

# Private Letter Ruling 9232030, 5/12/1992, IRC Sec(s). 1031

UIL No. 1031.00-00; 1031.03-00

## Headnote:

*Reference(s)*: Code Sec. 1031;

EXCHANGE OF AGRICULTURAL CONSERVATION EASEMENT FOR OTHER REAL PROPERTY QUALIFIES.

A state wishes to acquire an agricultural conservation easement in perpetuity on farm property. The owners of the farm hold the property for productive use in the trade or business of farming. An agricultural conservation easement is defined by a state statute as an interest in land, less than fee simple, which interest represents the right to prevent development or improvement of the land for any purpose other than agricultural production. Such an easement may be granted for a term of 25 years or in perpetuity, as the equivalent covenants running with the land. The owners of the property wish to convey the agricultural conservation easement to a state board and a county board in exchange for property of like-kind in an exchange that will qualify for nonrecognition of gain under section 1031.

The owners of the property have entered into an agreement for the sale and purchase of the agricultural conservation easement to the state and county jointly in perpetuity. The state's legal counsel has opined that neither the state nor the county can be a signatory to an agreement to acquire exchange property to be used in a tax-deferred exchange. Accordingly, the owners have entered into an exchange agreement with a lawyer to act as an intermediary to accomplish the exchange. Under the terms of the exchange agreement, the intermediary has entered into an assignable agreement to acquire acceptable exchange property to be acquired in fee and, at a simultaneous closing on the contract, will convey or cause to be conveyed the replacement property to the owners of the farm property in exchange for the agricultural conservation easement. The state and county will remit payment for the easement to the intermediary, who will disburse funds to the owner of the replacement property.

The Service has ruled that the agricultural conservation easement on the farm qualifies as like-kind with a fee simple interest in replacement real property. Further, the Service ruled, an exchange of the agricultural conservation easement on the farm for a fee simple interest in real property using a qualified intermediary will qualify for nonrecognition of gain under section 1031(a). Gain, if any, the Service added, will be recognized in an amount not in excess of cash or other property received by the owners in addition to the replacement property. In reaching its conclusions, the Service noted that the agricultural conservation easement in perpetuity is an interest in real property by virtue of state law.

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## **Full Text:**

Date: May 12, 1992

CC:IT&A:05 – TR-31-563-92

In re: \*\*\*

Dear \*\*\*

This is in reply to a letter dated March 17, 1992, submitted by you on behalf of Taxpayers requesting rulings under section 1031 of the Internal Revenue Code.

Taxpayers represent that they own a 170.8315 acre farm in fee simple absolute ("Farm"). The Farm is located in Town in County and State. Taxpayers hold The Farm for productive use in the trade or business of farming. State through its State Board, as cograntee with the County Board ("Grantees"), wish to acquire an agricultural conservation easement in perpetuity on The Farm.

An agricultural conservation easement is defined in section 903 of The Act as an interest in land, less than fee simple, which interest represents the right to prevent the development or improvement of the land for any purpose other than agricultural production. Such easement may be granted for a term of 25 years or in perpetuity, as the equivalent of covenants running with the land.

Section 914.1 of The Act provides that the State Board shall administer a program for the purchase of agricultural conservation easements by the State. This section also permits a county governing body to authorize a program to be administered by the county for purchasing agricultural conservation easements from landowners. Purchase of agricultural easements by the County Board furthers the State's policy set forth at section 902 of The Act of conserving and protecting and encouraging the development and improvement of agricultural lands for the production of food and other agricultural products.

Taxpayers desire to convey the agricultural conservation easement to the State Board and County Board in exchange for property of like-kind in an exchange which will qualify for nonrecognition of gain under section 1031 of the Code. Accordingly, the parties have entered into an agreement for the sale and purchase of an agricultural conservation easement to the State and County jointly in perpetuity ("Contract"). The Contract provides that Taxpayers will convey, in perpetuity, a conservation easement on the Farm to the Grantees. Article XIII, paragraph 7 of the Contract expressly provides that the Taxpayers may assign the Contract without the prior consent of the Grantees.

Legal counsel for the State has opined that neither Grantee can be a signatory to an agreement to acquire exchange property to be used in a tax-deferred exchange. Accordingly, Taxpayers have entered into an exchange agreement with A of your firm, as intermediary, to effectuate the deferred exchange. Taxpayers have represented that your law firm has not acted as the Taxpayers' attorney within the prior two year period. Further, the only services your law firm has provided to the Taxpayers are services with respect to the exchange of their agricultural easement, which they intend to qualify under section 1031 of the Code.

Under the terms of the exchange agreement, the intermediary has entered into an assignable agreement to acquire acceptable exchange property which shall be real property ("Replacement Property") to be acquired in fee and, at a simultaneous closing on the contract, will convey or cause to be conveyed such Replacement Property to the Taxpayers in exchange for the agricultural conservation easement, which, by virtue of the assignment, the intermediary is obligated to convey to Grantees. The Grantees will remit payment for the agricultural conservation easement to the intermediary who will disburse funds to the owner of the Replacement Property as payment of the purchase price of the Replacement Property and to the Taxpayers to the extent not used to acquire the Replacement Property.

After the exchange is consummated, Taxpayers represent that they will hold the Replacement Property for investment or for productive use in a trade or business.

Article four, paragraph 4.3 of the exchange agreement expressly limits the Taxpayers' rights to receive, pledge, or borrow any of the funds held by the intermediary until the exchange account is closed, as that term is defined in Article four, paragraph 4.4. The criteria for closing the exchange account are the same as the additional restrictions on safe harbors set forth at section 1.1031(k)-1(g)(6)(i), (ii) and (iii) of the Income Tax Regulations.

Taxpayers have requested a ruling that the agricultural conservation easement of the Farm is of like-kind with a fee simple interest in replacement real property and an exchange of the agricultural conservation easement of the Farm for a fee simple interest in such replacement property, as set forth above and structured in the exhibits to this request, will qualify for nonrecognition of gain under section 1031(a) of the Code.

Section 1031(a) of the Code provides that no gain or loss shall be recognized on the exchange of property held for productive use in a trade or business or for investment if such property is exchanged solely for property of like kind which is to be held either for productive use in a trade or business or for investment.

Section 1031(b) states that if an exchange would be within the provision of section 1031(a) if it were not for the fact that the property received in exchange consists not only of property permitted by such provisions to be received without the recognition of gain, but also of other property or money, then the gain, if any, to the recipient shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property.

Section 1.1031(a)-1(b) of the Income Tax Regulations provides that, as used in section 1031(a), the words "like kind" have reference to the nature or character of the property and not to its grade or quality. One kind or class of property may not, under that section, be exchanged for property of a different kind or class. The fact that any real estate involved is improved or unimproved is not material, for that fact relates only to the grade or quality of the property and not to its kind or class.

Section 1.1031(k)-1(g)(4)(i) of the regulations provides that in the case of a taxpayer's transfer of relinquished property involving a qualified intermediary, the qualified intermediary is not considered the agent for the taxpayer for purposes of section 1031(a). In such a case, the taxpayer's transfer of relinquished property and subsequent receipt of like-kind replacement property is treated as an exchange, and the determination of whether the taxpayer is in actual or constructive receipt of money or other property before the taxpayer actually receives like-kind replacement property is made as if the qualified intermediary is not the agent of the taxpayer.

Pursuant to section 1.1031(k)-1(g)(4)(ii) of the regulations, the preceding paragraph applies only if the agreement between the taxpayer and the qualified intermediary expressly limits the taxpayer's rights to receive, pledge, borrow, or otherwise obtain the benefits of money or other property held by the qualified intermediary as provided in paragraph (g)(6) of this section.

Section 1.1031(k)-1(g)(4)(iii) of the regulations states, in part, that a qualified intermediary is a person who is not the taxpayer or a disqualified person (as defined in paragraph (k) of this section), and enters into a written agreement with the taxpayer (the "exchange agreement") and, as required by the exchange agreement, acquires the relinquished property from the taxpayer, transfers the relinquished property, acquires the replacement property, and transfers the replacement property to the taxpayer.

Section 1.1031(k)-1(k) defines the term disqualified person, in part, as a person who has acted as the taxpayer's attorney within the 2-year period ending on the date of the transfer of the first of the relinquished properties. However, for purposes of this definition, performance of services for the taxpayer with respect to exchanges of property intended to qualify for nonrecognition of gain or loss under section 1031 will not be taken into account.

In Rev. Rul. 55-749, 1955-2 C.B. 295, land was exchanged for perpetual water rights that are considered real property rights under the applicable state law. The Service ruled that the fee interest in the land and a water right in perpetuity are sufficiently similar to constitute property of "like kind" for purposes of section 1031(a) of the Code.

In Rev. Rul. 72-549, 1972-2 C.B. 472, an easement and right-of-way granted to an electric power company were held to be properties of like kind with real property with nominal improvements and real property improved with an apartment building.

With respect to Taxpayers' ruling request, the agricultural conservation easement in perpetuity is an interest in real property by virtue of State law (The Act). Taxpayers intend to exchange that easement for a fee simple interest in like-kind property in a deferred exchange, using the "qualified intermediary" safe harbor set forth in section 1.1301(k)-1(g)(4) of the regulations. Taxpayers have selected an intermediary who is not a disqualified person. Additionally, we have determined that Taxpayers' exchange agreement will not enable Taxpayers to have actual or constructive receipt of the funds in the exchange account.

Based upon the above authorities and facts and representations that were submitted, we rule as follows:

1. the agricultural conservation easement on the Farm qualifies as like-kind with a fee simple interest in replacement real property; and
2. an exchange of the agricultural conservation easement on the Farm for a fee simple interest in real property using a qualified intermediary, as set forth above and in the Taxpayer's exhibits to this ruling, will qualify for nonrecognition of gain under section 1031(a) of the Code, and that, if Taxpayers receive cash or other property as defined in section 1031(b) in the exchange, then gain will be recognized in an amount not in excess of such cash or other property pursuant to section 1031(b) of the Code.

No opinion is expressed as to the tax treatment of the transaction under the provisions of any other section of the Code and regulations which may be applicable thereto, or the tax

treatment of any conditions existing at the time of, or effects resulting from, the transaction which are not specifically covered by the above ruling.

This ruling is directed only to the taxpayer who requested it. Section 6110(j)(3) of the Code provides that it may not be used or cited as precedent.

A copy of this letter should be attached to the federal income tax return of the taxpayer for the taxable year in which the transaction covered by this ruling is consummated.

Very truly yours,

Assistant Chief Counsel

(Income Tax & Accounting)

By: David L. Crawford, Jr.

Chief, Branch 5