
Oil Pipeline Easments
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Increasing energy demands are creating the need for more pipelines to carry petroleum resources to consumers. Two pipeline companies are currently contacting Illinois landowners to purchase easements through their farmland. One company will construct a North-South pipeline from Delavan, WI to Patoka, IL. The other company will construct an East-West pipeline through southern Illinois.

Payments are offered to entice landowners in the path of the construction to grant a permanent easement. The payment is based on a number of factors. These include:

- A permanent easement for a strip of land of approximately 25 feet on each side of the center of the pipeline,
- A temporary work easement of approximately 75 feet,
- Damages for crop loss on temporary easement due to the construction, and
- Damages for three years of crop loss on permanent easement due to soil damage.

The taxation of these payments differ, based on the type of payment received. Payments for a permanent easement are treated like a sale of the land. Therefore, the taxpayer is able to deduct land basis against the payment. However, the amount of the deduction is limited to the acreage taken by the easement. For example, the construction company pays $12,000 for a permanent easement for their pipeline. The payment is for a 50 foot wide easement running for 2,123 feet. This equals 106,150 square feet. Since an acre of land equals 43,560 square feet, the easement is for 2.44 acres (106,150 ÷ 43,560.) Assuming the farmland’s cost (basis) is $2,500 per acre, the farmer has a basis of $6,100 ($2,500 × 2.44 acres) in the easement. Therefore, the farmer must report a $5,900 ($12,000 - $6,100) capital gain on the sale of the permanent easement. The sale is reported on Part I of Form 4797, Sale of Business Property.

Note, however, that the basis in the farmland is reduced by any amounts allocated to fence or tile when the land was purchased and increased by any undepreciated improvements made since the purchase.

If the taxpayer can show that the permanent easement reduces the value of the entire farm, it is possible to reduce the basis of the entire property. This might occur if the farm is in an area where development is taking place and the pipeline will have a negative impact on the farm’s future sale. For example, a 100 acre farm is located on the city limits and is currently appraised at $20,000 per acre. However, the farm would only appraise at $15,000 per acre if the pipeline were constructed.

Any payments for a temporary easement are treated the same as if it was rent received for the use of the land. It is fully taxable and reported on Schedule E,
Supplemental Income and Loss. Payments for crop damages are treated as if it were for crops sold. Therefore, it is reported on Schedule F, Profit or Loss From Farming. The payment is fully taxable and also included in self-employment income. If the taxpayer is a cash rent landlord, the damage payment will probably go to the tenant. If the landowner is a crop share landlord, his share of the payment will be reported on Form 4835, Farm Rental Income and Expense.