

# Valuation of farm properties

## Recent developments

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The work of our state legislature can impact the appraisal process, sometimes in surprising ways. This article addresses the way one particular statute can present unusual challenges in the appraisal of ownership interests in an entity that owns a farm. The appraisal may be impacted by whether the farm is held in a partnership, corporation, limited liability company (LLC) or other entity, the magnitude of the owners' interest and the contents of the governing documents.

Section 381.135(1)(b) of the Kentucky Revised Statutes provides: *A . . . person with an ownership interest of twenty percent (20 percent) or more in a closely held farm corporation or partnership may file in the Circuit Court of the county in which the land or the greater part thereof lies a petition containing a description of the land, a statement of the names of those having an interest in it, and the amount of such interest, with a prayer for the division or allotment . . .*

KRS § 381.135 goes on to provide a process for the farm to be divided and partitioned among the owners of the entity. This statute changes the normal rights of the owners of a subject business entity and has surprised a number of lawyers.

### An example

The manner in which this provision can change and complicate

an appraisal is illustrated by the following example. Assume you have been called upon to value 1,000 acres of Kentucky farm property and provide a per-unit value for each ownership interest. Using a fair market value of \$1,000 per acre, there is an indicated land value of \$1 million. Each of the four owners (all descendants of the prior owners) owns the units equally.

Owner	Units (total = 100)
Daughter #1	25
Daughter #2	25
Son #1	25
Son #2	25

You start with an indicated value of \$10,000 per unit, discount 30 percent for lack of control and marketability, and deliver a valuation report reciting a FMV of \$7,000 per unit. Unfortunately, this valuation may be significantly impacted by KRS § 381.135 if the land is held by a partnership or a corporation or there is an agreement to be subject to it. This statute permits a 20 percent partner/shareholder in a farm partnership or corporation to cause a partition of the partnership's property. Having failed to consider the possible impact of this statute in the above outlined (and grossly oversimplified) valuation, the resulting report may be flawed because any right to partition may impact the applicable discounts. Is the statute applicable?

First, is a "farm" involved? For these purposes "farm" is a defined term in KRS § 381.135(1)(a) which

refers to five contiguous acres used for the production of agricultural/horticultural crops. We will assume that the farm in our example is being used for an appropriate agricultural/horticultural crop. Next, the ownership requirement is not an issue since the owners each hold in excess of a 20 percent ownership interest.

However, the issue gets more complicated. We may need to go outside KRS § 381.135 to determine the application of this particular statute. The right to partition is conditioned upon owning a 20 percent interest in a "closely held farm corporation or partnership" (emphasis added). It would be nice if there were a table reciting that KRS § 381.135 is always applicable to farms organized in certain forms of entities but not in others. Sadly, that is not the case.

### What about an LLC?

A question we have faced is whether the statute is applicable when the farm is organized as LLC. There can be a long and ultimately inconclusive debate as to whether an LLC falls within the ambit of "corporation or partnership" as utilized in KRS § 381.135(1)(a)1. The language referring to "corporations" and "partnerships" was adapted four years after the adoption of Kentucky's LLC Act – the omission of the LLC from the list is arguably telling. However, it may be possible, albeit with some contortions, to work through the statutory definitions to bring an LLC within the definition of a corporation. Fortunately, that

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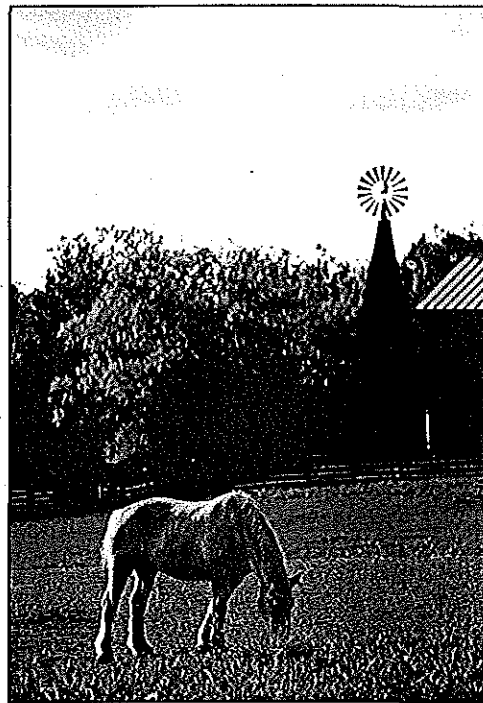
## Valuation continued

point of potential contention has been resolved as far as the applicability of KRS § 381.135 is concerned. The 2010 Kentucky General Assembly added a provision to the Kentucky LLC Act specifically exempting LLCs from KRS § 381.135. KRS § 275.220(3) (effective 7/15/2010). It is possible, however for an LLC to elect into this statute, so a case-by-case analysis may still be required.

When Kentucky adopted its modern partnership and limited partnership acts in 2006, each of them expressly provided that KRS § 381.135 would not apply. KRS §§ 362.1-402(2); and 362.2-506(2). As such, subject to a partnership governed by either of those laws electing into coverage of KRS § 381.135, the statute need not be considered. Conversely, both partnerships and limited partnerships governed by the predecessor statutes do fall within the scope of a "farm partnership" that may be subject to the statutes. However, KRS Chapters 362.1 and 362.2 only apply to a subject partnership which either (a) was formed on or after July 12, 2006 or (b) has elected in the manner provided in the statute to be governed by Chapter 362.1 or 362.2. Thus, since all partnerships are not currently governed by Chapter 362.1 or 362.2, additional information about the specific partnership would be needed to see if it may be subject to KRS § 381.135.

Even if the entity that owns the farm is a closely held corporation or a pre-2006 act partnership or limited partnership, the answer may still not be clear. In a recent "not to be

published" opinion, the Kentucky Court of Appeals recognized that the right to partition may be waived,



either expressly or by implication. *See Mills v. Mills*, No. 2007-CA-000774-MR (Ky. App. Oct. 24, 2008). The court determined that language in a partnership agreement impliedly waived the right to partition. The language simply stated: "The Partners agree that legal title to the Partnership property and assets shall remain in the Partnership." An express or implied waiver, based on a provision similar to the one in this case or other language, could potentially be found in the documents relating to a farm corporation or subject partnership.

Members of an LLC or the partners in a 2006 Act partnership or limited partnership may also be able to create contractual rights similar to

the rights in KRS § 381.135. While the merits of doing so are debatable, a minority owner might like such a provision.

Whenever called upon to prepare a valuation of the ownership interests in a corporation or partnership that owns farm property, a legal review and in some instances a legal opinion may be appropriate to determine whether KRS § 381.135 is applicable. That review will first need to include a determination of whether the form of entity may be subject to KRS § 381.135, and that determination may be more complex in the case of a partnership since only some partnerships are excluded by the partnership laws adopted in Kentucky in 2006. From there a review of the controlling documents may be necessary to consider whether there has been an election into or out of the statute. Only with those answers in hand can we determine whether an owner or owners may be entitled to partition under KRS § 381.135. A valuation report flawed because it fails to take into account a right to partition the property is obviously subject to challenge.



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