

## **TAX COURT CASE UPDATE**

### **Citation:**

*Palmer Ranch Holdings, Ltd. v. Commissioner*, T.C. Memo 2014-79, May 6, 2014.

### **Overview:**

The Tax Court has concluded that there was a reasonable probability that property on which the taxpayer had contributed a conservation easement could have been successfully rezoned. Therefore, the highest and best use of the property for purposes of valuing the charitable contribution deduction was development for multi-family dwellings. The court analyzed and rejected a number of IRS arguments as to why such a rezoning would likely be prohibited. This conclusion operated to allow a deduction in an amount greater than the IRS permitted, but other factors reduced the deduction from the even higher level claimed by the taxpayer.

### **The Facts:**

Palmer Ranch Holdings Ltd. (“Palmer Ranch”) was 98 percent owned by Hugh Culverhouse, with his wholly owned corporation, Palmer Ranch Holdings Inc., owning the remainder. Palmer Ranch owned two parcels of land: Parcel B-9 and Parcel B-10. Parcel B-10 was an irregularly shaped, undeveloped parcel of land consisting of 82.19 acres. Its general topography included upland developable acreage and wetlands, natural or man-made ponds, pinewood flats, and mesic hammocks. There was a bald eagle nest on the eastern portion of Parcel B-10. In 1991, the Board of County Commissioners (“BOCC”) approved a proposed wildlife corridor system for the east side of the taxpayer's property (of which Parcels B-9 and B-10 were a part) that was intended to provide open space for an eagle flyway and a habitat for small urban animals.

Mr. Culverhouse encumbered Parcel B-10 with a conservation easement and donated the easement to Sarasota County, Florida. Palmer Ranch claimed a \$23,942,500 charitable contribution deduction on its 2006 return, based on a valuation supported by both a licensed appraiser and a land planning and engineering firm. On audit, the IRS challenged the amount of the deduction, disallowing \$16,965,000.

### **Discussion:**

In determining the highest and best use of the property in valuing Parcel B-10, the appraiser argued that it was reasonably probable that 360 multi-family dwelling units could have been developed on Parcel B-10. He assumed that a rezoning of the property to allow two to five units per acre, as found in Sarasota County's comprehensive plan, was reasonably probable.

On the other hand, the IRS contended that the existing zoning designation allowing one unit per two acres reflected Parcel B-10's highest and best use, and that anything exceeding that designation was speculative. Further, it claimed that a zoning change for Parcel B-10 was not reasonably probable because of: (1) a failed rezoning history; (2) environmental concerns; (3) limited access to outside roads; and (4) neighborhood opposition.

### **Conclusion:**

The Tax Court found that there was a reasonable probability that Parcel B-10 could have been successfully rezoned to allow for the development of multi-family dwellings. Accordingly, the highest and best use of the property for valuation purposes was development for multi-family dwellings. However, the court also found that Palmer Ranch's "before" valuation was too high because there was a softening in the real estate market around the valuation date. It concluded that the conservation easement's fair market value was \$19,955,014.

The Tax Court reasoned that even though the county comprehensive plan established a two to five units per acre zone designation in the future land use map for Parcel B-10 which indicated that such a rezoning was legally permissible, it still had to be shown that the BOCC would have approved rezoning Parcel B-10. The court found that the prior rezoning history did not eliminate the reasonable probability of a successful rezoning. The BOCC's June 2004 denial of the former owner's rezoning and development plan that included both Parcels B-9 and B-10 related only to a portion of Parcel B-10 that did not include the eagle nest zone. Looking at that denial and the BOCC's later July 2004 denial of an amended rezoning and development plan for Parcel B-9 only, the court believed that the BOCC was concerned that the development application did not consider the nearby eagle nest zone, wetlands, and wildlife corridor. The court reasoned that the closeness of the BOCC's vote suggested that its decision could have changed over time, especially when a later application protected the eagle nest zone, the wetlands, and the wildlife corridor.

An ordinance stated that one of the necessary changes for a favorable determination would be that the developer should endeavor to keep Parcel B-10 intact as it related to the eagle preservation area, the wetlands, and the wildlife corridor. The court rejected the IRS's contention that the ordinance required that the land must not be developed. Rather, the court found that the ordinance required that the developer needed to amend the application to include Parcel B-10 and keep it "intact" as it related to the eagle nest zone, the wetlands, and the wildlife corridor. The court accepted the Palmer Ranch's interpretation that moderate development was allowed so long as the development did not encroach on the concerned lands.

The court rejected the IRS's contention that it was not reasonably probable that a developer could have built multi-family dwelling units on Parcel B-10 because the land did not abut either an arterial or connector road. Sarasota County required that residential developments of 100 dwelling units or more must have two fully functional access points unless the county engineer or the BOCC grants a variance. The Tax Court, noting that Sarasota County's land development regulations sought to maintain neighborhood interconnectivity, dismissed the IRS's argument based on the assumption that opposition from a neighborhood adjacent to Parcel B-10 would preclude access through an existing road. The court also noted that access through Parcel B-9 (by way of an easement) would have presented few difficulties because Palmer Ranch also owned that property.

The court found that the potential for neighborhood opposition did not bar the reasonable probability of a successful rezoning. While there was opposition to the former owner's 2004 development plan, the court pointed out that the 2004 plan involved different land segments, and not, as here, Parcel B-10 alone in its entirety. Further, the court was not willing to accept the multiple assumptions needed to make neighborhood opposition a factor: (a) that there would

be neighborhood opposition to such development; (b) that such opposition would be strong enough to have an effect; and (c) that BOCC would be swayed by such opposition.

While accepting that multi-family dwelling units could have been developed on Parcel B-10, the court found that the "before value" in the "before and after" computation of the encumbrance's valuation was too high. The taxpayer's appraiser stated that the real estate market peaked in late 2005. There was a softening in demand, but no notable nose dive or decrease in value in 2006. The court reasoned that even if property values did not decline in 2006, it was likely that they stagnated. Accordingly, the court found that a steady appreciation factor should not have been applied to Parcel B-10 for the months after the market hit its peak in 2005.