that would trigger recapture after the two-year grace period. In four private letter rulings, IRS has ruled that participation in the 10-year Conservation Reserve Program does not result in recapture.[21] In a 1989 ruling, IRS has indicated that participation in a similar state-level program likewise does not result in recapture.[22]

Legislation was enacted in 1983 specifically providing that participation in the 1983 Payment-in-Kind program would not lead to special use valuation recapture.[23] That legislation was not added to the Internal Revenue Code and expired with the 1984 wheat PIK program. IRS also, in early 1983, issued an announcement and a private letter ruling indicating that participation by a qualified heir in the 1983 PIK program or other Department of Agriculture program would not cause the qualified heir to be treated as having ceased to use the property for a qualified use for special use valuation purposes.[24]

FOOTNOTES

[1] Treas. Reg. § 1.61-4. See Baboquinari Cattle Co., 47 B.T.A. 129 (1942), *aff'd*, 135 F.2d 114 (9th Cir. 1943); Clara Driscoll, 3 T.C.M. 73 (1944), aff'd and rev'd, 147 F.2d 493 (5th Cir. 1945); Charles Graves, 88 T.C. 28 (1986), *aff'd on reconsideration*, 89 T.C. 49 (1987) (payment received under Water Bank Program in exchange for set-aside of 770 acres includible in gross income as rent).

[2] Treas. Reg. § 1.451-2(a).

[3] See Rev. Rul. 65-95, 1965-1 C.B. 208. See also Rev. Rul. 67-404, 1967-2 C.B. 159 (farmer required to include in gross income from taxable year 1966 payments received in that year for both 1965 and 1966 crops; no basis for requesting permission to change accounting treatment for those items).

[4] Rev. Rul. 65-98, 1965-1 C.B. 213 (advance and final diversion payments under 1963 Feed Grain Program includible in gross income when received or made available to taxpayer whichever was earlier; fact operator did not sign application for final payment not effective to defer income to later year).

[5] Rev. Rul. 68-44, 1968-1 C.B. 191.

[6] I.R. 86-175, Dec. 31, 1986.

[7] See Rev. Rul. 87-103, 1987-2 C.B. 41 (handling commodity redemption with certificates under "Pik and Roll" program).

[8] See Treas. Reg. § 1.61-4.

[9] Rev. Rul. 60-32, 1960-1 C.B. 23 (payments received under soil bank program subject to self-employment tax for owner-operator). See Maxwell v. Gardner, Unempl. Ins. Rep. (CCH) ¶ 14,533 (N.D. Ala. 1966) (materially participating crop share landlord).

[10] Letter from Peter K. Scott, Associate Chief Counsel, Technical, Mar. 10, 1987.

[11] Ltr. Rul. 8822064, Mar. 7, 1988.

[12] See Notice 87-26, 1987-1 C.B. 470 (dairy termination program payments); Rev. Rul. 60-32, 1960-1 C.B. 23 (soil bank payments).

[13] Soc. Sec. Rul. 67-42 (cropland adjustment income; dictum).

[14] See generally 5 Harl, Agricultural Law § 43.03[2][g] (1990).

[15] See I.R.C. § 2032A (c)(6)(B).

[16] *Id*.

[17] See I.R.C. § 2032A (c)(6)(A).

[18] See, e.g., Heffley v. Commr, 89-2 U.S.T.C. ¶ 13,812 (7th Cir. 1989) (cash rental to non-family member; qualified use test not met).

[19] I.R.C. § 2032A(c)(7)(A).

[20] See I.R.C.§2032A(b)(5)(A).

[21] Ltr. Rul. 8729037, Apr. 21, 1987; Ltr. Rul. 8743004, July 16, 1987; Ltr. Rul. 8745016, Aug. 7, 1987; Ltr. Rul. 8802026, Oct. 15, 1987.

[22] Ltr. Rul. 8946023, August 18, 1989 (qualified heir's enrollment of 9 acres of special use valued farmland in the Reinvest in Minnesota land conservation program did not cause recapture of special use valuation benefits).

[23] Pub.L. 98-4, 97 Stat. 7 (1983).

[24] Ann. 83-43, I.R.B. 1983-10, 29; Ltr. Rul. 8330016, Apr. 26, 1983.

DEVELOPMENTS IN PERSPECTIVE

THE ABSOLUTE PRIORITY RULE

A Chapter 11 plan may be confirmed over the objections of creditors, the so-called "cram down," if the plan does not discriminate unfairly and is fair and equitable to all objecting impaired classes of creditors.[1] The absolute priority rule states that a plan is not fair and equitable if the debtor, or any junior creditor, retains an interest in estate business property and unsecured creditors receive less than full payment on their claims.[2]

The U.S. Supreme Court has provided an exception to the absolute priority rule where the debtor contributes money or money's worth to the business in an amount at least equal to the debtor's interest in the business.[3]

The absolute priority rule provides a major obstacle to the farm debtor in Chapter 11 who wants to keep the farm business but who has little property not essential to the business with which to pay unsecured creditors. Generally, farm debtors have attempted to use the exception to the absolute priority rule by claiming a value in money's worth for some of the intangible aspects of the farm as a continuing business.

In an Eighth Circuit Court of Appeals case, the farm debtor claimed the contribution of the debtor's skill and labor as a contribution in money or money's worth.[4] Although the Appeals Court agreed with the debtor, with some conditions, the U.S. Supreme Court reversed, holding that a contribution of skill and labor was not a contribution of money's worth to the business.[5]

A farm debtor's contribution of future farm profits was held insufficient to invoke the absolute priority rule.[6] Farm debtors' contribution of farm machinery worth $20,000 over five years of Chapter 11 plan and contribution of $30,000 cash to farm operations were not substantial contribution of fresh capital to overcome the absolute priority rule where $1.1 million was owed to unsecured creditors.[7]

A recent Kansas bankruptcy case illustrates several other aspects of the absolute priority rule.[8] The debtors owned a farm

under a sole proprietorship and in their Chapter 11 plan proposed to contribute their labor and exempt property to the farm business to satisfy the absolute priority rule. The debtors' attorney also agreed to be paid out of future farm earnings instead of estate property.

The debtors claimed that because the farm business had little or no "going concern" value, the debtors did not retain any interest of value. The court rejected this argument, noting that the U.S. Supreme Court in *Ahlers* held that the retained control over the business and possible future earnings from the business were sufficient retained interests to invoke the absolute priority rule.

The court, after some discussion as to whether the exception to the absolute priority rule still exists, held that even under the exception, the debtor's contribution must be necessary for the reorganization and must be substantial and exceed the value of the debtors' retained interests in the business. The debtors were held not to have met the burden of showing their entitlement to the exception.

FOOTNOTES

[1] 11 U.S.C. § 1129(b)(1).

[2] 11 U.S.C.§ 1129(b)(2)(B)(ii).

[3] Case v. Los Angeles Lumber Products Co., 308 U.S. 106 (1939). See *In re* Henke, 90 B.R. 451 (Bankr. D. Mont. 1988) (absolute priority rule did not bar farm debtor's Chapter 11 plan where debtor would invest non-farm income in plan payments).

[4] *In re* Ahlers, 794 F.2d 388 (8th Cir. 1986), *rev'd* 485 U.S. 197 (1988).

[5] *Id.* See also *In re* Stegall, 64 B.R. 296 (Bankr. C.D. Ill. 1986), *aff'd* 85 B.R. 510 (C.D. Ill. 1987) (farmer-debtor's labor may not be considered as contribution sufficient to overcome absolute priority rule); *In re* Rudy Debruycker Ranch, Inc., 84 B.R. 187 (Bankr. D. Mont. 1988) (debtor's contribution of services and some property to farm operations not sufficient to allow exception to absolute priority rule).

[6] *In re* Olson, 80 B.R. 935 (Bankr. C.D. Ill. 1987) (absolute priority rule not met where secured creditor would not receive full payment and farmer-debtor's contribution would be from profits from farming).

[7] *In re* Snyder, 105 B.R. 898 (Bankr. C.D. Ill. 1989).

[8] *In re* Drimmel, 108 B.R. 284 (Bankr. D. Kan. 1989).

Cases, Regulations and Statutes

BANKRUPTCY

GENERAL

AVOIDABLE TRANSFER. Chapter 7 farm debtors had granted a new mortgage on farm land to creditor in exchange for release of mortgage on other land. The trustee had argued that because the previous mortgage was junior to other liens in excess of the property's value, the release of the old mortgage did not constitute new value received for the new mortgage and thus the granting of the new mortgage within 90 days of the bankruptcy filing was an avoidable preferential transfer. The court ruled that the exchange of mortgages was a contemporaneous exchange for new value. ***In re* Quade, 108 B.R. 681 (Bankr. N.D. Iowa 1989)**.

ESTATE PROPERTY. An ERISA qualified employee pension and profit sharing plan was not estate property because the plan qualified as a spendthrift trust under Missouri law. ***In re* Boon, 108 B.R. 697 (W.D. Mo. 1989), rev'g 90 B.R. 988 (Bankr. W.D. Mo. 1988)**.

EXEMPTIONS. The Illinois exemption for payments from pension (and other types of) plans was held not to apply to a lump sum distribution of the debtor's entire interest in the plan. ***In re* Summers, 108 B.R. 200 (Bankr. S.D. Ill. 1989)**.

The Bankruptcy Court for the Northern District of Oklahoma held that the exemption for qualified individual retirement accounts was not preempted by ERISA. ***In re* Ridgway, 108 B.R. 294 (Bankr. N.D. Okla. 1989)**.

A different Oklahoma Bankruptcy Court has held that the federal ERISA does preempt the Oklahoma exemption for retirement plans but also held that such plans are exempt under ERISA as a federal exemption. ***In re* Burns, 108 B.R. 308 (Bankr. W.D. Okla. 1989)**.

The Oklahoma exemption for tax qualified retirement plans was held unconstitutional because it did not limit exemption to amount necessary for support of debtor and did not exclude retirement plans over which the debtor had access to the funds. ***In re* Garrison, 108 B.R. 760 (Bankr. N.D. Okla. 1989); *In re* Walker, 108 B.R. 769 (Bankr. N.D. Okla. 1989)**.

LIEN AVOIDANCE. A debtor who had claimed a homestead exemption under state law for a mobile home was not allowed to avoid a nonpossessory, nonpurchase money lien against the mobile home as household goods under Section 522(f)(2). ***In re* Coonse, 108 B.R. 661 (Bankr. S.D. Ill. 1989)**.

SETOFF. The Commodity Credit Corporation attempted a setoff of a deficiency on a CCC crop storage loan owed by a farm corporation against disaster payments due to the sole shareholder from crop disaster losses in the shareholder's separate pecan growing operations. The court denied the setoff because lack of mutuality of debtors where the corporation and the shareholder were considered separate entities. ***In re* Jones, 107 B.R. 888 (Bankr. N.D. Miss. 1989)**.

CHAPTER 11

MODIFICATION OF PLAN. Dairy farm debtors' Chapter 11 plan provided that priority city real property taxes would be paid in full in installments over length of plan. The plan also gave the debtors the right to object to any claims under the plan within 60 days after confirmation of the plan. The court denied the debtors' attempt to bifurcate the real property tax claim into secured and unsecured claims after confirmation of the plan because the plan had provided that the claims would be paid in full. ***In re* Henderberg, 108 B.R. 407 (Bankr. N.D. N.Y. 1989)**.