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**THE ANNUAL BANKRUPTCY ISSUE**



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Chapter 12 had been in existence for thirty-three (33) years when the Family Farmer Relief Act of 2019 (“FFRA”) <sup>1</sup>; and the Small Business Reorganization Act of 2019 (“SBRA”) <sup>2</sup>, two bills amending the U.S. Bankruptcy Code, were signed into law by President Donald J. Trump on August 23, 2019. The FFRA raised the qualifying debt limit for “family farmers” <sup>3</sup> to \$10 million from the previous limit of approximately \$4.4 million. Adjusted for inflation the current debt limit for Chapter 12 family farmers is \$11,097,350.00. <sup>4</sup>

lapsed in March of 2022, Congress and the President acted again, albeit not as swiftly as before, and enacted the Bankruptcy Threshold Adjustment and Technical Corrections Act (the “Act”) <sup>8</sup> on June 21, 2022, extending the increased \$7.5 million Subchapter V debt limit for another 2 years. <sup>9</sup> There are compelling arguments for making the increased debt limits permanent, and even raising them further, but this article’s discussion focuses elsewhere.

# AN ARGUMENT TO INCLUDE CHAPTER 12’S DE-PRIORITIZATION OF TAX CLAIMS IN SUBCHAPTER V BANKRUPTCIES

While the FFRA modified existing bankruptcy law, the SBRA introduced an innovation: Subchapter V of Chapter 11, a new type of bankruptcy designed to make reorganization under the Bankruptcy Code faster and less expensive for America’s small businesses. Originally a “small business debtor” <sup>5</sup> eligible for Subchapter V was defined as “a person engaged in commercial or business activities ... that has aggregate noncontingent liquidated secured and unsecured debts ... in an amount not more than \$2,725,625.” At least half of those debts must have been incurred from commercial or business activities. About a month after the SBRA’s February 19, 2020 effective date, the COVID 19 pandemic upended the country. In response, Congress and the President acted swiftly to enact the CARES Act, <sup>6</sup> which increased Subchapter V’s debt limits to \$7.5 million for two years. <sup>7</sup> When Subchapter V’s increased debt limits

## SUBCHAPTER V’S SIMILARITIES WITH CHAPTER 12.

Comparing the SBRA with Chapter 12 shows many ways in which Chapter 12 inspired and influenced the creation of Subchapter V. Intended to make small business bankruptcies faster and less expensive, Subchapter V requires small business debtors to file a plan no later than 90 days after the order for relief. Subchapter V debtors wishing to extend that 90-day plan-filing deadline must demonstrate that “the need for an extension is attributable to circumstances for which the debtor should not justly be held accountable.” <sup>10</sup> Section 1221 contains identical language, and several courts have looked to Chapter 12 cases interpreting this provision for guidance in Subchapter V cases. <sup>11</sup> Similarly, both Chapter 12 and Subchapter V include an “engaged in” eligibility element—one of the elements of section 101(18)(A)’s definition of “family farmer” is being “engaged in a farming operation” <sup>12</sup> and section 101(19A)(A)’s definition of “family fisherman” requires engagement “in a commercial fishing operation,” <sup>13</sup> while section 1182(1) requires a Subchapter V debtor be “a

1 Public Law No. 116-51.

2 Public Law No. 116-54.

3 See 11 U.S.C. section 101(18). Unless otherwise noted all section citations are to the Bankruptcy Code, title 11 of the United States Code.

4 Section 104(b) mandates an adjustment of dollar amounts every three years to reflect the change in the Consumer Price Index for All Urban Consumers.

5 Section 101(51C) defines a small business case as a case “in which the debtor is a small business debtor and has not elected that subchapter V of chapter 11 ... shall apply.” Meeting this slightly broader definition allows debtors the option to use the Bankruptcy Code’s previous (and unrepealed) small business provisions of the Bankruptcy Code. However, dissatisfaction with the ineffectiveness of those provisions helped motivate the passage of the SBRA and Subchapter V. Moreover, section 101(51D)’s definition of a “small business debtor” retains the old debt limit, which is now \$3,024,725 after the most recent section 101(18) adjustment on April 1, 2022.

6 Coronavirus Aid, Relief, and Economic Security Act, Public Law 116-123.

7 The initial expiration of the \$7,500,000.00 Subchapter V debt limit was March 27, 2022.

8 Public Law No. 117-151.

9 The \$7,500,000.00 Subchapter V debt limit will expire on March 27, 2024.

10 Section 1189(b).

11 See *In re Seven Stars on the Hudson Corp.*, 618 B.R. 333 (Bankr. S.D. Fla. 2020); *In re HBL SNF, LLC*, 635 B.R. 725 (Bankr. S.D.N.Y. 2022).

12 Section 101(18)(B) allows corporations or partnerships to be family farmers if they are majority family-owned and the family conducts “the” farming operation—presumably referring to the corporation or partnership’s farming operation.

13 Section 101(19A)(B) is similarly parallel in content (but not structure) to section 101(18)(B).

person engaged in commercial or business activities.” Moreover, both Chapter 12 and Subchapter V are designed to be unavailable to publicly traded companies.<sup>14</sup> Finally, the SBRA mandates that more than 50% of the debtor’s debt must come from operating a business, just as the definition of “family farmer” requires more than 50% of the debtor’s debt come from the farming operation.<sup>15</sup>

However, as the court in *In re Trepetin*<sup>16</sup> pointed out, “Subchapter V and chapter 12 are not identical, and invoking chapter 12 standards may not be warranted in every instance. Subchapter V starts with chapter 11 as its base and then draws on the structure of chapter 12, certain elements of chapter 13, and the recommendations of the American Bankruptcy Institute’s Commission to Study the Reform of Chapter 11 and the National Bankruptcy Conference.” Despite their differences, the parallels between Subchapter V and Chapter 12 are unmistakable.



## SMALL BUSINESS DEBTORS SHOULD BE GRANTED THE SAME BANKRUPTCY RELIEF AFFORDED FAMILY FARMERS, ESPECIALLY TAX DE-PRIORITIZATION

Given these many parallels, one of the most striking differences between Chapter 12 and Subchapter V is tax de-prioritization—available in Chapter 12, but unavailable elsewhere. In contrast to the usual priority treatment and nondischargeability sections 507(a)(3) & (8) and 523(a)(1) generally provide tax claims, section 1232 allows a Chapter 12 farm debtor<sup>17</sup> to treat tax claims arising from the liquidation of farm assets used

<sup>14</sup> Sections 101(18)(B)(iii) & 101(19A)(B)(iii) for Chapter 12; section 1182(1)(B) for Subchapter V. For an interesting discussion of how an apparent drafting error in the SBRA led to the potential exclusion of many small businesses from Subchapter V’s definition of “small business debtor” because they were affiliated with corporations, how Congress fixed that error with the Act, and a different potential flaw in how the Act fixed the original problem, see Bill Rochelle, Rochelle’s Daily Wire, “A Mistake in the CARES Act on Eligibility for the SBRA Was Fixed by Congress in June” (August 9, 2022) <https://www.abi.org/newsroom/daily-wire/a-mistake-in-the-cares-act-on-eligibility-for-the-sbra-was-fixed-by-congress-in>.

<sup>15</sup> Compare section 1182(1)(A) with sections 101(18)(A) and 101(18)(B)(ii). Family fishermen have an 80% debt threshold, excluding debt on a principal residence. Sections 101(19A)(A)(i) and 101(19A)(B)(ii)(II).

<sup>16</sup> 617 B.R. 841 (Bankr. D. Md. 2020).

<sup>17</sup> Family fishermen are not eligible to use section 1232.

in the farming operation as unsecured, whether those claims arose before or after the bankruptcy petition was filed. Tax claims so treated can be discharged under section 1228 in a Chapter 12 plan.<sup>18 19</sup> This allows a family farmer to “right-size” their operation in a reorganization without being forced to liquidate more to pay taxes on those liquidations, or to exit the farming business entirely without the prospect of a large nondischargeable tax bill looming over them.

The de-prioritization and discharge of taxes for family farmers, coupled with streamlined confirmation procedures without creditor committees and the absence of the absolute priority rule, make Chapter 12 for family farmers arguably the most powerful chapter in the Bankruptcy Code. Family farmers have the flexibility to sell equipment or goods both before and during the case unfettered by the threat of taxes occasioned by the sale of the assets. Small business debtors can take advantage of streamlined confirmation

procedures, no creditor committees, and the absence of the absolute priority rule by using Subchapter V. However, why should the powerful tool of tax de-prioritization and discharge be available exclusively to family farmers? Last year there were 31.7 million small businesses<sup>20</sup> in the United States. Between 2000 and 2019, these small businesses created 10.5 million net new jobs and accounted for 65.1% of the net new job creation since 2000.<sup>21</sup> As our nation’s food producers, and participants in a difficult industry,<sup>22</sup> family farmers certainly deserve all

the assistance Congress has provided them. But when small businesses face many of the same problems family farmers face and make such a large impact on the country’s economy, there is every reason to extend the same benefits that are available to family farmers to all American small businesses through Subchapter V legislation that: (i) increases its debt limit to match that of Chapter 12; (ii) makes that debt limit increase permanent; and (iii) includes tax de-prioritization provisions like the ones found in section 1232. ■

<sup>18</sup> The taxes are not discharged if the family farmer does not receive a Chapter 12 discharge, in which case the taxing authorities can pursue the family farmer after the case is closed.

<sup>19</sup> Section 1232’s predecessor was section 1222(a)(2)(A), enacted as part of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (Public Law No. 109 8). The Supreme Court’s ruling in *Hall v. United States*, 566 U.S. 506 (2012) that section 1222(a)(2)(A) only allowed pre-petition tax claims to be de-prioritized led Congress to enact section 1232 to legislatively overrule this interpretation.

<sup>20</sup> Defined by the U.S. Small Business Administration, Office of Advocacy as an independent business having fewer than 500 employees. <https://cdn.advocacy.sba.gov/wp-content/uploads/2020/11/05122043/Small-Business-FAQ-2020.pdf>

<sup>21</sup> *Id.*

<sup>22</sup> “[T]he farmer is the only man in our economy who buys everything he buys at retail, sells everything he sells at wholesale, and pays the freight both ways.” Senator John F. Kennedy, Speech at the National Plowing Contest in Sioux Falls, SD (September 22, 1960) <https://www.presidency.ucsb.edu/documents/speech-senator-john-f-kennedy-national-plowing-contest-sioux-falls-sd>.