T.C. Memo. 1979-250

When a portion of a larger property is affected by an easement, and a rational basis allocation is feasible, the proceeds from granting the easement should reduce the basis of the affected portion, not the entire property.

Summary

In 1974, petitioners David and Barbara Fasken, and the Estate of Inez G. Fasken, granted four easements across their large Texas ranch for pipelines and communication facilities. They received consideration for these easements but did not report it as taxable income, arguing the proceeds should reduce the basis of their entire 165,000-acre ranch. The IRS determined a deficiency, arguing the gain should be calculated by allocating basis only to the acreage covered by the easements. The Tax Court agreed with the IRS, holding that because a reasonable allocation of basis to the easement areas was possible and the easements did not significantly impact the ranch's overall use, the basis should be allocated to the easement areas, and the excess of the proceeds over that basis was taxable gain.

Facts

Petitioners owned a 165,229.85-acre ranch in Texas used for grazing livestock and also engaged in oil and gas operations. In 1974, they granted four easements: two for pipelines to Pioneer Natural Gas and Mapco, one for guy anchorages to Arco Pipe Line, and one for a cathodic protection unit to Mapco. The easements totaled approximately 32 acres out of the vast ranch. Petitioners received $18,486.50 in total consideration for these easements. The ranch already had around 500 oil and gas wells and numerous existing easements. The granted easements did not materially affect oil and gas operations, and cattle access was largely unimpeded, except for a small fenced area for the Arco easement. While grass quality was diminished in pipeline easement areas post-excavation, the ranch continued to be leased for grazing.

Procedural History

The Commissioner of Internal Revenue determined deficiencies in the petitioners' federal income taxes for 1974, arguing that the proceeds from the easements constituted taxable gain. Petitioners contested this determination in the Tax Court.

Issue(s)

1. Whether the consideration received by petitioners for granting easements should be applied against their basis in their entire ranch acreage, or against their basis in only the portion of the acreage covered by the easements?

Holding

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1. No, the consideration received for the easements should be applied against the basis of the acreage covered by the easements, because a reasonable allocation of basis to the easement areas is possible and the easements did not render the entire ranch unusable or significantly diminish its value.

Court's Reasoning

The Tax Court relied on Treasury Regulation §1.61-6(a), which states that when part of a larger property is sold, basis must be equitably apportioned to the part sold. The court reasoned that easement rights are part of the "bundle of rights" of property ownership, and granting easements is a disposition of an interest in land. The court stated, "*Ownership of property is not a single indivisible concept but a collection or bundle of rights with respect to the property.*" Unless apportionment is impossible or impracticable, basis allocation is required. The court distinguished this case from *Scales v. Commissioner* and *Inaja Land Co., Ltd. v. Commissioner*, where easements rendered the remaining land practically unusable, making basis allocation impossible. In *Fasken*, the court found that the easements did not significantly impact the ranch's grazing capacity or potential subdivision use, and the easement areas were clearly defined, making basis allocation feasible. The court noted petitioners continued to lease the ranch for grazing after granting the easements, indicating no material impact on its primary use. The court concluded petitioners failed to prove that a reasonable allocation of basis to the easement areas was impossible or impracticable.

Practical Implications

This case clarifies the tax treatment of proceeds from granting easements, particularly on large properties. It establishes that landowners generally cannot reduce the basis of their entire property by the proceeds from easements unless they can demonstrate that the easement fundamentally impairs the use and value of the entire property and that a reasonable basis allocation to the easement area is impossible. For legal practitioners and landowners, *Fasken* underscores the importance of properly allocating basis when granting easements and recognizing that proceeds exceeding the allocated basis will likely be treated as taxable gain. This is particularly relevant in areas with extensive resource development where easements are common. Later cases applying *Fasken* often focus on whether the easement significantly impacts the usability of the larger property and whether a reasonable basis allocation to the easement area is feasible.

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