



The Voice of the 1031 Industry

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Conservation Benefits from IRC §1031 Like-Kind Exchanges

Conservation easements are used for a number of reasons, including wildlife and riparian habitat preservation, prairie restoration, mitigation of water quality issues, erosion prevention, creation of green belts and public recreation opportunities. IRC §1031 encourages landowners to convey title or permanent easements on sensitive acreage to achieve these important conservation goals.

Examples of such easements are the wetland reserve and grassland reserve programs administered under the Natural Resources Conservation Service's (NRCS) umbrella which helps America's farmers, ranchers and forest landowners conserve the nation's soil, water, air and other natural resources, including wetlands and native grasslands. In addition, various state land trusts and other environmental organizations, such as the Nature Conservancy and Rocky Mountain Elk Foundation, have developed funding to acquire conservation easements throughout the U.S.

Typically the land which will be subject to the conservation easement is appraised to determine current fair market value of the unencumbered land and then a secondary, encumbered value is determined by taking into account the future limitations on development and other land use under the easement. The value of the easement is the difference between the unencumbered and encumbered valuations. The landowner may be able to elect to 1) receive a tax deduction for the contribution of the easement or 2) be paid the value of the easement. The owner retains the land subject to the easement which is typically in perpetuity but could be limited to a term of years.

A landowner electing to be paid for a permanent conservation easement can use those proceeds to acquire replacement property through a §1031 like-kind exchange. In that case, sale proceeds are paid to a qualified intermediary on behalf of the landowner/taxpayer, and are typically used to acquire more productive, less environmentally sensitive, replacement acreage for the landowner.

Mississippi River Watershed

Water quality issues have been going on for some time along the Mississippi River. Nutrient discharge from agricultural watersheds in Iowa and other states along the Mississippi watershed has resulted in a large dead zone in the Gulf of Mexico. This is a major concern for the EPA, USDA, state agencies and farm groups. The State of Iowa is implementing a Nutrient Reduction Strategy to make improvements. Locally, concerns for drinking water, flooding impacts, and loss of recreational value are all downstream challenges that benefit from upstream solutions within watersheds.

In response to issues like this, the Iowa Department of Natural Resources (IDNR), the NRCS and other private and public organizations have implemented programs to acquire permanent conservation easements to take environmentally sensitive farm fields out of production, restore wetlands, install buffer strips, stabilize highly erodible acres and otherwise restore water quality to waterways in Iowa and other states that feed the Mississippi River.

Farmers are using §1031 to exchange permanent conservation easements in environmentally sensitive farmland for other productive farmland outside of these sensitive areas without any loss of investment occasioned by immediate tax liability on the gain. Given the need to maintain the value of their investments and to derive comparable income from replacement farmland, farmers would be far less likely to sell environmentally sensitive lands or conservation easements restricting productive use if they were required to use after-tax dollars, essentially being forced to downsize.

Grassland Reserve Program

A large grazing association in Southeastern Idaho was approached by the NRCS about placing a Grassland Reserve Program (GRP) easement to the USDA on some grazing land to limit further development and preserve the native grasslands and wildlife habitat. The amount of money generated by the sale of the easement if distributed to the individual members of the Association would not have provided any appreciable benefit after payment of taxes. However, by using §1031 to defer recognition of tax gain, the Association was able to acquire other neighboring properties to block up its ownership, expand its grazing capacity and generally enhance the operations of the Association, without any erosion of investment value. Because of the ranchers' ability to use like-kind exchanges, the NRCS succeeded in its goal of obtaining a limitation on development, enhanced public recreational opportunities and preservation of wildlife habitat and fisheries.

Conclusion

Conservation easement transactions like the examples above, used in conjunction with §1031 exchanges, result in a win-win situation for the landowner/taxpayers, the land itself, and the general public, along with state, local and Federal governments. The impetus to complete these transactions will be significantly reduced if §1031 is repealed or substantially limited.