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ALABAMA DEPARTMENT OF REVENUE REVENUE RULING 93-013

TO: Company A

FROM: Commissioner of Revenue
Alabama Department of Revenue

DATE: January 14, 1994

RE: Revenue Ruling 93-013

SUBJECT: The proper exercise of an option to renew a lease term for purposes of complying with Ad Valorem Tax Regulation 810-4-3-02(8).

FACTS

Company A and the Industrial Development Board of the City of Marion, Perry County, Alabama, entered into a lease agreement on November 1, 1976, covering certain real property and the improvements located thereon. Section 9.2 of the lease agreement confers on Company A (Lessee) the option to renew the lease for an additional term. The option to renew was to be exercised in writing by Company A on or about November 1, 1991, thereby extending the original lease term through October 31, 2006.

Company A failed to exercise the option to renew on or before November 1, 1991, due to its inadvertence, however, the Industrial Development Board (Lessor) and Company A continued to operate under the terms of the lease. Sometime after May 21, 1992, which was the effective date of the Tax Incentive Reform Act of 1992, the failure of Company A to submit a written notice to the Industrial Development Board exercising the option to renew was discovered. The Industrial Development Board then issued a written statement to Company A expressly waiving the requirement of a written notice to renew.

ISSUE

Whether the failure to exercise the option to renew, in accordance with the terms of §9.2 of the lease agreement, renders the property taxable pursuant to The Tax Incentive Reform Act of 1992.

LAW AND ANALYSIS

The Tax Incentive Reform Act of 1992, §40-9B-1 et seq., Code of Alabama 1975, became effective May 21, 1992. Section 40-9B-7(a)(1) states:

Notwithstanding any other provision of law, if a public authority or county or municipal government has title to or a possessory right in private use property, then:

- (1) The property shall be subject to ad valorem taxes as if the private user held title to the property.

This statute taxes property that prior to its passage would have been tax-exempt. However, §40-9B-7(c), commonly referred to as the grandfather clause, allows property to remain exempt ". . .if a private user was entitled to use the property pursuant to a lease or other agreement entered into before May 21, 1992. . . ."

The lease agreement between Company A and the Industrial Development Board was in effect prior to May 21, 1992, however, it was to have expired on or about November 1, 1991, unless renewed in accordance with §9.2. Ad valorem tax regulation 810-4-3-02(8) states:

When any lease or agreement entered into prior to the effective date of Act 92-599 [The Tax Incentive Reform Act of 1992] (May 21, 1992) expires, the property covered by the lease or agreement will become taxable upon execution of a new lease. If the old lease contains a separately stated option to renew for a clearly defined and limited period of time, and the option is properly exercised, the property shall remain exempt for the renewal period as long as the renewal period conforms precisely to the terms of the option. (Emphasis supplied.)

The above-quoted regulation requires that an option be properly exercised in order for the property to remain tax exempt.

The Alabama Supreme Court addressed for the first time in McIntyre v. Coker, 150 So.2d 220 (Ala. 1963), the question of whether the exercise of an option to renew a lease was valid in the absence of a written notice to the lessor. The lessor alleged that the option to renew was not properly exercised in that the leases provided for written notice to be given the lessor at least thirty days prior to the expiration of the primary term and that no such notice was given. However, the lessee remained in possession and continued to make monthly rental payments, which the lessor accepted without protest, for a period of three years.

The court held that the written notice requirement could be waived by the parties or, as in the case before it, a waiver of the written notice would be implied due to the lessee's payment of rents and remaining in possession of the property. Id. at 224. Company A could argue either or both of the above exceptions. It remained in possession of the property and continued to pay rent, which the Industrial Development Board accepted without protest. According to McIntyre, this would be an implied waiver of the written notice requirement. In addition, the parties expressly agreed to waive the written notice requirement. Therefore, Company A's option to renew was properly exercised.

HOLDING

The parties actions as well as their agreement to waive the written notice requirement effected a valid renewal of the lease. This renewal entitles the subject property to continued tax-exempt status pursuant to §40-9B-7(c) and ad valorem tax regulation 810-4-3-02(8).


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