



Tax Implications of Selling an Agricultural Conservation Easement

BACKGROUND

As of June 2006, 27 states have authorized state-level purchase of agricultural conservation easement (PACE) programs (also known as purchase of development rights programs). In addition, at least 55 independently funded PACE programs in 18 states have acquired funding and/or easements.

PACE programs compensate landowners for restricting activities that threaten future agricultural use. PACE programs provide an alternative to development and enable landowners to free up capital while keeping land available for agriculture. Proceeds from the sale of easements may be reinvested in the operation, used to reduce debt and/or plan for retirement. Finally, by limiting future development, PACE programs help make farmland affordable for beginning farmers and can be used to facilitate farm transfers within families.

ISSUES AND OPTIONS

Agricultural conservation easements are substantial conveyances of real estate interests and should be undertaken with careful thought and planning. When contemplating the sale of an agricultural easement, there are four main issues and questions to consider:

1. Land planning – How does the easement-restricted land relate to the agricultural operation or other agricultural land that is owned or operated?
2. Business planning – Will the easement provide the flexibility needed to adapt to changing business conditions?
3. Financial planning – Will the sale or other conveyance of an easement affect taxes and other finances?
4. Estate planning – Is the easement transaction integrated with other estate planning and transfer efforts?

Participants may receive an initial down payment for a portion of the easement's appraised value. The balance is received at the closing in exchange for surrendering the non-agricultural development potential of their property.

An easement is considered a capital asset, and so when it is sold, it is treated as a capital gain to the extent that the proceeds exceed the basis in the property. IRS Revenue Ruling 77-414 allows a taxpayer to apply the proceeds from the sale of a conservation easement first directly to reduce the taxpayer's basis in the property (rather than apportioning it between the easement and the property subject to the easement) under circumstances when it would be impractical or impossible to apportion basis in such sales. For example, if an agricultural landowner sells an easement for \$1,000 and his basis in the property is \$100, he would owe federal and state capital gains tax on \$900. Federal capital gains tax rates on assets held for at least one year were reduced in 2003 to

15 percent for higher-bracket taxpayers and to 5 percent for lower bracket taxpayers. Many states also impose capital gains taxes.

BENEFITS

- Selling an agricultural conservation easement can generate cash for retirement or life insurance, or provide liquid assets that can be given to heirs—even those who do not wish to farm.
- Selling an agricultural conservation easement can help facilitate intergenerational farm transfer by reducing future market value to agricultural or restricted land value.
- Considering the sale of an easement can serve as a catalyst for landowners to develop an estate plan.

DRAWBACKS

- Selling an easement is considered the sale of a capital asset and is treated as capital gain to the extent that the proceeds exceed the basis in the property.
- While cost-share payments are excluded from income under Section 126 of the Internal Revenue Code, this provision does not apply to easement payments as set forth in a tax court decision.¹

For additional information, contact American Farmland Trust at (800) 370-4879 or visit www.farmland.org or the Farmland Information Center Web site at www.farmlandinfo.org.

¹ (C. Graves, 88 Tax Court Decision # 43617)