

1031 Developments-Easement & Other

There have been a number of recent developments, which are of some interest to taxpayers. Those involve exchanges of conservation easements, water rights, timber rights and wetland mitigation credits.

With regard to conservation easements, some conservation groups and state agencies are now offering to purchase conservation easements on ranch, farm and other land. These offerings are especially attractive to landowners who can grant the easement on unproductive land, generating cash to acquire more productive property to enhance their ranching or farming operations. The Internal Revenue Service (IRS) issued letter ruling No. 9621012 on February 16, 1996. The IRS determined that a perpetual scenic conservation easement on ranch land was "like kind" with timberland, farmland and ranch land. In that instance, the state in which the property was located recognized the scenic conservation easement as a real property right and, therefore it was "like kind" with other real property interest.

Keep in mind that letter rulings are specific to the situation addressed in the request for letter ruling and are not binding in other situations. Even though the letter ruling is not controlling with regard to other transactions, but may be a good indication of how the IRS may look at a similar situation involving the exchange of a conservation easement for other land held for investment purposes or productive use in the trade or business.

In Letter Ruling No. 9612009, which was issued December 18, 1995, the IRS determined that mitigation credits for restoring wetland property could be exchanged utilizing Section 1031 for other mitigation credits.

Water rights are another potential basis for exchange. In many states, water rights are treated as real property interests. Increasingly, ranchers and farmers have conveyed or leased water rights and that trend will probably increase. In those states where water rights are classified as real property interests, the conveyance or long term leasing of water rights could be utilized for the purposes of effecting a 1031 exchange into other "like kind" investment or income producing property.

With regard to timber rights, there have been an increasing number of farmers and ranchers who own timber property and entered into timber sale contracts with various logging companies. They have attempted to use those sale proceeds to acquire properties in a Section 1031 exchange. Unfortunately, the Internal Revenue Service has relied upon a 1953 tax court case, known as the Oregon Lumber Company Case, in disallowing those transactions as exchanges. In TAM No. 9525002, the IRS disallowed the sale of timber as part of a Section 1031 exchange.

However, timber rights, much like water rights or mineral rights, are classified as real property interests in many states. Properly structured, the conveyance of timber rights should be the basis for an exchange into other "like kind" property. Use of real estate professionals who know how to structure these exchanges can result in an exchange acceptable to the IRS or at least the Tax Court.