

LESSON 9

FAMILY FARMER/FISHERMAN CASES ***(Chapter 12 Bankruptcy Code)***

CONTENTS

- I. Introduction
- II. Eligibility – 11 U.S.C. §§ 101(18) and (19A)
- III. Debtor's Powers - 11 U.S.C. §§ 1203 and 1204
- IV. Adequate Protection - 11 U.S.C. § 1205
- V. Sale of Property - 11 U.S.C. § 1206
- VI. Dismissal or Conversion - 11 U.S.C. § 1208
- VII. Filing of Plan - 11 U.S.C. § 1221
- VIII. Plan Contents - 11 U.S.C. §§ 1222 and 1223
- IX. Confirmation - 11 U.S.C. §§ 1224 and 1225
- X. Discharge - 11 U.S.C. § 1228
- XI. Special Tax Provisions 11 U.S.C. § 1231

I. INTRODUCTION

"The Family Farmer Bankruptcy Act of 1986" became effective on November 26, 1986. This Act was a response to the farm depression which rocked the family farmer during the 1980s. A new chapter of the Bankruptcy Code, Chapter 12, was created. This new chapter is similar in many ways to Chapter 13; however, it has many provisions which are different. The major differences are the jurisdictional dollar limits, the debtor may be either an individual or a corporation, the opportunity for debt restructuring, and the effect of a granted discharge. The major similarities are the existence of a standing trustee with fiscal control over the case, the time frame of the reorganization (3 to 5 years), inability of creditors to vote on the debtor's plan, no separate taxable estate for federal income tax purposes, and the quickness of confirmation.

Under the Bankruptcy Abuse Protection and Consumer Protection Act of 2005 (the BAPCPA), Chapter 12 became a permanent chapter of the Bankruptcy Code. The BAPCPA also extended the provisions of Chapter 12 to family fishermen.

II. ELIGIBILITY – 11 U.S.C. §§ 101(18) and (19A)

A. Individual Debtors – Family Farmer (Section 101(18)(A))

- Must have less than \$4,031,575 in total debt. Bankruptcy dollar amounts are adjusted automatically every three years. 11 U.S.C. § 104. The current amount under section 101(18), \$4,031,575, is effective for cases filed on or after April 1, 2013. (NOTE: Pre-BAPCPA, an individual debtor had to have less than \$1.5 million in total debt.)
- At least 50% (80% pre-BAPCPA) of total debt must have been incurred in a farming operation.
- Over 50% of preceding year's gross income must have been earned from farming (or, alternatively, under the BAPCPA, over 50% of income is from farming operations in each of the second and third taxable years preceding the bankruptcy).
- Debt on principal residence does not count in computing the applicable debt (currently \$4,031,575) limitation unless such debt "arises out of a farming operation."

B. Individual Debtors – Family Fisherman (Section 101(19A)(A))

- Must have less than \$1,868,200 in total debt. As with family farmer cases, the debt limit is adjusted in family fishermen cases under section 104(a)(1). The above amount, \$1,828,200, is effective for cases filed on or after April 1, 2013.
- Not less than 80% of aggregate non-contingent, liquidated debts must have been incurred in a commercial fishing operation.
- Over 50% of preceding year's gross income must have been earned from commercial fishing.

C. Corporate and Partnership Debtors – Family Farmer and Family Fisherman (Sections 101(18)(B) and 101(19A)(B))

- More than 50% of corporate stock or partnership equity must be held by family members, and one or more of these must be actually conducting farming operation (designed to eliminate hobby farms).
- More than 80% of the value of the assets must be related to farming operations.
- Same debt limitations as Chapter 12 individual debtors.
- No 50% income requirement from farming operations as with individuals.

Note: Effective for cases filed on or after October 17, 2005, the debt limitations discussed above will be adjusted under section 104(a)(1) based on the Consumer Price Index.

III. DEBTOR'S POWERS - 11 U.S.C. §§ 1203 AND 1204

- Retains property as debtor-in-possession, absent fraud or mismanagement.
- Works with standing trustee in channeling payments to creditors.
- On request of a party in interest, debtor may be removed as debtor in possession for cause, including fraud, dishonesty, incompetence, or gross mismanagement of the affairs of the debtor.

IV. ADEQUATE PROTECTION - 11 U.S.C. § 1205

- Normal rules are off with respect to real estate. Section 361 does not apply in Chapter 12 cases. Debtor needs only to provide fair rental value of land to adequately provide for secured creditor.
- For other farm assets, debtor only needs to provide for decreases in value during the period the stay is in effect.
- Interest or lost opportunity costs are not available.
- Short time frame prior to confirmation reduces the importance of securing adequate protection.

V. SALE OF PROPERTY - 11 U.S.C. § 1206

- Farm equipment, farm land or property used to carry out a commercial fishing operation (including a commercial fishing vessel) may be sold prior to confirmation without secured creditor's consent; however, proceeds are impressed with creditor's lien.
- Sale must be on notice and opportunity for hearing.

VI. DISMISSAL OR CONVERSION - 11 U.S.C. § 1208

- Debtor can move to convert to Chapter 7 at any time.

- Debtor can move for dismissal at any time if case has not been converted to Chapter 12 under section 706 or 1112.
- Creditor or other party in interest can move to dismiss case based on similar grounds as Chapter 11 case.
- As in Chapter 11 cases involving farmers, a creditor cannot move for conversion to Chapter 7 in the absence of fraud. A creditor cannot convert debtor to Chapter 11 or 13.
- Court cannot dismiss case sua sponte except for administrative matters (e.g., failure to timely file plan).

VII. FILING OF PLAN - 11 U.S.C. § 1221

- Must be filed within 90 days after filing petition.
- May be filed with petition as in Chapter 13.
- 90-day period can be extended by court if the need for an extension is attributable to circumstances for which the debtor should not justly be held accountable.
- Only the debtor can file a plan.

VIII. PLAN CONTENTS - 11 U.S.C. §§ 1222 AND 1223

- Similar to Chapter 13, except for some provisions regarding treatment of secured and priority claims (see below).
- Needs to provide interest on secured claims as in Chapter 13. 11 U.S.C. § 1225(a)(5)(B)(ii). Compare section 1225(a)(5) with section 1325(a)(5). For cases filed on or after October 17, 2005, section 511 provides that if payment of interest on a tax claim or on an administrative expense tax is required by the Bankruptcy Code, or the payment of interest is required so that a creditor receives the present value of its allowed tax claim, the rate of interest shall be the rate determined under applicable nonbankruptcy law. Applicable nonbankruptcy law for the determination of interest on federal tax liabilities is I.R.C. § 6621.
- Needs to provide for interest on priority claim as in Chapter 13 to extent claim would have been paid in a Chapter 7 liquidation case. Compare section 1225(a)(4) with section 1325(a)(4). The weight of authority provides that such a liquidation analysis should be performed as of the

date of confirmation rather than the date of filing. See In re Bremer, 104 B.R. 999 (Bankr. W.D. Mo. 1989), and In re Bluridg Farms, Inc., 93 B.R. 648 (Bankr. S.D. Iowa 1988).

- For cases filed on or after October 17, 2005, section 1222(b)(11) specifically allows post-petition interest on claims that are nondischargeable under section 1228(a). The provision allows payment of post-petition interest on such claims only if the debtor has sufficient disposable income to pay the interest after making provision for full payment of all allowed claims. Because section 1228(a) does not discharge a debt excepted from discharge under section 523(a), the Service may be able to obtain interest on its priority claim and on general unsecured claims that are nondischargeable under section 523(a)(1)(B) and (C).
- Provides for payments over three years, unless the court for cause approves a longer period up to five years. Section 1222(c).
- Debtor may modify plan at any time before confirmation as long as plan provision requirements are met. Section 1223(a).
- Plan may alter rights of secured creditors and may provide for repayment over a period of time that will exceed the life of the plan. Sections 1222(b)(2) and (9).

Note: Section 1222(a)(2) was amended under the BAPCPA to provide that a claim of a governmental unit arising from the sale, transfer, exchange or other disposition of any “farm asset used in the debtor’s farming operation” is treated as a general unsecured claim, rather than a priority claim under section 507, for plan payment purposes. Section 1222(a)(2)(A). The section applies only if the debtor receives a discharge under section 1228. The apparent purpose of the amendment to section 1222(a)(2) is to avoid the situation in which a family farmer is forced to liquidate over-encumbered assets to pay secured creditors, while incurring an additional priority capital gains tax. There was debate over whether section 1222(a)(2)(A) applies to postpetition tax claims. Although the Government argued the section only applies to prepetition priority claims in individual cases, debtors initially were successful in arguing that the provision also applies to postpetition taxes in individual cases; they argued the postpetition taxes were administrative expense priority taxes under section 503(b)(1)(B). In re Knudsen, 581 F.3d 696 (8th Cir. 2009); In re Dawes, 415 B.R. 815 (D. Kan. 2009) (appealed to the 10th Circuit); and In re Ficken, 430 B.R. 663 (10th Circuit BAP 2010) (appealed to the 10th Circuit). In 2010, however, the Ninth Circuit reversed the district court of

Arizona and held for the Government in United States v. Hall, 617 F.3d 1161 (9th Cir. 2010). This was followed by another favorable decision by a Pennsylvania bankruptcy court. In re Smith, 447 B.R. 435 (Bankr. W.D. Pa. 2011). The Tenth Circuit later reversed the Dawes and Ficken decisions, and held for the Government. United States v. Dawes, 652 F.3d 1236 (10th Cir. 2011); and United States v. Ficken, 2011 WL 3678690 (10th Cir. 2011). The matter, ultimately, was resolved by the Supreme Court in Hall v. United States, 132 S. Ct. 1882 (2012). In a victory for the Government, the Court held that section 1222(a)(2)(A) does not apply to postpetition taxes. The Court said the Internal Revenue Code makes clear that only certain estates are liable for federal income taxes and that under I.R.C. §§ 1398 and 1399, there is no separate taxable estate in Chapter 12 and 13 cases. As a result, it said the debtors, not the estate itself, were required to file the tax return at issue and were liable for the taxes resulting from the postpetition sale of farm assets.

Two other issues related to section 1222(a)(2)(A) continue to be litigated: (1) what qualifies as a “farm asset used in the farming operation” and (2) what method of allocation should be used to determine the portion of tax subject to the priority-stripping benefits of section 1222(a)(2)(A), the proration method or the marginal rate method. The debtors in Knudsen and other cases have argued with respect to the first issue that section 1222(a)(2)(A) applies to taxes on income from the sale of farm inventory. The Government has argued that inventory is not an asset “used in” a debtor’s farming operation. Rather, inventory is the end product. The Eighth Circuit disagreed with the Government on this issue in Knudsen. However, a Kansas bankruptcy court ruled in favor of the Government in In re Keith, 2013 WL 3467315 (Bankr. D. Kan. July 8, 2013), saying end products are not “used in” a farming operation the way breeding stock, land, and equipment are. It said reading section 1222(a)(2)(A) to mean an end product is “used in” is unnatural and gives no meaning to the word “used.” So far, however, courts have not agreed with the Government’s argument on the second issue that a proration method of allocation should be used with respect to section 1222(a)(2)(A).

NOTE: Cases involving section 1222(a)(2)(A) issues should be coordinated with PA Branch 5.

IX. CONFIRMATION - 11 U.S.C. §§ 1224 AND 1225

- Except for cause, hearing on confirmation must be concluded within 45 days from the plan filing date. NOTE: This could cause real problems for the Service where the plan is filed simultaneously with the petition.

However, frequently, it will take as long as 12-15 months to obtain confirmation.

- Any party in interest may object.
- Creditors do not vote.
- Plan must offer general unsecured creditors at least what they would get in a Chapter 7 liquidation proceeding and, as in Chapter 13, any unsecured creditor not scheduled for full payment may object and force the debtor to commit all disposable income to the plan.
- Under the BAPCPA, section 1225(b)(1) was amended to permit the court to confirm a Chapter 12 plan that provides for property distribution equal to or exceeding the debtor's projected disposable income in lieu of a provision providing that all of the debtor's disposable income will fund the plan.

X. DISCHARGE - 11 U.S.C. § 1228

- Discharge language is very similar to section 1328. In general, the debtor is granted a discharge after completing all the payments under the plan. Section 1228(a). Therefore, if all priority taxes (plus prepetition interest) are not paid as a part of the proceeding, these obligations may be collected after the discharge is granted. In addition, even if the priority tax obligations are paid through the plan, the accruing post-petition interest is not discharged. In re Wayne Cousins, dba Cousins Gardens, 209 F.3d 38 (1st Cir. 2000).
- Relates back to section 523(a).
- Hardship discharges are possible if unsecured creditors receive at least as much as they would have in a Chapter 7 proceeding and modification of the plan is not practicable. See section 1228(b).

XI. SPECIAL TAX PROVISIONS - 11 U.S.C. § 1231

- The BAPCPA amended section 1231(b) to provide that a plan proponent may request a determination of the tax consequences of the plan from any governmental unit. The request must be authorized by the court and is limited to questions of law. In the event of an actual controversy, the court can make a declaration of the tax effects after the earlier of the date the Government makes its determination, or 270 days after the request.

- This provision applies to cases commenced on or after the date of enactment (April 17, 2005).
- Rev. Proc. 2006-52, 2006-2 C.B. 995, contains the procedures for a plan proponent to make a request.