



SIMMONS PERRINE MOYER BERGMAN PLC

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Automatic Stay Violations and Chapter 12 Update

June 19, 2018

Summer Ag Law Webinar Series

Register at: www.spmblaw.com/agwebinar

Tuesday, July 24, 2018 | 12:00 - 1:00 PM

Lynn Hartman and Jared Knight will present a reprisal of the Iowa Agriculture Mortgage Foreclosures and Related Issues webinar. This hour will be packed with information on preparing for mandatory mediation, a review of the Iowa farm homestead, satisfying debt and marshaling between competing real estate creditors, and a review of the timeline for Iowa ag mortgage foreclosure.

Thursday, September 13, 2018 | 12:00 - 1:00 PM

Lynn Hartman and Christopher Loftus will give an update on minimizing risk on problematic ag loans. They will focus on the risks and pitfalls of ag lending and provide helpful reminders to lenders on working with their farmers and other lenders.



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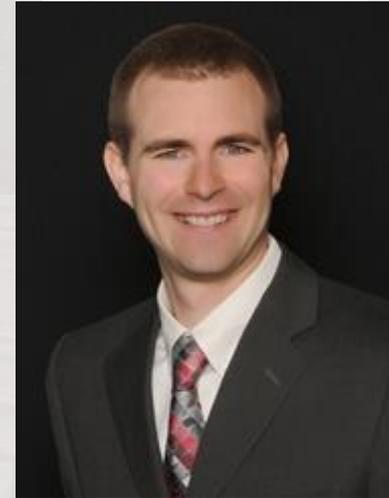
Today's Presenters:



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Automatic Stay Violations and a Review of Recent Decisions

Please refer to the downloadable file on the webinar.



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Developments in Chapter 12 Farm Bankruptcy Laws



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Chapters of Bankruptcy Review

Chapter 7: Liquidation

Chapter 11: Business Reorganization or Orderly Sale

Chapter 12: Farm Bankruptcy

Chapter 13: Consumer Bankruptcy

Also: Chapter 9 (Municipality) and Chapter 15 (International Bankruptcy)



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Chapter 12 – Farm Bankruptcy

Depression Era History

- Section 75 of Bankruptcy Act in 1933
- Cram down added in 1934
- Expired 1949

Birth from 1980's Farm Crisis

- Unique financial position of farmers
- (Also family fishermen)

Qualifications:

- “Family Farmer”
 - Individual engaged in farming (broad)
 - Total Debts less than \$4,153,150
 - At least 50% of debt from farming
 - At least 50% of gross income from farming



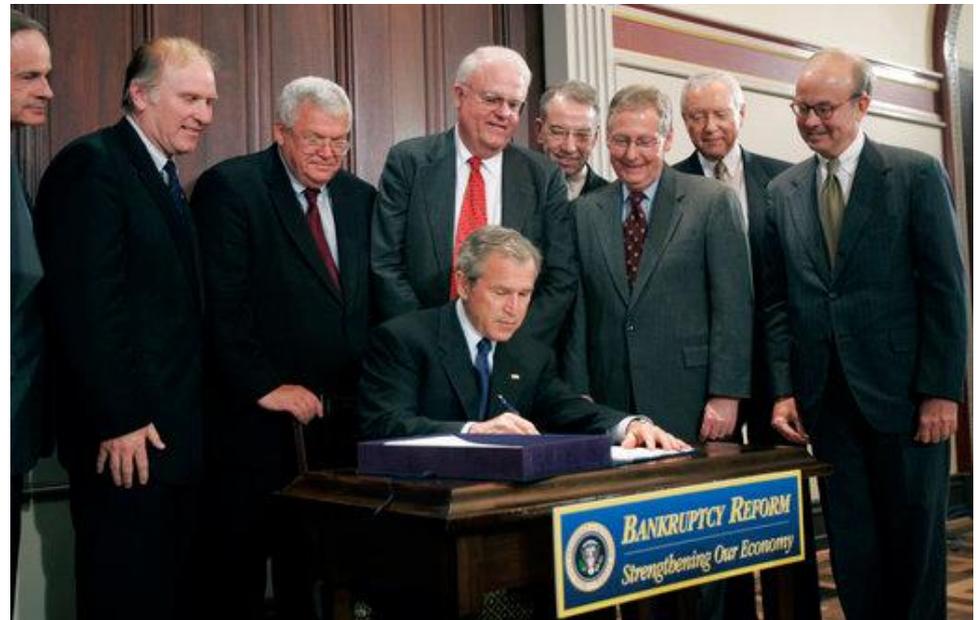
Chapter 12 – Farm Bankruptcy

Originally enacted for 7 years:

- Designed to give family farmers a “fighting chance” to reorganize debts and keep their land.
- Chapter 11 not effective

Significant 2005
Reforms:

- Made permanent
- Introduced Concept of Deprioritizing Tax and Other Government Claims – 1222(a)(2)(A)



Chapter 12 – 1222(a)(2)(A)

Problem: Farm “right-sizing” often includes the sale of farm assets.

- Capital Gains
- Depreciation Recapture
- USDA Penalties

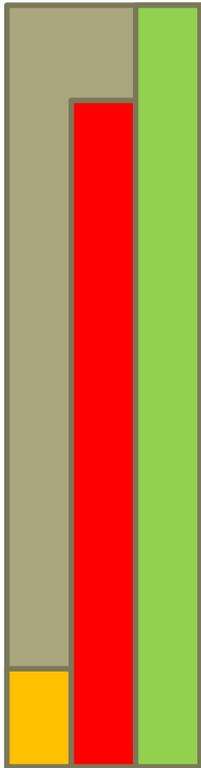
Catch-22:

- Incur tax before bankruptcy – cannot cash flow priority claim
- Incur tax after bankruptcy – defeats the purpose



Chapter 12 – 1222(a)(2)(A)

Tax Review – Real Estate Liquidation



High Yield Farm:

\$1,500 80's Purchase & Basis

\$10,500 Debt Load

\$12,000 Sale Price

Consequence of Sale:

Auction Price \$12,000

Auction Fee (2%): \$240

Bank Payment: \$10,500

Tax: \$10,500 Gain * 24%: \$2,520

Tax Owed \$1,260/acre

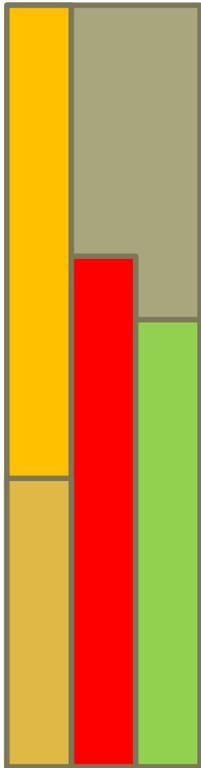


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Chapter 12 – 1222(a)(2)(A)

Tax Review: - Farm Equipment Liquidation



Combine:

\$300,000 Purchase with \$112,500 Basis

\$200,000 Debt Load

\$175,000 Sale Price

Consequence of Sale:

Auction Price \$175,000

Auction Fee (2%): \$3,500

Debt Payment: \$171,500

Tax: \$62,500 Recapture * 39%: \$24,375

Debt Owed: \$29,000 Tax Owed \$24,375



Chapter 12 – 1222(a)(2)(A)

Grassley Solution: 1222(a)(2)(A) - Deprioritize the Government's Claims

The Farmer's Plan of Reorganization Shall:

“provide for the full payment, in deferred cash payments, of all claims entitled to priority under section 507, unless – the claim is a claim owed to a governmental unit that arises as a result of the sale, transfer, exchange, or other disposition of any farm asset used in the debtor's farming operation, in which case the claim shall be treated as an unsecured claim that is not entitled to priority under section 507”



Chapter 12 – 1222(a)(2)(A)

Problem – The IRS Does Not Enjoy Being Deprioritized

IRS Argument: 1222(a)(2)(A) only applies to tax incurred in tax years before bankruptcy filing.

- Knudsen v. I.R.S., 581 F.3d 696 (8th Cir. 2009) – Debtor Wins
- United States v. Hall, 617 F.3d 1161 (9th Cir. 2009) – IRS Wins
- In re Dawes, 652 F.3d 1236 (10th Cir. 2011) – IRS Wins

The United States Supreme Court decided to hear the Hall case on June 13, 2011.



Chapter 12 – Hall v. U.S.

May 14, 2012 – Hall Decided:

- 5-4 decision
- Legislative history and Grassley’s statement of intent does not refute text and structure of Bankruptcy Code
- IRS wins
- The 2005 amendments did not go far enough...



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Chapter 12 – Reaction to Hall

In the Field: Farmers pre-planning farm reorganizations in tax year before bankruptcy filing

- Bank foreclosures and land sales complete.
- Equipment repossession or auction complete.
- Grain sales.
- CRP contracts.
- Any other governmental liability subject to 1222(a)(2)(A)

In the Legislature: Grassley begins plan to implement intent of 1222(a)(2)(A) with amendment.



Chapter 12 – 2017 Amendment

Family Farmer Bankruptcy Clarification Act of 2017:

- Attached to Puerto Rico Disaster Relief Appropriations Bill. 82-17 vote in the Senate.
- Signed by President Trump October 26, 2017.
- Effective immediately.



Chapter 12 – 2017 Amendment

New Section 1232:

- (a) Any unsecured claim of a governmental unit against the debtor or the estate that arises before the filing of the petition, or that arises after the filing of the petition and before the debtor's discharge under section 1228, as a result of the sale, transfer, exchange, or other disposition of any property used in the debtor's farming operation--
- (1) shall be treated as an unsecured claim arising before the date on which the petition is filed;
 - (2) shall not be entitled to priority under section 507;
 - (3) shall be provided for under a plan; and
 - (4) shall be discharged in accordance with section 1228.



Chapter 12 – 2017 Amendment

Consequences:

- Pre-planned liquidations not necessary
- Increased bankruptcy sales
 - Less leverage for secured creditors
 - Partial sales
 - Forced repayment terms beyond plan life
- Allow stall tactics for favorable market shift



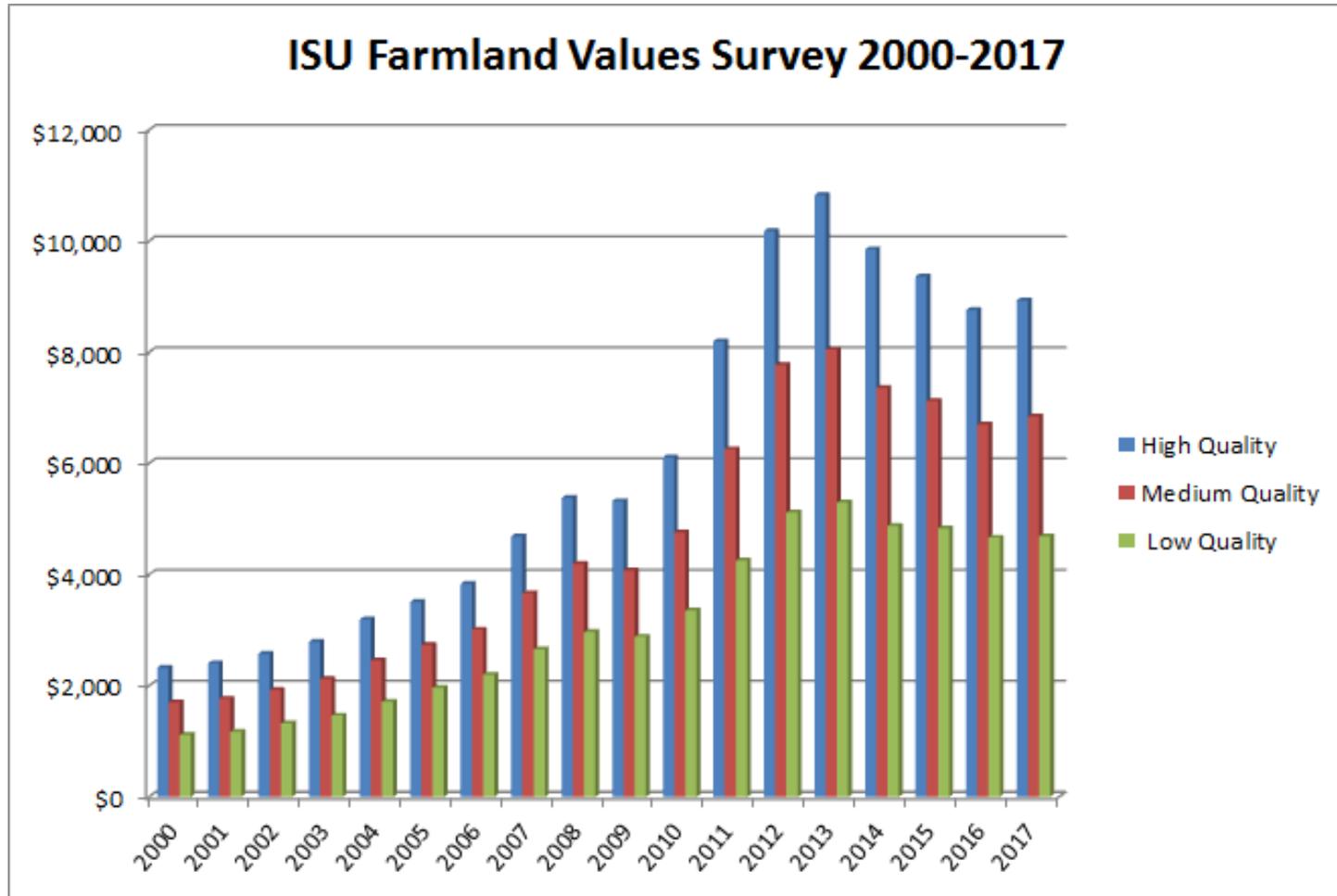
Chapter 12 – Unresolved Issues

Debt Limits:

- \$4,153,150 too low
- Liquidate outside of bankruptcy to reach limit
- Cannot liquidate down in Chapter 11
- Chapter “19” = 7 + 12
 - Homestead tokenism farming
 - Unresolved non-recourse debt tax issues
 - Continued income qualification?



Chapter 12 – Unresolved Issues



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Chapter 12 – Unresolved Issues

Tax Review – Non-Recourse Debt

High Yield Farm:

\$1,500 80's Purchase & Basis

\$12,000 Debt Load

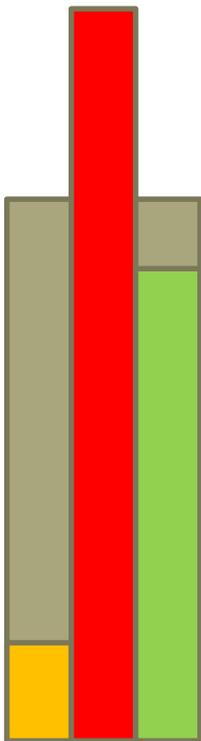
\$9,000 Appraisal

\$8,000 Sale Price

Consequence of Sale:

- Supreme Court *Tufts* opinion: sale price or arguable fair market value irrelevant to amount realized where nonrecourse debt is higher
- Gain: \$10,500

Effect on subsequent use of 1222(a)(2)(A)?



Chapter 12 – Unresolved Issues

Cash Collateral or Operating Financing

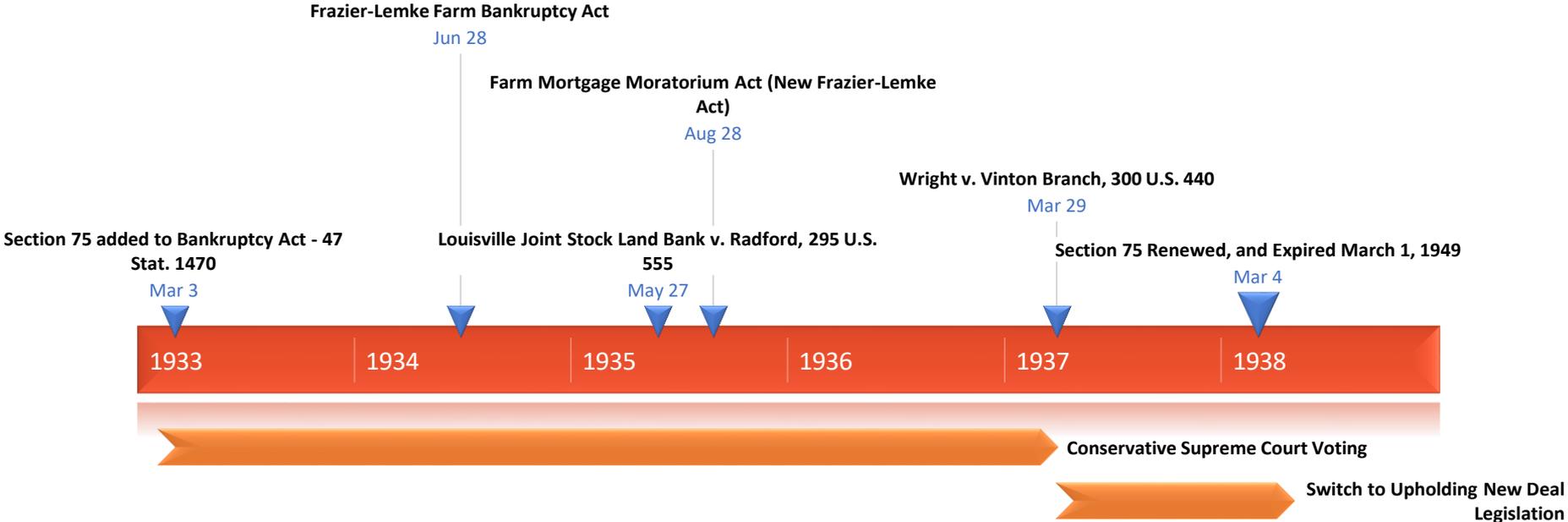
- 2018 crop as 2019 input financing?

Cash Flow:

- Farmers remain subject to “liquidation value” test
- Poor market conditions
- Chinese sanctions on ag. products

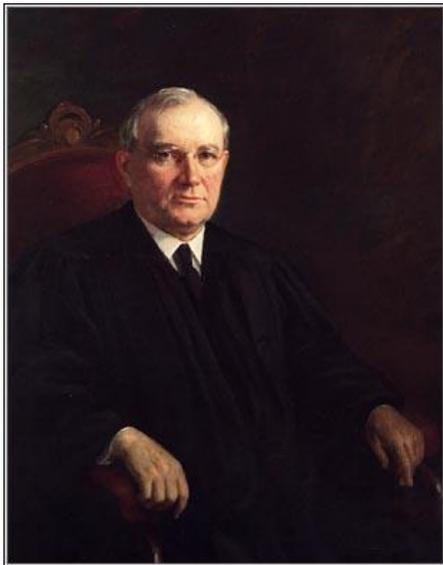


Farm Bankruptcy History



Supreme Court History

The Four Horsemen: Justices Pierce Butler James Clark McReynolds, George Sutherland, and Willis Van Devanter



Conservative philosophy

Consistently invalidated President Roosevelt's New Deal

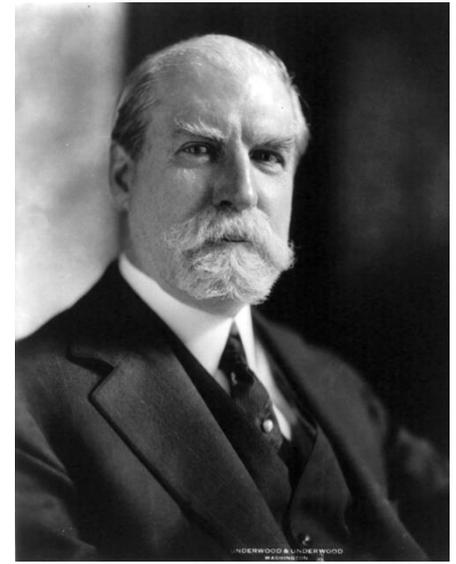


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Supreme Court History

Progressive Jurists: Justices Louis Brandeis, Benjamin Cardozo, Harlan Fiske Stone, and Chief Justice Charles Evans Hughes.

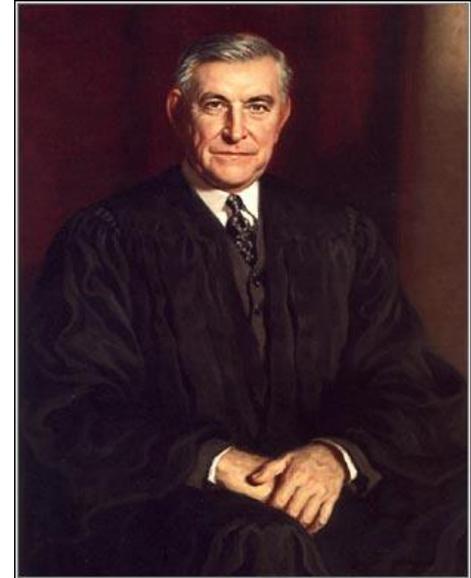


Voted to uphold New Deal legislation

Supreme Court History

The Switchman: Justice Owen Roberts

- Consistently voted against New Deal legislation in 1935 & 1936.
- Roosevelt announces Judicial Procedures Reform Bill Feb. 5, 1937
- Justice Stone returns to the Court February 1937.



March 29, 1937 – Three Opinions:

- West Coast Hotel Co. v. Parrish (upholding state min. wage)
- Virginian Railway Co. v. Railway Employees (upholding Railway Labor Act)
- Wright v. Vinton Branch (upholding New Frazier-Lemke Act)



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We will respond to your questions individually via email following today's presentation.

Thank you for attending.

CLE Notice: This presentation is an accredited program under the regulations of the Iowa Supreme Court Commission on Continuing Legal Education. This program will provide a maximum of 1 hour of regular credit toward the mandatory continuing legal education requirements established by Rules 41.3 and 42.2. [Activity #300041]



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