

Chapter 12 Bankruptcy, § 1232 v § 553: Setoff as an Effective Veto?

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I. INTRODUCTION

“You have acres and acres of arable land: fields and orchards, mountains and dells, rivers and springs. But what comes after this? Is not all that awaits you a six-foot plot of earth?”¹

From Thomas Jefferson’s yeoman farmer,² to our current image of a modestly prosperous family working the land,³ the independent farmer has long held a significant role in the American psyche⁴—and for good reasons. Studies have shown that small farmers are better on the environment than big agribusiness operations and are a cornerstone to the economic and social well-being of rural communities.⁵ However, since the beginning of the twentieth century, the small family farm has been in decline.⁶ This is in part because of increased use of technology, a development that decreases the amount of labor input needed to produce food,⁷ and the increased number of mid to large sized farming enterprises controlling the industry.⁸ In tandem with this long-term transition, the farming industry has gone through periodic crises, usually resulting in the loss of farmers and further consolidation of the industry. In response, Congress created Chapter 12

1. Saint Basil the Great, *Sermon to the Rich*, in ON SOCIAL JUSTICE 35 (C. Paul Schroeder trans.), St Vladimir’s Seminary Press 1st ed. 2009) (ebook). The Patristic theologian St. Basil the Great wrote these words in his *Sermon to the Rich* in 368 C.E. At the time Cappadocia, in what is now modern-day Turkey, was rocked by two problems. The first was a climate change-induced famine in 368 C.E. where an unusually cold winter had led to an unusually hot and dry summer. KYLE HARPER, *THE FATE OF ROME: CLIMATE, DISEASE, AND THE END OF AN EMPIRE* 169–70 (2017); SUSAN R. HOLMAN, *THE HUNGRY ARE DYING: BEGGARS AND BISHOPS IN ROMAN CAPPADOCIA* 68–69 (2001). The second was a debt crisis that was affecting the Roman Empire and effectively destroying the remaining free peasantry. DAVID GRAEBER, *DEBT: THE FIRST 5,000 YEARS* 283 (2011). Diocletian and the emperors after him taxed small landowners under the same tax burden as their larger counterparts. Small landowners were forced to either abandon their land in a self-imposed exile or sell their land to their richer neighbors and became their serfs to avoid the imperial tax collectors. Tax burdens and landownership increasing one’s prestige and political status, led to the ownership being predominately in the hands of the rich. BARRY GORDON, *THE ECONOMIC PROBLEM IN BIBLICAL AND PATRISTIC THOUGHT* 92, 94–95 (1989).

2. DANIEL IMHOFF, *FOOD FIGHT THE CITIZEN’S GUIDE TO THE NEXT FOOD AND FARM BILL* 72 (2d ed. 2012) (ebook).

3. See Alana Semuels, *‘They’re Trying to Wipe Us Off the Map.’ Small American Farmers Are Nearing Extinction*, TIME (Nov. 27, 2019, 1:16 PM), <https://time.com/5736789/small-american-farmers-debt-crisis-extinction/> [<https://perma.cc/4TDM-JDC4>] (commenting that within the American imagination the family farm is still a picturesque, modestly prosperous, and wholesome space).

4. Imhoff, *supra* note 2, at 72; see also Todd Holmes, *Farmer’s Market: Agribusiness and the Agrarian Imaginary in California and the Far West*, 90 CAL. HIST. 24, 33 (2013), <https://online.ucpress.edu/ch/article-abstract/90/2/24/27483/Farmer-s-Market-Agribusiness-and-the-Agrarian?redirectedFrom=fulltext> [<https://perma.cc/5GHA-UV4J>] (detailing the perspective of the past, present, and future of farming).

5. *Infra* Part II.B

6. Imhoff, *supra* note 2, at 73.

7. Linda Lobao & Katherine Meyer, *Farm Power Without Farmers*, 3 CONTEXTS 12, 13 (2004).

8. Chris McGreal, *Animals Farmed: How America’s Food Giants Swallowed the Family Farms*, GUARDIAN, (Mar. 09, 2019, 11:30 AM), <https://www.theguardian.com/environment/2019/mar/09/american-food-giants-swallow-the-family-farms-iowa> [<https://perma.cc/6QE4-VJDB>]; see generally Linda Lobao & Katherine Meyer, *The Great Agricultural Transition: Crisis, Change, and Social Consequences of Twentieth Century US Farming*, 27 ANN. REV. SOCIO. 103, 103 (2001), <https://www.annualreviews.org/doi/pdf/10.1146/annur-ev.soc.27.1.103> [[HTTPS://PERMA.CC/2SKK-4ZZP](https://perma.cc/2SKK-4ZZP)] (noting that the top 3.6% of farms by earnings contribute more than half of national sales).

bankruptcy⁹ as a temporary provision in 1986 to mitigate the worst family farm crisis in the twentieth century.¹⁰

Since 1986, Chapter 12 bankruptcy has struggled over tax issues. Often a farmer's Chapter 12 plan will require selling farm equipment and land. Naturally this creates capital gain taxes, which until 2017 were not subject to discharge. Farmers were unable to follow their plans and pay the capital gains taxes that arose under the plans. This gave the government an effective veto over otherwise viable plans to help farmers reorganize.¹¹ In an attempt to clarify how these taxes are to be treated and to get rid of this veto power in a Chapter 12 bankruptcy plan, Congress passed the Family Farmer Clarification Act of 2017. This act makes any claims held by the government falling under section 1232¹² pre-petition nonpriority unsecured claims subject to discharge.

A recent district court case in the Eighth Circuit utilized the legislative history of the Family Farmer Clarification Act of 2017 to argue that the IRS's and Iowa Department of Revenue's (IDR) use of their right to setoff (section 553)¹³ acted as an effective veto. The court gave an expansive reading to the effects of section 1232, holding that it conflicted with section 553 and that section 1232 controlled. This decision was reversed on appeal, but the appellate court did not address if this use of setoff acted as an effective veto for otherwise viable bankruptcy plans.

This Note will address whether these sections should be read in conflict with one another and if the right to setoff acts as a veto power in this context. If an effective veto power exists, then small farmers may face a new barrier to successfully filing for Chapter 12 bankruptcy and saving their farms. This Note will start by providing background on the farming industry, Chapter 12 bankruptcy, and the court decision before delving into whether the right to setoff in this context acts as an effective veto.

II. BACKGROUND

Most urban shoppers would tell you that food is produced on farms. But most of them do not know what farms, or what kinds of farms, or where the farms are, or what knowledge of skills are involved in farming. They apparently have little doubt that farms will continue to produce, but they do not know how or over what obstacles. For them, then, food is pretty much an abstract idea—something they do not know or imagine—until it appears on the grocery shelf or on the table.¹⁴

9. Brett Morrison, *Spoiling a Fresh Start: In re Dawes and a Family Farmer's Ability to Reorganize Under Chapter 12 of the U.S. Bankruptcy Code*, 53 B.C. L. REV. 89, 91 (2012).

10. Alexandria C. Quinn, *The Next Generation of Chapter 12 Bankruptcy: Revising the Remedy*, 22 DRAKE J. AGRIC. L. 245, 246 (2017).

11. 163 CONG. REC. S3216 (daily ed. May 25, 2017) (statement of Sen. Chuck Grassley) (“Since the IRS has the ability to require full payment, it essentially holds veto power over the confirmation of a family farmer’s chapter 12 plan.”).

12. Family Farmer Clarification Act of 2017, S. 1237, 115th Cong. § 1232 (2017).

13. 11 U.S.C.A. § 553.

14. Wendell Berry, *The Pleasure of Eating*, CTR. FOR ECOLITERACY (Jun. 29, 2009), <https://www.ecoliteracy.org/article/wendell-berry-pleasures-eating> [<https://perma.cc/YC7K-QJXL>].

A. *Trends in the Agriculture Industry: Early 20th Century to Early 21st Century.*

While there has been much recent coverage about the family farm crisis in the United States, the problem has been occurring for decades. There has long been a trend in people leaving the family farm, seeking a new life in the city throughout U.S. history, but the most rapid migration came after World War II.¹⁵ Between 1940 and 1980, the population on farms decreased tenfold. According to agricultural historian Paul Conkin, the total value of farm output increased forty percent between 1950 and 1970.¹⁶ This led to over-production and chronically low prices.¹⁷ Prices began to rebound in the 1970s when stockpiles of grain were drawn down¹⁸ under a secret “Russian grain deal” made by the United States to sell wheat to the U.S.S.R.¹⁹ when poor weather resulted in diminished crops overseas.²⁰ This led the Secretary of Agriculture, Earl Butz, to conclude that exports could solve America’s farm production surplus problem.²¹ In response to higher prices, the U.S. Government instituted production loans and new forms of income compensation that heavily favored larger producers and encouraged farmers to lease land, buy out smaller farmers, and remove conservation methods to increase farmable land.²²

Robust agriculture production figures led to optimistic lending secured on increasing land prices.²³ Of course, good times cannot last forever, and crop prices began to turn in the late 1970s.²⁴ This occurred in part because President Carter stopped supplying agriculture products to the U.S.S.R. in response to their 1979 invasion of Afghanistan.²⁵ To make matters worse, in October 1979, the federal reserve increased interest rates to fight inflation.²⁶ Interest rates soared into double digits, hitting a record high twenty-one percent in 1981.²⁷ Still lenders remained over-secured because of land prices, so they continued to extend credit to farmers when they lacked positive cash flows.²⁸ Eventually, this land price boom busted, and farmers saw their net worth plummet by more than half.²⁹ The farm crisis was so severe that the farmer insolvency rate was higher than during the Great Depression.³⁰ Amid the response to this crisis, Congress created Chapter 12 in 1986. The aim was to help the family farmers who could successfully reorganize get relief from heavy debt burdens while paying creditors what was reasonable under the

15. Lobao & Meyer, *supra* note 7, at 13; *see also* Lobo, *supra* note 8, at 107–09 (describing the decline in more detail).

16. IMHOFF, *supra* note 2, at 79.

17. *Id.*

18. THE FARM CRISIS (Iowa PBS broadcast June 30, 2013).

19. IMHOFF, *supra* note 2, at 80.

20. THE FARM CRISIS, *supra* note 18.

21. IMHOFF, *supra* note 2, at 80.

22. *Id.* at 81.

23. J. David Aiken, *Chapter 12 Family Farmer Bankruptcy*, 66 NEB. L. REV. 632, 635 (1987).

24. Jamey Mavis Lowdermilk, *A Fighting Chance? Small Family Farmers and How Little We Know*, 86 TENN. L. REV. 177, 188 (2018).

25. THE FARM CRISIS, *supra* note 18.

26. Carl E. Walsh, *October 6, 1979*, FED. RSRV. BANK OF S.F. (Dec. 03, 2004), <https://www.frbsf.org/economic-research/publications/economic-letter/2004/december/october-6-1979/> [<https://perma.cc/B53A-2NFA>].

27. THE FARM CRISIS, *supra* note 18.

28. Lowdermilk, *supra* note 24, at 188.

29. Quinn, *supra* note 10, at 248. Land prices did not fully recover for two decades. *See*, THE FARM CRISIS, *supra* note 18 (describing the dynamics of farm land prices before and after the 1980s farm crisis).

30. Morrison, *supra* note 9, at 91.

difficult economic circumstances of the day.³¹

Chapter 12 bankruptcy was an important stop-gap for ailing family farmers amid the farm crisis. However, it did not stop the general consolidation of the farming industry in the United States.³² In 1935, the number of farms in the United States reached an all-time high, at 6.8 million.³³ By 1990, that number had dwindled to 2.1 million.³⁴

To help farmers, Congress passed the Agriculture Improvement and Reform Act, or the “Freedom to Farm Bill,” in 1996, which sought to deregulate the industry.³⁵ Congress hoped that a deregulated market would find opportunities in exports, and thus help farmers.³⁶ This export boom, however, failed to materialize.³⁷ Instead, Congress had to triple the amount they were paying in subsidies to farmers when prices fell below production costs.³⁸

Good times did eventually come in the 2000s. In 2006, a commodity boom began. Land prices and commodity prices went up once again, encouraging some farmers to borrow heavily.³⁹ However, by 2013 prices for staple farm products like corn, soybeans, milk, and meat started to fall.⁴⁰ Bankruptcies were again surging as this fall in prices corresponded with a host of other negative indicators: net farm income fell 50% since 2013;⁴¹ farm debt jumped by a third since 2007;⁴² bad weather prevented farmers from planting twenty million acres in 2019;⁴³ and soybean exports to China fell 75% in 2017–2018 because of the ongoing trade war.⁴⁴ “[D]elinquency rates for commercial agricultural loans in both the real estate and non-real estate lending sectors are at a six-year high.”⁴⁵ There has been a surge in Chapter 12 bankruptcy filings, but it is not near

31. 132 CONG. REC. S15082 (1986).

32. Katherine M. Porter, *Phantom Farmers: Chapter 12 of the Bankruptcy Code*, 79 AM. BANKR. L.J. 729, 742 (2005).

33. THE FARM CRISIS, *supra* note 18.

34. *Id.*

35. Lobao & Meyer, *supra* note 7, at 16.

36. *Id.*

37. *Id.*

38. *Id.*

39. Jesse Newman, *More Farmers Declare Bankruptcy Despite Record Levels of Federal Aid*, WALL ST. J. (AUG. 6, 2020), <https://www.wsj.com/articles/more-farmers-declare-bankruptcy-despite-record-levels-of-federal-aid-11596706201> [<https://perma.cc/QV64-UJH3>].

40. Semuels, *supra* note 3.

41. Debbie Weingarten, *Why are America’s Farmers Killing Themselves*, GUARDIAN (Dec. 11, 2018), <https://www.theguardian.com/us-news/2017/dec/06/why-are-americas-farmers-killing-themselves-in-record-numbers> [<https://perma.cc/3LFQ-WXR2>].

42. Katie Wedell et al., *Midwest Farmers Face a Crisis. Hundreds are Dying by Suicide.*, USA TODAY (Mar. 9, 2020), <https://www.usatoday.com/in-depth/news/investigations/2020/03/09/climate-tariffs-debt-and-isolation-drive-some-farmers-suicide/4955865002/> [<https://perma.cc/LG6K-U49P>]. According to U.S. Department of Agriculture estimates the farm debt for this year is at \$425 billion, which is the largest sum since the farm crisis in the 1980s. See Newman, *supra* note 39 (describing increase of farmers filing for bankruptcy while receiving higher amounts of federal aid).

43. Wedell, *supra* note 42.

44. *Id.*

45. *Farm Loan Delinquencies and Bankruptcies Are Rising*, FARM BUREAU (July 31, 2019), <https://www.fb.org/market-intel/farm-loan-delinquencies-and-bankruptcies-are-rising#:~:text=Farm%20Bankruptcy%20Filings%20Rise%2013%25,Market%20Intel%20%2F%20July&text=For%20the%20first%20quarter%20of,the%20historical%20average%20of%202.1%25> [<https://perma.cc/GQ5J-PGLR>].

the levels of the 1980's family farm crisis.⁴⁶ This is in part because land prices are still high.⁴⁷

B. *Who is a Small Family Farmer*

As the preceding paragraphs indicated, the decline of the small family farm and the rise of agribusiness in the agriculture sector has been the trend over the twentieth century. This trend radically changed how farming is conducted while simultaneously warping the landscape of the United States, and its rural communities. The transition of the agriculture sector from small enterprises to large businesses can be seen in the sharp decline of “the number of farms and in farm population, the increased acreage of farms and real estate capitalization, and the replacement of the family with hired labor.”⁴⁸ This transition is due in part to limited liability entities in agribusiness have less risk exposure, tax advantages, and easier access to investment.⁴⁹ This squeezes out the small family farms and increasingly makes the agricultural sector a layered cake arrangement of management and control⁵⁰ that has been compared to feudalism.⁵¹

Differentiating between our idealized small family farm and corporate agribusiness is not as easy as it seems. Some small family farms are partnerships or corporations run by one family. What differentiates a small farm operation compared to a large agribusiness operation largely comes down to gross annual sales. To further complicate this, what qualifies as small varies amongst the geographic locations and production sectors.⁵² Generally, the USDA definition for a small farmer is an informative way to conceptualize the ideal family farmer. Under the USDA, a small farmer makes \$350,000 or less in gross annual sales.⁵³ About a third of all family farmers make \$10,000–250,000 in gross annual sales and own around 231 acres.⁵⁴ While small farms still make up most farms in the United States, the majority of production is done on mid to large sized operations.⁵⁵

The statutory definition of a family farm in Chapter 12 bankruptcy largely follows the same scheme as the USDA. Just as the USDA definition does not differentiate between individuals, partnerships, and corporations, Chapter 12 does not limit a small family farmer to individuals. Certain partnerships and corporations can also qualify for

46. Tyne Morgan, *Chapter 12 Bankruptcies Don't Fully Reveal the Pain in Farm Country—Ag New Feed*, FARMER MAC (May 9, 2019), <https://www.farmermac.com/chapter-12-bankruptcies-dont-fully-reveal-the-pain-in-farm-country/> [<https://perma.cc/226Z-3CZF>].

47. *Id.* However, Chapter 12 bankruptcy filings were never as high as some expected they would be—when Chapter 12 was first enacted in the 1980s, some estimated that as many as 30,000 farmers would file but only a few thousand did. Lowdermilk, *supra* note 24, at 194.

48. Lobao & Meyer, *supra* note 8, at 107.

49. Randolph Canney, *Amendment E: A Personal Perspective on Defending Its Constitutionality*, 49 S.D. L. REV. 777, 778 (2004).

50. Ralph Wolf, *Agriculture and Law*, 285 N. AM. REV. 75, 75 (2000).

51. Semuels, *supra* note 3; *see also*, Wolf, *supra* note 50, at 75 (describing how agribusiness is structured in layers of management and ownership today).

52. Mary Beth Miller & D. Lee Miller, *Insuring a Future for Small Farms*, 14 J. FOOD L. & POL'Y 56, 58 (2018).

53. *Id.*

54. *Id.*

55. Christine Whitt, *A Look at America's Family Farms*, USDA (Jan 23, 2020), <https://www.usda.gov/media/blog/2020/01/23/look-americas-family-farms> [<https://perma.cc/KXX3-BTDB>].

Chapter 12 bankruptcy.⁵⁶

To qualify for Chapter 12, an individual or couple's debt must not exceed ten million dollars, and fifty percent or more of those debts must come from the farm operation.⁵⁷ Fifty percent of the family farm's gross income must also come from the farming operation in one of the three years preceding the Chapter 12 petition filing.⁵⁸

To qualify a family farm as a partnership or a corporation, fifty percent of the outstanding stocks or equity must be held by one family or one family and extended family members. The family or relatives must conduct the farming operation. The stock cannot be publicly traded, eighty percent of the assets must be related to the farming operation, and the aggregate debts cannot exceed ten million dollars and (at least fifty percent of which must come from the farming operation).⁵⁹

C. Chapter 12 Bankruptcy, What is it Good For?

Chapter 12 bankruptcy is an important safety measure that can help family farmers continue to operate, which is important to maintaining rural communities.⁶⁰ At first blush, it would appear that the other chapters of U.S. bankruptcy law would suffice. However, each one fails to address the issues facing family farmers that Chapter 12 was designed to fix. Primarily, that many of a farmer's assets are not liquid, which inhibits a "family farmer's ability to restructure liabilities and remain operational."⁶¹

For example, Chapter 7 bankruptcy is a great tool if the goal is to extinguish large amounts of under-secured or unsecured debts.⁶² This, however, is very unattractive to many family farmers. Because in many cases, the family farm has been in the family for generations,⁶³ Thus losing the family farm feels like a personal failure that will not only let down their immediate family but all past and future generations as well.⁶⁴ Furthermore, many family farmers believe they can reorganize or adjust their debts and continue to farm, which is far more ideal than liquidating and losing the farm. Finally, many of them want to at least attempt to pay back all their debts.⁶⁵

56. Susan Schneider, *Chapter 12 Bankruptcy: Family Farm Restructuring*, ARK. L. NOTES 1, 1 (May 15, 2015).

57. Arthur Boelter, *Family Farmer Bankruptcy*, 14A MERTENS LAW FED. INCOME TAX'N, 1 (2020); see also Lance Martin, *New Law More Than Doubles Chapter 12 "Family Farmer" Debt Limit*, THE NAT'L L. REV., <https://www.natlawreview.com/article/new-law-more-doubles-chapter-12-family-farmer-debt-limit> [<https://perma.cc/J7TF-DH7S>] (detailing the expansion of the debt limit allowed to be declared under Chapter 12).

58. Boelter, *supra* note 57; see also Martin, *supra* note 57.

59. Boelter, *supra* note 57; see also Martin, *supra* note 57.

60. See generally Neil Hamilton, *Myth Making in the Heartland—Did Agriculture Elect the New President*, 13 J. FOOD L. & POL'Y 5, 9 (2017) (discussing current farm issues and their effects on rural America); see generally Lobao & Meyer, *supra* note 8 (discussing the transition of the agriculture sector to agribusiness and its effects on rural communities); see Miller & Miller, *supra* note 52, at 59 (detailing how the definition of the farm is variable depending on location).

61. Morrison, *supra* note 9, at 89.

62. Jeffrey L. Dull, *Bankruptcy Chapter 12: How Many Family Farms Can It Salvage*, 55 UMKC L. REV. 639, 642 (1987). While bankruptcy law precluded farmers from being forced to file Chapter 7 prior to Chapter 12, most farmers did not meet the statutory definition of farmer and thus could be subject to forced filings and liquidation. *Id.*

63. *Id.*

64. Semuels, *supra* note 3.

65. Dull, *supra* note 62, at 642.

Before Chapter 12, if a family farmer believed they could survive debt reorganization, then they could opt for Chapter 11 bankruptcy.⁶⁶ However, Chapter 11 bankruptcy is complicated, expensive, and time consuming for farmers.⁶⁷ There were also issues with its absolute priority rule.⁶⁸ The absolute priority rule arose when a court would “cram down” a plan on creditors who objected to it, so long as it was “fair and equitable” in the court’s eyes.⁶⁹ To “cram down” a plan, claimants would have to receive the full amount of their claims before junior ownership interests could retain any property.⁷⁰

Most family farmers would be treated as junior to any unsecured claims, meaning they would be forced to liquidate all their property.⁷¹ A farmer with too much debt could come out of reorganization highly leveraged and unable to complete a plan because of the inherent risks of farming.⁷² The only other alternative would be to liquidate the operation.⁷³ This dynamic essentially forced farmers into liquidating their farming operation and losing their family farm.

The final alternative before Chapter 12 was Chapter 13. Chapter 13 was intended for the adjustment of debts of individuals with regular income.⁷⁴ Chapter 13 tends to be less complicated, burdensome, and expensive than Chapter 11.⁷⁵ However, there are several problems for farmers with this Chapter. First, Chapter 13’s debt limit is too low.⁷⁶ Second, it excludes farm partnerships and corporations. Third, the requirement of regular income does not match the large periodic flows of cash into and out of the farming operation as they prepare for the season and when they harvest.

None of these bankruptcy Chapters were able to address the desires, situations, or needs of farmers; they either shoehorned farmers into the painful process of liquidating their operations and losing the family legacy or excluded a large number of operations that would otherwise be able to reorganize and keep operating. Chapter 12 was enacted to help family farmers avoid the painful liquidation of their family heritage by creating a process that matched the situations of most farmers. It did this generally by allowing partnerships and corporations to file and by setting the debt limit high enough to include most small farm operations.

D. *The Development of Chapter 12 Bankruptcy*

When Chapter 12 bankruptcy was first enacted, it had a sunset period of seven years because it was intended to be a remedial measure to help ailing farmers during a difficult economic time.⁷⁷ This sunset clause left many farmers without the means to restructure

66. *Id.*

67. Quinn, *supra* note 10, at 248; *see also* Lowdermilk, *supra* note 24, at 189 (describing generally the issues farmers face with Chapter 11 bankruptcy).

68. Dull, *supra* note 62, at 645.

69. 11 U.S.C. § 1129(b)(1) (Supp. 11 1984).

70. Dull, *supra* note 62, at 645.

71. *Id.*

72. *Id.*

73. *Id.*

74. *Id.* at 650.

75. Dull, *supra* note 62, at 650.

76. Schneider, *supra* note 56, at 1.

77. David A. Martin, *The Farmer and the Tax Man: The Scope of the Tax Forgiveness Provision in*

their farming operations. While the Chapter was often reinstated, it could take several months and it always included a sunset period. Small family farmers were left without the means to get help to save their family legacies when the reinstatement of Chapter 12 reached the end of its term.

Furthermore, since its inception, Chapter 12 has been dogged by tax questions, which made otherwise good bankruptcy plans impossible to complete due to the tax burdens that arose from selling farm assets as a part of the bankruptcy plan. This has been described as giving the government effective veto powers over otherwise viable bankruptcy plans. The original language of the chapter was ambiguous about how to treat capital gains taxes arising from the sale of farm assets in a bankruptcy plan.⁷⁸ Many early cases attempted to address this question.⁷⁹

Chapter 12 was extended eleven times with minimal changes, which left the ambiguity of the statute and its tax problem in limbo. It was not until 2005 when the Chapter was permanently added to bankruptcy law that a new section was created to address these tax questions. Up until this point, “speculative triggering of massive taxes upon reorganization prevented many bankruptcy plans from ever coming to fruition.”⁸⁰ Under bankruptcy law, tax liabilities were given priority status. This required farmers to pay the taxes incurred by the sale of farm assets in full over the life of the plan, which gave the IRS a de facto veto power over otherwise viable bankruptcy plans.⁸¹ Congress added section 1222 so that all claims owed to government entities like the IRS would be treated as unsecured claims subject to a likely discharge upon completion of the bankruptcy plan.⁸²

Section 1222 was a boon to farmers, but it brought another tax question with it. Specifically, how the tax deprioritization of section 1222 affected 507(a)(2)(A) which granted priority to administrative expenses under 503(b).⁸³ These administrative expenses included “taxes incurred by the estate whether secured or unsecured.”⁸⁴

The bankruptcy estate is created when the debtors or creditors file a bankruptcy petition. This also means that any taxes that arise after the creation of the estate arise post-petition.⁸⁵ Under Chapter 12 bankruptcy, the estate is not a separable taxable entity like Chapter 7 or 11.⁸⁶ In Chapter 12 bankruptcy, the debtors are solely responsible for filing income earned by the estate and paying the bankruptcy estate taxes.⁸⁷ The ambiguity arose over whether the provisions of section 1222 applied to the post-petition taxes incurred by the estate.

This eventually led to a circuit split. The Eighth Circuit held that section 1222 applied to the taxes incurred by the estate post-petition, but the Ninth and Tenth Circuits

Chapter 12 Bankruptcy, 78 MO. L. REV. 243, 253 (2013).

78. Joseph A. Peiffer, *Thirty-Three Years of Asking, “Are We There Yet?”*, 33 COM. L. WORLD 14, 15 (2019).

79. *Id.*

80. Daniel Fischer, *Old MacDonald Files Chapter 12 Bankruptcy: How Should the IRS Tax the Reorganization?*, 97 IOWA L. REV. 589, 599 (2012).

81. 163 Cong. Rec. S3216, *supra* note 11.

82. Fischer, *supra* note 80, at 599.

83. Martin, *supra* note 77, at 253.

84. 11 U.S.C. § 503(b).

85. Martin, *supra* note 77, at 259–60.

86. *Id.*

87. *Id.* at 263.

sided with the IRS and held that section 1222 did not apply to the taxes.⁸⁸ The Supreme Court granted *certiorari* to the Ninth Circuit case, *Hall v. United States*, to resolve this issue. The Court held that all taxes stemming from post-confirmation sales are tax liabilities of the reorganized entity.⁸⁹

In 2017, Congress passed the Family Farmer Bankruptcy Clarification Act of 2017, to overrule the holding in *Hall v. United States*.⁹⁰ The act made it explicit that all taxes arising from the sale of assets held by the reorganized entity were to be treated as unsecured claims subject to discharge.⁹¹ It did this by adding section 1232. The aim of this statute and section 1232, as with section 1222, is to keep the IRS from making de facto vetoes on otherwise viable bankruptcy plans.

Enacting section 1232 was a thirty-year process of overcoming a significant hurdle to many farmers attempting to stay viable and operational during a financial crisis and eventual bankruptcy. The other major hurdle at the time was the debt limit.⁹² This obstacle was eliminated in 2019 when Congress passed the Family Farmer Relief Act of 2019, which raised the debt limit to ten million dollars. It appeared that the major hurdles facing farmers from a successful restructuring had been overcome, but a new hurdle may be on the horizon. Once again, the IRS may have an effective veto over family farmer plans based on its right to setoff.

E. The Setoff

Setoff is a doctrine arising out of equity that seeks to avoid “the absurdity of making A pay B when B owes A.”⁹³ To avoid this absurdity, setoff allows insolvent A to discharge their debt owed to B by the amount B owes A. The Bankruptcy Code in section 553 does not create a right to setoff but recognizes setoff rights that arise under state and federal law.⁹⁴ To assert setoff, a creditor must establish a claim and right to do so under state and federal law.⁹⁵ While setoff is an expansive right, it is not an unlimited right in bankruptcy law.⁹⁶ The statute, itself, makes express limitations on the right, and there are

88. Peiffer, *supra* note 78, at 15–17.

89. See generally *Hall v. United States*, 566 U.S. 506 (2012) (holding that the taxes incurred after post-petition are incurred by the bankruptcy estate and thus not subject to 11 U.S.C. § 1222).

90. 163 Cong. Rec. S3216, *supra* note 11.

91. Family Farmer Clarification Act of 2017, *supra* note 12.

92. Quinn, *supra* note 10; Peiffer, *supra* note 78, at 15.

93. *Citizens Bank of Maryland v. Strumpf*, 516 U.S. 16, 18 (1995) (quoting *Studley v. Boylston Nat'l Bank*, 229 U.S. 523, 528 (1913)).

94. Susan Schneider, *The Family Farmer Bankruptcy Recent Developments in Chapter 12*, 3 DRAKE J. AGRIC. L. 161, 170 (1998).

95. See *In re Dillard Ford, Inc.*, 940 F.2d 1507, 1512 (11th Cir. 1991) (“A pre-petition setoff is valid as long as it complies with the state law governing a creditor’s right to setoff and with the requirements of section 553 of the Bankruptcy Code.”); see also *In re Public Serv. Co.*, 884 F.2d 11, 14 (1st Cir. 1989) (“In addition to the existence of such mutual obligations, Creditor A must also possess a valid right of setoff under some applicable provision of either federal or state substantive law; section 553(a) of the Bankruptcy Code.”); *Durham v. SMI Indus.*, 882 F.2d 881, 881 (4th Cir. 1989) (explaining that to effect a setoff a creditor must have a claim under state and federal law); *In re Pieri*, 86 B.R. 208, 210–11 (Bankr. 9th Cir. 1988) (describing how a setoff pre-petition must be established under state and federal law); *United States v. Norton*, 717 F.2d 767, 772–73 (3d Cir. 1983) (stating “. . . the courts below were correct in looking to state law to determine when a setoff has occurred.”); *In re McLean Indus.*, 90 B.R. 614, 618–19 (Bankr. S.D.N.Y. 1988) (explaining that a creditor seeking to setoff a debt must establish it under state and federal law).

96. HON. JOAN N. FEENEY ET AL., BANKRUPTCY LAW MANUAL § 6:69 (5th ed. 2020).

equitable defenses that limit this right.⁹⁷

The right to setoff is available in every chapter of the bankruptcy code. There are three requirements under section 553 that must be met for the setoff to be permissible: (1) the creditor must owe a debt to the debtor before bankruptcy's commencement, (2) the debtor must have a claim against the creditor prior to the bankruptcy's commencement, and (3) the debt and the claim must be mutual obligations.⁹⁸ Mutuality in this context means "something must be owed by both sides."⁹⁹ Furthermore, the debts must be in the same right and between the same parties standing in the same capacity. This means that if a creditor in their capacity as a sole shareholder and director of a corporation has a claim on the debtor, there will not be mutuality if the debtor has a claim on the creditor in their private capacity. Finally, setoff will not be allowed if one debt arises pre-petition and the other arises post-petition.¹⁰⁰

Section 553(a)(2) has two restrictions on the right to setoff a debt.¹⁰¹ The setoff is not allowed if: (1) the claim was transferred by some entity other than the debtor to the creditor after the case was commenced or; (2) within 90 days of the debtor filing, and while the debtor was insolvent.¹⁰² These exceptions are meant to prevent "abusive trafficking of claims in order to obtain an unfair advantage over the debtor."¹⁰³

Section 553(a)(3) also has a corollary express limitation to section 553(a)(2). If a creditor incurs a debt within 90 days before the debtor filing for bankruptcy, the creditor may not be allowed to setoff the debt they hold against the debtor. This limitation is meant to prevent "deliberate manipulation by the creditor to obtain setoff rights."¹⁰⁴ Specifically, this limitation was established to prevent a creditor who realizes a debtor is about to file bankruptcy to incur a debt from their debtor. The creditor could incur a massive debt to their insolvent debtor only to have it setoff by the now mutual debts held by the parties.¹⁰⁵ This limitation can be overcome if the setoff is allowed under specific circumstances arising in the automatic stay.

F. *In re DeVries*

The *In re DeVries* holding came out of a bankruptcy plan confirmation hearing

97. *Id.*

98. Schneider, *supra* note 94, at 170.

99. *Id.* at 171 (quoting 4 LAWRENCE P. KING, COLLIER ON BANKRUPTCY ¶ 553.04[1] (1989)). There is debate amongst the circuits as to whether a creditor can offset mutual debts arising post-petition. See *In re Morris*, 616 B.R. 499, 502 (Bankr. N.D. Miss. 2020) (joining the majority on the circuit split that mutual debts arising post-petition may be setoff). Courts treat setoff as a permissive remedy at the discretion of the court to use within the rights of equity. See *In re Cascade Rds., Inc.*, 34 F.3d 756, 766 (9th Cir. 1994) (denying setoff because Government's conduct was inequitable). While other views presume the right of setoff and only curtail it when there is evidence of fraud or significantly harm or destroy a debtor's ability to reorganization. See *In re Lincoln*, 144 B.R. 498, 503 (Bankr. D. Mont. 1992) (denying setoff where payments necessary for chapter 12 reorganization); see also *In re Blanton*, 105 B.R. 321, 337 (Bankr. E.D. Va. 1989) (explaining that setoff must be allowed unless inconsistent with the provisions of the Bankruptcy Act).

100. Harold Israel & Kathryn Schmanski, *Section 553-Setoff*, 2010 ANN. SURV. BANKR. LAW 33.

101. Feeney et al., *supra* note 96.

102. 11 U.S.C.A. § 553(a)(2) (West 2021). Certain exceptions to the automatic stay may allow a creditor to setoff debt within the 90-day period. *Id.*

103. Feeney et al., *supra* note 96.

104. *Id.*

105. 11 U.S.C.A. § 553(a)(3) (West 2021).

between a farming operation, the Internal Revenue Service and the Iowa Department of Revenue. Paul and Angie DeVries were a farming couple; Paul and his brother Mark farmed together.¹⁰⁶ In 2016, through a mediated process with their secured creditor, the brothers separated their business interests in the farm operation. As a part of this mediated process, the brothers were required to sell land and farm equipment.¹⁰⁷ Paul and Angie sold assets in 2017, which resulted in them accruing \$986,612 in capital gains taxes.¹⁰⁸ Some of this tax burden was reduced by income taxes that had been withheld during Angie’s off-the-farm employment.¹⁰⁹ The couple filed Chapter 12 bankruptcy to get out from underneath the resulting tax burden, and the amended plan demanded that the withheld taxes be refunded to the DeVries.¹¹⁰

The DeVries argued that sections 553 and 1232 were in direct conflict with one another, and that as a matter of statutory interpretation, the more specific section 1232 should control the more general section 553. The court agreed with this argument, diving into the legislative history of section 1232 to determine that the purpose of the statute was to treat capital gains taxes arising from the sale of farm assets as unsecured claims.¹¹¹ Section 1232 was meant to stop the veto power of the IRS over the confirmation of bankruptcy plans.¹¹² The court held the IRS could not offset the debt, and that they must pay the DeVries their tax refund.¹¹³

III. ANALYSIS

“They are small farmers who have lost their farms, or farm hands who have lived with the family in the old American way. They are men who have worked hard on their own farms and have felt the pride of possessing and living in close touch with the land.”¹¹⁴

A. Was the Appellate Court Correct in Overturning *In Re DeVries*?

In the *DeVries* case, both the capital gains taxes from the sale of the farm assets and the tax refund from off-farm employment arose pre-petition, so ordinarily, the IRS and IDR would have the right to setoff these debts, but it was a part of the bankruptcy plan that the IRS and IDR would return these refunds.¹¹⁵ The IRS and IDR argued against this plan requirement because of their claimed right to setoff the debts. The district bankruptcy court held that sections 553 and 1232 were in direct conflict with one another, and that the more specific 1232 should control the general 553. The court also found that this reading of the statute was in line with the legislative intent of section 1232 because allowing the right to setoff would give the government an effective veto over an otherwise viable bankruptcy plan.

106. *In re DeVries*, No. 19-00181 2020 WL 2121260 at *1 (Bankr. N.D. Iowa Apr. 28, 2020).

107. *Id.* at *2–3.

108. *Id.*

109. *Id.* at *3.

110. *Id.*

111. *In re DeVries*, 2020 WL 2121260 at *8–9.

112. *Id.* at *12.

113. *Id.* at *13.

114. JOHN STEINBECK, *Article 1*, in *THE HARVEST GYPSIES* 3, 5 (1936).

115. *In re DeVries*, 2020 WL 2121260 at *3.

It is a principle of statutory construction that courts discern the legislative intent of the statute.¹¹⁶ This discernment begins with the plain meaning of the language utilized in the statute.¹¹⁷ A court may deviate from the plain meaning of the text if enforcement would create an absurdity.¹¹⁸ In the plain language of these statutes, neither section mentions the other. Section 1232 delineates certain sections that it supersedes and section 553 lists sections that prevail over its general rule, but neither statute references the other.¹¹⁹ Furthermore, section 553 preserves the broad right to setoff with only three specific limitations.¹²⁰

What is clear in the text of 1232, which the *DeVries* district court notes, is that all liabilities held by a government unit against the debtor or the bankrupt estate are treated as nonpriority unsecured claims subject to discharge.¹²¹ This means that they are not first in line in terms of payment. Nor are they secured by collateral, and they will be discharged when the bankrupt estate completes the bankruptcy plan, which means what remains of the debt does not have to be paid. Under section 1232, these priority-stripped debts will be subject to discharge according to section 1228.¹²² Provided the debtor follows their plan and makes the necessary payments as required, these debts will generally be discharged. Any unsecured debt held by the government against the bankrupt estate or debtor should be held as a pre-petition nonpriority unsecured debt, which is then subject to discharge under 1228 with all of its effects.¹²³ Under section 524, when a debt is discharged under 1228, it cannot be setoff by the creditor.¹²⁴

The debtors argue that allowing the setoff conflicts with the mechanics of section 1232, and thus conflicts with the intentions of 1232.¹²⁵ The point being that capital gains taxes that would be subject to 1232 are separated from the other taxes owed so the full amount of the taxes owed are discharged.¹²⁶

Both the capital gains taxes from the sale of the farm assets and the tax refund from off-farm employment arose pre-petition. While the tax debt to the IRS and IDR was destined to be subject to 1232 and ultimately discharged,¹²⁷ they do not gain this status until after the plan is confirmed, which means they would not be barred from setoff. Since this case arose pre-confirmation, the Appellate court was correct to hold that the plain language of the statutes was not in conflict with one another, nor was setoff barred through section 524. Without the direct conflict in the language the appellate court saw no reason for the district court to delve into the legislative history of section 1232, and

116. Martin, *supra* note 77, at 245.

117. *Id.*

118. *In re DeVries*, 621 B.R. 445, 448 (Bankr. N.D. Iowa 2020) (quoting *Lamie v. United States Trustee*, 540 U.S. 526, 534 (2004)).

119. Brief of Appellant Iowa Department of Revenue at 25–26, *Iowa Department of Revenue v. DeVries*, 621 B.R. 445, 448 (Bankr. N.D. Iowa 2020).

120. *Id.* at 26.

121. Family Farmer Clarification Act of 2017, *supra* note 12.

122. *Id.*; *In re DeVries*, 2020 WL 2121260 at *7.

123. Family Farmer Clarification Act of 2017, 11 U.S.C.A. § 1232.

124. *In re DeVries*, 621 B.R. at 447.

125. Brief of Appellees Philip Charles DeVries and Angie Marie DeVries at 12, *Iowa Department of Revenue v. DeVries*, 621 B.R. 445 (B.A.P. 8th Cir. 2020).

126. *Id.*

127. Brief of Appellant Iowa Department of Revenue at 12, *Iowa Department of Revenue v. DeVries*, 621 B.R. 445 (B.A.P. 8th Cir. 2020).

therefore, did not address if this setoff would act as an effective veto power for the government against an otherwise viable plan.¹²⁸

B. Setoff as an Effective Veto?

Turning to whether setoff acts as an effective veto requires first establishing whether the intention of the Family Farmer Bankruptcy Clarification Act of 2017 could include an act by the IRS that would bar it from its right to setoff. Then it still needs to be established that using setoff in this context would act as an effective veto.

Since the beginning of Chapter 12, the intention was to help farmers reorganize and keep their family farms.¹²⁹ This goal has met significant hurdles— effective vetoes the government had because of capital gains taxes arising from the sale of farm assets.¹³⁰ The intent was to strip capital gains taxes from the disposition of farming property from its priority status in bankruptcy plans.¹³¹ This would “free up funds for reorganization and boost reorganization possibilities for family farmers.”¹³² The hope of this de-prioritization is that the IRS would not effectively veto any bankruptcy plan because of a tax burden arising from the disposition of property. Before 2005 when the first version of the priority stripping statute was passed, capital gains taxes would have been secured priority claims and would have to be paid to the government in order for the plan to be confirmed.¹³³ The payment of these taxes would make the plan unviable because farmers would be unable to pay off the extra claim in the timeline required by Chapter 12.¹³⁴ The Eighth Circuit district court concluded that the legislative history points to this intent, and that allowing Section 553 to control Section 1232 would be contrary to this intent.¹³⁵ Specifically, the Court held that:

Congress intended the priority-stripping provision to be interpreted to promote successful reorganizations of family farming operations—by limiting the impact of the substantial capital gains taxes that tend to follow the sale of farm land or equipment—and to put that capital into the farmers’ hands—not the taxing authorities.¹³⁶

The district court’s interpretation of the legislative history extends its original meaning to include putting capital into the farmers’ hands. Senator Chuck Grassley was clear in his remarks introducing the Family Farmer Bankruptcy Clarification Act of 2017 that the act intended to give family farmers the chance to reorganize successfully and “remove the Internal Revenue Service’s veto power over a plan’s confirmation.”¹³⁷ Specifically, the goal of this bill was to overturn *Hall v. United States* and “to relieve family farmers from having their reorganization plans fail because of certain tax

128. *In re DeVries*, 621 B.R. 445 at 450.

129. Peiffer, *supra* note 78, at 15.

130. *In re Devries*, 2020 WL 2121260 at 9–12.

131. 163 CONG. REC. S3216, *supra* note 11.

132. *In re Devries*, 2020 WL 2121260 at 10.

133. 163 CONG. REC. S3216, *supra* note 11.

134. *Id.*

135. *In re DeVries*, 621 B.R. at 450.

136. *In re Devries*, 2020 WL 2121260 at *5 (emphasis added).

137. 163 CONG. REC. S3216, *supra* note 11.

liabilities owed to the government.”¹³⁸

In the literal sense, the right to setoff acting as a veto was not contemplated by the 115th Congress, but it is not preposterous that legislators, and Senator Grassley in particular, would want any new form of veto to family farm bankruptcy plans to be denied. Furthermore, by stripping the capital gains taxes of their priority, farmers have freed up capital to be used elsewhere.

But does this actually act as a veto in the same way as capital gains taxes? Allowing the setoff does bar the debtor from having more capital in their hands to follow through with their plan, but this is not an outright bar in the same way that many capital gains taxes would be for farmers. Allowing the IRS to setoff claims with a refund they owe the debtor may not make the plan impossible, but it does severely hurt the farmer. The DeVries’ refund from the IRS and IDR was approximately \$6,000. That is a significant amount of money that the DeVries were going to use to pay off attorney fees as a part of their bankruptcy plan.¹³⁹ Missing \$6,000 may not make the plan unviable and thus unconfirmable for the DeVries—they can amend the plan—but other farmers may be barred from accessing Chapter 12 bankruptcy for such an amount.

Allowing the IRS or other state revenue departments to setoff capital gains taxes by the tax refund may effectively bar an otherwise viable plan. While the appellate court was correct, the language of 1232 and 553 do not conflict with one another, it ignored the current plight of small farmers. Between 1996 and 2018, the median income earned by farm households was negative,¹⁴⁰ and between 2013 and 2018 farmers had nearly a 50% drop in net income.¹⁴¹ Income rose in 2019, but only because of government payments,¹⁴² and government checks will make up to 40% of farmers’ income in 2020.¹⁴³ Pre-pandemic numbers indicated that farm income was negative for 2020.¹⁴⁴

Farmers rely on credit to pay for the necessary inputs like seeds, fertilizer, etc., to produce the commodities they sell. Farmers’ ability to pay loans on time is what determines their financial health and ability to keep their operations afloat, and increasingly, farmers are struggling to make payments.¹⁴⁵ Finally, the number of small farmers filing for bankruptcy is rising, but even this number can be misleading. Tens of thousands of farmers simply stop farming because they know bankruptcy will not save

138. *Id.*

139. *DeVries*, 621 B.R. at 445, 447.

140. *Farm Household Income for 2021F–February 2021 Update Median Income of Farm Operator Households Forecast to Rise in 2020, Remain Flat in 2021*, U.S. DEP’T OF AGRIC., <https://www.ers.usda.gov/topics/farm-economy/farm-household-well-being/farm-household-income-forecast/> [<https://perma.cc/6EGR-97VM>].

141. *Understanding the Economic Crisis Family Farms are Facing*, FARM AID, (Sept. 14, 2020), <https://www.farmaid.org/blog/fact-sheet/understanding-economic-crisis-family-farms-are-facing/#14text> [<https://perma.cc/LK9S-JHEK>].

142. *Id.*

143. David Pitt, *Federal Checks Salvage Otherwise Dreadful 2020 for US Farms*, ASSOC. PRESS (Dec. 31 2020), <https://apnews.com/article/global-trade-iowa-coronavirus-pandemic-financial-markets-weather-193e2a32e52e00d15afeb4cb6316fded> [<https://perma.cc/354L-X4SB>].

144. *Farm Household Income for 2021F–February 2021 Update Median Income of Farm Operator Households Forecast to Rise in 2020, Remain Flat in 2021*, *supra* note 140 (This source was updated in 2021. The rise in income in 2020 is partly from Government aid in the form of disaster relief, PPP loans and other sources.).

145. *Id.*

them.¹⁴⁶ The IRS withholding the tax refund because of their right to setoff may be another disincentive for many farmers to file for bankruptcy.

Family farmers are often required to sell off assets to pay their debts. By allowing the capital gains taxes to become nonpriority unsecured claims, farmers would be able to get a plan confirmed and complete it. This could help them keep control of their farms. Chapter 12 was created to help family farmers retain their operations to continue farming, but the small family farming sector generally underutilizes Chapter 12 bankruptcy. When it was first enacted during the farming crisis of the 1980s, it was expected that 30,000 farmers would use it.¹⁴⁷ Numbers never reached that height, and while numbers are currently increasing,¹⁴⁸ they are nowhere near the levels of the 1980s.¹⁴⁹ This is in part because farmers generally do not seek out help until it is too late to utilize Chapter 12. Chapter 12 bankruptcy is a specialty within a specialty, and many times just hinting that you might file for Chapter 12 bankruptcy is enough to get creditors to the table to negotiate favorable terms without having to file.¹⁵⁰

Why should there be concern about small family farmers not using Chapter 12 and staying in operation? Many of the reasons these farmers fail to use Chapter 12 mirror other ordinary consumers or small businesses, yet different industries do not have their own specific chapter of bankruptcy. Congress did not create expansive rights for ordinary consumers or other small businesses that severely limit otherwise broad rights like setoff. What makes small farmers special? The decision to provide special relief for small family farmers underscores the unique role played by an industry that helps shore up the social and economic fortunes of a large swathe of rural America. Studies suggest that small and midsize farming operations bring outsized economic and social benefits to surrounding rural communities.¹⁵¹ As larger farming operations have taken over, local economic functions have moved outside of small towns.¹⁵² Local businesses that were reliant on small farmers close when there are no small farmers to buy seed, fertilizer or other farming equipment, which causes a ripple effect to other local businesses.¹⁵³ Furthermore, small and mid sized farms tend to also take better care of the environment.¹⁵⁴

When Chapter 12 was created, it, in part, acted to preserve an industry, a way of life,

146. Semuels, *supra* note 3.

147. Lowdermilk, *supra* note 24, at 194.

148. *Farm Loan Delinquencies and Bankruptcies Are Rising*, *supra* note 45.

149. Morgan, *supra* note 46.

150. Dull, *supra* note 62, at 645.

151. Earl O. Heady & Steven T. Sonka, *Farm Size, Rural Community Income, and Consumer Welfare*, 56 AM. J. AGRIC. ECON. 534, 542 (1974); Hamilton, *supra* note 60, at 9.

152. See Rick Barrett, *There are Pockets of Growth, but Many Parts of Wisconsin Continue to Lose People*, MILWAUKEE J. SENTINEL (Aug. 31, 2021), <https://www.jsonline.com/story/news/2021/08/31/rural-wiscounties-losing-population-small-farms-have-dwindled/5594415001/> [<https://perma.cc/KYT7-YGWP>] (connecting the decline of family farms in central Wisconsin to the collapse in demand for various kinds of local service providers, from midwives to home builders).

153. NICHOLAS SHAXSON, *THE FINANCE CURSE: HOW GLOBAL FINANCE IS MAKING US ALL POORER* 286–87 (2018); Heady & Sonka, *supra* note 151.

154. Robert Wolf, *Agriculture and Law*, 285 N. AM. REV. 75, 78 (2000); see also Louisa Chalmer, *How Small Farms can (Sustainably) Feed the Future and Big Farms Can't*, MEDIUM (May 4, 2019), <https://medium.com/age-of-awareness/how-small-farms-can-sustainably-feed-the-future-45baf2ef6b4e> [<https://perma.cc/VD2R-DZZT>] (discussing how small farms are better at conserving natural resources, using fewer synthetic fertilizers, and devote twice as much land to soil-improving practices).

and the communities around the small farmers. It has been the repeated legislative intent to help viable small farmers continue to farm and pay their creditors.¹⁵⁵ If we want to keep family farmers on their farms and operational then we need to give them every encouragement to utilize the tools available to them.

IV. RECOMMENDATION

*We spend only 10 percent of our budget on food, compared to 40 percent by our great-grandparents in 1900, and 30 percent by our grandparents in the 1950s . . . [W]e spend less money than almost every other country in the world on food and we spend less time gathering that food than at any time in history. Somehow each year those numbers continue to shrink while the quality, quantity, variety, and safety of the food available have gotten better and better.*¹⁵⁶

Chapter 12 bankruptcy has been dogged by tax problems for nearly thirty years. When Section 1232 finally was enacted, it appeared to be the last hurdle to effective restructuring for farmers, which would allow them to stay as viable operations. With any new law, unforeseen problems arise. While this problem may not be the same bar to access the tools of Chapter 12 bankruptcy, it does disincentivize the people it is intended to help fully utilize it.

A. Three Possible Remedies

1. Pass Legislation

If U.S. society wants farmers to be able to retain their farms and continue to farm, then they need to be given every chance to do that. This means stopping any effective veto power on plans that would otherwise be effective. It also means helping farmers file by simplifying barriers that disincentivize them from filing. The most direct way to address the conflict between setoff and section 1232 is to pass legislation amending section 1232 to prevent unsecured nonpriority claims held by the government to be setoff by tax refunds owed to the debtors. In order to achieve this, a new subsection should be added to 1232(a): “(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 . . . (5) Shall be barred from being set off by debts owed to the debtors by the government entity.” This explicitly prevents the problem the debtors faced in *Devries*; it would allow debtors to keep more capital to use elsewhere in their plan or household, and this could incentivize more farmers to file for Chapter 12 bankruptcy.

Critics of this proposal may argue this cuts against the grain of setoff rights. Setoff is an expansive right that each chapter of bankruptcy recognizes and originally came out of the courts of equity.¹⁵⁷ The limitations that have been imposed by section 553 are mostly to prevent fraud and abuse of the right to setoff.¹⁵⁸ Furthermore, this proposal would give

155. 99 CONG. REC. 25,096 (1986).

156. BENJAMIN LORR, *THE SECRET LIFE OF GROCERIES, THE DARK MIRACLE OF THE AMERICAN SUPERMARKET 1*, 8–10 (2020) (ebook).

157. *Infra* Part I.E.

158. *Id.*

increased special treatment to a class of people that is already generally favored by the bankruptcy codes and the federal government in terms of financial support. It also further limits the government's own rights in bankruptcy.

While the proposed limitation on setoff rights is not entirely in line with the reasons for the other three or the general expansive right to setoff, it does flow from the purpose of the Chapter 12 bankruptcy. Which is to help small family farmers stay in business to preserve this way of life and maintain the economic and social bonds created by small farmers in their rural communities.

As for the expanded special treatment of small farmers, farmers have always received special treatment in U.S. bankruptcy law. Since the late 19th century, U.S. bankruptcy laws protected farmers from being forced by creditors to file for bankruptcy.¹⁵⁹ Continuing to give farmers special treatment would not be out of line with this history.

Finally, whether or not the government wants to limit their right to setoff is up to Congress, but Congress has already severely limited the government's creditor rights in terms of capital gains taxes arising from the sale of farm property post-petition. It is not a giant leap or a much greater limitation on the government's right to bar them from setoff in this context.

2. *Rely on Legal Counsel*

Until a statute like this gets passed or if it never gets passed, bankruptcy lawyers will be the source of any remedy. Bankruptcy lawyers could construct plans to deny any right to setoff that was not approved by the debtors.¹⁶⁰ Lawyers should plan to give clients as much control over the plan as possible, particularly when it requires selling off farm assets that would catch many of these problems without having to resort to Congress amending a section of bankruptcy law.

Of course, constructing a plan that puts this sort of power in the hands of the debtor would not help the DeVries. The DeVries' plan had not been confirmed yet, so a plan giving them the power to deny a creditor to setoff mutual debts would be useless. Unfortunately, it is more likely that farmers will be in similar situations to the DeVries because small farmers are unlikely to see Chapter 12 as a tool they can use to their advantage to save their farm.¹⁶¹ To confront this problem, attorneys will need to do a lot of work up front with any small farmers they have as clients. Discussing bankruptcy as an option if the need arises and encouraging them to start the bankruptcy process sooner rather than later are ways to make bankruptcy more of a viable option.

Putting in the work on the front end before bankruptcy may even be on the horizon, is a very imperfect solution. Farmers may never believe it will happen to them, and when it does, they may be in denial about it until it is too late, even if they are given perfect legal advice consistently well in advance.

3. *Equitable Considerations to Deny Setoff*

Even though many farmers do not view bankruptcy as a viable option until it is too

159. Porter, *supra* note 32, at 730.

160. *In re Richards*, 616 B.R. 879, 881–83 (Bankr. S.D. Ind. 2020).

161. *Infra* Part II.B.

late, there are still other potential remedies that arise in the right to setoff. The right to setoff is not created by federal bankruptcy law.¹⁶² Section 553 merely preserves rights that may exist under state or federal law with some specific limitations.¹⁶³ The right to setoff is not mandatory nor compulsory.¹⁶⁴ This means within Section 553 there is no express limitation for equitable considerations.¹⁶⁵ There is a real question amongst the circuits as to whether the right to setoff can be limited by equity considerations of the court¹⁶⁶ with some circuits assuming a wide discretion when it comes to setoffs including the right to deny setoff for equity considerations.¹⁶⁷

Generally, when a court exercises this right it is when the creditor has acted fraudulently or illegally, when there is a public policy consideration, or when the setoff would harm or destroy the debtor's ability to reorganize.¹⁶⁸ In this scenario, a court could deny the IRS's right to setoff for public policy considerations, because allowing these kinds of setoffs goes against the purpose of Chapter 12, which is to help small family farmers by freeing up cash flow. Or the court could argue that the setoff would harm or destroy the debtors' ability to reorganize, and should therefore, not be allowed.

This leaves the question largely in the hands of the individual judge and creates more variation in outcomes because the circuits are split on this issue.¹⁶⁹ While it does not protect every farmer, it does promise to be another stop gap for meritorious cases, and thereby better balances creditor versus debtor rights. This way, good debtor cases are protected while the government does not have to limit an otherwise expansive right to setoff.

V. Conclusion

*Rational farmers know that when the price of corn goes down, producing less corn to drive prices up is not a real option. They know that their individual decisions to reduce corn acres in an effort to balance supply with demand will have little effect on supply or price. It will simply reduce their own income.*¹⁷⁰

Chapter 12 bankruptcy has always been an imperfect solution to the many problems facing small family farmers. Many times, Congress has left small farmers in free fall

162. Citizens Bank of Maryland v. Strumpf, 516 U.S. 16, 18 (1995).

163. *Id.*

164. *In re* IML Freight, Inc., 65 B.R. 788, 792 (Bankr. Utah 1986).

165. 11 U.S.C.A. § 553.

166. *See generally In re* Elcona Homes Corp., 863 F.2d 483, 488 (7th Cir. 1988) (questioning discretion of courts to limit setoffs); *see also* Melamed v. Lake County Nat'l Bank, 727 F.2d 1399, 1404 (4th Cir. 1984) (stating that setoffs are generally favored).

167. *In re* Cascade Roads, Inc. v. Arkison, 34 F.3d 756, 763 (9th Cir. 1994); *see generally In re* S. Indus. Banking v. Foster, 809 F.2d 329, 332 (6th Cir. 1987) (arguing that when issues of justice arise the right to setoff must be denied).

168. *See In re* Cascade Roads, Inc., 34 F.3d at 765 (detailing the options a court can exercise when faced with certain situations related to the setoff in bankruptcy court); *see also In re* Blanton v. Prudential-Bache Sec., Inc., 105 B.R. 321, 337 (Bankr. E.D. Va. 1989) (detailing a case of setoff and court operation related to its employment and disuse); *In re* Lincoln, 144 B.R. 498, 503 (Bankr. D. Mont. 1992) (denying setoff because payments were necessary for Chapter 12 reorganization); *In re* Cloverleaf Farmers Co-op, 114 B.R. 1010, 1017 (Bankr. D.S.D. 1990) (denying setting because it was inconsistent with purpose of Chapter 12 and the rehabilitation of American farmers).

169. *See supra* notes 162–168 and accompanying text.

170. Imhoff, *supra* note 2, at 18.

because of the sunset clause that stayed with the chapter until 2005,¹⁷¹ and the complications and impediment that capital gains taxes caused blocked many farmers from successfully reorganizing their debts. These issues, as well as other factors, either kept farmers from successfully filing for bankruptcy or disincentivized them from starting the process. Allowing the government to setoff capital gains taxes by tax refunds owed to the farmers may block or disincentivize otherwise viable plans.

Small family farmers are the source of a lot of economic and social value for the rural communities around them as well as to the U.S. economy as a whole. It is also a way of living that many small farmers want to preserve, and Chapter 12 acts as a stop-gap to preserve this way of life as well as this industry. This is the fundamental issue to Chapter 12 that no change to setoff rights, equity considerations to stop setoff, or better legal advice and planning will fix. Chapter 12 bankruptcy is not going to help the small family farmer solve the issues that they are currently facing: the growing control of agribusiness in the sector and the increasing use of technology making the cost to produce higher than what farmers can sell the goods for on the market. These issues were already hurting the farm before *Hall v. U.S.* and before section 1232 was added to Chapter 12. They are not going to go away simply because Chapter 12 makes it easier for them to file bankruptcy. If we as a society want to help farmers we need to significantly rethink how the agriculture sector is structured in the United States and what inducements consumers are giving the industry to continue to run this way—making it increasingly difficult for small family farmers to make a profit.

The small family farmer is important to the social and economic life of many rural communities, and it is becoming increasingly difficult to maintain this way of life. Until changes are made, small family farmers should be provided every tool possible to stay afloat. Passing legislation to address setoff problems will be a long time coming if it occurs, but attorneys can mitigate these problems by working proactively as much as possible with farmers to better position themselves if bankruptcy occurs, and by utilizing equitable considerations for their client if the IRS decides to setoff capital gains taxes by tax refunds farmers owe the debtor.

171. Quinn, *supra* note 10, at 249–51.