

What's in a Name? When is a Farmer a Family Farmer Under the Bankruptcy Code?

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The United States Bankruptcy Code contains a special bankruptcy chapter for family farmers with regular income. Chapter 12 of the Bankruptcy Code allows family farmers to reorganize in a preferred way. For example, a family farmer that liquidates a portion of the farm property while in bankruptcy can obtain favorable tax treatment. Likewise, the standards for confirming a plan are relaxed from those imposed by Chapter 11. Of course, the first question is whether the debtor constitutes a family farmer within the meaning of the Bankruptcy Code. And the details matter.

The Bankruptcy Code defines a family farmer as an individual or individual and spouse “engaged in a farming operation” with aggregate debt of \$10,000,000.00 or under. Additionally, 50 percent of the family farmer’s noncontingent, liquidated debts must arise out of a farming operation, and the debtor (and spouse, if applicable) must have received more than 50 percent of his/her gross income in the taxable year prior to the petition from farming operations. The definition suggests a mathematical computation based upon the debtor’s tax return. But the term “farming operation” is open to interpretation. The Bankruptcy Court for the Western District of Wisconsin recently examined the finances of a proposed Chapter 12 debtor and concluded that the debtor, while a farmer, did not receive more than 50 percent of his gross income from farming operations. *In re Hoel*, 2020 WL 4382760 (Bankr. W.D. Wis. 2020). As a result, he could not use Chapter 12 of the Bankruptcy Code to reorganize.

In the *Hoel* case, the putative debtors, a husband and wife, had gross income of \$47,650.00 in 2019, the year before their Chapter 12 filing. This excluded income from social security and insurance sales. The gross income number was further broken down into income from cattle sales and breeding as well as income from the boarding of horses. The horse boarding income accounted for roughly 70 percent of the family’s gross income in 2019. The Chapter 12 Trustee contended that the debtors were not eligible for relief under Chapter 12 since their income from farming operations did not meet the 50 percent test set forth in section 101 (18) of the Bankruptcy Code.

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The Bankruptcy Code provides an illustrative, but not exhaustive, list of the activities that constitute a farming operation. In the more than 30 years since the enactment of Chapter 12, courts have created standards for determining when an activity is considered a “farming operation.” The Seventh Circuit Court of Appeals has determined that only those “whose activities involved the inherent risks and cyclical uncertainties that are associated with farming” were entitled to the Bankruptcy Code’s unique protections for farmers. *In re Armstrong*, 812 F.2d 1024, 1027 (7th Cir. 1987). In looking at the guidance provided by *Armstrong*, the Bankruptcy Court acknowledged that its review of the debtor’s activities must be “pragmatic.” *Hoel*, p. 2.

The *Hoel* court examined the horse boarding operation in order to determine whether the operators were exposed to the risks and vagaries of weather and pricing that farmers typically endure. After a review of other cases dealing with horse boarding operations, the court concluded that the income from horse boarding was simply too far removed from farming operations to qualify. The court noted that the putative debtors had “absolute control over establishing the terms of the boarding agreements.” *Hoel*, p. 4. This allowed them to compensate for the impact of increased feed prices or other demands on their time from the boarding operation. The court granted the motion to dismiss.

In the current environment, farm bankruptcies are expected to skyrocket. Farmers faced significant financial challenges before the COVID-19 pandemic, and the closing of schools and restaurants has added to the tensions for the farming community, particularly small farmers. Decisions such as *Hoel* demonstrate the importance of carefully scrutinizing bankruptcy filings.

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