

Condemnation in Kentucky

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The movie “Little Pink House” has been in the news lately. The movie is about a US Supreme Court case, *Kelo v. City of New London*. In that case, the City of New London, Connecticut, wanted to redevelop an area in the city for the benefit of Pfizer, Inc. Several home owners in the neighborhood contested the taking of their property on the grounds that the taking was not for public use. The City argued that the condemnation had a public purpose for economic development, and so was a public use under US and Connecticut law. The US Supreme Court agreed with the City’s position. The case is now the subject of a movie, “Little Pink House,” which puts a human face on a very dry area of the law.

The issue of condemnation has been in the news, and Denton Law Firm believes a brief outline on condemnation law in Kentucky might be interesting. In Kentucky, most property owners will deal only with an acquisition by the government for a public use, such as a new water or sewer line, school, or highway.

In the Purchase and Pennyriple areas, it is easy to appreciate the benefits of I-24, I-69, Kentucky Lake, Lake Barkley, LBL, and the Parkways, and to forget that those large-scale projects were built after the government took private property. Homes were torn down; farms were split into sections; and the lives of the landowners forever altered to benefit the public at large. Now, most everyone enjoys a day on the lake, or the ease of traveling on a controlled access four-lane highway to Nashville for shopping, or to

Lexington or Louisville for a ballgame. While driving, though, you can still see abandoned houses and barns. LBL has cemeteries relocated from the property that was flooded, which are still in use by those families.

We now enjoy the benefits of those projects, and they have made our area more accessible and attractive to tourists. As the old saying goes, though, most people are conservative about what they know best. When the government knocks on your door to take your property, attitudes can change about all those benefits for the public at large, and your concern is for your property.

So one day, someone comes to your door, or sends you a letter, or leaves a note on your door that there are going to be surveyors or geotechnical engineers on your land in the next few days to stake or drill on your property. Sometimes, you might even find out after the fact. You're upset and concerned and want to know what is happening. While you probably knew that some sort of public improvement project was being planned for your area, you were not sure the project would directly affect you and your property. You have now learned that your property is necessary for the project, and you want to know your rights and the process for acquiring your property.

The United States Constitution, in the Fifth Amendment, prohibits the taking of private property for public use without just compensation. The Kentucky Constitution requires that compensation must be paid before any such taking.

Kentucky law authorizes a condemnor (the government agency) to enter on any land or improvements which it has the power to condemn to make studies, surveys, tests, soundings, and appraisals provided the owner of the land was given notice ten days before the entry. After the engineering work is complete and the plans are final,

then the appraisal process begins. This is where your property is appraised or valued by an appraiser.

If a full appraisal is made on your property, it will contain a before value and an after value, which takes into account the effect the taking will have on your property. The standard of compensation is the difference between the fair market value of the property immediately before the taking and the fair market value of the property immediately after the taking. The value of the property is also determined based on its highest and best use. If a property is suitable and adaptable for another more valuable use with consideration of existing market demands, then the property may be valued based on its potential use rather than its current use.

The agency is required to make the property owner a good faith offer. For a KYTC project, this must be based on an appraisal or a minor acquisition review. In addition, for any project involving federal funds, the KYTC (and most other government agencies) must follow federal regulations in the appraisal and negotiating process. While the agency must make you a good faith offer, it is not required to “horse trade” with you as in a private sale where the parties can simply agree to disagree and end negotiations.

The law in Kentucky prohibits the use of certain factors in determining just compensation because they are irrelevant or they are considered non-compensable as a matter of law. Examples of irrelevant factors are the prices paid for other property on the same project or the sales price on non-comparable properties. Costs too remote or speculative, such as potential liability after the project is complete, are also irrelevant to determining compensation.

Kentucky law also considers some factors non-compensable as a matter of law. Examples of non-compensable factors are loss of business and a more circuitous route to access the property (circuitry of travel). Any change in access is not compensable as long as the owner retains reasonable access for the current use of the property after the project is constructed.

If you and the agency cannot agree on compensation, the next step is for the agency to file a condemnation suit in the circuit court of the county where the property is located. Once the suit is filed, the circuit judge appoints three commissioners to value the property. After the commissioners file their report of value with the court, the property owners, and other interest holders (such as the mortgage holder or lessees) are served with summons, then the agency moves for an “interlocutory order and judgment.” This is an interim or temporary judgment, not a final resolution of the case. Once the court enters this judgment, the agency may pay the commissioners’ award into court and obtain what is called “right of entry.” “Right of entry” is the latter of the entry of the interlocutory order and judgment and payment of the commissioners’ award into court, and is commonly referred to as the “date of taking.” After that date, the agency is allowed to go on your property and build the project pending determination of final compensation, either through settlement or a trial by jury. If suit is filed, the agency is not required to pay the property owner’s attorney or expert witness fees. Those expenses must be borne by the property owner.

At the point in time the lawsuit is filed, if you do not already have an attorney, you need to get one as soon as possible. There are certain very specific time periods established by the statute and strictly interpreted by the courts, in which specific legal

pleadings must be filed, or you as the landowner can waive and lose your rights in the condemnation case.

The compensation paid to you by the agency or state is also subject to taxes. We also have some information on the tax consequences of the payment to you for your land. Even though the condemnation may be against the wishes of the taxpayer, the exchange is still seen as a taxable event. Normally, the taxpayer will pay tax on the amount received that exceeds their basis. However, the Internal Revenue Code provides many exceptions and favorable treatment to being taxed on a condemnation.

Luckily, even if there is a gain, it will most likely be taxed at favorable capital gains rates. Conversely, if the proceeds received from the exchange are less than the basis, the taxpayer will be able to deduct the loss against at least some of his or her income, if not wholly against income.

Still, the Code provides for the possibility of no tax being paid at all on the gain, or at least delaying payment of any gain until a later year. A taxpayer may defer, but not exclude, paying tax on those gains if the funds are used to purchase replacement property. Additionally, if the property involved in the condemnation is the personal residence of the taxpayer, the gain may be completely tax-free. Lastly, if the taxpayer receives payments in order to compensate for a decrease in the value of the retained property, taxes might only be paid if they exceed the taxpayer's basis.

Perhaps all of these points are better illustrated as an example: Joe owns a large farm in which the state wants to build a road. Joe's house is in the middle of his farm. The state will split Joe's farm into two separate pieces, building directly through Joe's house, as such they purchase land through the middle of his farm. The state pays Joe

for the land as well as paying him for the loss in value of the two, now separate, pieces of property. Joe can decrease the basis of his two remaining pieces by the amount he received from the state, and pay no tax for those payments. Using proceeds from the actual land purchase, Joe then purchases another farm, deferring any gain, and thus once again not paying any tax in the current year. Lastly, Joe is able to exclude the gain, up to a certain amount, for any gain on the condemnation of his personal residence.

While Joe, or any taxpayer, most certainly does not prefer to have his property involuntarily sold to the state through condemnation, a silver lining is he may have experienced a sizable financial gain yet experienced zero immediate taxable consequences.