

Tax Planning in Preserving Your Farm Whatcom County PDR Program

Whatcom County PDR program staff is not qualified to give tax advice to applicants. The information contained in this outline provides a generalized synopsis of some of the tax planning considerations in enrolling in a PDR Program. The actual impact to you greatly depends on your own financial situation and goals. We advise that you consult with your legal and/or financial advisors before deciding among the payment option offered by the PDR Program.

1. **Capital Gains Tax:** The Payment for your development rights is taxed as a capital gain. The amount of tax that you will pay on the sale of your development rights will depend upon the amount of gain recognized and the effective tax rate. Your accountant or tax attorney can help you calculate your capital gains tax.
2. **Installment Purchase Agreement (IPA):** The seller can spread out payment of the development rights purchase price for up to 30 years, receiving semi-annual tax-exempt interest payments on the outstanding principal. The principal is due at the end of the contract term. The landowners may defer capital gains taxes until they receive the principal payment for the development rights.
3. **Like-Kind Exchange:** The tax law allows for the deferral of capital gain if you take the proceeds from the sale of development rights and roll the proceeds into other real estate. This is called “like-kind exchange” or “1031 exchange”. To qualify (1) the proceeds must be used to buy other real estate, but not necessarily farmland, and (2) the replacement property must be used for business or investment. If the farm from which the development rights are being sold is owned by a partnership, then the replacement property must be bought by the partnership. Any portion of proceeds from the sale that is not used to purchase other qualified real estate is subject to capital gains tax.

3a. **Deferred Like-Kind Exchange.** A “deferred like-kind exchange” is an exchange in which the sale of the development rights and the purchase of the replacement property do not occur on the same day.

3b. **Reverse Like-Kind Exchange.** The I.R.S. released guidelines to allow taxpayers to accomplish a “reverse like-kind exchange”. This is an exchange in which the replacement property is acquired prior to the sale of the agricultural development rights. Consult someone who has experience in like-kind exchanges.

The IRS has strict timeframes and documentation requirements for completing the exchange. To ensure adherence to IRS rules, the assistance of someone experienced with 1031 Exchanges is crucial.

4. **Your Estate Plan:** Consider how the sale of your development rights fits into the big picture of your estate plan and the business succession plan for your business. In a transfer of the family farm from an estate, a conservation easement may significantly reduce the value of the farmland subject to transfer taxes.
5. **Bargain Sale:** If development rights are willingly sold by the property owner at an amount that is less than the appraised value (typically 20% less than the appraised fair market value), then the property owner may use the difference between the appraised value of the development rights and the sale price of the development rights, as a federal income tax charitable gift deduction if meeting I.R.S. rules. Depending on the donor's income, the deduction may be taken over as many as six years.
6. **Other Tax Reduction Strategies:** A tax or financial advisor can provide you with information on other tax-reduction strategies tailored to your individual circumstances. These strategies may involve charitable donations to the creation of a trust.