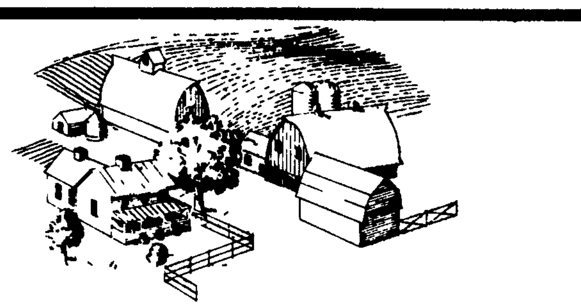
FARM MANAGEMENT



TAX IMPLICATIONS WHEN SELLING YOUR CONSERVATION EASEMENT

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(Fifth in a series on farmland preservation.)

When contemplating selling your conservation easement, you have complex decisions and issues to face. The real estate, federal and state inheritance, and income tax implications are very important factors which you will have to wrestle with.

The sale of the conservation easement is a taxable event and the taxes must be planned for by setting funds aside to pay the taxes when due.

Federal income taxes?

Yes, federal income tax may take a substantial amount of your conservation easement payment — up to 33 percent of your profit! Landowners who sell their easement may elect to receive the proceeds in payments over a period of up to five years, including a lump sum distribution at settlement.

When calculating the gain from the easement sale, one has two options. One can calculate the gain like any other sale and subtract the basis, i.e., purchase price less accumulated depreciation of your property from the sale price and the difference is your taxable gain. The other option is to reduce the basis of your property, even down to zero, by the amount of the easement — then have a new basis upon which to calculate depreciation and gain for any future sales of real estate.

Remember, this lower basis will result in higher tax when the farm is sold. If the original adjusted basis is greater than the conservation easement payment, you would pay no federal tax. This option may be particularly advantageous to the young farmer whose property has a high tax basis and has no plans to sell any land, or to the older farmer who has a low tax basis but plans on passing the farm to the next generation through his estate, since the farm will realize a stepped-up basis at the time of death for estate evaluation purposes. Be sure you or your accountant calculates your income tax liability before you sign on the dotted line, especially if you gift a portion of the easement.

Charitable contribution tax benefits?

You may consider donating a portion of your easement sale to lower your tax liability and allow the county and/or state to purchase more easements.

If a conservation easement is willfully sold by the landowner at an amount that is less that the appraised value (bargain sale) of the easement, the landowner may use the difference between the appraised value of the easement and the sale price of the easement as a federal income tax charitable contribution deduction.

The charitable contribution deduction is limited to 50 percent of a person's annual adjusted gross income, so plan carefully if you choose this option. It could, however, substantially lower your federal tax liability.

State income taxes?

State income tax at 2.1 percent is not overwhelming, but on a taxable income of $200,000, the state would still get $4,200 — not much compared to the federal tax bite of $52,864!

Because the sale involves intangible personal property, you would not be eligible to declare the income on an installment basis, as you could for federal taxes, even if you received the money over two to five years.

The good news is that if the property was acquired after May 31, 1971, taxable income would be calculated on a pro-rated basis, proportionate to the number of months owned after May 31, 1971, divided by total months owned.

Real estate taxes?

Presently, it is uncertain how the assessed value of the farm will be affected by the conservation easement.

The new assessment (if done) should be based solely on agricultural value, but this has not yet been tested in Pennsylvania courts. If it has been a long time since your farm has been assessed, it is conceivable that your assessed value could rise after the conservation easement is sold. Your total real estate taxes will still rise even if your assessment stays the same when and if your local millage rates increase. Before making a final decision to sell your conservation easement, try to get a ruling from your county tax assessment office on how your assessment will be affected by selling your conservation easement.

Reassessment is a hot topic in many Pennsylvania counties and selling your conservation easement may result in a lower assessed value, or preferential treatment, because the value should be based on agriculture value only. You may still want to look into the preferential assessed value provided for in Pennsyania's Act 515 legislation, "The Pennsylvania Farmland and Forest Land Assessment Act of 1974," or in Pennsylvania's Act 319 legislation, "The Pennsylvania Clean and Green Act," even if you don't sell your easement.

Inheritance taxes?

When planning the transfer of the family farm, the conservation easement will limit the IRS valuation of the farm to "eased value."

That is the fair market value of the farm with the easement in place. Current IRS regulations limit the reduction in value of the property under the farmland special use evaluation, used for federal estate value computation only, to not exceed $750,000.

The conservation easement may make this election easier for your heirs to exercise and result in significant federal estate tax savings. Pennsylvania has a different farmland use valuation that is easier to take advantage of than the federal program. Tax savings may be especially common in areas of high development pressure, as land values continue to rise and the difference between "eased value" and "fair market value" continues to grow.

Selling your conservation easement and then gifting cash or other assets may be an excellent tool in lowering your taxable estate. Don't forget that as long as the cash or other assets you bought stay in your control, you won't have lowered the value of your estate.

Summary

Be sure to thoroughly research all your options, especially their tax implications, before you sell your farm's conservation easement. Compare your total tax liability when taking the easement money in one year versus yearly payments over two, three, four, or five years. Factor in the interest you would earn by investing the after-tax dollars, if you take all the money at settlement. List the pros and cons and consult your tax advisor to make an informed decision which is right for you and your family.

(Next issue: Family Considerations.)

Indiana Livestock

Homer City, PA
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Report supplied by PDA

CATTLE 138. SL. COWS STEADY FEW CHOICE 74.00-75 50, CH. HIGH YIELDING SEL. & LOW CH. 74 25-75.25, SEL. 68.00-73.50, LOAD HIGH YIELDING H. SELECT & CHOICE SL. HEIFERS 73.00-76.25, CH. 70.00-72.50, FEW STAND. 50.75-64.25. BREAKING UT. & COMMERCIAL SL. COWS 53.00-57.25, COUPLE 58.50, CUTTER & BON. UT. 50.50-55.00, FEW HIGH DRESSING 57.25, CANNER & LO CUTTER 44.00-50.50, YIELD GRADE NO. 1 980-2489 LBS. SL. BULLS 62.00-66.00, COUPLE 68.00 & 68.75. HEIFERS FEW MEDIUM FRAME NO. 1 515-550 LBS. 70.50-74.00. BULLS MEDIUM FRAME NO. 1&2 470-710 LBS. 63.75-74.50.

CALVES 105. FEW GOOD 94.50-101.00, STAND. & GD. 90-125 LBS. 70.00-79.00, 60-85 LBS 60.00-70.00, NO. 1 HOLSTEIN BULLS 90-130 LBS. 100.00-145.00, NO. 2 90-110 LBS. 80 00-100.00, FEW HOL. HEIFERS 75-100 LBS. 87.50-126.00, BEEF CROSS 70-140 LBS. BULLS & HEIFERS 92 50-142.50, COUPLE 167.50 & 180 00.

SHEEP 68. CHOICE 80-110 LBS 47.00-53.00, 40-75 LBS. 50.00-56 00 SLAUGHTER SHEEP 10.50-20.50.