

KREKELER LAW REPORT



FEBRUARY 2018

VOL. 4 NO. 1

UNDUE HARDSHIP CLAIMS FOR STUDENT LOAN DEBT



“Student debt can never be eliminated in bankruptcy.”

The answer is actually false. Student loan debt -- privately-held and government-sponsored -- can be eliminated or “discharged” through a bankruptcy. However, the burden falls on the student loan debtors to prove that there would be an “undue hardship” if the debt remains.

To discharge the student loan debt, the debtor has to file an adversary proceeding, a lawsuit inside the bankruptcy, against the student loan company or companies.

To prove this undue hardship, most courts follow a test that requires three things: that the borrower can't maintain a minimum standard of living if he or she is forced to repay the loans, that the state of affairs will persist for a significant portion of the repayment period, and that there has been a good faith effort to repay the loans.

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VALENTINE'S DAY



\$19.6 Billion. That is what consumers likely spent this year celebrating Valentine's Day, according to the National Retail Federation. That spending includes flowers, cards and chocolate. And jewelry.

My wife loves jewelry, but one piece she will not be getting is a diamond recently recovered in the Letšeng diamond mine in Lesotho. At 910 carats and 182 grams, the stone is about the size of 2 golf balls. It is believed to be the 5th largest ever recovered.

It is a D color grade, which means the stone is colorless. This in turn means it has little to no nitrogen, and is very high quality. For comparison purposes, a 357-carat diamond from Letšeng mine sold for \$19.3 million in September 2015.

We are all in favor of Valentine's Day and all its traditions, but watch what you spend. Stay within your budget.

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NEW TAX LAW MAY HELP DISTRESSED FARMERS

A recent change in tax law may help more farmers survive tough financial times, although issues still remain. David Krekeler discusses the Additional Supplemental Appropriations for Disaster Relief Requirements Act 2017, and what it means for farmers facing bankruptcy.

Jan. 17, 2018 -- Contracting the size of the operation, or downsizing, is often a valuable tactic for businesses in financial trouble.

Farms are no different from other businesses in this respect. Selling nonproductive or low productive assets to reduce debt can be the difference between success and failure going forward.

Sometimes advance planning can permit a farmer to dispose of such assets before filing a bankruptcy, but much more often, these asset dispositions take place later. The farmer, and even his or her attorney, may have waited until absolutely necessary to consult with reorganization counsel. The farmer may be extremely reluctant to part with any of these assets and only does so as a last resort. The need to contract the operation may not even have been obvious, or it may come about as part of the negotiations that are integral to the reorganization process. Whatever the reason, the post-petition disposition of assets is common and often results in non-dischargeable tax debt.

The Additional Supplemental Appropriations for Disaster Relief Requirements Act 2017

Congress passed and the president signed the Additional Supplemental Appropriations for Disaster Relief Requirements Act 2017.

Effective Oct. 26, 2017, the capital gain taxes resulting from the post-petition disposition of capital assets may be de-prioritized and treated as general unsecured claims. The effect is that these tax debts will share in any distribution to unsecured creditors and will be discharged upon the completion of the Chapter 12 plan.

This change in tax law may help more farmers survive tough financial times. 2017 has proven to be a tough year for many farmers. While bankruptcy numbers are down from 2016 in Chapters 7, 11, and 13, Chapter 12 filings increased more than 10 percent, and there were double the Chapter 12 filings in 2017 compared with 2015.

Chapter 12

Chapter 12 was enacted in 1986, during another, and more severe, time of financial stress for farmers.

The other forms of reorganization available at the time under the Bankruptcy Code were not effective for many farmers, due to the debt limits and time constraints of Chapter 13 and the voting process and absolute priority rule under Chapter 11.

Among the benefits of Chapter 12 is the ability to de-prioritize the claims. Most taxes are not dischargeable in bankruptcy. They generally are priority claims and must be paid in full during the term of the reorganization plan and always within five years.

Income taxes can be discharged, but only if certain requirements are met. Those requirements are as follows:

- The return's due date was at least three years prior to the bankruptcy filing.
- The return was filed at least two years prior to the bankruptcy filing.
- The tax claim was assessed at least 240 days prior to the bankruptcy filing.

Downsizing and Tax Liabilities for Farmers

These limitations, particularly the three-year waiting period, results in few farmers being able to downsize without facing potential tax liabilities.

Farm businesses generally require capital assets. Land, equipment, and livestock are significant assets necessary to a farm operation. Such assets are often held for a long time. The adjusted basis of these assets is often very low or zero by the time the asset is sold. Land may have been acquired long ago and have a low basis in comparison to current market prices.

In what was then the leading case on this issue, the Eighth Circuit held that taxes on post-petition sales qualified for de-prioritization in *Knudsen v. Internal Revenue Serv.*¹

A split in the circuits arose a few years later when the Ninth Circuit held that the taxes from post-petition sales of a farm did not so qualify. *United States v. Hall*² went to the U.S. Supreme Court and was affirmed in a 5-4 decision.³

SPEAKING OF TAXES...



Gather your records and tell the truth... the whole truth. Mike “The Situation” Sorrentino, the reality TV personality from “Jersey Shore” is learning this lesson the hard way.

The success of the show allowed Sorrentino to make millions through endorsements and paid personal appearances. But he allegedly understated his income by claiming business expenses for “high-end vehicles, ...clothing, and personal grooming expenses.”

The charges include filing false tax returns by understating income. The trial date was set for this month.

FIXED RATE MORTGAGES



30 year fixed rate mortgages	3.99%
15 year fixed rate mortgages	2.44%

Sources: Freddie Mac, as reported by Associated Press, week of January 14

These rates are still historically low and we generally like our clients to have fixed rate loans. But be aware that these rates do not tell the whole story, nor disclose your full borrowing cost. Most borrowers must pay extra fees, known as points, in order to get the lowest rates available.

We are always happy to counsel and advise about loans and mortgages. We find that many of our clients have taken out loans without knowing what is contained in the “fine print”. They only learn about the negative aspects after problems arise and it is too late. Make sure you fully understand your loan terms before you borrow.

The effect of the *Hall* decision was that farmers could not utilize downsizing in their reorganization efforts, at least not without facing potentially damaging tax consequences. We have seen cases which failed because of this problem. We have had to dismiss cases in which farmers downsized and then filed new cases to be able to include the tax debt as a pre-petition claim.

Chapter 12 permitted farmers to de-prioritize the taxes owing on the disposition of capital assets and treat those tax liabilities as general unsecured debts. This meant that the tax claims would be discharged upon completion of the plan, even if the taxes would otherwise not be dischargeable.

The statutes, however, left numerous issues, and the courts began wrestling with these. Among these issues was whether the favorable de-prioritization treatment applied to assets disposed of prior to filing, post-filing, or both.

The Ninth Circuit had invited Congress to rectify this – and now Congress has at least in part. The new statute will help some Wisconsin farms stay farming.

Issues Still Remain

A number of issues still remain when it comes to the treatment of taxes in Chapter 12. For example:

- What farm assets will qualify for this special tax treatment?
- How will the tax be calculated?

Follow this newsletter for future development – and please let me know what you think about this change in the law, or if you have questions. I can be reached at (608) 258-8555 or via email at jdkrek@ks-lawfirm.com.



Our firm has filed nearly 25 percent of the Chapter 12 cases in Wisconsin over the past two years.

This article was originally published on the State Bar of Wisconsin's [Agriculture Law and Rural Practice Blog](#) of the Solo/Small Firm & General Practice Section. It has also been published by [Inside Track](#).

Endnotes

¹ 581 F.3d 696 (8th Cir. 2008).

² 617 F.3d 1161 (9th Cir. 2010).

³ *Hall v. United States*, 18 132 S. Ct. 1882 (2012).

WHERE'S KREKELER ?

Attorney Kristin Sederholm, a partner here at Krekeler Strother, has been asked to serve on an advisory committee of the Bankruptcy, Insolvency, & Creditors' Rights (BICR) section of the State Bar of Wisconsin. That group is exploring revisions to Wisconsin Chapter 128 assignments for the benefit of creditors. Chapter 128 is a unique state court proceeding that allows for a receiver-supervised liquidation of a business outside of bankruptcy. Chapter 128 also has provisions allowing individual debtors to repay unsecured debts in full at 0% interest during a 3-year period.

If you have questions about Chapter 128 options for individuals or businesses, please Contact Us.

STUDENT LOAN DEBT

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This test is over 30 years old and was written when student loans were easier to discharge. Because of this, it is still very difficult to eliminate student loans, even when bankruptcy judges agree that the debts should go away. Student loan companies have appealed these decisions and have often won on appeal.

Now the US Department of Education is looking at this undue hardship standard. To evaluate it, the Department is requesting responses and comments through May 22. The Education Department can't re-write the Bankruptcy Code section on student loan debts being non-dischargeable – that's Congress's job. The department also can't overrule judges who follow the undue hardship three-part test – that's up to the courts or to Congress to define what "undue hardship" means today.

But the Education Department has influence on what government-backed student loan companies do with these adversary lawsuits. It could push for reforms on when student loan lenders challenge or avoid challenges to these lawsuits.

If you have a comment or want information, you can visit ["Request for Information on Evaluating Undue Hardship Claims in Adversary Actions Seeking Student Loan Discharge in Bankruptcy Proceedings"](#) at www.FederalRegister.gov

We deal with Student Loan litigation both in and out of bankruptcy. For an analysis of your student loan situation and potential options to discharge debts in bankruptcy, please contact us.



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2901 W. Beltline Highway, Suite 301
Madison, WI 53713

Phone: 608/258-8555

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