For Chapter 12 Bankruptcy Purposes, What is "Gross Income from Farming"?

Roger McEowen (roger.mceowen@washburn.edu) – Washburn University School of Law
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Overview

One of the eligibility requirements for Chapter 12 bankruptcy is that more than 50 percent of an *individual* debtor's gross income must come from farming in either the year before filing or in both the second and third tax years preceding filing. *11 U.S.C. §1325(b).* This provision seeks to disqualify tax shelter and recreational farms from Chapter 12 protection.

A recent case from New York involved the question of whether income from horse breeding and training counts as "farm income" for purposes of Chapter 12.

What is "gross income from farming" for purposes of Chapter 12 (farm) bankruptcy – it's the topic of today's post.

Chapter 12 and Farm Income

The farm income test is to be applied at the time of bankruptcy filing. *See, e.g., In re Nelson, 291 B.R. 861 (Bankr. D. Idaho 2003).* Gross income from farming has been held to include government program payments, proceeds of the sale of farm equipment, and income from rental of farm equipment where the lessor has some risk in the farm operation. *See, e.g., In re Wilson, No. 05-65161, 2007 Bankr. LEXIS 359 (Bankr. D. Mont. Feb. 7, 2007).* However, income from the sale of farmland and income from custom farming, even if performed for the debtor's farm operation, is not included in gross income from farming. *See, e.g., In re Ross, 270 B.R. 710 (Bankr. S.D. Ill. 2001).* However, income from the sale of farmland may be included in gross income from farming if it is sufficiently connected to the farming activities, such as being sold to allow the debtor to continue farming. *See, e.g., In re Bircher, 241 B.R. 11 (Bankr. S.D. Iowa 1999).*

Although income from cash leasing of farmland is not included in gross income from farming, a corporate farm debtor has been allowed to file in Chapter 12 even though a majority of the farmland would be cash leased. Generally, cash rent income is not income from a farming operation that counts toward the 50 percent test. *See, e.g., In re Swanson, 289 B.R. 372 (Bankr. D. Ill. 2003).* The basic test is whether the lessor is subject to the risks from farming under the lease.

For example, in *In re Maynard, 295 B.R. 437 (Bankr. S.D. N.Y. 2003),* the debtor operated a farm as an S corporation which leased the land from the debtor. The debtor's pre-petition farm income consisted entirely of the rent from the corporation. The rents were held to be income from farming to the

debtor because no rent was paid if the corporation lacked income, the debtor was actively involved in the farming operation, the rent came from farming operations, and the debtor continued to farm the property after bankruptcy. However, in a 1990 bankruptcy case from Iowa, *In re Easton, 118 B.R. 676 (Bankr. N.D. Iowa 1990),* an individual farm debtor was allowed to file a Chapter 12 bankruptcy where farmland was cash leased to the debtor's son and the court found that the lease was part of the total family farm operation.

Note: Income from crop-share leases is generally considered to be gross income from farming unless the lessor has no participation in the operation of the farm.

What About Horse Boarding and Training?

As noted above, the basic test in determining whether income is sufficiently tied to a farming operation to constitute gross income from farming is whether the debtor's income is subject to the risks of farming such as production and price risk. That's an important question when it comes to horse boarding and training. The primary issue is whether the debtors income is derived from services or from farming/ranching activities.

There are analogies with other similar activities. Consider the following:

- While the breeding of dogs has been held to constitute farming for purposes of Chapter 12 eligibility, the activity must be engaged in at the time the debtor files bankruptcy. Any post-petition change in the debtor's business is immaterial. *See, e.g., In re Degutis, No. 20-11420-MSH, 2020 Bankr. LEXIS 3578 ((Bankr. D. Mass. Dec. 23, 2020).*

- A cattle rancher's income from hauling cattle for third parties was farm income where the hauling was found to be related to the debtor's own operations, and, in another case, the income from the debtors' timber operation was farm income where the debtors sold their own timber, lived in a traditional farm setting, had traditional farm equipment, and were subject to the same risks inherent in an ordinary farming business. *In re Glenn, 181 B.R. 105 (Bankr. E.D. Okla. 1995).*

With respect to horse boarding and training, the general rule is that boarding and training of horses owned by others does not generate gross income from farming. For example, in one case the debtor operated a business of boarding and training horses owned by others and for a flat fee. The court held that the debtor was not engaged in farming and was ineligible for Chapter 12 relief because the debtor only provided services and income derived from fixed fees that were only indirectly tied to inherent risks of farming. *See, e.g., In re Jones, No. 10-65478-FRA12, 2011 Bankr. LEXIS 2982 (Bankr. D. Ore. Aug. 2, 2011).* But sometimes courts distinguish between breeding and raising horses from training and showing. In *In re Buchanan, No. 2:05-0114, 2006 U.S. Dist. LEXIS 50968 (M.D. Tenn. July 25, 2006),* the court held that the debtor's failure to file Schedule F associated with the debtors' horse breeding operation did not negate other factors showing that debtors were engaged in a traditional farming operation.

Recent case. In *In re Leonaggeo, No. 23-35092 (CGM), 2023 Bankr. LEXIS 1355 (S.D. N.Y. May 24, 2023),* The debtor filed a Chapter 12 case in early 2023 as a repeat filer. The debtor's previous case was dismissed

for lack of regular income (the debtor's income was only seasonal). In the present case (which was filed to forestall foreclosure proceedings), two creditors motioned to either dismiss the case or have the automatic stay lifted on the basis that the debtor didn't qualify for Chapter 12 for lack of having sufficient farm income. The debtor's income is derived from horse boarding, training, and rider instruction that the debtor and her husband had conducted for 50 years. The debtor claimed the operation was subject to the same inherent risks and cyclical uncertainties that are associated with farming operations.

The court noted a split of authority on whether horse breeding, boarding and training businesses were eligible for Chapter 12. Some courts have determined that such activities are service-oriented business ineligible for Chapter 12. *See, e.g., In re Cluck, 101 B.R. 691 (Bankr. E.D. Okla. 1989); In re McKillips, 72 B.R. 565 (Bankr. N.D. Ill. 1987).* But, other courts have ruled otherwise where the debtors were also involved in the growing of feed and the raising of the horses to maturity for later sale as livestock. See, e.g., In re Buchanan, No. 05-114, 2006 U.S. Dist. Tenn. Jul. 25, 2006). In the present case, however, the court determined that the debtor was primarily providing a service. Key to that determination was that the debtor did not raise crops or raise the horses to maturity to sell as livestock. Thus, the Chapter 12 case was dismissed.

Additionally, the court did not allow the debtor to convert the Chapter 12 case to Chapter 11, but the court determined that such a conversion was not allowed under 11 U.S.C. §1208, citing the legislative history of the provision did not suggest that the Congress intended to allow a Chapter 12 case to be converted to anything other than a Chapter 7 case.

Conclusion

The definition of "gross income from farming" is an important one in the context of Chapter 12 bankruptcy. To meet the definition, the debtor's income must be from a farming activity where the debtor is bearing the risks of production or the risks of price change. Income from a service activity doesn't meet the test.