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Landlord and Tenant - Liabilities for Taxes and Assessments - Whether, Absent Agreement on Point, Lessee Is Liable for Increased Real Estate Taxes Attributable to His Improvement of Demised Premises

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treated as a separate asset for the purpose of determining the applicability of the statute here concerned. So long as the cash is still identifiable as being the product of the real estate, why should it not be held under the same form of ownership until the parties clearly demonstrate that it is their wish to do otherwise? Also to be considered is the fact that the joint tenancy form of ownership is used, perhaps most commonly used, between a husband and his wife. Acting as a "poor man's will," it is uniquely adaptable to that relationship since it provides a practical and usually an inexpensive way of passing title on death without resort to a formal will or to the administration of an estate. Under holdings of the type illustrated by the instant case, however, the exacting formal requirements of the statute have worked to destroy, to a great extent, the practical and dollar-saving features of the joint tenancy. As the law now stands, it would require the services of a lawyer to establish a joint tenancy at the outset and further legal services each time an item of property so held was sold and the proceeds reinvested if continuity in the joint tenancy is to be achieved.

It is the application, by the court, of the exception enumerated in the statute that has created the problems discussed above. It cannot be told, from a simple reading of the legislative language, whether the unyielding strictness was intended by the legislature or has been developed through judicial construction and application. The evolution of the idea is academic; the need of an active community is not. That need calls for legislative enactment and judicial determination sensitive to its requirements. As a practical proposition, therefore, there is evident occasion to reappraise the law in this area to make it serve the reasonable expectations and desires of the community.

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LANDLORD AND TENANT—LIABILITIES FOR TAXES AND ASSESSMENTS—WHETHER, ABSENT AGREEMENT ON POINT, LESSEE IS LIABLE FOR INCREASED REAL ESTATE TAXES ATTRIBUTABLE TO HIS IMPROVEMENT OF DEMISED PREMISES—The Supreme Court of New Jersey dealt with a situation unique to the appellate tribunals of that state when it decided the case of *The Crewe Corporation* v. *Feiler*.[1] The plaintiff therein, as lessor-owner, and the defendant, as lessee, had entered into a lease of a specified tract of land and the building thereon for a term of fifteen years which included an option to purchase. The premises were industrial in nature. Immediately after taking possession, the defendant effected a complete conversion of the building from its industrial character to that of an office

1 28 N. J. 316, 146 A. (2d) 458 (1958).

building, leading to a greatly increased value of the premises. The lessor sued the lessee to recover the increment to the real estate taxes paid by the lessor which were attributable solely to the improvements the lessee had made upon the demised premises. The lessee claimed that in the absence of an agreement, express or implied, permissive or prohibitive, relating to the making of improvements or to the taxes thereon,[2] the law imposed an obligation on the lessor to pay all real estate taxes assessed against the demised premises. The lessee accordingly moved for and was granted a summary judgment in favor of the defendant. The appellate division, by a divided court, affirmed this order.[3] The plaintiff thereafter, as a matter of right,[4] appealed the case to the Supreme Court of New Jersey, which tribunal reversed the holding, indicating that a lessee must bear any tax burden resulting from improvements made for his sole benefit and, where a lessee holds an option to purchase the premises, any improvements made thereon were to be regarded as made for the lessee's sole benefit.

The rule relied upon by the defendant, as expressed above, has long been recognized and consistently applied by the courts of the common law nations[5] as the rule for determining who shall bear the burden of real estate taxes assessed as a result of improvements made by a lessee upon demised premises. Equally well recognized is an exception to this general rule, *viz.*, that in the absence of a controlling agreement the lessee will be liable for taxes assessed as the result of improvements made by the lessee for his sole benefit.[6]

[2] The lease did provide that the premises could be "used and occupied" by the lessee for any "lawful" purpose, but these words were held to be inadequate to authorize the making of improvements on the premises by the lessee. The lease further provided that the lessor should pay the real estate taxes assessed upon the premises, but this general covenant was held not to have been made in contemplation of the additional tax burdens here concerned, hence was inconclusive to establish that the liability fell on the lessor.

[3] See 49 N. J. Super. 532, 140 A. (2d) 411 (1958).

[4] N. J. Const., Art. 6, § 5, provides that appeals may be taken to the Supreme Court in those cases where there is a dissent in the Appellate Division of the Superior Court. Such was the situation in the instant case.

[5] See Beck v. Woolworth, 111 F. Supp. 824 (1953); People v. Barker, 153 N. Y. 98, 47 N. E. 46 (1897); People ex rel. Hudson River Day Line v. Franck, 257 N. Y. 69, 177 N. E. 312 (1931); and the cases collected in 1 Amer. Law of Prop., § 3.76; 51 C. J. S., Landlord and Tenant, § 359; 18 A. & E. Encyc. of Law (2nd Ed.) 651; 73 A. L. R. 824.

[6] Yeo v. Leman, 2 Strange 1190, 93 Eng. Rep. 1120 (1743); Graham v. Wade, 16 East 29, 104 Eng. Rep. 1000 (1812); Smith v. Humble, 15 C. B. 321, 80 Eng. Cas. Law 321 (1854); Kent Farm & Cattle Co. v. Williams, 140 F. Supp. 449 (1956); Beck v. Woolworth, 111 F. Supp. 824 (1953); Woolford Oil Co. v. Weemsfuller, 166 Ga. 173, 142 S. E. 887 (1927); Melhop v. Meinhart, 70 Iowa 865 (1886); Walston v. Wray, 54 Iowa 531 (1880); Phinney v. Foster, 189 Mass. 182, 75 N. E. 103 (1905); LaPaul v. Heywood, 113 Minn. 376, 129 N. W. 763 (1911); Leach v. Goode, 19 Mo. 501 (1854); Amoskeog Savings Bank v. Shell Eastern Petro. Products Co., 89 N. H. 30, 192 A. 149 (1937); Revell's Estate v. Heron, 187 Okla. 618, 105 P. (2d) 426 (1940); Smith v. Sugar Creek Coal Co., 110 W. Va. 553, 158 S. E. 903 (1931). See also annotation in 73 A. L. R. 828.

In considering the reason for making such an exception, it should be recognized that the landlord and tenant may contract to treat those buildings and improvements annexed to the land by the lessee as being the lessee's property, and that such an agreement will be effective, as between them, to determine the ownership of such annexations.[7] It has also been consistently held that, where the lessee has the right, upon the termination of the lease, to remove such buildings and improvements as he may have annexed to the premises, these improvements are to be treated as his property.[8] This ownership by the lessee is such that its effectiveness extends beyond the lessor-lessee relationship and is, in certain circumstances, enforcible against third parties such as the lessor's mortgagee or a purchaser of the reversion.[9] The respective ownerships of the lessor and lessee are also to be recognized in relation to condemnation awards.[10]

The importance of these general principles is demonstrated when the cases which apply the exceptions are examined. It is, with very few deviations,[11] the fact that, whenever an exception was applied to a particular set of circumstances, the lessee was treated as the owner of the property upon which the tax was assessed, either by virtue of an established right of removal or because of an agreement which rendered such improvements as his property. By a circular process of reasoning, courts have said that whenever the lessee has been found to have a right of removal, the improvements were his property and were erected for his sole benefit or, approaching from the other direction, whenever the improvements were placed on the premises for his sole benefit, he had a right of removal for they were then his property.

7 Exall v. Partridge, 8 T. R. 308, 101 Eng. Rep. 1405 (1799); Kent Farm & Cattle Co. v. Williams, 140 F. Supp. 449 (1956); Woolford Oil Co. v. Weemsfuller, 166 Ga. 173, 142 S. E. 887 (1927); Phinney v. Foster, 189 Mass. 182, 75 N. E. 103 (1905); Nichols v. Bucham, 177 Mass. 488, 59 N. E. 79 (1901); People ex rel. Muller v. Board of Assessors, 93 N. Y. 308 (1883); People ex rel. Van Nest v. Comrs. of Taxes, 80 N. Y. 573 (1880); Smith v. Mayor, 68 N. Y. 552 (1877); People v. Casity, 46 N. Y. 46 (1871); Revell's Estate v. Heron, 187 Okla. 618, 105 P. (2d) 426 (1940).

8 In addition to the cases cited in notes 6 and 7, ante, see Callahan v. Broadway Nat. Bk. of Chelsea, 286 Mass. 743, 190 N. E. 792 (1934); Lawyers Mtg. Invest. Co. v. Paramount, 279 Mass. 314, 181 N. E. 262 (1932); Stone v. Livingston, 222 Mass. 192, 110 N. E. 297 (1915); Ryder v. Faxon, 171 Mass. 206, 50 N. E. 631 (1898); East Tennessee, V. & G. Ry. Co. v. Mayor, etc., Morristown, — Tenn. —, 35 S. W. 771 (1895). See also Tiffany, Landlord and Tenant (1910 Ed.), Vol. 1, § 141, and 36 C. J. S., Fixtures, § 15.

9 Lawrenson v. Worcester Lunch Car & Cartage Mfg. Co., 300 Mass. 543, 15 N. E. (2d) 978 (1938); Holtgreve v. Sobolewski, 336 Mo. 412, 31 S. W. (2d) 993 (1930); Kelleson v. Collete, 61 N. Dak. 768, 240 N. W. 920 (1932); Kennedy v. City of Hood River, 122 Ore. 531, 259 P. 911 (1911); M. P. Molder, Inc. v. Mainker, 314 Pa. 314, 171 A. 476 (1934); Workman v. Henrie, 71 Utah 400, 266 P. 1033 (1928).

10 Matter of New York, 122 N. Y. S. 321, 66 Misc. 488 (1910).

11 The deviations are discussed in connection with notes 12 to 15, post.

Certain situations have arisen, however, wherein the courts, notwithstanding the fact that the taxed improvements made by the lessee were not made for his sole benefit, have held the lessee liable for the tax burden. These situations have arisen in cases where the tax increase, directly attributable to the lessee's improvements, exceeded the amount of rent to be received by the lessor;[12] a possibility, recognized by the English courts as early as 1827, as a shortcoming in the established rules.[13] A similar doctrine has been applied where the landlord is a tax exempt entity,[14] or where the lessee has a right to be compensated for the improvements he has made.[15]

Except for the three last mentioned situations, which represent true exceptions to the general proposition, the rule in relation to assigning the tax burden can best be stated in terms of the basic rationale which underlies it, *i.e.*, he who owns the property and receives the benefits of ownership should also bear the burdens of that ownership. He is the one who should have the ultimate duty of protecting his ownership from being foreclosed by a tax sale and should not be permitted to shift this duty to one who derives no benefits, nor be allowed to depend on such a "stranger" to protect his rights. The application of taxing statutes should not be regarded as determinative in this connection, for the classification of the tax assessor as to what constitutes real estate subject to be taxed is not binding for purposes other than the levy of taxation.[16]

In the immediate case, there was no expression on the point that the improvements made by the lessee were to remain his property or were to be removable by him. The relative shortness of the term compared to the permanent nature of the improvements made indicated that it would be extremely unlikely that the improvements would become useless, in the ordinary course of events, prior to the expiration of the lease. They would, therefore, form a part of the reversion, owned by the lessor and taxable to him as such. To achieve the result it did, the court had to rely upon the existence of the option to purchase as the basis for holding that the improvements were for the sole benefit of the lessee. This it did by treating the option to purchase as giving to the lessee a right to effect a

12 Roach v. Matanuska Valley Farmers Co-op. Ass'n, 12 Alaska 512, 87 F. Supp. 641 (1949), affirmed in 188 F. (2d) 162 (1949).

13 Watson v. Home, 7 B. & C. 285, 14 Eng. Cas. Law. 455 (1827).

14 See 1 Amer. Law of Prop., § 3.76.

15 This situation may be said to fall under the sole benefit rule, for the lessee removes the value of the improvement without removing the physical estate.

16 Beck v. Woolworth, 111 F. Supp. 824 (1953); City of Boston v. Quincy Market Cold Storage & W. Co., 312 Mass. 638, 45 N. E. (2d) 959 (1943); Town of Franklin v. Metcalfe, 307 Mass. 368, 30 N. E. (2d) 262 (1940); LaPaul v. Heywood, 113 Minn. 376, 129 N. W. 763 (1911); Leach v. Goode, 19 Mo. 501 (1854). See also 32 L. R. A. (N. S.) 368.

removal, at least in the sense that, by exercising the option, the lessee could deny to the lessor any benefit from the improvements as effectually as if the lessee had physically removed them from the premises at the end of the term. The court was not indulging in the tenuous speculation that the lessee would exercise the option; it merely recognized the existence thereof as giving, in effect, the lessee a right to remove. It has been the existence of this right, in all prior cases, which has been the determining factor rather than the actuality of its exercise.[17]

To offset this, the defendant maintained that, on the authority of the case of *Keogh* v. *Peak,*[18] the lessor's right to sue the lessee for waste to the premises was merely suspended until it was known whether or not the lessee's option to purchase would be exercised. Several factors appear to distinguish that case from the instant one. In the Keogh case, the action was one for waste in which damages were claimed for an injury to the reversion, an injury which would be non-existent if the option was exercised by the lessee. In the case at hand, at least as expressed by the court,[19] the action was not founded on any doctrine of waste but rather seemed to be founded on a quasi-contractual basis for a benefit conferred by an involuntary discharge of the lessee's principal obligation for him to avoid the risk of foreclosure by tax sale. It is also pertinent to notice that the lease in the Keogh case was for ninety-nine years, while the one at hand was for a much shorter term; a fact calling for the application of different considerations.[20] In addition, the knowledge and consent of the lessor in the instant case to the making of the improvements by the lessee,[21] and his failure to seek injunctive relief promptly, which could have barred a suit proceeding on a theory of waste,[22] were regarded as being immaterial to the instant action.

In deciding the instant case the way it did, the court, for the first time in that particular jurisdiction, appropriately recognized and applied the common law rules as to tax liability in general. The case is, however, the more noteworthy in that, insofar as the case concerned the effect to be given to an option to purchase in the context presented, the court achieved a decision not only of first impression for that state but for the first time in any common law jurisdiction as to the specific question.

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17 See note 8, ante.

18 316 Ill. 318, 147 N. E. 266 (1925).

19 28 N. J. 316 at 327, 146 A. (2d) 458 at 464.

20 Prettyman v. Walston, 34 Ill. 175 (1864). See also 1 Amer. Law of Prop., § 3.76.

21 The lessor not only admitted knowing of the construction by the lessee but also willingly gave consent thereto when requested so to do by the municipal authorities.

22 28 N. J. 316 at 327, 146 A. (2d) 458 at 464.