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BOARD OF EQUALIZATION[1]

STATE OF CALIFORNIA

In the Matter of the Appeal of:	**HEARING SUMMARY**
	PERSONAL INCOME TAX APPEAL
DONALD L. MAXTED AND	Case No. 558105
JAN E. MAXTED	

Year	Claim For Refund
2007	$96,940[2]

Representing the Parties:

For Appellants: Mitchell B. Dubick, Attorney at Law[3]

For Franchise Tax Board: Maria Brosterhous, Tax Counsel

QUESTION: Whether appellants have shown that they are entitled to a casualty loss under Internal Revenue Code (IRC) section 165(c)(3).

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[1] This matter was originally scheduled for oral hearing at the October 25-28, 2011 Culver City Board meeting. However, it was postponed due to a scheduling conflict of appellants' witness. The matter was rescheduled for oral hearing at the January 31/February 1-2, 2012 Culver City Board meeting.

[2] Because appellants have reduced during the appeal process the amount of casualty losses they are claiming, the amount of their refund claim will be correspondingly less than $96,940.

[3] Mr. Faustino J. Medina, CPA, filed the appeal letter in this matter. Subsequently, Mr. Dubick filed appellants' opening brief.

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HEARING SUMMARY

Background

Appellants owned real property in Jamul, an unincorporated area of eastern San Diego County. They were also partners in Sutter Uptown, L.P. (Sutter Uptown), a limited partnership that owned three pieces of real property in Jamul. Each of the four pieces of real property was zoned primarily for general agricultural use. In October 2007, a large fire (the "Harris fire" or "fire") swept through San Diego County and destroyed large amounts of naturally growing vegetation as well as burning parts of some residential structures and related landscaping on the four pieces of real property.

Appellants filed timely federal and California tax returns for 2007. Subsequently, appellants filed amended federal and California tax returns for 2007 (Resp. Br., Exhibits C and D, respectively). On Internal Revenue Service (IRS) Form 4684 (Casualties and Thefts) (Resp. Br., Exhibit F) attached to a Schedule A included with their amended 2007 federal return, appellants reported with regard to the real property they owned and on which they had their personal residence (on Sierra Cielo Lane) that the real property had a cost or other basis of $600,000 and they received insurance or other reimbursement of $60,835. They also reported that the Fair Market Value (FMV) of the real property before the casualty was $994,300 and the FMV of the real property after the casualty was $812,500, for a difference of $181,800. After determining that the difference of $181,800 was less than the basis in the real property of $600,000, appellants subtracted insurance reimbursement of $60,835 from $181,800 for a casualty loss in the amount of $120,965. (Resp. Br., p. 4.)

With regard to the three pieces of real property at issue owned by Sutter Uptown (Deerhorn Valley Road, Granite Oaks, and Trudeau Way), appellants reported a total basis of $2,150,911 for the properties but did not report insurance or other reimbursement.[4] Appellants also reported the FMV of the properties before the casualty was $2,150,911 and the FMV of the properties after the casualty was zero. Appellants then subtracted zero from $2,150,911 and reported $2,150,911 as the casualty loss for the three properties because that amount was the same as the total basis of the properties and there was no reimbursement to take into account. Appellants stated that the information

[4] See below for a more complete description of the three properties.

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regarding the three properties was "Per K-1 (Sutter Uptown, LP 33-0786864) Various." (Resp. Br., pp. 4-5 of Exhibit F.)

After adding together the two casualty losses of $120,965 and $2,150,911, appellants subtracted $100 from their sum of $2,271,876 for an amount of $2,271,776. Appellants completed their calculations by subtracting $115,340 (10 percent of their adjusted gross income for 2007) from $2,271,776 to reach a claimed total casualty loss of $2,156,436. Appellants indicated on both their amended federal and California returns for 2007 that the claimed total casualty loss was the result of the Harris fire. Appellants also stated on both amended returns that "[a]dditionally, we are amending for a reduction of partnership income as a result of a casualty loss endured by the partnership."[5] On their amended 2007 California return, appellants claimed a refund of $96,940. (Resp. Br., p. 1 of Exhibit C.)

Respondent reviewed appellants' 2007 return and concluded that it needed more information from appellants regarding their claimed casualty loss. On September 9, 2009, respondent sent appellants an Initial Contact Letter (ICL) stating that their refund claim for 2007 would be examined. Included with the ICL was an Information Document Request (IDR) of the same date. The IDR requested that appellants provide: (1) K-1 information from all partnerships of which they were partners; (2) descriptions of the casualty losses sustained, including the use of each property and its street address or parcel number; (3) a schedule calculating the basis of each property, with improvements and depreciation taken into account; (4) escrow statements for each property; and (5) correspondence with the insurer if the property was insured and other documentation that supports reimbursement. On October 26, 2009, respondent sent appellants a second IDR in which respondent requested photographs of the properties after the fire, additional information regarding the insurance policies on each property, any documents indicating that appellants planned improvements to the vacant

[5] Respondent states that, on IRS Form 4684 of the amended 2007 partnership return of Sutter Uptown (Resp. Br., Exhibit G) appellants reported a basis of $1,310,000 for Deerhorn Valley Road, a FMV for the property of $5,893,800 before the fire and a FMV of $1,080,000 after the fire, for a loss of $1,310,000. Similarly, respondent states that appellants reported a basis in Trudeau Way of $550,000, a FMV for the property of $1,281,450 before the fire and a FMV after the fire of $225,000, for a loss of $550,000. With regard to Granite Oaks, respondent states that appellants reported a basis of $335,000, a FMV for the property of $2,659,400 before the fire and a FMV of $435,000 after the fire, for a loss of $335,000. Respondent observes that although appellants reported an insurance reimbursement of $22,363 for Granite Oaks, an insurance reimbursement of the same amount was received for the Deerhorn Valley Road property. Therefore, in respondent's view, the attribution of that amount to Granite Oaks was probably in error.

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pieces of property, clarification regarding previously submitted information, and copies of rental contracts for one of the properties as well as certain other information. (Resp. Br., p. 6.)

Respondent states that, in response to its requests for information, appellants provided landscape damage assessments by Mr. Shawn P. O'Brien, whom respondent characterizes as a licensed building contractor and landscaping contractor, for each of the pieces of property at issue (the "O'Brien estimates"). Respondent states further that Mr. O'Brien determined the replacement cost for the vegetation on all four pieces of property was significant and, for three of the four properties, the replacement cost for the vegetation on the property exceeded appellants' basis in the property. (See Resp. Br., Exhibits K, M, O, Q, and R.) In addition, respondent states that appellants also provided post-casualty property value estimates by Ms Marcia Spurgeon, a San Diego real estate agent (the "Spurgeon estimates"). Respondent states that Ms Spurgeon compared each damaged property with other local properties that had been sold during 2008. (See Resp. Br., Exhibits S-V.) Further, respondent alleges that Ms. Spurgeon's estimates showed the FMV's of the properties at issue after the Harris fire either increased after the fire or were the same as before the fire. Finally, respondent states that appellants provided insurance documents from State Farm Insurance Company (State Farm), escrow or closing statements for the properties at issue, and ledgers relating to the purchase of the three properties owned by Sutter Uptown. (Resp. Br., p. 6.)

Respondent states that, after review of the O'Brien and Spurgeon estimates and the insurance documents provided by appellants, respondent's auditor determined that most of the damages were the result of the loss of local vegetation and that appellants' residence suffered minor damage for which they received insurance reimbursement. With regard to the O'Brien estimates, respondent states the auditor noted that "while the costs of revegetating the properties far exceeded the original cost basis, the estimate did not purport to be a real property fair market appraisal, and any tax loss was limited to the purchase price (less any insurance reimbursements) per Internal Revenue Code section 165." (Resp. Br., p. 9.) In addition, respondent states the auditor determined that because appellants had not allocated basis between the land, trees, and shrubs, there was no basis in the trees and shrubs. (Resp. Br., p. 9.)

With regard to the Spurgeon estimates, respondent states that the auditor noted that "the current market values were similar to the purchase prices and therefore, no loss was recognized." (Resp.

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Br., p. 9.) Respondent further states that the auditor noted that because no insurance policies were carried on properties without structures, the absence of insurance on the trees and shrubs may have indicated that appellants perceived the trees and shrubs as having no value. (Resp. Br., p. 9.)

In a letter dated April 9, 2010, the auditor informed appellant that their claim for refund would be denied in full. The auditor stated in his letter that "[t]he valuation conducted by the real estate agent was based on a comparison of similar sized property recently sold. The valuation found that the properties had nearly retained all of their value. Two properties in fact had a proposed gain in value." (Resp. Br., Exhibit W.)

Contentions

Appeal Letter

Appellants filed an appeal in a letter dated December 4, 2010. With their appeal letter, appellants made reference to the O'Brien and Spurgeon estimates and provided appraisals for each of the four properties in preparation for the appeal. The appraisals were performed by Mr. Robert E. James, a certified real estate appraiser in La Mesa, California (the "James appraisals"). Appellants state in their letter that the appraisals yielded results favorable to the taxpayers' original claim. Appellants included in their letter charts from the appraisals indicating that the amount of their casualty loss from the Harris fire was $2,141,739, $151,863 less than the amount of casualty loss originally claimed. As a result, appellants requested that their claim for loss for 2007 be adjusted to $2,141,739.

Respondent's Brief

Respondent summarizes its contentions in the Background section of its opening brief. In that section, respondent states that "[t]axpayers are entitled to a casualty loss in an amount which is the lesser of the decrease in fair market value due to the casualty or the cost of repairs. The casualty loss which taxpayers are entitled to deduct is reduced by insurance proceeds received." (Resp. Br., p. 1.) Respondent states the Spurgeon estimates concluded that the FMV's of the properties at issue were the same or increased after the fire when compared to those values before the fire. Respondent also states the O'Brien estimates concluded that the replacement cost of the vegetation far exceeded even the purchase price of the property. Respondent argues that the O'Brien report was not probative of the FMV of the properties either before or after the fire because the repairs were not actually made. (Resp.

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Br., p. 1.)

With regard to the James appraisals, respondent states that they allege a significant decrease in the value of three of the four properties on the assumption of the highest and best use of the properties was as an environmental subdivision or mitigation bank. However, respondent argues that the appraisals do not support appellants' claimed casualty loss deduction because they provided no evidence that the properties were used as an environmental subdivision or mitigation bank or have met any of the requirements for either of them, or that appellants even began the substantial and complex process to receive the necessary official designation. Respondent also argues that even though the appraisal on the fourth property states that the highest and best use of the property was as a residential subdivision, it does not demonstrate that the loss of vegetation had an impact on its value. Respondent alleges that the lack of probative value of the appraisal is especially pronounced because the Spurgeon estimates and San Diego County real estate assessment documents indicate that the value of the property was the same or increased slightly after the fire. (Resp. Br., pp. 1-2.)

In the Facts section of its brief, respondent describes each of the properties for which appellants claimed a casualty loss as follows:

(a) Sierra Cielo Lane

Respondent states that this property was comprised of two parcels. The first parcel consisted of 5.83 acres, and the second parcel consisted of 58.96 acres. Respondent also states that the property was zoned for "general agricultural use" and the foregoing term means "intended for crop or animal agriculture." In addition, respondent states that appellants resided on this property in a home of 5,299 square feet. (Resp. Br., p. 2.)

(b) Deerhorn Valley Road

Respondent states that this property and the following two properties were owned by Sutter Uptown. Respondent also states that this property was comprised of two parcels. The first parcel consisted of 92.33 acres, and the second parcel consisted of 200 acres. Respondent states that San Diego County zoned this property for general agricultural use. In addition, respondent states that insurance documents provided by appellants indicate this property contains a dwelling but that appellants have not provided additional details.

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(c) Granite Oaks

Respondent states that this property is comprised of two parcels. The first parcel (Granite Oaks 1) consists of 50.17 acres, and the second parcel (Granite Oaks 2 or Bratton Valley Road) consists of 19.6 acres. Respondent states that the land was zoned for general agricultural use and according to the San Diego County Assessor, "these lots" are unimproved. (Resp. Br., p. 3.)

(d) Trudeau Way

Respondent states the Trudeau Way property is comprised of four parcels, three of which consisted of approximately eight acres each and the fourth of which consisted of 14.55 acres. Respondent states that the property was zoned by general agricultural use, as well as permitting "limited uses, and after adoption of a specific plan, any use allowed by that plan." (Resp. Br., p. 3.) In addition, respondent states the San Diego County Assessor's Office indicates that "these lots" are unimproved. (Resp. Br., p. 3.)

Respondent provides, in subdivisions of the Facts section of its brief, details about the application of the O'Brien and Spurgeon estimates to all four properties. Respondent states that Mr. O'Brien estimated the replacement value of the vegetation at Sierro Cielo Lane to be $994,300. Respondent asserts that such a replacement value of the vegetation was approximately $275,000 less than appellants' basis in the property as set forth in the final settlement statement provided by appellants. Respondent also states that Mr. O'Brien estimated the replacement value of the vegetation at Deerhorn Valley Road to be $1,340,000 and asserts that such a replacement value was $200,000 more than appellants' basis in the property as stated in the escrow document provided by appellants. With regard to the Granite Oaks property, respondent indicates that Mr. O'Brien estimated the replacement value for the vegetation was $2,659,400. Respondent states that such a replacement value was $2,327,953 more than appellants' basis in the property as set forth in the final closing statement and escrow receipt provided by appellants. In addition, respondent states that Mr. O'Brien estimated the landscaping damage to the Trudeau Way property was $1,281,450. Respondent asserts that such an estimate was $714,756 more than appellants' basis in the property as set forth in the settlement statement provided by appellants. (Resp. Br., pp. 7-8 and Exhibits K-R.)

Respondent states that Ms. Spurgeon compared the property at Sierra Cielo Lane with

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two other Jamul properties with homes that were similar in size to appellants and sold during 2008. Respondent states that Ms. Spurgeon provided an estimated value ranging between $925,000 and $1,000,000. With regard to the Deerhorn Valley Road property, respondent states that she estimated a value between $400,000 and $500,000 for the larger parcel and a value between $580,000 and $680,000 for the smaller parcel. With regard to the Granite Oaks property, respondent states that Ms. Spurgeon compared the value of each of the two parcels with San Diego County properties that were either on the market or sold during 2008. Respondent also states Ms. Spurgeon observed that the latter properties are "out of water district, backcountry houses." (Resp. Br., p. 8.) Respondent states that Ms. Spurgeon estimated the value for one of the parcels to be between $240,000 and $300,000 and the value for the other parcel to be between $80,000 and $150,000. Respondent observes that the Granite Oaks parcels appear to be unimproved and do not contain structures, while the comparison properties contain houses ranging between 1,500 and 2,200 square feet. With regard to the Trudeau Way property, respondent states that Ms. Spurgeon compared the property with two other Jamul properties, one sold in 2004 and the other sold in 2007, of a similar size to each of the four parcels. Respondent states that she provided an estimated value ranging between $200,000 and $250,000 per parcel for a total estimated value between $775,000 and $850,000. (Resp. Br., pp. 8-9 and Exhibits S-V.)

In the Appeal section of its brief, respondent states that, in separate letters for each of the properties at issue, Mr. James explained to appellants that he inspected each property and consulted with a registered civil engineer in making the appraisals. Respondent continues that Mr. James explained further that photographs provided with the appraisals demonstrate that the properties were populated with local vegetation before the fire while, as a result of the fire, much of the remaining vegetation was scorched. Mr. James determined that the highest and best use of the properties before the fire, with the exception of the Trudeau Way property, would have been as an environmental subdivision or mitigation bank and the loss in value experienced by the properties for those uses was largely a result of the loss of vegetation.[6] (Resp. Br., p. 10.)

Respondent next states that Mr. James determined the highest and best use of the Trudeau

[6] Respondent indicates that Mr. James appraisal of the property on Sierra Cielo Lane was limited to the 34.8 acres that were not used for residential purposes. (Resp. Br., p. 10, fn. 30.)

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Way property to be residential. Respondent states that Mr. James provided documentation explaining the highest and best use of the land, the scope and methodology of his appraisals, descriptions of each property along with maps and photographs, sales comparisons, and his certification. Finally, respondent states that Mr. James provided appraisals of the four properties as indicated below:

Property	Value on October 27, 2007 (Prior to the Harris Fire)	Value on October 28, 2007 (After the Harris Fire)	Loss Attributable to the Harris Fire
Sierra Cielo Lane	$350,000	$175,000	$175,000
Deerhorn Valley Road	$2,800,000	$1,460,000	$1,340,000
Granite Oaks	$950,000	$350,000	$600,000
Trudeau Way	$930,000	$485,000	$445,000

(Resp. Br., pp. 10-11.)

Respondent states that, at the outset of this appeal, it contacted appellant's representative to obtain additional substantiation for their claimed casualty loss. Respondent requested appellants to provide any documents that would substantiate the FMV of the properties before the fire, as well as documents regarding the insurance coverage on those properties before the fire and any reimbursements received from their insurance company. Respondent states that appellants provided additional insurance documents and copies of documents respondent had already received that purported to establish basis for the properties. Respondent also states that the insurance documents indicated that appellants had insurance for the two properties for which they received reimbursement. Respondent discusses State Farm insurance documents and reimbursements from that company with respect to the Sierra Cielo Lane property and the Deerhorn Valley Road property. In addition, respondent states that any reimbursement with respect to the landscape appears to be for trees and shrubs associated with the structures and observes that appellants have not provided any documentation showing there was insurance for the naturally occurring vegetation described in the James appraisals. Finally, respondent states that, in reply to its telephone calls requesting further information, appellants' representative indicated that he believed the Granite Oaks and Trudeau Way properties were uninsured and that he did not have any documents regarding appellants' intent to convert any of the properties at issue into environmental subdivisions or mitigation banks. (Resp. Br., pp. 11-13.)

In the Argument section of its brief, respondent states that "Treasury Regulation section

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1.165-7 sets forth two methods of valuation of loss, decline in fair market value and cost of repairs. The amount allowed as a deduction is the lesser of the two under the regulations." Quoting Treasury Regulation section (Treasury Regulation) 1.165-7(a)(2)(i), respondent states that the Treasury Regulation addressing the "decline in fair market value method" emphasizes that a loss is allowed only for actual damages suffered rather than fluctuations in value resulting from changes in the market demand for real property, even when the change is generated by fear of a repetition of the particular casualty. Respondent then quotes from a section of Revenue Ruling 66-242, 2 C.B. 56, to describe a "competent appraisal." Summarizing Treasury Regulation 1.165-7(a)(2)(ii), respondent says that the second method of determining a loss deductible under IRC section 165(c)(3) is the cost of repairs to the damaged property. Citing the *Appeal of Costa Zmay* (87-SBE-078), decided by the Board on December 3, 1987, respondent states that the cost of repairs method applies only to repairs and expenditures actually made. (Resp. Br., pp. 13-14.)

Respondent discusses the deductibility of the alleged casualty losses for each property as follows:

Sierra Cielo Lane

Respondent asserts that, as a result of Mr. James' appraisal, appellants are now claiming a casualty loss in the amount of $175,000, which is based upon an alleged FMV of $350,000 before the fire with respect to the portion of the property on which they did not have their residence and an alleged FMV of $175,000 of that portion after the fire. However, respondent states that tax assessment printouts from the San Diego County Tax Assessor's Office (Tax Assessor's Office) show the total value of the portion of the property containing appellants' residence increased from $493,461 in 2007 to $503,329 in 2008. (Resp. Br., p. 15 and Exhibit AG.) Further, respondent states that tax assessment printouts from Lexis Public Records Search show that the smaller parcel increased in value from $53,060 to $54,120. (Resp. Br., p. 15 and Exhibit AH.) In summary, respondent states that, contrary to appellants' assertion that the property decreased in value, the property as a whole increased more than $10,000 after the fire. (Resp. Br., p. 15.)

Respondent also states that the State Farm insurance policy on the property had a total policy limit of $1,856,660 at the time of the fire and that the policy covered the residence, the residence

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extension, and personal property. Respondent states that the James appraisal indicates appellants are not claiming a casualty loss with respect to their residence and that a State Farm claim statement provided by them shows appellants received $51,434.50 for landscaping destroyed by the fire. Respondent argues that because appellants have not provided any documents showing to what extent the remaining vegetation was insured or if it was part of the personal portion of the policy limit, the only reliable information that is available is from the Tax Assessor's Office and such information indicates that appellants' property did not suffer a reduction in value as a result of a loss of vegetation. (Resp. Br., pp. 15-16.)

Further, respondent questions the reliability of Mr. James' appraisal. Respondent points out that his appraisal of the property before and after the fire in 2007 occurred in 2010, several years after the fire. Respondent states that appellants provided no documentation that was dated or performed before the fire which assesses the value of the property before the fire. Respondent also states that Mr. James determined the value of the properties at issue before the fire "by examining the properties after the fire and examining the prices of comparable properties with the same highest and best use which were either on the real estate market or sold during the six to twelve months leading up to the fire." (Resp. Br., p. 16, fn. 50.)

Moreover, respondent states that appellants' reliance on the James appraisal to show a decline in the value of the property presupposes that appellants were in the process of converting this property to use as an environmental subdivision. Respondent states that California legislative history indicates that "environmental subdivisions are a form of mitigation, i.e. a method of environmental preservation, thus allowing a landowner to subdivide property and sell parcels to another landowner who is then required to mitigate the impacts of development." (Resp. Br., p. 16.) Citing California Government Code section 66418.2, respondent states that the rules are strict for converting land to an environmental subdivision. Respondent observes that a person seeking to convert his land to an environmental subdivision must meet with various governmental agencies to be sure that his land satisfies their requirements, as well as obtain an easement and establish procedures to ensure that the land is perpetually maintained in accordance with applicable governmental guidelines. (Resp. Br., pp. 16-17.)

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In addition, respondent states that because the James appraisal considers "market values" before and after the fire, it is likely the appraised reduction in value incorporated buyer resistance as a result of the fire. Citing *Kamanski v. Commissioner* (9th Cir. 1973) (*Kamanski*) 477 F.2d 452, respondent states that a deduction is not allowed for a loss in value resulting from perceived buyer resistance. Respondent indicates that, in *Kamanski*, the taxpayers claimed a deduction for a casualty loss to their property resulting from a landslide 250 feet from their property. The landslide did a minor amount of damage to appellants' property, but the market value of their property declined. The Tax Court, and later the Ninth Circuit Court of Appeals, denied the taxpayers' claimed deduction after concluding the major part of the decline in market value was not attributable to physical damage caused by the landslide but to the resistance of buyers to purchasing property in an area suffering a landslide. Respondent argues that because, as in *Kamanski*, the primary drop in value stated in the James' appraisal was attributable to temporary buyer resistance resulting from fear of future fires like the Harris fire, appellants are not entitled to the casualty loss deduction that they have claimed. (Resp. Br., pp. 17-18.)

Respondent also notes that, under IRC section 165, appellants are required to reduce their claimed loss by the amount of insurance proceeds received. Respondent states that, according to their IRS Form 4864 and consistent with State Farm documents, appellants reduced the amount of the loss with respect to this property that was reported on their amended 2007 federal return by insurance proceeds of $60,835. Respondent argues that the claimed loss with regard to the property in the James' report should also be reduced by this amount. (Resp. Br., pp. 18-19.)

Deerhorn Valley Road

Respondent asserts that appellants are now claiming a loss on this property of $1,340,000, which is based on FMV's indicated in the James appraisal of $2,800,000 before the fire and $1,460,000 after the fire. However, respondent states that, according to the Tax Assessor's Office, at least one of the parcels in this property maintained its value after the fire. Respondent states that printouts obtained electronically from that office indicate the smaller parcel (92 acres) of that property increased in value from $228,191 in 2007 to $232,358 in 2008. (Resp. Br., Exhibit AI.)

With regard to the James appraisal, respondent again alleges that appellants provided no documentation dated before the fire regarding the value of the property before the fire or other

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documentation that the property was examined before the fire to determine such a value. Respondent states that several documents from State Farm indicate there was a total policy limit of $975,000 on the property at the time of the fire, with $300,000 of that amount associated with the dwelling and $600,000 as an annual aggregate for business liability. Respondent argues that none of the foregoing insurance limits establishes the value of the land or vegetation on the land at the time of the fire. (Resp. Br., pp. 19-20.)

Respondent states that appellants provided a State Farm statement of loss that shows a loss of $15,345 for trees and shrubs from the fire but that it is not clear whether this loss was for "natural-occurring vegetation." (Resp. Br., p. 20.) Respondent alleges that appellants have not provided any documents showing the extent to which "any of the remaining vegetation was insured or if it was included as part of the personal property portion of the property limit." (Resp. Br., p. 20.) Again, respondent argues the only reliable information that is available is from the Tax Assessor's Office.

Respondent also continues to argue that the James appraisal should be given little or no weight because appellants have not provided any evidence that appellants intended to convert this property into an environmental subdivision. Further, respondent continues to allege that the reason for the reduction in value of the property was buyer resistance attributable to the fire and to argue under *Kamanski* that their claimed casualty loss was not deductible. (Resp. Br., p. 20.)

Finally, respondent notes again that, under IRC section 165, appellants are required to reduce their claimed loss by the amount of any insurance proceeds received. Respondent states that although appellants did not report any insurance reimbursement for this property on their own 2007 return, IRS Form 4684 submitted with their Sutter Uptown partnership return for 2007 is consistent with State Farm documents indicating an insurance payment of $15,345.00 for trees and shrubs and a payment of $8,495.96 for a bridge. Respondent states that while it appears appellants may have received some insurance reimbursement for loss of vegetation on the property, it is uncertain whether such reimbursement was taken into account in their updated claim for loss stated in the James' appraisal. (Resp. Br., pp. 20-21.)

Granite Oaks

Respondent indicates that, under the James appraisal, appellants are claiming a casualty

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loss of $600,000 based on an alleged FMV of $950,000 for the property before the fire and an alleged FMV of $350,000 after the fire. However, respondent states that, according to the Tax Assessor's Office, the property did not decrease in value after the fire. Respondent states that the larger parcel (50 acres) maintained an assessed value of $250,639 while the smaller parcel maintained an assessed value of $134,961, for a total assessed value of $385,600. In addition, respondent states that the Tax Assessor's Office did not report any improvements on the two parcels. Respondent argues that because the James' appraisal was performed well after the fire and there were no other documents indicating a valuation of the property before the fire, the only reliable information that is available is from the Tax Assessor's Office. (Resp. Br., Exhibit A.)

Respondent states that appellants' reliance on the James appraisal presupposes that appellants were in the process of converting the property into a mitigation bank. Respondent indicates that the California Department of Fish and Game (Department) provides the following information about a mitigation bank and the process of forming one: "a mitigation bank is privately or publicly owned land managed for it [sic] natural resource values. In exchange for permanently protecting the land, the bank operator is allowed to sell habitat credits to developers who need to satisfy legal requirements for compensating environmental impacts of developments [sic] projects." (Resp. Br., pp. 21-22 and citation to the website of the Department.) Respondent indicates further that the Department explains on the procedures page of its website that a mitigation bank is: "land protected in perpetuity and managed for its natural resource values. The bank owner sells habitat credits to developers or others who are required to compensate for the environmental impacts of their activities or who wish to fund land conservation efforts." Respondent states that the procedures page continues by identifying steps in the process of developing a mitigation bank, including (1) entering into a legally enforceable Implementing Agreement signed by relevant local agencies as well as the Department, (2) establishing a fee title or conservation easement to protect the mitigation bank, and (3) providing for a long term managing and monitoring of the bank. (Resp. Br., p. 22 and citation to the website of the Department.)

Respondent alleges that appellants provided no documentation of any kind supporting the intent to convert the property at issue into a mitigation bank. In addition, respondent argues that because the James' appraisal was at least partly based on market values before and after the fire, it is likely the

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primary drop in value of the property was attributable to temporary buyer resistance resulting from fear of wild fires like the Harris fire. Citing *Kamanski*, respondent argues that appellants are not entitled to their claimed loss deduction. Finally, respondent indicates that appellants have not provided any insurance or tax documentation indicating there was insurance on this property even though they assert the property had a FMV of $950,000 before the fire. (Resp. Br., pp. 22-23.)

Trudeau Way

Respondent states that, under the James appraisal, appellants are now claiming a loss of $445,000 on property alleged to have a FMV of $930,000 before the fire and a FMV of $485,000 after the fire. Respondent asserts, however, that the records of the Tax Assessor's Office indicate the property increased in value after the fire. Respondent indicates that the land on the three eight-acre parcels increased in value during 2008 and that the land on the fourteen and a half acre parcel retained its value during that year. Respondent states the four parcels as a whole rose in value more than $17,000 after the fire. Respondent also states that the Tax Assessor's Office did not report any improvements on the four parcels. (Resp. Br., Exhibit B.)

Respondent notes that the James appraisal on the property was performed after the fire and that appellants provided no documentation showing that any other appraisal was performed before the fire. Respondent also notes that the James' appraisal on the property was based on highest and best use as residential lots rather than as an environmental subdivision or a mitigation bank. Respondent alleges that appellants have not stated any reason why the loss of vegetation on the property diminishes its value for sale as residential lots. In contrast, respondent restates its position that assessments from the Tax Assessor's Office indicated the property did not lose value from 2007 to 2008. (Resp. Br., pp. 23-24.)

Respondent argues that because the James appraisal was at least partly based on market values before and after the fire, it is likely the primary drop in value of the property was attributable to temporary buyer resistance resulting from fear of wild fires like the Harris fire. Citing *Kamanski*, respondent argues that appellants are not entitled to their claimed loss deduction. In addition, respondent states that appellants have not provided any insurance documents on the property even though they have asserted a FMV of $930,000 for the property before the fire. (Resp. Br., p. 24.)

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Appellants' Reply Brief

At the beginning of their brief, appellants list a number of alleged misstatements in respondent's brief. (App. Reply Br., pp. 1-5.) Appellants assert that although many of the alleged misstatements are collateral to the legal issues involved, they are pointing out each one separately to ensure a correct record. Among the alleged misstatements is respondent's statement that the basis of the property on Sierra Cielo Lane is $1,110,000. Appellants state that the total basis for the property is $668,510.23. They assert that they are claiming a casualty loss only for the portion of the property that consists of the "vegetative lot." (App. Reply Br., no. 5 at p. 2.) Appellants further state that, after bifurcation of the property, the basis applicable to the 40.9 acre vegetated portion is $206,726, while the basis for the 23.89 acres on which their personal residence is located is $461,784.23, for a net basis of $399,903.23 in the personal residence portion after insurance proceeds of $61,881.00 are subtracted. Appellants refer to the Addendum to the revised appraisal of the property at Exhibit A of its brief for a calculation and explanation of the bifurcation. (App. Reply Br., no. 5 at p. 2.)

With regard to the Trudeau Way, Deerhorn Valley Road, and Granite Oaks properties, appellants state that the correct basis for each property, after accounting for insurance proceeds, is as follows: (1) $566,133 for Trudeau Way, (2) $1,167,929 for Deerhorn Valley Road, and (3) $331,447 for Granite Oaks. (App. Reply Br., no. 8. at pp. 2-3.) Appellants also acknowledge that respondent is correct in its view that an insurance reimbursement was properly attributed to Deerhorn Valley Road rather than to Granite Oaks. (App. Br., no. 7 at p. 2.) Appellants state that respondent incorrectly asserted that the amount of the insurance reimbursement to Deerhorn Valley Road was $7,018.45 when the correct amount was $22,363.00. (App. Reply. Br., no. 9 at p. 3.) In addition, appellants state that respondent misstated that State Farm made an insurance reimbursement of $1,045 with respect to the Sierra Cielo Lane property when the correct amount of the reimbursement was $61,881. (App. Reply Br., no. 10 at p. 3.) Further, appellants state there was no insurance on the "natural growing vegetation" described in the O'Brien estimates. (App. Reply Br., no. 18 at p. 4.)

Appellants address respondent's arguments with each of the properties at issue as follows:

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Sierra Cielo Lane

Appellants reiterate that the James appraisal with regard to this property bifurcates and analyzes the effect of the fire and the alleged casualty loss on the "vegetative lot" portion of the property. Referring to Exhibit A of their brief, appellants state that the James appraisal determined that (1) the FMV of the property before the fire was $410,000; (2) the FMV of the property after the fire was $205,000; and (3) the basis of the "vegetative lot" portion of the property was $206,726. Appellants also state that, under Treasury Regulation 1.165-7(b)(1), a casualty loss is equal to the lesser of the adjusted basis of the property and the decline in its FMV that is attributable to the casualty. Appellants conclude that, under Treasury Regulation 1.165-7(b)(1), they may properly take a casualty loss deduction of $205,000, which is the lesser of the adjusted basis ($206,726) and the decline in FMV of the property ($205,000). (App. Reply Br., p. 5.)

Appellants address the valuation of the property by the San Diego County Tax Assessor the "Assessor") by first noting the requirement of Treasury Regulation 1.165-7(a)(2)(i) that the decline in FMV be determined by a "competent appraisal." (App. Reply Br., p. 6.) Appellants also state that IRS Publication 547 suggests the appraiser be reliable and experienced, with knowledge of sales of comparable property, conditions in the area, and familiarity with the property before and after the casualty. In addition, appellants state that IRS Publication 547 indicates the importance of the method the appraiser uses to ascertain the amount of the loss. (App. Reply Br., p. 6.)

Appellants assert that Mr. James, in his appraisal of 72 pages, both analyzed market conditions and the unique landscape and provided photographic evidence and personal reports after visiting the property. They observe that, rather than relying on data in the James' appraisal, respondent relied upon the Assessor's valuation. Citing *Emmet v. Commissioner* (1948) 11 TC 90, and other cases, appellants state that the courts have generally regarded local real estate tax assessments as not determinative for analyzing the FMV of a property. (App. Reply Br., p. 6.)

Appellants argue that respondent's reliance on the Assessor's valuation was inappropriate. Appellants allege that the Assessor has limited staff and data sources and conclude, for that reason, that it is not capable of appraising every property in San Diego County every year. Appellants also allege that the bulk of the Assessor's data is drawn from public records that reveal very

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little about a property other than the reported sales price. Appellants state that such factors as sales concessions, financing terms, the presence of duress in the sale, as well as other special factors, are not included in the public records from which the Assessor draws data. Appellants allege that the workload of the Assessor is so great that it is forced to use unreliable computer modeling to estimate assessed values for the purposes of property taxes. (App. Reply Br., pp. 6-7.)

Appellants also state that Proposition 13 has a constraining effect on the valuation of property because assessed values are limited to mechanical increases of up to, but no more than, two percent a year. Appellants state further that they interviewed D. Painter, Supervising Appraiser I, San Diego County Assessor's office, regarding the valuation method to adjust properties for annual increases. Appellants quote Ms. Painter as stating that "the 2% annual increase is tied to changes in the Consumer Price Index. 2010 was the first time since Prop 13 that it was negative…-0.237%." Appellants allege the method used by the Assessor has no relation to the actual activity of the real estate market and argue the Assessor's valuations are unreliable for any purpose other than the assessment of property taxes. (App. Reply Br., p. 7.)

Appellants state that the Assessor's method of valuation does not meet the requirements of either Treasury Regulation 1.165-7(a)(2)(i) or IRS Publication 547. Therefore, in appellants' view, the Assessor's valuation should not be considered for purposes of determining a casualty loss under IRC section 165(c)(3). Appellants also argue that reliance on the opinions of Ms Spurgeon is misplaced because the opinions do not meet the requirements of either Treasury Regulation 1.165-7(a)(2)(i) or IRS Publication 547. (App. Reply Br., p. 7.)

Appellants argue that Mr. James used the proper valuation method to determine the FMV of the "vegetative lot." Citing the *Estate of D. D. Palmer, Deceased v. Commissioner* (*Palmer*) (1986) 86 T.C. 66, and other cases, appellants state it is well established that the highest and best use of real estate will be analyzed when determining the FMV for tax purposes. Appellants state further that the FMV of the property in the James' appraisal was based on the highest and best use of the property under the following definition of market value described in the appraisal:

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> The value to be estimated in this report is the market value of the subject fee simple estate in its as-is condition as of the dates of appraisement, subject to the Certification and Statement of Limiting Conditions contained in this report. Market value, as used in this report, is drawn from the Uniform Standards of Professional Appraisal Practice, and is defined as "The most probable price which a property should bring in a competitive and open market under all conditions requisite to a fair sale, the buyer and seller, each acting prudently, knowledgeably and assuming the price is not affected by undue stimulus."

(App. Reply Br., p. 8.)

Appellants also state that the California Supreme Court ("Court") in *Sacramento Southern Railroad Company v. Heilbron* (*Heilbron*) (1909) 156 Cal. 408, 409 "defined a fair market value determination as 'the highest price estimated in terms of money which the land would bring if exposed for sale in the open market, with reasonable time allowed in which to find a purchaser, buying with knowledge of all the uses and purposes to which it is adapted *and for which it was capable of being used*.'" (Emphasis added by appellants.) (App. Reply Br., p. 8.)

Appellants assert that it is an implicit assumption of the concept of FMV that the buyer and seller are operating with full knowledge of the current and potential uses of the property. They take the position that it is not a market value sale when one party is ignorant of all the uses and purposes to which the property is adapted and for which it is capable of being used, and buys and sells in ignorance of the true highest and best use of the property. Appellants argue that, as a result, "it is inappropriate in a market value appraisal to add such a consideration to the analysis." (App. Reply Br., p. 9.)

Appellants states that the James appraisal provides that the "vegetative lot" was heavily vegetated with oak trees and other vegetation, some of which was over 100 years old. It also indicates that the property had many other types of vegetation valued highly as natural habitat for endangered and otherwise protected species. Appellants state that the property was located in the Multiple Species Conservation Plan "(MSCP)" district, which was designated for the protection of the foregoing specific plant types. Appellants indicate that, for those reasons, the value of the property before the Harris fire was based on its use as an environmental subdivision. (App. Reply Br., p.9.)

Appellants state that, to determine the value of the property before the fire, "the property was compared to sales of similar properties with the same highest and best use." (App. Reply Br., p. 9.) Appellants allege the fire destroyed most of the vegetation and habitat, with the result that the property

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became unsuitable for use as an environmental subdivision. They indicate that, after the fire, the property "was compared to sales of residential properties without the potential to become an environmental subdivision." (App. Reply Br., p. 9.)

In response to the argument that they have not provided documentation to establish the FMV of the property before the fire because the James appraisal was completed in 2010 while the fire occurred in 2007, appellants state that the appraisal contains photographic evidence and sales data for the period before the fire "for this exact purpose of establishing the value." (App. Reply Br., p. 9.) Appellants argue that it is not necessary for an appraisal be conducted before a casualty but, rather, that it is only necessary that the taxpayers provide an explanation of the value of property before the casualty, as they have allegedly done. (App. Reply Br., p. 9.)

Appellants also argue that, despite statements by respondent, it is irrelevant for purposes of determining the highest and best use of the property whether they actually designated the property as an environmental subdivision. Appellants take the position that the real issue is whether a potential buyer could designate the property as an environmental subdivision. Appellants state that, for purposes of establishing the value of the property before the fire, the James appraisal took into consideration (1) the location of the property in a MSCP district, (2) the quality and amount of the vegetation existing on the property, (3) the costs of achieving designation as an environmental subdivision, and (4) the demand for such properties. Appellants state that Mr. Gary Piro, a registered engineer with experience in forming environmental subdivisions, provided Mr. James with a report stating that, in Mr. Piro's opinion, the property would have qualified as an environmental subdivision in all respects. (App. Br., Exhibit G (the "Piro Report").) Appellants allege that, in view of the information available to him, Mr. James concluded in his report that "a knowledgeable buyer, aware of the [property's] potential to be designated as an environmental subdivision, and the cost to achieve such designation, would recognize the significant profit such a designation would bring to the property." (App. Reply Br., p. 10.)

With regard to the application of the "buyer's resistance" theory and the result in *Kamanski* to the property at issue, appellants argue the facts in the instant matter are distinguishable from those in *Kamanski*. Appellants state that while in *Kamanski* the value of the property under consideration decreased as a result of a buyer's resistance to purchase in an area that experienced a

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landslide, the property at issue in the instant matter decreased as a direct result of the casualty's impact on the property. Appellants argue that the destruction of the vegetation on their own property by the fire disqualified it for use as an environmental subdivision and resulted in a new highest and best use of the property as residential property. Appellants state that "[t]he [James appraisal] compared the value of the [property] before the Harris Fire to sales of land similarly qualified for use as an environmental subdivision. The [James appraisal] then valued the [property] after the Harris Fire by comparing it to sales of residential properties with the new similar highest and best use of residential. The [James appraisal] analyzed sales from the period around each valuation date." (App. Reply Br., p. 10.) Appellants allege the issue of "buyer's resistance" was not a factor in valuing the property.

Deerhorn Valley Road

Appellants indicate that they own this property as a result of being partners in Sutter Uptown. Referring to Exhibit E of their reply brief, they state that they have a basis in the property of $1,190,292. Appellants state further that Mr. James in his appraisal analyzed the property and determined its FMV before the fire was $2,800,000 while the FMV of the property after the fire was $1,460,000. Appellants note again that, as a result of the fire, they received an insurance reimbursement of $22,363 and state that the reimbursement generated a revised adjusted basis for the property of $1,167,929. Applying Regulation 1.165-7(b)(1), appellants argue that they may properly take a deduction for the casualty loss of $1,167,929, the lesser of the adjusted basis of the property ($1,167,929) and the decline in its FMV ($1,340,000). (App. Reply Br., p. 11.)

Appellants indicate that the James appraisal concluded that the highest and best use of the property before the fire was as an environmental subdivision. Their discussion of the contents of the James appraisal of the property, and the relative merits of that appraisal and the valuation by the Assessor, are in no material way different from their discussion of those matters associated with the property on Sierra Cielo Lane. For essentially the same reasons stated in their discussion of alleged "buyer's resistance" with regard to the latter property, appellants deny that "buyer's resistance" was a consideration in the James appraisal of the Deerhorn Valley Road property. (App. Reply Br., pp. 11-12.)

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Granite Oaks

Appellants state that they have a basis of $331,447 in the Granite Oaks property. Appellants indicate that Mr. James analyzed the Granite Oaks property in his appraisal and determined that the FMV of the property before the fire was $950,000 and the FMV of the property after the fire was $350,000. Applying Treasurry Regulation 1.165-7(b)(1), appellants argue that they may properly take a deduction for the casualty loss in the amount of $331,447, the lesser of the difference between the adjusted basis ($331,447) and the decline in FMV ($600,000). (App. Reply Br., pp. 13-14.)

Appellants indicate the James appraisal concluded that the highest and best use of the property before the fire was as a mitigation bank. The only material difference between appellants' discussion of the contents of the James appraisal of the property, and the relative merits of that appraisal and the valuation by the Assessor, and their discussions of those matters associated with the properties on Sierra Cielo Lane and Deerhorn Valley Road, respectively, is Mr. James determination that the highest and best use of the property at issue before the fire was as a mitigation bank rather than as an environmental subdivision. For essentially the same reasons stated with regard to the properties on Sierra Cielo Lane and Deerhorn Valley Road, appellants deny that "buyer's resistance" was a consideration in the James appraisal of the Granite Oaks property. (App. Reply Br., pp. 14-15.)

Trudeau Way

Appellants indicate that the basis of the Trudeau Way property was $566,133. Appellants state that Mr. James analyzed the property and determined its FMV before the fire was $930,000 and its FMV after the fire was $485,000. Applying Regulation 1.165-7(b)(1), appellants argue that they may properly take a deduction for the casualty loss in the amount of $445,000, the lesser of the adjusted basis of the property ($566,133) and the decline in its FMV ($445,000). (App. Reply Br., pp. 15-16.)

Appellants state that the value of the Trudeau Way property before the fire was based on its highest and best use as "vegetated residential lot." (App. Reply Br., p. 17.) Appellants further state that, to determine the value of the property before the fire, "it was compared to sales of similar properties with the same highest and best use." (App. Reply Br., p. 17.) Appellants assert that because the fire destroyed the vegetation and habitat on the property, the value of the property after the fire "was

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compared to sales of similar residential properties which had lost their vegetation to the Harris Fire or did not have such vegetation before the Harris Fire." (App. Reply Br., p. 17.)

Appellants' discussion of the other issues considered with respect to the three properties above is essentially the same as the discussions there. However, appellants state that respondent argued that because the Trudeau Way property was not eligible for use before the fire as a mitigation bank or environmental subdivision, it could not sustain the applicable casualty loss. Citing *Hesler v. Commissioner*, T.C. Memo 1954-176, *Lindley v. Commissioner*, 1952 T. C. Memo LEXIS 256, and other cases, appellants assert that the courts have continuously held that damage to trees, shrubbery, and other vegetation is a deductible casualty loss under IRC section 165. (App. Reply Br., pp. 17-18.)

Applicable Law

Revenue and Taxation Code section 17201, subdivision (a), incorporates by reference IRC section 165, except as otherwise provided. IRC section 165(a) provides that there shall be allowed as a deduction any loss sustained during the taxable year and not compensated for by insurance or otherwise. IRC section 165(c) states that, in the case of an individual, the deduction under IRC section 165(a) shall be limited to (except as provided in IRC section 165(h)) losses of property not connected with a trade or business or a transaction entered into for profit, if such losses arise from theft or from fire, storm, shipwreck, or other casualty.

It is well settled that deductions are a matter of legislative grace and that the taxpayer bears the burden of establishing his entitlement to the claimed deductions. (*Appeal of Robert R. Telles*, 86-SBE-061, Mar. 4, 1986.) To carry that burden, the taxpayer must point to a statute and show by credible evidence that he comes within its terms. Unsubstantiated assertions by the taxpayer are not sufficient to carry the burden of proof. (*Appeal of Robert R. Telles*, *supra*.)

Regulation 1.165-7(a)(2) provides as follows:

> *(2) Method of Valuation*. (i) In determining the amount of loss deductible under this section, the fair market value of the property immediately before and immediately after the casualty shall generally be ascertained by competent appraisal. This appraisal must recognize the effects of any general market decline affecting undamaged as well as damaged property which may occur simultaneously with the casualty, in order that any deduction under this section shall be limited to the actual loss resulting from damage to the property.

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ii) The cost of repairs to the property damaged is acceptable as evidence of the loss of value if the taxpayer shows that (a) the repairs are necessary to restore the property to its condition immediately before the casualty, (b) the amount spent for such repairs is not excessive, (c) the repairs do not care [sic] for more than the damage suffered, and (d) the value of the property after the repairs does not as a result of the repairs exceed the value of the property immediately before the casualty.

Regulation 1.165-7(b)(1) provides as follows:

(b) Amount Deductible. *(1) General rule*. In the case of any casualty loss whether or not incurred in a trade or business or in any transaction entered into the profit, the amount of loss to be taken into account for purposes of section 165(a) shall be the lesser of either –

(i) The amount which is equal to the fair market value of the property immediately before the casualty reduced by the fair market value of the property immediately after the casualty; or

(ii) The amount of the adjusted basis prescribed in § 1.1011-1 for determining the loss from the sale or other disposition of the property involved. However, if property used in a trade or business or held for the production of income is totally destroyed by casualty, and if the fair market value of such property immediately before the casualty is less than the adjusted basis of such property, the amount of the adjusted basis of such property shall be treated as the amount of the loss for purposes of section 165(a).

STAFF COMMENTS

In the view of staff, appellants' quotation from the James appraisal of the Sierra Cielo Lane property, allegedly with respect to the role of the highest and best use of property in determining FMV (App. Reply Br., p. 8), may not completely reflect the state of the law regarding that issue. Staff notes that *Palmer*, a case cited by appellants in the same context, contains the following quotation from a publication of the American Institute of Real Estate Appraisers that discusses the highest and best use of land:

HIGHEST AND BEST USE

Fundamental to the concept of value is the theory of highest, best, and most profitable use. Land is valued as if vacant and available for its highest and best use. Highest and best use for the land is *the use that, at the time of appraisal, is the most profitable likely use*. It is the use that will provide the greatest return to the land after the requirements of labor, capital, and coordination have been satisfied. Thus it may also be defined as *the available use and program of future utilization that produces the highest present land value*. (Emphasis added.)

(*Estate of D. D. Palmer, Deceased v. Commissioner, supra*, 86 T.C. at p. 74.)

The Tax Court has subsequently stated that "[i]n determining the highest and best use, and in turn the fair market value of property, 'the realistic, objective potential uses' of the property

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control." (*Frazee v. Commissioner* (*Frazee*) (1992) 98 T.C. 554, 563 (quoting *Stanley Works v. Commissioner* (1986) 87 T.C. 389, 400.) The Tax Court in *Frazee* explains that "the highest and best use of property is the 'reasonable and probable use that supports the highest present value.'" (*Frazee v. Commissioner*, *supra* (quoting *Symington v. Commissioner* (1986) 87 T.C. 892, 897).) The Tax Court further explains that "[t]o determine what uses are reasonable and probable, we focus on 'the highest and most profitable use of the property for which the property is adaptable and needed or likely to be needed in the reasonably near future.'" (*Frazee v. Commissioner*, *supra* (quoting *Olson v. Commissioner* (1934) 292 U.S. 246, 255).)

At the hearing, the parties should be prepared to discuss the applicability of *Frazee* to the facts of the instant matter as well as its relationship to *Palmer*, *Heilbron*, and other cases cited by appellants. In that regard, the parties should be prepared to discuss whether appellants have shown that each of the Sierra Cielo Lane, Deerhorn Valley Road, and Granite Oaks properties was, at the time of the fire, "likely to be needed in the reasonably near future" as an environmental subdivision or a mitigation bank. In addition, the James appraisals seem to indicate that none of the properties allegedly comparable to the foregoing properties was in use as either an environmental subdivision or a mitigation bank at the time of the appraisals. Appellants should be prepared to discuss whether those allegedly comparable properties were in use for either of those purposes at the time of the fire or subsequently have been placed in such use. If any of those allegedly comparable properties has not ever been placed in use as an environmental subdivision or a mitigation bank, the parties should be prepared to discuss (1) why that property was, at the time of the fire, "likely to be needed in the reasonably near future" as an environmental subdivision or a mitigation bank, (2) whether that property is otherwise suitable as a comparable property, and (3) whether, if otherwise suitable, a discount should be applied to the valuation in the James appraisal of that property and how such a discount would be calculated.

As indicated above, respondent has stated that "[a]ppellants are entitled to a casualty loss in an amount which is the lesser of the decrease in fair market value due to the casualty or the cost of repairs." (Resp. Br., p. 1; see also Resp. Br., pp. 13-14.) Respondent should be prepared to clarify at the hearing whether its statement is consistent with the method of calculating the amount of a casualty loss stated in Treasury Regulation 1.165-7(b)(1) (the lesser of the decline in FMV of the property attributable

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to the casualty and the adjusted basis of the property). If the two methods are not consistent, respondent should be prepared to discuss, with appropriate citation to authority, why the method of calculating that amount stated in its brief is the correct method, rather than the method stated in Treasury Regulation 1.165-7(b)(1), to be applied here. The parties should also be prepared to discuss the practical consequences under the facts of this matter of adopting respondent's method rather than the method stated in Treasury Regulation 1.165-7(b)(1).

For ease of reference, staff has summarized in the following tables (1) the calculation of the casualty loss for each property claimed on IRS Form 4684 of the amended 2007 federal partnership return of Sutter Uptown (see p. 2 and fn. 4 on p. 3 of this Hearing Summary (HS)), (2) respondent's statement regarding the unrevised James appraisals, with the claimed casualty loss for each property calculated under the method stated in its brief (see p. 9 of the HS), and (3) appellants' current calculation, after taking into account its own revisions and concessions, of the claimed casualty loss with respect to each of the properties (see pp. 17-23 of the HS):

IRS Form 4684 of Amended 2007 Federal Partnership Return					
Property	**Value on October 27, 2007 (Prior to Harris Fire)**	**Value on October 28, 2007 (After the Harris Fire)**	**Reduction in Value**	**Adjusted Basis of Property**	**Loss Attributable to the Harris Fire**
Sierra Cielo Lane	$994,300	$812,500	$181,800	$600,000	$120,965 ($181,800 - insurance reimbursement of $60,835)
Deerhorn Valley Road	$5,893,800	$1,080,000	$4,813,800	$1,310,000	$1,310,000
Granite Oaks	$2,659,400	$435,000	$2,224,400	$335,000	$335,000
Trudeau Way	$1,281,450	$225,000	$1,056,450	$550,000	$550,000

Respondent's Statement Regarding James Appraisals			
Property	**Value on October 27, 2007 (Prior to the Harris Fire)**	**Value on October 28, 2007 (After the Harris Fire)**	**Loss Attributable to the Harris Fire**
Sierra Cielo Lane	$350,000	$175,000	$175,000
Deerhorn Valley Road	$2,800,000	$1,460,000	$1,340,000
Granite Oaks	$950,000	$350,000	$600,000
Trudeau Way	$930,000	$485,000	$445,000

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Appellants' Current Calculation of Loss Attributable to the Harris Fire					
Property	**Value on October 27, 2007** (Prior to the Harris Fire)	**Value on October 28, 2007** (After the Harris Fire)	**Reduction in Value**	**Adjusted Basis of Property**	**Loss Attributable to the Harris Fire**
Sierra Cielo Lane	$410,000	$205,000	$205,000	$206,726	$205,000
Deerhorn Valley Road	$2,800,000	$1,460,000	$1,340,000	$1,167,929[7] ($1,190,292 – insurance reimbursement of $22,363)	$1,167,9299,000
Granite Oaks	$950,000	$350,000	$600,000	$331,447	$331,447
Trudeau Way	$930,000	$485,000	$445,000	$566,133	$445,000

Appellants should provide any documentation, including but not limited to revenue agent's reports, indicating the position taken by the IRS regarding the calculation of the amount of casualty loss reported on appellants' 2007 federal return. Each party should also provide any additional documentation that it believes will assist the Board in making a correct determination in this matter. Documentation should be sent, with a copy to the other party, 14 days or more, if possible, from the date of the hearing to the following:

Claudia Madrigal, Appeals Analyst
Board Proceedings Division
State Board of Equalization
P.O. Box 942879, MIC: 80
Sacramento, CA 94279-0080

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[7] Appellants should provide at the hearing authority for the proposition that insurance proceeds are used in the determination of adjusted basis for purposes of calculating the amount of a casualty loss.

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