

QUALIFYING FOR RELIEF UNDER CHAPTER 12 OF THE UNITED STATES BANKRUPTCY CODE: HOW TO DO IT AND WHY DO IT!

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I. INTRODUCTION

Chapter 12 (Chapter 12) of the United States Bankruptcy Code (the Code), under Title 11 of the United States Code was established to help family farmers and family fishermen in economic difficulty reorganize their debts without losing their farms or commercial fishing operations.¹ While *Hall* specifically applied to a case involving a family farmer, it applies to Chapter 12 and, therefore, applies equally to a case involving a family fisherman.² Chapter 12 first appeared in 1986 as a temporary measure by the Bankruptcy Judges, United States Trustees, and Family Farmer Bankruptcy Act of 1986 and became permanent as of July 1, 2005, under the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA).³ Until BAPCPA, Chapter 12 relief was available only to family farmers.⁴ BAPCPA extended Chapter 12 relief to family fisherman.⁵

II. SELECTED BENEFITS TO A DEBTOR OF PROCEEDING UNDER CHAPTER 12

Chapter 12 offers unique bankruptcy relief, not available under any other Chapter of the Code. It contains the best parts of Chapter 13 and Chapter 11 and results in a powerful arsenal of debt and asset reorganization tools.⁶ Chapter 12 combines the streamlined confirmation process of Chapter 13 with the Chapter 11 ability to reorganize and pay secured debts—including real property and crop liens—which is well beyond the three or five year Chapter 13 plan length.⁷ The Chapter 12 plan confirmation process eliminates the cumbersome and time intensive Chapter 11 confirmation process by, among other things, eliminating the absolute priority rule making it easier to obtain confirmation of a Chapter 12 plan

1. *Cf.* *Hall v. United States*, 566 U.S. 506, 508-09, 524 (2012).

2. *Id.* (limiting the Chapter 12 capital gains tax benefits described in this essay to sales of applicable assets which had occurred prior to the filing of the bankruptcy case). In this regard, on October 26, 2017, *Hall v. United States* was legislatively overruled by Congress. *See* Additional Supplemental Appropriations for Disaster Relief Requirements Act, Pub. L. No. 115-72, § 1005(a), 131 Stat. 1232 (2017). That notwithstanding, *Hall*'s characterization of the purpose of Chapter 12 was not impacted by the Additional Supplemental Appropriations for Disaster Relief Requirements Act (Post-Petition Capital Gains Tax Amendment) and remains an appropriate and proper description thereof.

3. Bankruptcy Abuse Prevention and Consumer Protection Act, Pub. L. No. 109-8, 19 Stat. 23 (2005); ROBIN JEWELER, CONG. RESEARCH SERV., RS20742, CHAPTER 12 OF THE U.S. BANKRUPTCY CODE: REORGANIZATION OF A FAMILY FARMER OR FISHERMAN 1-2 (2005), <https://perma.cc/9EB8-BMNP>.

4. JEWELER, *supra* note 3, at 2.

5. *Id.*

6. *See id.* at 2-3.

7. *See* 11 U.S.C. § 1222(b)(9) (2020).

which proposes a pro rata payment of unsecured debt rather than payment in full.⁸ Chapter 12 also eliminates the preparation, solicitation, and acceptance of the time-intensive Disclosure Statement,⁹ which results in a process more akin to the confirmation process provided by Chapter 13 than by Chapter 11.¹⁰ As in Chapter 11, sales of assets through a Chapter 12 plan are free of transfer and recordation taxes.¹¹ The debtor also has the *unqualified* ability to cram down liens on the debtor's principal residence.¹² This enables the debtor to reduce the amount secured by the lien to the market value of the real property and restructure the total obligation by paying (1) the resulting reduced secured debt in full under different and more favorable payment terms, and (2) the amount of the debt in excess of the market value as a general unsecured claim—often pro rata and not payment in

8. 11 U.S.C. § 1129(b)(2)(B) (2020). *But see* 11 U.S.C. §§ 1181(a), 1191(c) (2020). Which provides for the elimination of the absolute priority rule in a Chapter 11 case in which the debtor has elected to proceed under new Subchapter V of Chapter 11 pursuant to Title 11 of Section 103. *See* 11 U.S.C. §§ 103(i), 1181-1195 (2020). The new addition of Subchapter V to Chapter 11 intended to enable qualified small business debtors to have a better chance of success in reorganizing under Chapter 11 than through a traditional Chapter 11 reorganization proceeding. The provisions of Sections 1181 through 1195 comprise the Small Business Reorganization Act of 2019 (SBRA). Small Business Reorganization Act of 2019, Pub. L. No. 116-54, § 2, 133 Stat. 1079 (being enacted on August 23, 2019 and effective on February 19, 2020).

9. *See* 11 U.S.C. § 1125 (2020). *But see* 11 U.S.C. § 1181(b) (providing the disclosure statement requirement is inapplicable absent court order stating otherwise in a Chapter 11 case in which the debtor has elected to proceed under new Subchapter V of Chapter 11).

10. *Compare* 11 U.S.C. §§ 1222-1225 (2020), *with* 11 U.S.C. §§ 1322, 1324-1325 (2020) *and* 11 U.S.C. §§ 1123-1126, 1129 (2020).

11. *See* 11 U.S.C. § 1231(a) (2020).

12. *See* 11 U.S.C. §§ 506(a), 1222(b)(2) (2020). *But see* 11 U.S.C. § 1190(3) (2020) (providing that a debtor may cram down certain specific liens secured solely by its principal residence *if*: (1) The new value received in connection with the granting of the specific security interest to be crammed down (2) *was not used* primarily to acquire the residence and (3) *was used* primarily in connection with the debtor's small business). The residential security interest subject to modification in the SBRA appears to involve liens from funds secured by a mortgage or deed of trust lien collateralized by the debtor's principal residence in which the funds were used solely in connection with the business and with the lien not being collateralized by any other assets—including business assets such as furniture, fixtures, equipment, or a general blanket lien covering all business assets in general. In light of the fact that many, if not most, commercial financing transactions involve liens on business assets along with an indemnity mortgage or deed of trust lien on the principal's real property, including the principal residence, if any, the security interests subject to modification under the SBRA may ultimately prove to represent a modicum of financing transactions. No such limitation or qualification exists regarding the principal residence cram down remedies available under Chapter 12.

full.¹³

Chapter 12, however, offers much more than that. There is at least one significant form of relief available only in Chapter 12 and nowhere else in the Code. Capital gains tax on the pre-petition and post-petition sale of farm assets used in the debtor's farming operation is treated as a dischargeable, general unsecured debt often payable pro rata and not in full.¹⁴ This is a significant departure from the usual treatment of capital gains taxes in bankruptcy cases. Capital gains taxes are often priority taxes, nondischargeable, and payable in full.¹⁵

In light of the enhanced nature of Chapter 12 relief, in particular the cram down and tax benefits, Chapter 12 relief is highly sought. Conversely, and for the same reasons, the eligibility requirements for Chapter 12 relief are stringent. To the extent the enhanced relief benefits debtors, it potentially operates to the detriment of creditors. Regular creditors are detrimentally impacted by the cram down provisions and the ability to more completely restructure long term secured debt. Taxing authorities are detrimentally impacted by conversion of what otherwise would be nondischargeable, priority tax debt—which is payable in full to general unsecured debt. This is distinctive as general unsecured debt is often dischargeable and not payable in full.

Consequently, motions to dismiss Chapter 12 administrative proceedings are routinely filed so the court may determine the debtor's eligibility for Chapter 12 relief. The motions are filed by creditors to avoid being subject to the enhanced

13. *Cf. Nobelman v. Am. Savings Bank*, 508 U.S. 324, 331 (1993) (discussing bifurcation of mortgage on principal residence into secured and unsecured components and prohibition thereof in Chapter 13).

14. *See* 11 U.S.C. § 1232(a) (2020).

15. By including post-petition sales of assets to the existing capital gains tax benefits already existing under Chapter 12, the Post-Petition Capital Gains Tax Amendment represents a significant further enhancement of the tax benefits of Chapter 12. Prior to its enactment, only sales of assets occurring prior to the filing of the bankruptcy case were entitled to receive the favorable treatment of the capital gains tax. *Hall v. United States*, 566 U.S. 506, 509-17 (2012). However, under the Post-Petition Capital Gains Tax Amendment, all sales of applicable assets are covered, regardless of whether the sale occurred prior to, or after, the filing of the bankruptcy case. This enables asset downsizing decisions to be made during the pendency of the case without the necessity of the requirement to pay applicable capital gains taxes in full. In turn, it potentially eliminates significant debt and promotes the likely successful Chapter 12 reorganization. Under prior law, capital gains taxes resulting from the sale of applicable assets during the pendency of the Chapter 12 case generated tax liability that could not be administered through the Chapter 12 plan and was required to be paid in full. Consequently, Section 1232(a), added to Chapter 12 by the Post-Petition Capital Gains Tax Amendment, represents a more complete significant tax benefit to a Chapter 12 debtor than has existed since the inception of Chapter 12. 11 U.S.C. § 1232(a).

relief and by Chapter 12 trustees to preserve the integrity of the bankruptcy system by ensuring that only eligible debtors proceed under Chapter 12. This article describes the eligibility requirements for a debtor to file and continue to proceed under Chapter 12.

With all due respect to the Code, which is an extraordinary statutory scheme that fulfills its promise to equitably balance the competing financial and survival interests of both debtors and creditors, the provisions which define the specific Chapter 12 eligibility requirements are not a model of clarity. Sorting through the provisions can often require an exercise of statutory interpretation which is cumbersome at best. Therefore, it is the intent and aim of this essay to describe the Chapter 12 eligibility requirements in a more clear and concise manner. As a result, the statutory requirements are laid out in this essay without regard to the specific order in which they appear in the Code. Rather, this essay strives to comprehensively present those requirements so they can be a working tool in determining a debtor's eligibility for Chapter 12 relief under the Code. It is hoped that aim has been achieved.

III. QUALIFYING FOR CHAPTER 12 RELIEF

In addition to the definition of both a family farmer and a family fisherman with “regular annual income,”¹⁶ the practitioner must determine if the debtor satisfies additional specific Chapter 12 eligibility requirements found in the Code.¹⁷ In the interests of effective comprehension, the aggregate eligibility requirements are categorized as Tier One—Preliminary Chapter 12 Eligibility Requirements and Tier Two—Final Chapter 12 Eligibility Requirements. However, it is important to note that for a debtor to meet the statutory definition of either a family farmer or a family fisherman, satisfaction of *both* Tier One and Tier Two is required.

IV. TIER ONE—PRELIMINARY CHAPTER 12 ELIGIBILITY REQUIREMENTS

For the first tier qualification, preliminarily only a family farmer or family fisherman with regular annual income may be a debtor under Chapter 12.¹⁸ Regular annual income means annual income sufficiently stable and regular to enable

16. See 11 U.S.C. § 101(19), (19B) (2020) (defining family farmer in subsection 101(19) and family fisherman in subsection 101(19B)).

17. See 11 U.S.C. § 101(18)(A), (18)(B) (outlining eligibility requirements for family farmers); 11 U.S.C. § 101(19)(A), (19)(B) (outlining eligibility requirements for family fisherman).

18. See 11 U.S.C. § 109(f) (2020).

payments to be made under a Chapter 12 plan.¹⁹ Individuals,²⁰ and to a limited extent, corporations and partnerships (an entity)²¹ may be family farmers and family fishermen. In either case, a farming operation or commercial fishing operation must exist.²²

Whether a Limited Liability Company (LLC) or a Limited Liability Partnership (LLP) would qualify to be a debtor under Chapter 12 is potentially an issue inasmuch as the Code does not specifically refer to those business formations but, rather, expressly limits an entity to either corporations and partnerships.²³ Notably, one court mentioned, but did not decide, the issue since it had not been raised in the objection to eligibility.²⁴

An Entity may be a family farmer or family fisherman if:

1. More than 50% of the outstanding stock or equity is held either by (1) one family, or (2) by one family and the relatives of the members of such family;
2. Such family or such relatives conduct either the farming operation²⁵ or the commercial fishing operation;²⁶ and
3. If the entity is a corporation which issues stock, such stock is not publicly traded.²⁷

In essence, to qualify as a family farmer or family fisherman, the entity must be family-held, as opposed to being a conglomerate. Notably, a conglomerate may be a “farmer” under the Code²⁸ and, along with a family farmer, is immune from being subject to an involuntary bankruptcy proceeding instituted against it.²⁹ And further, a conglomerate is immune from conversion of a Chapter 11 case in which it is a debtor to a case under Chapter 7 without its consent.³⁰ However, in light of

19. See 11 U.S.C. § 101(19) (defining family farmer with regular annual income); 11 U.S.C. § 101(19B) (defining family fisherman with regular annual income) (2020).

20. See 11 U.S.C. § 101(18)(A), (19A)(A).

21. See 11 U.S.C. § 101(18)(B), (19A)(B).

22. See 11 U.S.C. § 101(18)(A), (18)(B), (19A)(A), (19A)(B).

23. See 11 U.S.C. § 101(18)(B), (19A)(B).

24. See *In re Victorious, LLC*, 545 B.R. 815, 822 (Bankr. D. Vt. 2016).

25. See 11 U.S.C. § 101(18)(B) (combining number one and two).

26. See 11 U.S.C. § 101(19A)(B)(i) (combining number one and two).

27. See 11 U.S.C. § 101(18)(B)(iii) (discussing family farmer); 11 U.S.C. § 101(19A)(B)(ii)(III) (discussing family fisherman consisting solely of number three).

28. See 11 U.S.C. § 101(20).

29. See 11 U.S.C. § 303(a) (2020).

30. See 11 U.S.C. § 1112(c) (2020).

the specific qualification factors for an entity,³¹ a conglomerate does not, and cannot, qualify as a family farmer or family fisherman for eligibility for Chapter 12 relief.

Once a debtor—individual or entity—*preliminarily* qualifies as either a family farmer or family fisherman, the debtor must satisfy further requirements before it *completely* qualifies as a family farmer or family fisherman. These additional requirements are described herein as the Tier Two requirements.

V. TIER TWO—FINAL CHAPTER 12 ELIGIBILITY REQUIREMENTS

For this second tier of final eligibility requirements, a debtor must satisfy certain separate, but intertwined, tests, to wit:

1. The debt test,
2. The income test, and
3. The asset test.

Which test applies to a specific case depends on whether the debtor is an individual or an entity, to wit:

1. The debt test—applies to both individual and entity debtors,
2. The income test—applies to individual debtors only, and
3. The asset test—applies to entity debtors only.

As such, each debtor must satisfy two tests.

As a preliminary matter and prior to performing (1) the debt test and either (2) the income or (3) the asset test, whichever is applicable, the meaning of a farming operation and of a commercial fishing operation must first be understood. The factors to be satisfied by the eligibility tests *cannot* be determined in a vacuum.³² They are only determinable within the context of either a farming operation or a commercial fishing operation.

31. See 11 U.S.C. § 101(18)(B), (19A)(B)(i), (18)(B)(iii), (19A)(B)(ii)(III).

32. See *In re Watford*, 898 F.2d 1525, 1527 (11th Cir. 1990) (explaining after the appellants met the income and debt requirements of 11 U.S.C. § 101(21), the determination must be made as to whether the applicants were engaged in a farming operation).

A. Farming Operation Defined

The term “farming operation” includes—but is not limited to—farming, tillage of the soil, dairy farming, ranching, production or raising of crops, poultry, or livestock, and production of poultry or livestock products in an unmanufactured state.³³

What constitutes a farming operation is not intuitive. However, the definition of farming operation is to be liberally construed in order to further Congress’ purpose of helping family farmers continue farming.³⁴ Courts will look at the totality of the circumstances to determine if the operation is a farm operation, and consider factors such as: (a) whether the location of the operation would be considered a traditional farm, (b) the nature of the enterprise, (c) the type of product and its eventual market, (d) the physical presence or absence of family members on the farm, (e) ownership of traditional farm assets, and (f) whether the operation involves the growing or development of crops or livestock.³⁵ In addition to the above factors, by far the most significant factor is whether the operation is subject to the inherent risks of farming.³⁶ Stated another way, whether the operation is a risk-laden enterprise in which bad weather or disease can have a devastating effect on the farmer’s business.³⁷ An additional factor is whether the operation is a service-oriented business, which renders services for a fee, rather than a self-contained farming operation, which produces agricultural goods for consumption with compensation measured as a share of profits.³⁸ The following operations have been held to be farming operations: raising timber,³⁹ dog breeding,⁴⁰ operating a dairy farm,⁴¹ leasing farmland on a crop share basis,⁴² and horse breeding for resale.⁴³ The following operations have been held not to be farming operations: excavation, crushing, and sale of rock as gravel;⁴⁴ cleaning chicken houses and selling manure as a service business;⁴⁵ aerial crop dusting as a

33. See 11 U.S.C. § 101(21).

34. See *In re Watford*, 898 F.2d at 1528.

35. See *In re Sugar Pine Ranch*, 100 B.R. 28, 31(Bankr. D. Or. 1989).

36. See *id.*; see also *In re Showtime Farms, Inc.*, 267 B.R. 541, 543 (Bankr. E.D. Tex. 2000); *In re Carter*, 570 B.R. 500, 510 (Bankr. M.D. N.C. 2017).

37. See *In re Poe*, No. 08-906, 2009 WL 2357160, at *3-4 (Bankr. N.D. W. Va. 2009).

38. See *id.* at 3.

39. See *In re Glenn*, 181 B.R. 105, 108 (Bankr. E.D. Okla. 1995).

40. See *In re Maike*, 77 B.R. 832, 839 (Bankr. D. Kan. 1987).

41. See *In re Wolline*, 74 B.R. 208, 211 (Bankr. E.D. Wis. 1987).

42. See *In re Burke*, 81 B.R. 971, 976-77 (Bankr. S.D. Iowa 1987).

43. See *In re Poe*, 2009 WL at *6.

44. See *In re Carter*, 570 B.R. 500, 511 (Bankr. M.D.N.C. 2017).

45. See *In re McNeal*, 848 F.2d 170, 172 (11th Cir. 1988) (affirming Fed. Land Bank of

service business;⁴⁶ horse breeding, boarding, showing, and training where breeding was an incidental part of operation;⁴⁷ and a stone crabbing operation⁴⁸ prior to the addition of the family fisherman provisions to Chapter 12 by BAPCPA.

Equine operations present unique circumstances. They are often found not to constitute traditional farming operations. Whether a horse farm is a farming operation is often a matter of degree. There are cases which hold that only the breeding and sale of horses is a farm operation.⁴⁹ There are also cases which hold that horse breeding, training, and boarding are farm operations as well, depending on the degree that the specific activity constitutes a primary, or a minor, portion of the overall operation.⁵⁰

For example, the court in *Showtime Farms* stated as follows, to wit:

[The] Debtor's business [i]s raising horses for resale, boarding horses, training horse, renting horses and giving riding lessons . . . The Debtor maintains a pasture for the horses owned by [the] Debtor and by others that are boarded on the premises. The Debtor raises Bermuda grass . . . but most of the hay and feed for the animals is purchased. The property is insured under a farm policy and has an agricultural exemption for state tax purposes. . . . the real property owned by the Debtor contains traditional farm facilities and [the] Debtor conducts traditional farming operations. *The Debtor's operations are subject to the inherent risk of any farming operation including fluctuating market prices, feed prices, uncertain weather and risk to livestock from disease and injury. The [c]ourt must overrule [the] argument that the Debtor is not eligible for Chapter 12 relief because it is not a traditional farm.*⁵¹

B. Commercial Fishing Operation Defined

Commercial fishing operation means *either*: (1) “the catching or harvesting of fish, shrimp, lobsters, urchins, seaweed, shellfish, or other aquatic species or products of such species;”⁵² or (2) “aquaculture activities consisting of raising for market any species or product described in” category 1 above.⁵³

Columbia, 77 B.R. 315 (Bankr. S.D. Ga. 1987)).

46. See *In re Van Air Flying Service*, 146 B.R. 816, 818 (Bankr. E.D. Ark. 1992).

47. See *In re McKillips*, 72 B.R. 565, 568 (Bankr. N.D. Ill. 1987).

48. *In re Watford*, 898 F.2d 1525, 1527 (11th Cir. 1990).

49. See *In re Poe*, No. 08-906, 2009 WL 2357160, at *3, *6 (Bankr. N.D. W. Va. 2009); *In re McKillips*, 72 B.R. at 568-69.

50. See *id.* (discussing breeding as an incidental part of operation).

51. See *In re Showtime Farms, Inc.*, 267 B.R. 541, 543 (Bankr. E.D. Tex. 2000).

52. See 11 U.S.C. § 101(7A)(A) (2020).

53. See *id.* § 101(7A)(B).

There is a dearth of case law regarding a family fisherman. Until the body of case law is more developed, courts may rely on or refer to the similar case law for family farmer in determining certain issues regarding family fisherman eligibility under Chapter 12—while also relying on the Code’s definition of a commercial fishing operation.⁵⁴ Due to the exact language of the definition, it may be easier to determine a commercial fishing operation than a farming operation.⁵⁵ After determining if the debtor is engaged in either a farming operation or a commercial fishing operation, the analysis moves to the final eligibility factors.

C. Final Eligibility Factors

The remaining eligibility factors are contained at the Code provisions which define a “family farmer”⁵⁶ and a “family fisherman.”⁵⁷

VI. DEBT TEST (BOTH INDIVIDUALS AND ENTITIES)

A. Family Farmer

The debt test is a two-part test, and each part must be separately satisfied.⁵⁸ Part One requires that on the petition date, the individual (or individual and spouse) or entity must be engaged in a farming operation and have “aggregate debts” not exceeding \$10 million.⁵⁹ Part Two requires not less than 50% of the “aggregate

54. See *In re Victorious, LLC*, 545 B.R. 815, 821 (Bankr. D. Vt. 2016).

55. See, e.g., *Lakefront Investors LLC v. Clarkson*, 484 B.R. 72, 75-76 (D. Md. 2012) (holding debtors as Eastern Shore watermen were engaged in commercial fishing operation, but were not eligible for Chapter 12 relief as debt limits were exceeded); *In re Sine*, No. J08-00152-DMD, 2009 WL 8413039, at *1-3 (Bankr. D. Alaska 2009) (holding that a commercial fisherman debtor who owned three fishing vessels with the majority of income derived from a commercial fishing operation qualified as a Chapter 12 debtor). But see *In re Allen*, No. 0:00-bk-15206-EWH, 2012 WL 1207233, at *2 (Bankr. D. Ariz. 2012) (holding a debtor did not qualify for Chapter 12 relief since he did not own or operate a commercial fishing operation but was a non-management employee of a fishing operation and also failed the income test).

56. See 11 U.S.C. § 101(18).

57. See 11 U.S.C. § 101(19A).

58. See 11 U.S.C. § 101(18)(A).

59. See *id.* The \$10 million debt limit represents the most recent development in the evolution of Chapter 12. On August 23, 2019, the President signed the Family Farmer Relief Act of 2019 (FFRA) into law. With enactment of FFRA, the aggregate debt limit for family farmers to qualify for Chapter 12 bankruptcy was increased to \$10 million. Prior thereto, as of April 1, 2019, the aggregate debt limit had been \$4,411,400. This 126.68% increase is effective for all bankruptcy cases filed on and after August 23, 2019. The change in the aggregate debt limit for family farmers represents the latest congressional intervention on behalf of the American farming community in response to challenging economic conditions and to enable more family farmers to potentially qualify for Chapter 12 relief. This is

noncontingent, liquidated debts” must have arisen out of a farming operation owned or operated by the individual or entity, exclusive of any debt for a principal residence or dwelling unit unless that debt arises out of the farming operation.⁶⁰ Note that the debt limits contained in Part One of the debt test consist of *all* debts of the debtor, regardless of whether those debts are contingent, unmatured, contested, or unliquidated.⁶¹ However, in order to satisfy Part Two of the debt test, at least 50% of the total of all of the debtor’s noncontingent, liquidated debts must have arisen out of the farming operation.⁶² This essentially means at least 50% of the debtor’s aggregate debt must have arisen from the farming operation and that specific 50% amount must be noncontingent and completely liquidated debt to a sum certain.⁶³ The challenge will be to show the debt test has been satisfied with debt arising from a qualifying farming operation.

Notably, all dollar amounts contained in the Code automatically adjust on April 1st of each three-year period in accordance with the consumer price index.⁶⁴ The latest consumer price index adjustment occurred on April 1, 2019.⁶⁵ Therefore, the aggregate debt limit amount of \$4,411,400 further adjusted to \$10 million as of August 23, 2019 by the FFRA is effective for all Chapter 12 bankruptcy cases for family farmers filed between April 1, 2019 through August 22, 2019 and on and after August 23, 2019, respectively, and will adjust again from a base of \$10 million on April 1, 2022, and every three years thereafter.⁶⁶

evidenced from testimony at the oversight hearing held before the Subcommittee on Antitrust, Commercial, & Administrative Law of the House Judiciary Committee on June 25, 2019, as follows: “Farmers are currently facing a fifth year of declining net farm income. Prices are low, inputs are high, and current trade policies make the future unknown.” *Oversight of Bankruptcy Law and Legislative Proposals: Hearing on H.R. 23336 Before the H. Comm. on the Judiciary*, 116th Cong. (2019) [hereinafter *Hearing on H.R. 23336 Before the H. Comm. on the Judiciary*] (statement of Rep. Antonio Delgado). The increase in debt eligibility reflects the fact that land and equipment values have increased as well as the average size of United States farming operations. *Id.* (statement of Robert J. Keach, the American Bankruptcy Institute) (“Debt amounts are much higher today, given capital requirements for farm land, equipment and inputs.”). “The National Farmers Union also joined in endorsing this the [FFRA] saying that is, ‘will help more family farmers avoid liquidation or foreclosure, allowing them to stay in operation.’” *Id.* (statement of Rep. Antonio Delgado) (quoting National Farmers Union).

60. See 11 U.S.C. § 101(18)(A), (18)(B)(ii).

61. See 11 U.S.C. § 101(18).

62. 11 U.S.C. § 101.

63. See *id.*

64. 11 U.S.C. § 104 (2020).

65. Revision of Certain Dollar Amounts in the Bankruptcy Code Prescribed Under Section 104(a) of the Code, 84 Fed. Reg. 3488, 3488 (Feb. 12, 2019).

66. See 11 U.S.C. §§ 101, 104. For previous Chapter 12 cases filed between April 1,

B. Family Fisherman

As for a family farmer, the debt test is also a two-part test. Each part must be separately satisfied. Part One requires on the petition date, the individual (or individual and spouse) or entity must be engaged in a commercial fishing operation and have aggregate debts not exceeding \$2,044,225.⁶⁷ Part Two requires not less than 80% of the aggregate noncontingent, liquidated debts must have arisen out of a commercial fishing operation owned or operated by the individual or entity, exclusive of any debt for a principal residence or dwelling unit unless that debt arises out of the commercial fishing operation.⁶⁸

Again, similar to that for a family farmer, note that the debt limits consist of all debts of the debtor—regardless of whether those debts are contingent, unmatured, contested, or unliquidated. However, in order to satisfy Part Two of the debt test, at least 80% of the total of all of the debtor's noncontingent, liquidated debts must have arisen out of the commercial fishing operation.⁶⁹ This essentially means at least 80% of the debtor's aggregate debt must have arisen from the commercial fishing operation *and* that specific 80% amount must be noncontingent debt and completely liquidated to a sum certain.⁷⁰

The challenge will be to show the debt test has been satisfied with debt arising from a qualifying farming operation. Moreover, due to the reduced aggregate debt limits and the increased percentage amounts as applied to family fisherman, the eligibility requirements for Chapter 12 relief as a family fisherman may ultimately prove more stringent than those for a family farmer.⁷¹ As previously stated, all dollar amounts contained in the Code automatically adjust every three years in accordance with the consumer price index.⁷² Therefore, the amount contained in above in this section is effective for all bankruptcy cases filed on and after April 1, 2019, and will adjust again on April 1, 2022, and every three

2016 and March 31, 2019, the aggregate debt limit for a family farmer was in the amount of \$4,153,150. For Chapter 12 cases filed for a family farmer during the period from April 1, 2019 through August 22, 2019, the aggregate debt limit was in the amount of \$4,411,400. For Chapter 12 cases filed for a family farmer on and after August 23, 2019, the aggregate debt limit is in the amount of \$10 million and will remain effective through March 31, 2022, readjusting on April 1, 2022).

67. See 11 U.S.C. § 101; Revision of Certain Dollar Amounts in the Bankruptcy Code Prescribed Under Section 104(a) of the Code, 84 Fed. Reg. at 3488 (showing the aggregate debt limit for a family fisherman was not changed by the FFRA).

68. 11 U.S.C. § 101(19A)(A)(I), (19A)(B)(ii)(II).

69. See 11 U.S.C. § 101(19A)(A)(i).

70. See 11 U.S.C. § 101(19A)(A)(i).

71. *In re Victorious*, 545 B.R. 815, 821 n.6 (Bankr. D. Vt. 2016).

72. See 11 U.S.C. § 101(19A)(A)(i).

years thereafter.⁷³ After satisfying the debt test, the analysis moves to the income test if the debtor is an individual or to the asset test if the debtor is an entity.

VII. INCOME TEST (INDIVIDUALS ONLY)

A. Family Farmer

The individual (or individual and spouse) must have received from the farming operation more than 50% of the individual's (or individual and spouse's) gross income for: (a) the taxable year preceding the taxable year in which the bankruptcy case is filed,⁷⁴ or (b) for each of the second and third taxable years preceding the taxable year in which the bankruptcy case is filed.⁷⁵

B. Family Fisherman

The individual (or individual and spouse) must have received from the commercial fishing operation more than 50% of the individual's (or individual and spouse's) gross income for the taxable year preceding the taxable year in which the bankruptcy case is filed.⁷⁶ As with the debt test, in light of the reduction in the time frame available to demonstrate qualifying income—two distinct periods allowed for qualification as a family farmer compared with only one time period allowed for qualification as a family fisherman—the eligibility requirements for a family fisherman continue to be potentially more stringent than those for a family farmer.⁷⁷

Gross income is not defined in the bankruptcy code.⁷⁸ Generally, however, cases have held that the term “gross income” for purposes of Chapter 12 eligibility should be defined as it is in the United States Tax Code, Title 26.⁷⁹ The United States Tax Code generally defines gross income as “all income from whatever source derived.”⁸⁰ That said, the use of the United States Tax Code definition of

73. For previous Chapter 12 cases filed between April 1, 2016 and March 31, 2019, the aggregate debt limit for a family fisherman was in the amount of \$1,924,550.

74. See 11 U.S.C. § 101(18)(A)(i).

75. See 11 U.S.C. § 101(19A)(A)(ii).

76. See *id.*

77. *In re Victorious*, 545 B.R. 815, 821 (Bankr. D. Vt. 2016).

78. See 11 U.S.C. § 101.

79. See, e.g., *In re Sandifer*, 448 B.R. 382, 385-86 (Bankr. D. S.C. 2011); *In re Wagner*, 808 F.2d 542, 549 (7th Cir. 1986) (construing gross income for purposes of definition of farmer, not family farmer, but cited in family farmer case law); *In re DeGour*, 478 B.R. 1, 5 (Bankr. C.D. Ca. 2012).

80. See 26 U.S.C. § 61(a) (2020).

gross income for Chapter 12 eligibility purposes is not absolute, and a limited minority of cases determine the meaning of gross income by a consideration of the totality of the circumstances of the case.⁸¹

As with the debt test, the income test must be satisfied with income arising from a qualifying farming operation or commercial fishing operation.⁸² As with the definition of a farming operation, what income arises from a qualifying farming operation or commercial fishing operation is likewise not intuitive and is susceptible to challenge to the extent the income at issue is not income directly received from the qualifying farming operation or commercial fishing operation.⁸³

The following income has been found to be qualified income: the sale of farm equipment when the sale was equipment “inescapably interwoven” with the farming operation which, when sold in order to scale down the operation, resulted in proceeds which constituted farm income;⁸⁴ money paid to the debtor by another for services not related to the debtor’s own farm was farm income when used to pay farm debts;⁸⁵ and income generated by the debtor’s LLC or Subchapter S corporation which owned and operated the farming operation was included in the individual debtor’s gross income for purposes of Chapter 12 eligibility of the individual since income is received from a pass through entity.⁸⁶

The following income has been found not to be qualified income: rental of farm land where the rent was paid in cash and up front on the basis that the rental income was not “a risk-laden venture in the nature of farming,”⁸⁷ rental of a farm

81. See, e.g., *In re Rott*, 73 B.R. 366, 371-72 (Bankr. D. N.D. 1987) (holding debt forgiveness income not considered income for Chapter 12 eligibility purposes since debtor did not receive such income even though it qualified as gross income under the United States Tax Code), *abrogated on other grounds by In re Wruck*, 183 B.R. 862, 862 (Bankr. D. N.D. 1995). *In re Faber*, 78 B.R. 934, 935-36 (Bankr. S.D. Iowa 1987) (holding the United States Tax Code definition should apply but a strict tax code approach should be modified or abandoned in cases in which a tax code solution would be “absurdly irreconcilable” with the purpose of Chapter 12); *In re DeGour*, 478 B.R. 1, 5 (Bankr. C.D. Cal. 2012).

82. IRS, FARMER’S TAX GUIDE 8, (Oct. 28, 2019), <https://perma.cc/3YFZ-QA6A>.

83. See *id.*

84. See, e.g., *In re Armstrong*, 812 F.2d 1024, 1026 (7th Cir. 1987).

85. See, e.g., *In re Hettinger*, 95 B.R. 110, 113-14 (Bankr. E.D. Mo. 1989).

86. See, e.g., *In re Sandifer*, 448 B.R. 382, 385-86 (Bankr. D. S.C. 2011); see also *In re Schafroth*, 81 B.R. 509, 511-12 (Bankr. S.D. Iowa 1987).

87. Notably the dissent disagreed on the basis that the result should be derived from an analysis based on the totality of the circumstances and reviewed on a case by case basis. To the dissent, the determining factor is whether the land under lease is part of the ongoing farming operation or whether it is a separate and distinct venture. *In re Armstrong*, 812 F.2d at 1027 (7th Cir. 1987).

house on debtors' land was not farm income,⁸⁸ and income generated by a debtor's Subchapter C corporation which owned and operated the farming operation and which is not a pass through entity except to the extent of corporate distributions paid to the debtor.⁸⁹

Moreover, current economic farming conditions may make the income test especially challenging for those farmers who find that they have to subsidize their farm income by engaging in additional employment off the farm in order to meet their operating and living expenses.⁹⁰ In addition to the impact of the coronavirus pandemic, it is well known that net farm income has declined for the last five years and continues to decline as a result of, among other things, uncertain economic and climate conditions which negatively impact production and income.⁹¹ More likely than not, as negative economic conditions for farmers persist, more family farmers may have to seek outside sources of income to make ends meet. To the extent farm income decreases and the outside sources of income increase, it likely may be that the threshold 50% of income from the farming operation may become more difficult, or impossible, to satisfy for many family farmers and possibly for the class of family farmer or family fisherman who would benefit most from the benefits of Chapter 12.

VIII. ASSET TEST (ENTITIES ONLY)

A. Family Farmer & Family Fisherman

The asset test is the same whether the entity is a family farmer or a family fisherman.⁹² For each, more than 80% of the value of the entity's assets must consist of assets related to the farming operation or to the commercial fishing operation respectively.⁹³

IX. SUMMARY OF THE TIER TWO CHAPTER 12 FINAL QUALIFICATION PROCESS

Upon satisfaction of the debt test and (1) the income test if the debtor is an individual, or (2) the asset test if the debtor is an entity, the debtor qualifies as a family farmer or family fisherman.⁹⁴ If the family farmer or family fisherman has

88. See, e.g., *In re Maschhoff*, 89 B.R. 768, 768 (Bankr. S.D. Ill. 1988) (following *Armstrong*).

89. *In re Schafroth*, 81 B.R. 509, 512 (Bankr. S.D. Iowa 1987).

90. See, e.g., *In re Armstrong*, 812 F.2d at 1029 (7th Cir. 1987).

91. See *Hearing on H.R. 23336 Before the H. Comm. on the Judiciary*, *supra* note 59.

92. See 11 U.S.C. § 101(18)(B)(i), (19A)(B)(ii)(i) (2020).

93. 11 U.S.C. § 101(18)(B)(i), (19A)(B)(ii).

94. 11 U.S.C. § 109(f) (2020).

regular annual income sufficiently stable and regular to enable payments to be made under a Chapter 12 Plan—⁹⁵ the debtor qualifies for Chapter 12 relief.⁹⁶

X. CONCLUSION

The foregoing demonstrates the requirements for a debtor to qualify for Chapter 12 relief. Experience proves that many more petitions will be filed under Chapter 12 than will be allowed to remain and proceed thereunder. For those which remain, the debtor will be entitled to the best and most comprehensive relief available to a debtor in bankruptcy under the provisions of the United States Bankruptcy Code.

95. See 11 U.S.C. § 101(19), (19B).

96. 11 U.S.C. § 109(f).