

**INTERNAL REVENUE SERVICE**

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CC:IT&A:2    PLR-106211-01  
**Date:**  
October 2, 2001

Taxpayer                =

Con Org                 =

Old Ranch              =

New Ranch             =

Family Group No. 1 =

Family Group No. 2 =

Family Group No. 3 =

StateX                 =

Citation X             =

Dear

This responds to your letter dated January 26, 2001, requesting a ruling on the proper treatment of an exchange, under § 1031 of the Internal Revenue Code, of a Perpetual Conservation Easement (PCE) in real property for a fee interest in other real estate that will also be burdened with PCE upon receipt. These are the applicable facts:

Taxpayer is a member, along with one other entity, of Family Group No. 1. The two entities comprising Family Group No. 1, along with the entities comprising Family Group No. 2 and Family Group No. 3, are co-owners of the fee interest in Old Ranch in State X.

Family Group No. 1 (including Taxpayer) operates a cattle ranching business on Old Ranch through a limited liability company (LLC). Family Group Nos. 2 and 3 lease their respective undivided interests in Old Ranch to LLC for grazing of cattle. In addition, the co-owners of Old Ranch have formed a general partnership (GP) under state law to perform routine maintenance on Old Ranch. However, GP does not hold any interest in Old Ranch and will not own any interest in property to be received in the

planned exchange. All of Old Ranch, consisting of approximately 11,500 acres, is used for cattle ranching purposes except for approximately 6 acres used for personal residences.

Taxpayer and other co-owners wish to engage in a like-kind exchange with ConOrg, a § 501(c)(3) organization. Under an agreement entered into by Taxpayer and the other co-owners with ConOrg, Taxpayer and the other co-owners will convey a PCE on the Old Ranch to ConOrg in exchange for the fee estate of New Ranch, in State X, which will also be burdened with a PCE when received by Taxpayer and the other co-owners.

The planned transaction will be a simultaneous, two-sided exchange (*i.e.*, involving no accommodation parties, third party sellers of replacement property or third party buyers of relinquished property). Following the exchange, New Ranch will be held by Taxpayer and the other co-owners in the exact same proportions as the interests they now hold and will retain in Old Ranch burdened with the PCE.

The State X Civil Code provides at Citation X.1 that the purpose of a conservation easement is to retain land predominately in its natural, scenic, historical, agricultural, forested, or open space condition. Citation X.2 provides that a conservation easement is an interest in real property voluntarily created and freely transferable in whole or in part for the purposes stated in Citation X.1 by any lawful method for the transfer of interest in real property in State X. Citation X.2 further provides that a conservation easement shall be perpetual in duration and shall constitute an interest in real property notwithstanding the fact that it is negative in character.

Section 1031(a)(1) of the Code provides generally 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 provisions 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. Unproductive real estate held by one other than a dealer for future use or future realization of the increment in value is held for investment and not primarily for sale.

Section 1.1031(a)-1(c) of the regulations, as an example, provides that no gain or loss is recognized if a taxpayer who is not a dealer in real estate exchanges city real estate for a ranch or farm, or exchanges a leasehold of a fee with 30 years or more to run for real estate, or exchanges improved real estate for unimproved real estate.

Rev. Rul. 55-749, 1955-2 C.B. 295 holds that where, under applicable state law, water rights are considered real property rights, the exchange of perpetual water rights for a fee interest in land constitutes a nontaxable exchange of property of like kind within the meaning of § 1031(a).

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

Under the regulations cited, the types of real estate interests that are within the same kind or class as fee interests in real estate is broad. Both revenue rulings cited demonstrate that perpetual easements in the form of water rights and right-of-ways are of the same kind or class of property to which a fee interest in real estate belongs. The PCE is also an easement. Under State X law, a PCE is an interest in real estate which, like a fee, is of a perpetual nature.

Therefore, based upon the above authorities and the facts and representations that were submitted, and assuming the proposed conservation easement is, by virtue of state law, an interest in real property, Taxpayer's exchange of a conservation easement in real property, under § 1031(a), for a fee interest in other real estate that is also subject to a conservation easement will qualify as a tax deferred exchange of like-kind property, provided that the properties are held for productive use in a trade or business or for investment. If Taxpayer receives money or other unlike-kind property in the exchange, gain will be recognized to the extent of the such money received and the fair market value of such other property. Also, Taxpayer (and each of the co-owners) must recognize whatever gain is realized with respect to the fair market value of the replacement property received attributable to the transfer of the PCE as to that portion of the Old Ranch used for residential purposes and not for use in a trade or business or for investment.

No determination is made by this letter as to whether the described transaction otherwise qualifies for deferral of gain realized under § 1031. Except as specifically ruled above, no opinion is expressed as to the federal tax treatment of the transaction under any other provisions of the Code and the Income Tax Regulations that may be applicable or under any other general principles of federal income taxation. No opinion is expressed as to the tax treatment of any conditions existing at the time of, or effects resulting from, the transaction that are not specifically covered by the above ruling.

Under the Power of Attorney Form 2848 on file with this office, we are sending this original letter to you and a copy to your representative stated on line 2 of the form.

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

Sincerely yours,  
ROBERT M. CASEY  
Senior Technician Reviewer, Branch 3  
Office of Associate Chief Counsel  
(Income Tax & Accounting)

cc: