lease in question is separate property, vendible, subject to the consent of the lessor, and inheritable, hence there is no reason to hold that it is not taxable as well. . . .
>
> What plaintiffs, as private business lessees of publicly owned property are saying is that there can be no severance of total ownership into the dominant and lesser estates just because the legal title of the property lies in the tax exempt owner. With this we cannot agree. . . .
>
> . . . .
>
> Here it is obvious that no burden is placed upon the United States Government in either a direct or indirect manner by the tax in question, and no constitutional question is involved.[104]

Clearly the constitutional doctrine of intergovernmental tax immunity does not limit the power of state and local governments to tax the *private* lessee's *private* property interest and, unless within an area subject to exclusive legislation by Congress, without regard to whether the federal government has or has not given its consent.

While a state or local government may validly tax the private lessee of federal government property, it may not do so in a discriminatory manner. A levy which imposes a heavier tax burden on lessees of federal property than on lessees of property

102. *Id.* at 482.

103. 142 Colo. 249, 350 P.2d 825 (1960).

104. *Id.* at 252-53, 350 P.2d at 826-27; *accord* Sproul v. Gilbert, 226 Ore. 392, 359 P.2d 543 (1961) (possessory interest in federal grazing lands).

owned by the state or its subdivisions is invalid because it works an unconstitutional discrimination against the United States.[105] "It still remains true, as it has from the beginning, that a tax may be invalid even though it does not fall directly on the United States if it operates so as to discriminate against the Government or those with whom it deals."[106]

2. Valuation of the Lessee's Interest

In three landmark decisions, all decided on the same day, and all originating in the state of Michigan, the Supreme Court of the United States held that a state or its political subdivision may tax a federal government contractor's possessory interest in federally owned real or personal property notwithstanding the fact that the tax is measured by the full value of the property in possession and not just the value of the possessory interest.[107] The Michigan tax statutes then in effect provided that when tax-exempt *real property* was used by a private party in a business conducted for profit the private party was subject to taxation to the same extent as though he owned the property. The tax had been characterized by the Supreme Court of Michigan as a tax on the lessee's privilege of using the property in a private business conducted for profit—a tax on the privilege of using property, as distinguished from a tax on the property itself—thus, in the nature of a use tax as distinguished from an ad valorem property tax.[108] No similar provision existed with respect to personal property, the taxing authorities having to rely instead upon the provisions of the general property tax statute, which contained no express provision for taxing the right to possess or use property measured by the value of the property possessed. Nevertheless, the U.S. Supreme Court, in *City of Detroit v. Murray Corporation*,[109] sustained a tax on a possessory interest in personal property measured by the full value of the property, because "to strike down a tax on the possessor because of such verbal omission would only prove a victory for empty formalisms."[110] Subsequently, however, the Michigan Supreme Court, carrying out its

105. Moses Lake Homes, Inc. v. Grant County, 365 U.S. 744 (1961); Phillips Chemical Co. v. Dumas Independent School District, 361 U.S. 376 (1960); Thiokol Chemical Corp. v. Morns County, 76 N.J. Super. 232, 184 A.2d 75 (1962).

106. United States v. City of Detroit, 355 U.S. 466, 473 (1958).

107. United States v. City of Detroit, 355 U.S. 466 (1958); United States v. Township of Muskegon, 355 U.S. 484 (1958); City of Detroit v. Murray Corporation, 355 U.S. 489 (1958).

108. United States v. City of Detroit, 345 Mich. 601, 77 N.W.2d 79 (1956).

109. 355 U.S. 489 (1958).

110. *Id.* at 493.

duty and authority to construe the acts of its own legislature, held that the general property tax act did not authorize taxation of "possessory interests in personal property legal title to which is in one other than the possessor."[111]

New Mexico clearly has no statute purporting to tax the privilege of possessing or using either real or personal property and, for that reason, an ad valorem tax imposed on the private lessee's interest, but measured by the value of the entire property, would be invalid because in part a tax on the government's interest.[112] As has been shown earlier, however, New Mexico's ad valorem tax statutes can and should be construed to apply to a private lessee's *ownership* interest in his leasehold estate. In such instance, the measure of the tax is the value of that interest and not the value of the entire property.

New Mexico could, if it chose, enact a non-discriminatory tax on possessory interests based on use instead of ownership and thereby subject the value of the entire property to taxation. Some states have done this, whereas others have declined to do so in the belief that such action would have the adverse effect of driving U.S. government contracts out of the state.[113]

3. Effect of Location of Leased Property in Area of Exclusive Federal Jurisdiction

The Constitution immunizes property of the United States from taxation by a state and its political subdivisions, but it does not forbid a tax whose legal incidence is upon a private contractor doing business with the United States, even if the economic burden of the tax may ultimately rest upon the United States.[114] If it chooses to do so, Congress may grant an immunity by statute even broader in scope than that provided by the Constitution;[115] but in the absence of such statutory immunity, the only basis for asserting immunity would be that the property

111. Continental Motors Corp. v. Township of Muskegon, 365 Mich. 191, 198, 112 N.W.2d 429, 433 (1961). To the same effect, in California and Maryland, respectively, *see* General Dynamics Corp. and Aerojet Corp. v. County of Los Angeles, 5 Cal.2d 59, 330 P.2d 794 (1958) and Martin Company v. State Tax Commission, 225 Md. 404, 171 A.2d 479 (1961).

112. *Id.*

113. K. Wolf, State and Local Taxation 8-10 (Gov't Contracts Monograph No. 5 George Washington Univ. 1962); A. Balk, The Free List 56 (1971).

114. Alabama v. King & Boozer, 314 U.S. 1 (1941); James v. Dravo Contracting Co., 302 U.S. 134 (1937).

115. United States v. Boyd, 378 U.S. 39 (1964); Carson v. Roane-Anderson Co., 342 U.S. 232 (1952); James v. Dravo Contracting Co., 302 U.S. 134 (1937).

is situated in an area of exclusive federal jurisdiction—the so-called federal enclave.

Article I, section 8, clause 17 of the Constitution provides in part that Congress shall have power:

> To exercise exclusive Legislation in all Cases whatsoever, over such District [of Columbia] . . . and to exercise like Authority over all Places purchased by the consent of the Legislature of the State in which the Same shall be, for the Erection of Forts, Magazines, Arsenals, dock-yards, and other needful buildings. . . .

The power of "exclusive legislation" necessarily means exclusive jurisdiction.[116]

If land acquired within a state by the federal government is within the scope of the "exclusive legislation" clause, and if the consent by the state is not qualified, the exclusive jurisdiction of the United States is absolute and would prohibit a state tax on private property situated within such area.[117] At the other extreme, the United States can acquire land within a state by purchase or condemnation without the state's consent, in which event the federal jurisdiction is not exclusive and the state laws, including tax laws, would still be operative provided they do not impair the intended use of the land by the United States.[118]

An intermediate position is also possible. A state may qualify its consent, reserving concurrent jurisdiction to the extent specified if not inconsistent with the intended federal uses; or, having previously withheld consent, the state may cede its jurisdiction to the United States either qualifiedly or unqualifiedly.[119] Conversely, the United States, having previously acquired exclusive jurisdiction, may waive it and grant to a state or states the right to tax private interests within the federal enclave.[120]

In summary, a state's power to tax private property is limited only if it is situated in a federal enclave, and then only if the federal jurisdiction is exclusive under the principles just described. In many, and perhaps most, cases either the state will have reserved concurrent jurisdiction or the United States will have

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116. Surplus Trading Co. v. Cook, 281 U.S. 647, 652 (1930).

117. *Id.* at 657; Paul v. United States, 371 U.S. 245, 263 (1963).

118. Paul v. United States, 371 U.S. 245, 263 (1963); Surplus Trading Co. v. Cook, 281 U.S. 647, 650 (1930). This assumes, of course, that Congress has not exercised its power to confer immunity by statute.

119. James v. Dravo Contracting Co., 302 U.S. 134, 147-48 (1937).

120. Offut Housing Co. v. Sarpy County, 351 U.S. 253 (1956). *See, e.g.*, Buck Act, 4 U.S.C.A. § 104, *et seq.*

waived its exclusive jurisdiction so as to permit taxation of the private property in any event.

B. Leasehold Interests in Other Property Owned by State and Local Governments

In this jet age, the tax issue often arises with respect to leasehold interests granted to airlines and various concessionaires in connection with the operation of municipally owned airports.[121] Another common situation in New Mexico is the leasing to commercial and other private interests of property owned by the state institutions of higher learning.[122] In each of these instances, one might question the importance of the issue on the ground that it is of no importance to the City or the educational institution, as the case may be, whether it receives benefits in the form of higher rentals (if the leasehold is exempt) or higher taxes or more support from the state (if the leasehold is taxable). This would perhaps be true if there were only one taxing jurisdiction involved, but when there is more than one the tax status of such leaseholds can materially alter the allocation of tax revenues among the affected jurisdictions.

In Attorney General's Opinion No. 70-24, March 3, 1970, the New Mexico Attorney General concluded that faculty member-lessees of land owned by New Mexico Highlands University and used by the lessees to accommodate private homes constructed thereon for their personal use are not liable for ad valorem taxes on the land itself. Noting that land owned by a university is state land and that *ownership* is the sole test of tax exemption for state land, the Attorney General concluded that the land was constitutionally exempt from ad valorem taxation. He seemingly distinguished the *Kirtland Heights, Inc.* case[123] with the following enigmatic statement:

> Moreover, in *Kirtland Heights, Inc. v. Board of Commissioners,* 64 N.M. 179, 326 P.2d 672 (1958), the New Mexico Supreme Court permitted taxation of residential property leased from the United States only after first finding that the federal government had waived the tax-exempt status of the land.

The federal property involved in *Kirtland* was in an area of

121. *See, e.g.,* People v. American Airlines, Inc., 39 Ill.2d 11. 233 N.E.2d 568 (1967); Delta Air Lines, Inc. v. Coleman 219 Ga. 12, 131 S.E.2d 768 (1963).

122. *See, e.g.,* Jetton v. University of the South, 208 U.S. 489 (1908); City of Chicago v. University of Chicago, 302 Ill. 455, 134 N.E. 723 (1922).

123. 64 N.M. 179, 326 P.2d 672 (1958).

exclusive federal jurisdiction, and thus the lessee's interest was held subject to local ad valorem taxation only after the federal government had given its consent by statute. Underlying that aspect of the case, however, was the court's conclusion that, absent exclusive jurisdiction in the federal government, the lessee's interest is clearly taxable under New Mexico law, contrary to the position taken in Attorney General's Opinion No. 70-24.

Undoubtedly there is a large variety of private leasehold interests in publicly owned property in New Mexico beyond those described in this paper. All should be caught in the assessor's tax net under the principles heretofore discussed.

THE CHALLENGE TO GOVERNMENTAL INACTION: A PROBLEM OF STANDING

Assuming that private leasehold interests in publicly owned property in New Mexico are legally subject to ad valorem taxation, but are not in fact being taxed, what remedies are available to force mistaken or delinquent taxing jurisdictions to initiate the assessment and collection process? This question might be answered either by a summary treatment of alternative possibilities or by a more detailed investigation of the intricacies of the law of standing to challenge governmental action or inaction in New Mexico. The latter approach is beyond the intended scope of this paper and, fortunately, the subject has been comprehensively treated by Professor Albert E. Utton in a recent issue of this journal.[124] Although the New Mexico law of standing is "complicated and confusing,"[125] an examination of a few of the leading New Mexico cases may suggest some ways to secure corrective action insofar as the taxation of leaseholds is concerned.

The possibility always exists, of course, that the tax authorities will voluntarily take corrective action once the issue has been raised. § 72-6-12.1 of the New Mexico statutes provides:

> The state tax commission shall constitute and be the state board of equalization, and as such board of equalization shall require that all taxable tangible property be assessed uniformly in proportion to the value thereof. To the end that all taxable tangible property may

124. Utton, *Through a Glass Darkly: The Law of Standing To Challenge Governmental Action in New Mexico, or, All You Wanted To Know About Standing and Were Afraid to Ask*, 2 N.M. L. Rev. 171 (1972).
125. *Id.* at 171.

> be assessed and valued in accordance with article VIII, section 1 of the Constitution of the state of New Mexico, and in order to perform the duties imposed upon it by law, the state tax commission may promulgate all necessary rules and regulations, including standards of assessment, which rules and regulations shall be followed by the county assessors and the county boards of equalization in connection with the assessment and valuation of property for tax purposes.

Thus, the Property Appraisal Department, successor to the State Tax Commission,[126] could simply promulgate an order directing the taxing authorities in each county to assess ad valorem taxes on all private leaseholds in publicly owned property, with appropriate instructions for valuing such leaseholds. In the event of a county's refusal to comply with the order, an action for writ of mandamus brought by the Property Appraisal Department against the board of county commissioners, assessor and treasurer of the offending county should be sustained. As the Supreme Court of New Mexico has recently stated:

> The P.A.D. [Property Appraisal Department] has the duty to establish and promulgate standards of assessment to insure that all property in the state, subject to ad valorem taxes, is assessed equally and uniformly in proportion to its value on a continuing basis. . . . The county taxing authorities have no statutory authority or right to assess taxable tangible property contrary to the directions, rules, regulations and orders of the P.A.D., as the functions of the local taxing authorities are purely ministerial.[127]

If, on the other hand, a county assessor, or board of county commissioners, were to institute suit to force a recalcitrant Property Appraisal Department to issue an order requiring the statewide taxation of private leaseholds, the suit would in all likelihood be dismissed for lack of an actual controversy and for want of a sufficient interest in the county officials to entitle them to raise the question. In an analogous situation, the New Mexico Supreme Court has held that "[t]he Assessor has no personal stake in the matter. He is under the direction of the State Tax Commission, a superior office. . . . [A] public officer as such does not have such an interest as would entitle him to question the constitutionality of a statute so as to refuse to comply with its provisions."[128]

126. N.M. Stat. Ann. § 72-25-2(F) (Supp. 1971).

127. New Mexico Prop. App. Dep't v. Board of County Comm'rs of Lea County, 82 N.M. 267, 268-69, 479 P.2d 771, 772 (1971).

128. State *ex rel.* Overton v. New Mexico State Tax Comm'n, 81 N.M. 28, 31, 462 P.2d 613, 616 (1969).

If the Attorney General, instead of the county officials, were convinced that the private leaseholds should be taxed, the odds in favor of maintaining a suit against a recalcitrant Property Appraisal Department would be enhanced. In *State ex rel. Maloney v. Sierra,*[129] the dispute was between the Attorney General and the Director of the Department of Alcoholic Beverage Control over the validity and interpretation of certain statutes concerning Sunday liquor sales. The Attorney General filed a declaratory judgment action and the Director counterclaimed for a declaratory judgment on the same statutes. The District Court entertained the action based upon its determination that an actual controversy existed and that the public interest required its settlement. The Supreme Court upheld the lower court on the ground that the Attorney General had standing to sue and a justiciable controversy was presented, distinguishing the *Overton* case as follows:

> Our situation is much different. We have here an administrative stalemate between two superior officers detrimental to public interest. The attorney general is charged by statute with the duty of prosecuting in court any action when in his judgment the interest of the State requires such action. . . . He also must represent the State in any appeal. . . . The defendant is charged with the duty of administering and enforcing the liquor laws. Both parties are superior officers in separate realms and each in his own area is charged with ultimate responsibility for official action. Because of their duties each is an "interested party." Each in the area of public law has a personal stake involved, a required duty and ultimate responsibility, and the "rights, status or other legal relations of the parties" . . . not only call for, but the interests of the State and public require that we break the deadlock. . . .
>
> A real, actual, concrete controversy exists. Our decisions will be productive and meaningful by terminating the controversy. Hence we are not departing from reality, or dispensing advice on assumed hypotheses to unconcerned parties. If all parties held the same viewpoint and merely sought confirmation from us, a different situation would be presented. (citations omitted)[130]

The Court acknowledged, however, that the assumption of jurisdiction by the District Court was discretionary, not mandatory, noting that court's finding that it was in the public interest to settle the controversy. Furthermore, Justice Watson, joined by Justice Tackett, entered a strong dissent on the ground that the

129. 82 N.M. 125, 477 P.2d 301 (1970).
130. *Id.* at 130, 477 P.2d at 306.

only interest of the plaintiff and defendant, as public servants, was that the matter be decided, not *how* it should be decided, and therefore, there being no interested parties, the effect was that of an advisory opinion, not authorized in New Mexico.

In the perhaps more likely event of no action being taken by any public official or agency to force the taxation of private leaseholds, what can the citizen-taxpayer do about it? He is faced at the outset with the long-standing and recently reiterated rule that a taxpayer suit will not be permitted against state officials.[131] An important qualification must now be added, however. If the question is of unusually great public interest, the Supreme Court may feel called upon to exercise its discretion and determine the issue. The Court did so in the *Castillo* case,[132] wherein a writ of mandamus was issued requiring the State Tax Commission to promulgate an order providing for a uniform assessment percentage ratio to be used in all counties for state ad valorem tax purposes. The high degree of public interest in a uniform assessment ratio is obvious. How willing the Court might be to exercise its discretion to entertain and decide issues of lesser, but nevertheless substantial, public interest cannot be predicted. Nevertheless, the *Castillo* case does ameliorate the strict rule of *Asplund v. Hannett*[133] and offers some hope that the New Mexico Supreme Court would assume jurisdiction to determine the tax status of private leasehold interests in publicly owned property.

Finally, the possibility exists for taxpayer action (mandamus, declaratory judgment, or both) against *local* officials such as the board of county commissioners, county assessor and county treasurer. Taxpayer suits against local officials, as distinguished from state officials, have always been permitted, even when the moneys, out of which the expenditures sought to be enjoined were to be made, were realized through donations and not through taxation.[134] As for the requisite showing of injury, in *Ward v. City of Roswell,* wherein taxpayers sought to enjoin the furnishing of free water to city officials, the court said:

> It is argued by appellants that, if the action taken by the council is void, it leaves city official still liable for water used, leaves the city

131. Asplund v. Hannett, 31 N.M. 641, 249 P. 1074 (1926); State *ex rel.* Castillo Corp. v. New Mexico State Tax Comm'n, 79 N.M. 357, 359, 443 P.2d 850, 852 (1968).

132. State *ex rel.* Castillo Corp. v. New Mexico State Tax Comm'n, 79 N.M. 357, 443 P.2d 850 (1968).

133. 31 N.M. 641, 249 P. 1074 (1926).

134. Shipley v. Smith, 45 N.M. 23, 107 P. 1050 (1940).

> free to enforce the liability, and leaves appellee free to compel such enforcement by mandamus. Taxpayer's suits are exceptional. *The remedy suggested does not preclude injunction. Nor need the taxpayers, in such suits, show greater or more irreparable injury than the public loss in which he shares.* (emphasis added)[135]

Apparently taxpayer suits are not confined to attacking public expenditures. They may have nothing to do with the amount of public expenditures or with the amount of taxes to be paid. In *Shipley v. Smith*,[136] the New Mexico Supreme Court, in stating the rationale in support of taxpayer suits, quoted with approval certain language of the Supreme Court of Wisconsin, in *Linden Land Co. v. Milwaukee El. R. & L. Co.*, including the following:

> Here the basis of the right is not that there is necessarily a direct pecuniary loss to the taxpayer, but that the public moneys, *rights*, or property are about to be squandered or *surrendered*, and that such moneys, *rights*, or property belong to the body of taxpayers, and are simply held in trust by the unfaithful public officers. (emphasis added)[137]

Thus, the surrender of rights, such as the failure to assess and collect an ad valorem tax, would seem to be within the ambit of a taxpayer's suit against local officials.

New Mexico authority on the scope of a taxpayer's suit is admittedly sparse. In *Zellers v. Huff*,[138] the plaintiffs, as citizens, taxpayers and parents of school children, for themselves and others similarly situated, were held entitled to enjoin the teaching of religion in the public schools. The court did not deal exhaustively with the issue of standing, but that it necessarily dealt with the issue is evidenced by the fact that it ordered the injunction dissolved as against those defendants who were state officers. The injunction remained in effect against members of local boards of education and teachers in the schools who were also defendants.

Taxpayers alone were given standing to enjoin the teaching of religion in public schools in *Miller v. Cooper*.[139] The court made no mention of the issue of standing as such, but it did cite with approval and rely on *Zellers v. Huff* for its action in enjoining the defendant teachers from teaching religion.

Zellers v. Huff and *Miller v. Cooper* seem to stand as authority

135. 34 N.M. 326, 327-28, 281 P. 28 (1929).
136. 45 N.M. 23, 26, 107 P.2d 1050, 1052 (1940).
137. 107 Wis. 493, 504, 83 N.W. 851, 854 (1900).
138. 55 N.M. 501, 236 P.2d 949 (1951).
139. 56 N.M. 355, 244 P.2d 420 (1952).

for the validity of taxpayer suits to challenge actions at the local level other than public expenditures.[140] If so, a taxpayers' suit against county officials for a declaratory judgment or writ of mandamus for enforcement of the taxation of private leasehold interests should not fail for lack of standing. In a recent case, however, the New Mexico Supreme Court cast doubt on the validity of this conclusion with no mention whatever of either of these cases in its opiniion.[141]

In *Overton II*,[142] the plaintiff, as a resident taxpayer of Bernalillo County, a parent of children in the Albuquerque public schools and a lawyer required to represent indigents in criminal cases, brought suit against members of the State Tax Commission, the members of the Bernalillo County Board of Equalization and the Bernalillo County Assessor to challenge (1) the failure to assess property at full value, (2) the allowance of the veterans' and household exemptions as deductions from assessed value instead of from full value and (3) the assessment of agricultural lands on the basis of capacity to produce. The trial court assumed jurisdiction over the objection by the defendant State Tax Commissioners that the plaintiff lacked standing. On appeal, the Supreme Court held that it was not enough to merely allege discrimination but a showing of injury was necessary, and "[w]e simply cannot find from the complaints any indication of a personal stake in the outcome of the controversy which would assure the concrete adverseness which we believe necessary."[143] Accordingly, the case was remanded with directions to dismiss for want of jurisdiction.

Overton II is perplexing. If, as clearly appears, the suit in question was a taxpayer's suit, why is a showing of injury or personal stake in the outcome necessary? The whole significance of a taxpayer's suit is that it overcomes the necessity of showing

140. Perhaps an unstated limitation in Zellers v. Huff is that a taxpayer's challenge will be permitted only when the issue involves a First Amendment right–in that case, the right not to have religion taught in the public schools. Thus, Zellers v. Huff was perhaps the forerunner of Flast v. Cohen, 392 U.S. 83 (1968), in which the U.S. Supreme Court liberalized the law of standing in the federal courts by permitting taxpayers to challenge the expenditure of federal funds for religious schools. Also worthy of note is the continuing endorsement by the New Mexico Supreme Court in the *Castillo* case, of its "many decisions in which we refused to permit a taxpayer to raise constitutional questions in actions against state officials," despite *Flast v. Cohen*. However, this still leaves open the possibility of standing for an issue of unusually great public interest or for a taxpayer suit against local officials.

141. State *ex rel.*Overton v. State Tax Comm'rs, 80 N.M. 780, 461 P.2d 913 (1969).

142. *Id.*

143. *Id.* at 783, 461 P.2d at 916.

injury. Why did the court not just dismiss the suit against officers of the state, as it did in *Zellers v. Huff,* and allow jurisdiction to the extent the proceedings were against local officials? Despite its assertion[144] that "we are not inclined to extend the doctrine" of *Asplund v. Hannett,* the court appears to have done just that by denying jurisdiction not only over the suit against state officers but against local officials as well.

Perhaps the court, without saying so, regarded the state officers as the real parties in interest inasmuch as the county tax officials are inferior to the state tax officials and really perform ministerial acts in ad valorem tax matters. Otherwise, the dismissal of the suit against the county officials in *Overton II* would seem to have resulted from the inexplicable failure of the Supreme Court to follow its own precedents governing taxpayer suits.

The law of standing in New Mexico is indeed complicated and confusing. Perhaps a taxpayer suit challenging the failure of the taxing authorities to assess and collect ad valorem taxes on private leasehold interests in publicly owned property could serve as the vehicle for much needed clarification not only of the law of ad valorem taxation but the law of standing as well.

CONCLUSION

Penetrating questions are being raised, and at least tentatively answered, concerning the desirability of continued economic growth. At the worldwide level, one eminent group of scientists recently concluded:

> If the present growth trends in world population, industrialization, pollution, food production, and resource depletion continue unchanged, the limits to growth on this planet will be reached sometime within the next one hundred years. The most probable result will be a rather sudden and uncontrollable decline in both population and industrial capacity.[145]

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144. *Id.* at 782, 461 P.2d at 915.

145. D. H. Meadows, D. L. Meadows, J. Randers and W. Behrens III, The Limits to Growth 23 (1972). The Limits to Growth is a report on the first phase of the Club of Rome's Project on the Predicament of Mankind in which an international team of seventeen scientists, working at Massachusetts Institute of Technology, examined the interaction of "five basic factors that determine, and therefore, ultimately limit, growth on this planet—population, agricultural production, natural resources, industrial production, and pollution." *Id.* at 11-12. As indicated by the quotation from the report, the findings in the first phase of the study suggested that our dedication to economic growth and "progress" may be misplaced and that such growth coupled with population growth, if not controlled, could cause the world in a comparatively short span of years to encounter its capacity to support human life. For evaluation and criticism of the report, *see* Time, August 14, 1972 at 56-57; N.Y. Times, March 3, 1972, at 35.

Less frightening, perhaps, but of much more immediate interest and concern to New Mexico citizens, is the situation in New Mexico and the other mountain and Pacific states, faced with a combined population growth of 24.1% since 1960, as described in a recent Time Magazine article:

> *Ecologists point out that the very nature of the West—little water and enormous stretches of arid soil—makes it impossible to support the continued migration. Legislators, scientists and citizens are now openly concerned about the threat of "Californication"—the hap-hazard, mindless development that has already gobbled up most of Southern California. TIME Correspondent Sandra Burton recently spent two weeks traveling throughout the West, taking the measure of Californication and the attempts being made to stop it. Her report:*
>
> In a starkly beautiful New Mexico setting, a billboard catches the eye: UNDEVELOP! Undevelop? Out here in the middle of a desert where freeways lead only to mesas and mirages? Out here on the range where the skies are not smoggy all day? Minutes later, however, the message of the half-whimsical New Mexico Undevelopment Commission begins to make sense as the car whizzes past a transformer station. Utility poles grow stouter and taller, then pick up extra arms to hold more wires. The highway takes on another lane. Exit ramps and gas-station signs run closer together. The road cuts through the backyards of a hundred tract homes, passes the parking lots of the satellite shopping centers and suddenly rises above the city—affording a view of Albuquerque's ugly urban sprawl. The city's future and that of much of the rest of the once-wild West is written large upon a developer's billboard dead ahead: TOMORROW FOR SALE, 36 MILES, THEN TURN LEFT.[146]

Concurrent with this increasing concern over unrestrained (and, in fact, encouraged) economic growth is the highly publicized inability of state and local governments to satisfy the ever increasing demands for governmental services out of state and local revenues, as described by President Nixon in his 1972 state of the Union message:

> In recent years the growing scope and rising costs of education have so overburdened local revenues that financial crisis has become a way of life in many school districts. As a result, neither the benefits nor the burdens of education have been equitably distributed.
>
> The brunt of the growing pressures has fallen on the property tax—one of the most inequitable and regressive of all public levies. Property taxes in the United States represent a higher proportion of

146. Time, August 21, 1972, at 16.

public income than in almost any other nation. They have more than doubled in the last decade and have been particularly burdensome for our lower and middle income families and for older Americans.[147]

One need not agree wholeheartedly with the dire predictions of either the conservationists or the revenue sharing proponents to question whether the practice in some New Mexico municipalities of promoting economic growth by further narrowing the ad valorem tax base through tax exemptions to new or expanding industry is fundamentally sound either as a matter of law or public policy.[148]

Private leasehold interests in publicly owned property are subject to ad valorem taxation in New Mexico whether or not such interests are created pursuant to the New Mexico Industrial Revenue Bond Act. The legislature should not, and probably cannot, alter the taxable status of these interests. The tax preference presently being accorded such private lessees through the inaction of the appropriate taxing authorities is unwarranted and inequitable and should be terminated either voluntarily by such authorities or by appropriate action taken against them.

ADDENDUM

On November 7, 1972, the voters of New Mexico approved an amendment to section 1, article 8, of the Constitution of New Mexico which reads in part as follows:

> Exemptions of personal property from ad valorem taxation may be provided by law if approved by a three-fourths majority vote of all the members elected to each house of the legislature.[149]

Thus, the New Mexico legislature now has clear authority to exempt personal property, and presumably selected classes of

147. 118 Cong. Rec. H158 (daily ed. Jan. 20, 1972).

148. In 1968 the federal government acted to remove or substantially reduce two important benefits theretofore associated with industrial revenue bonds. Section 103 of the Internal Revenue Code of 1954 was amended to eliminate the federal tax exemption for interest on such bonds except for issues for certain specified purposes and issues within certain specified limitations as to amount. Revenue and Expenditure Control Act of 1968, § 107, Pub. L. No. 90-364, 82 Stat. 251; Renegotiation Amendments Act of 1968, § 401, Pub. L. No. 634, 82 Stat. 1345. The Securities and Exchange Commission adopted new rules which, in most cases, had the effect of foreclosing corporations from avoiding S.E.C. registration requirements by raising new capital through the use of industrial revenue bonds. 17 C.F.R. §§ 230.131, 240.3b-5 (1972). Both actions were based upon the conclusion that industrial revenue bonds are not truly obligations of the municipality in any substantive sense and, with respect to the interest on such bonds, that the tax exemption is really a federal subsidy to private corporations. *See* McDaniel, *Federal Income Taxation of Industrial Bonds: The Public Interest*, 1 The Urban Lawyer 157 (1969); Mumford, *The Past, Present and Future of Industrial Development Bonds*, 1 The Urban Lawyer 147 (1969).

149. N.M. Session Laws, S.J.R. 1, p. 703 at 704 (1972).

personal property, from ad valorem taxation. A lessee's leasehold interest in real estate is personal property, called a chattel real, both at common law[150] and under the New Mexico cases.[151]

In these circumstances, what options are open to the legislature? Neither time nor space permits an exhaustive consideration of the alternatives. In all likelihood, the legislature would have no desire to incur the loss of revenue that would result from a blanket exemption of all leaseholds of real estate. At most, perhaps, it might choose to create an exempt class of personal property consisting of leaseholds created pursuant to the terms of the Industrial Revenue Bond Act.[152] Such a classification would in all probability qualify as a reasonable one under the equality and uniformity requirements of the New Mexico Constitution as well as the equal protection clause of the Fourteenth Amendment.[153]

For reasons stated in the foregoing paper, however, the use of ad valorem tax exemptions to subsidize industrial revenue project lessees may be unwise as a matter of sound public policy.[154] Concurrence in this view by more than one-fourth of the members of each house of the legislature would offer the prospect of termination, in fact, of a tax benefit which has never been sanctioned by law.

150. 1 H. Tiffany, The Law of Real Property §§ 25, 73 (3d ed. 1939); 49 Am Jur. 2d *Landlord and Tenant* § 7 (1970); 51C C.J.S. *Landlord and Tenant* § 26 (1968).

151. Ellison v. Ellison, 48 N.M. 80, 146 P.2d 173 (1944); State ex rel. Truitt v. District Court of Ninth Judicial District, Curry County, 44 N.M. 16, 96 P.2d 710 (1939); American Mortgage Co. v. White, 34 N.M. 602, 287 P. 702 (1930).

152. Such classification obviously would not be effective to exempt real property with respect to which the purported "lessee" is in fact taking title and, therefore, is actually the owner of the fee instead of a mere leasehold interest.

153. *See generally,* Matthews, *The Function of Constitutional Provisions Requiring Uniformity in Taxation,* 38 Ky. L. J. 31, 187, 378, 503 (1949-50); Allied Stores of Ohio v. Bowers, 358 U.S. 522, 527-28 (1959).