Table 8 of the summary report shows these changes in land cover/use between 1992 and 1997. Read it horizontally to see how a land use was distributed at the end of the reporting period. Read vertically to determine where that land use came from, in terms of 1992 land uses. For example, to determine how much agricultural land was developed between 1992 and 1997, read down the “Developed Land” column. You will see 4,257,100 acres of crop; 17,900 acres of CRP; 2,992,500 acres of pasture and 1,689,900 acres of range were converted to development over five years. To calculate net changes, subtract the total acres reported at the beginning of the reporting period (last column) from the total acres reported at the end of the reporting period (last row). Between 1992 and 1997, Table 8 shows that developed land increased by 15,966,000 acres.

GOOD DEALS
LIKE-KIND EXCHANGE: LEVERAGING CAPITAL GAINS TOWARD FARMLAND PROTECTION

Farmers Steve and Kathy Melnik are no strangers to farmland protection. The Deerfield, Mass. dairy farmers have placed 430 acres of prime river-valley cropland under the state’s Agricultural Preservation Restriction Program. Now, with the assistance of American Farmland Trust and aided by a section of the Internal Revenue Code that defers taxes on the sale of development rights, they will protect another 143 acres.

For 14 years, the Melniks had leased 90 neighboring acres, known as the Peffer Farm, with a right of first refusal, from three elderly sisters who were now ready to sell the fertile riverbottom land. To raise the cash, Steve Melnik decided to sell development rights—worth approximately $290,000—on an additional 55 acres of his own land. Under IRC Section 1031, Melnik can defer paying capital gains on that sale if he applies the entire amount toward a “like-kind exchange” of property. This type of exchange requires a “qualified intermediary,” to acquire the second property and swap it for the development rights.

Enter American Farmland Trust. AFT purchased the Peffer farm, placed an agricultural preservation restriction on it, and exchanged the protected farmland for the APR on Melnik’s land. AFT will recover its costs when it sells the development rights on both parcels to the state program. It’s a win-win situation: the Melniks apply what would have been a considerable tax bill to new land, the land is protected, and the deal closes quickly.

While not a new provision, §1031 has only been applied to conservation easements since a 1992 IRS ruling determined that such easements are property interests. The law allows exchange of business or investment property for property that is of a like kind, without recognizing financial loss or gain. Thus, a farmer who wants to expand operations—or invest in other business ventures—can use the proceeds from the sale of a conservation easement to buy more farmland or other real estate. Personal property, such as first or second homes or recreational lands, does not qualify, but a non-agricultural business does. In the Melniks’ case, the newly acquired 100 acres includes an 1864, 14-room, Victorian house which they intend to turn into a bed and breakfast operation.

According to Tim Storrow, land protection program manager for AFT, this is a little known option that more landowners could employ. For the Melniks, “They were able to leverage their development rights into land they might otherwise have lost,” says Storrow. And, as the adage goes, a tax deferred is a tax avoided.

So why hasn’t this provision been used more frequently? Not all farmers are looking to expand their operations, or they need the cash for other purposes. In some cases, it may be advantageous to pay capital gains taxes on the first property and establish a higher base for the new property. But in many cases, says AFT’s General Counsel Simon Sidamon-Eristoff, people simply may not have known about this option. “People may not think of easements as property interests that can be used in a like-kind exchange,” he says, “but they are interest in real estate. They certainly qualify.”

Steve Melnik is pleased. “We all had a goal that we wanted to preserve 90 acres of good fertile land. We put our minds together, the figures worked out, it was affordable, and it’s a benefit to everybody.” He pauses, then adds, “It’s something to say you’re going to preserve land, to really go and do it and sign your name to the bottom line, to know this land is going to be farmed for my generation and generations after You feel a lot better afterwards.”
Lancaster County, PA Agricultural Preserve Board Obtains Ruling from IRS on Innovative Use of Easement Payments

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The Agricultural Preserve Board of Lancaster, PA has received a favorable ruling from the Internal Revenue Service for the use of an easement payment in a tax-deferred, like-kind exchange under Section 1031 of the Internal Revenue Code. This means that a landowner, instead of receiving a cash payment for an easement, can use a "qualified intermediary" (such as an attorney) to put the easement money toward purchasing real estate. The real estate purchased can be additional farmland or other "like-kind" real estate for business, trade, or investment purposes, such as an apartment building or even a shopping center.

Capital gains taxes that would normally be due on the sale of an easement are deferred under a like-kind exchange until the acquired property is sold. If the farm owner holds the replacement property at death, his heirs receive a "stepped up basis" in the farm and the gains tax which has been deferred as a result of
the exchange is avoided entirely. But estate taxes may still apply.

This ruling will be especially helpful to landowners who have owned their farms for many years and little "basis" left in the farm and so would face a sizeable tax bill if they sold an easement to preserve their farms. Through a like-kind exchange, a long-time landowner could acquire additional farmland for a family member or else purchase an investment property which would provide a nestegg for retirement.

Two landowners in Lancaster County have used the easement payment in a like-kind exchange to purchase additional farmland. Another landowner used the easement payment to acquire a rental property. Like-kind exchanges with easement payments have also been completed in Chester, Montgomery, Berks, York, and Cumberland Counties.

Preservation organizations in other states should be careful to make sure that their state's statutes define a conservation easement as an interest in real property. A further caveat is that a private letter ruling cannot be cited as precedent by another individual or group. A letter ruling, however, does indicate how the IRS is likely to view similar situations.

Finally, a successful tax-deferred exchange can be accomplished only with careful legal documentation and adherence to IRS regulations. The assistance of an attorney trained in like-kind exchanges is essential.