

# Exemptions and Pensions

(Controlling Case Law - 10<sup>th</sup> Circuit<sup>1</sup>)

IRA accounts are exempt and are "similar plans" under § 522(d)(10)(E) because a debtor's right to payment from an IRA is causally connected to their age by a 10% penalty that was designed by Congress to preclude early access to the IRA. The 10% penalty is substantial, deters early withdrawal and effectively prevents access to the entire balance of the IRA. Because the 10% penalty is removed when the account holder turns age 59½, the right to the balance of the IRA is on account of age. IRA income substitutes for wages lost upon retirement and distinguishes IRAs from typical savings accounts. Rousey v. Jacoway, 544 U.S. 320, 125 S.Ct. 1561 (2005)

"Applicable nonbankruptcy law" within the meaning of § 541(c)(2) is not limited to state law and an ERISA-mandated anti-alienation provision satisfied the literal terms of § 541(c)(2) thus permitting the debtor to exclude an ERISA-qualified retirement plan from the bankruptcy estate. Patterson v. Shumate, 504 U.S. 753, 112 S. Ct. 2242 (1992).

Rule 4003(b) establishes a 30-day period for objecting to exemptions under § 522(l). After the 30-day period has run the exemption cannot be contested under 522(l) even if there is no colorable statutory basis for claiming the exemption. The court noted that other remedies were available to discourage debtors from unreasonably declaring exemptions such as § 727(a)(4)(B), Rule 1008, Rule 9011 and 18 U.S.C. § 152. Note that the Court refused to rule on the argument that § 105 could be used to disallow the exemption. We have no authority to limit the application of § 522(l) to exemptions claimed in good faith. Taylor v. Freeland & Kronz, 503 U.S. 638, 112 S. Ct. 1644 (1992).

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An exemption is an interest withdrawn from the estate and hence from the creditors for the benefit of the debtor. Property that is properly exempted under § 522 is (with some exceptions) immunized against liability for prebankruptcy debts. § 522(c). No property can be exempted (and thereby immunized), however, unless it first falls within the bankruptcy estate. Section 522(b) provides that the debtor may exempt certain property "from the estate"; obviously, then, an interest that is not possessed by the estate cannot be exempted. Thus, if a debtor holds only bare legal title to his house - if, for example, the house is subject to a purchase-money mortgage for its full value - then only that legal interest passes to the estate; the equitable interest remains with the mortgage holder, 11 U.S.C. § 541(d). And since the equitable interest does not pass to the estate, neither can it pass to the debtor as an exempt interest in property. Legal title will pass, and can be the subject of an exemption; but the property will remain subject to the lien interest of the mortgage holder. The correct application of § 522(f) is to ask not whether the lien impairs an exemption to which the debtor is in fact entitled, but whether it impairs an exemption to which he would have been entitled but for the lien itself. This rule applies to both federal and state exemption lists. Owen v. Owen, 500 U.S. 305, 111 S. Ct. 1833 (1991).

Unless the debtor has a property interest to which a lien can attach at some point in time before the lien actually attaches, the debtor cannot avoid the lien under the terms of § 522(f)(1). A debtor cannot use § 522(f)(1) to avoid a lien on an interest acquired after the lien attached. Farrey v. Sanderfoot, 500 U.S. 291, 111 S. Ct. 1825 (1991).

We do not think it appropriate to approve any generalized equitable exception-either for employee malfeasance or for criminal misconduct-to ERISA's prohibition on the assignment or alienation of pension benefits. If exceptions to this policy are to be made, it is for Congress to undertake that task. Guidry v. Sheet Metal Workers Nat. Pension Fund, 493 U.S. 365, 110 S.Ct. 680 (1990).

ERISA § 206(d)(1) protects ERISA-qualified pension benefits from garnishment only until paid to and received by the plan participants or beneficiaries. State law will not be preempted when it has only a tenuous, remote, or peripheral connection with federal law. In keeping with the state law conclusion that exemptions must be construed liberally, it is assumed that absent specific language in a statute limiting the extent of an exemption, the legislature did not intend to impose a limitation. Guidry v. Sheet Metal Workers Nat. Pension Fund, 39 F.3d 1078 (10<sup>th</sup> Cir. 1994)(en banc), *cert*

*denied*, 514 U.S. 1063, 115 S.Ct. 1691 (1995), and *cert denied*, 514 U.S. 1063, 115 S.Ct. 1691 (1995).

A trustee seeking to establish a debtor's bad faith in an exemption proceeding under § 522 must do so by a preponderance of the evidence. Debtors may amend bankruptcy schedules as a matter of course. But an amendment may be denied, however, if there is bad faith by the debtor or prejudice to creditors. Bad faith may be established by circumstantial evidence, or by inferences drawn from a course of conduct. In exemption proceedings, the burden to establish bad faith rests on the party challenging the amended schedule. An inadvertent omission may be an affirmative defense to a debtor's failure to disclose an asset in bankruptcy. Inadvertence can be established by showing among other things, either (1) the debtor had no knowledge of the undisclosed asset, or (2) the debtor had no motive to conceal it. The burden of establishing the inadvertence lies with the debtor. In re Ford, F.3d , 2007 WL 1445519 (10<sup>th</sup> Cir. 2007).

Equitable conversion is neither a fixed rule of law nor a remedy, but rather is a legal fiction devised in recognition of the maxim that equity regards as done that which ought to be done. Equitable conversion refers only to a way of thinking about certain issues, a reasoning process. Applying the doctrine of equitable conversion to a bankruptcy exemption issue, at the moment the debtor and contractor entered into an enforceable contract, the deposit is equitably converted into the addition of debtor's home that is to be constructed. Whether the construction contract is specifically enforceable is immaterial because we apply the doctrine of equitable conversion only to the extent the improvement is made. The equitable conversion doctrine is not limited to sales contracts cases. It may be invoked in any case in which a party is under a legal duty to convey. Debtors are entitled to claim as exempt any improvements made before the petition date as well as any improvements that were made from the deposit after the petition date up to the amount ultimately expended on the addition to their home. If the contract is a sham, the court is justified in refusing to characterize the assets as equitable converted. In re Hodes, 402 F.3d 1005 (10<sup>th</sup> Cir. 2005).

Exemption laws are to be construed liberally in favor of exemption. Once a debtor claims an exemption, the objecting party bears the burden of proving the exemption is not properly claimed. The test of co-ownership for purposes of the tools of the trade exemption is not whether a spouse can demonstrate he or she acquired an ownership interest by purchase with separate property, gift or inheritance. Instead, the

debtors' intent and conduct controls. This test recognizes the practical realities of the marital relationship. Spouses do not regularly document gifts between themselves, and many spouses choose to co-mingle assets and co-pay expenses out of joint accounts without keeping the strict accounting requirements required to prove co-ownership. In re Lampe, 331 F.3d 750 (10<sup>th</sup> Cir. 2003).

Bankruptcy courts must resort to state law for interpretation of state exemption rights in homesteads. The plain language of § 522(g)(1) provides that a debtor cannot assert any exemption in property a trustee recovers after the debtor's voluntary transfer of the property. The term "transfer" is broadly defined. The court generally recognizes that a debtor is entitled to convert nonexempt property into exempt property up until the filing of the bankruptcy petition, and that this practice is not fraudulent *per se*. However, when the conversion is intended to defeat the interests of creditors, such exemptions may be denied to the extent of any fraudulent conduct. The purpose of § 522(g) is to prevent a debtor from claiming an exemption in recovered property which was transferred in a manner giving rise to the trustee's avoiding powers, where the transfer was voluntary or where the transfer or property interest was concealed. The opportunity for a fresh start is available only to the honest debtor. In re Duncan, 329 F.3d 1195 (10<sup>th</sup> Cir. 2003).

Federal and state tax withholdings are not 'earnings from personal service' and therefore cannot be exempted as earnings from personal service. In re Annis, 232 F.3d 749 (10<sup>th</sup> Cir. 2000).

Interpretation of Oklahoma homestead provision applying to rural homestead. In re Kretzinger, 103 F.3d 943 (10th Cir. 1996).

A nonconsensual lien can be avoided pursuant to section 522 of the code only to the extent that the lien impairs the homestead exemption. (But consider the impact of the 1994 amendments). In re Sanders, 39 F.3d 258 (10th Cir. 1994).

The debtor's right to amend schedules to claim a different homestead exemption cannot be denied on procedural grounds where the case has not been closed. In re Osborn, 24 F.3d 1199 (10th Cir. 1994).

The law in effect on the petition date and not the conversion date controls regarding exemptions. In re Marcus, 1 F.3d 1050 (10th Cir. 1993).

Without a timely objection, even exemptions that have no basis in state law cannot be denied. (citing Taylor v. Freeland & Kronz, 112 S. Ct. 1664 (1992)). In re Coones, 996 F.2d 250 (10th Cir. 1993), *cert. denied*, 114 S. Ct. 684 (1994).

The debtor's attempt to amend exemption schedules may be denied if there is bad faith by the debtor or a showing of prejudice to creditors. In re Calder, 973 F.2d 862 (10th Cir. 1992).

Conversion of nonexempt property to exempt property for the purposes of placing the property out of the reach of creditors, without more, will not deprive the debtor of the exemption to which he otherwise would be entitled, however the debtor may be denied discharge if he converts property "with intent to hinder, delay, or defraud a creditor ... within one year before the date of the petition." In re Carey, 938 F.2d 1073 (10th Cir. 1991).

The bankruptcy court can extend the period for objections to exemptions, but may only do so by acting within the original time period. In re Brayshaw, 912 F.2d 1255 (10th Cir. 1990).

While state law governs the question of the debtor's exemptions under state statute, federal law determines the availability of lien avoidance under § 522(f). Liens in property exempt under state law are avoidable only if enumerated in § 522(f)(2). In re Heape, 886 F.2d 280 (10th Cir. 1990).

Whether a pre-bankruptcy transaction which converts non-exempt property into life insurance is fraudulent should be gauged by considering the so-called "badges of fraud". In re Mueller, 867 F.2d 568 (10th Cir. 1989).

A debtor can avoid any nonpossessory, non-purchase-money lien on property to which they would have been entitled to exempt under § 522(b), which may be either the federal list or the state list depending on the state. In re Leonard, 866 F.2d 335 (10th Cir. 1989).

A motor vehicle needed by the debtor to commute to work was not used and kept for purpose of carrying of a trade or business and would not be allowed as an exemption. Johnston v. Barney, 842 F.2d 1221 (10th Cir. 1988).

The refinancing of a purchase money loan does not automatically extinguish the

creditor's purchase money security interest in the debtor's collateral. If the identical collateral remains as security for the refinanced debt, then neither the debt nor the security has changed its essential character and the creditor has not committed the type of overreaching that § 522(f) aims to prevent. In re Billings, 838 F.2d 405 (10th Cir. 1988).

The debtor (former wife) could avoid former husband's claim on property claimed as exempt by debtor as homestead because divorce decree contained no additional language creating lien against homestead property and was judgment lien under state law that could be avoided pursuant to § 522(f). Maus v. Maus, 837 F.2d 935 (10th Cir. 1988).

A temporary abatement of work in a trade is not fatal to a claim for an exemption for tools or implements of that trade. In re Liming, 797 F.2d 895 (10th Cir. 1986).

A bankruptcy court is empowered under § 105(a) to authorize the trustee to "surcharge" the debtor's exempt assets and retirement fund to compensate the estate for property of the estate which the debtor refuses to surrender. A "surcharge" should be authorized only where it is necessary to further the provisions of the bankruptcy code and where such an order is equitable. To "surcharge" the debtor's exempt assets and retirement funds, the bankruptcy court need not make a finding of fraud or hold the debtor in contempt. In re Scrivner, B.R. (10<sup>th</sup> Cir. BAP June 2007), (*but see dissent*).

Where a trustee persuaded a creditor to release its unperfected lien on debtor's vehicle, but failed to timely object to debtor's claimed exemption in the vehicle, the trustee lost her right to contest debtor's entitlement to the claimed exemption. The exception found under In re Duncan, 329 F.3d 1196 (10<sup>th</sup> Cir. 2003) did not apply. In re Kuhnel, 346 B.R. 528 (10<sup>th</sup> Cir. BAP 2006).

Debtor's pre-petition refinancing of home did not constitute a "sale" which, under Colorado law would provide that proceeds of the sale are exempt for up to one year after the sale if kept in a separate account. Debtor's claimed exemption is proceeds from the refinance of debtor's home were not exempt as proceeds from a "sale". In re Polimino, 345 B.R. 708 (10<sup>th</sup> Cir. BAP 2006).

Under Kansas law, a self settled revocable trust's interest in real property held by

the trust may properly be claimed as a homestead exemption by the beneficiary of the trust. In re Kester, 339 B.R. 749 (10<sup>th</sup> Cir. BAP 2006).

If a lien on debtor's principal residence is wholly unsecured, then the antimodification clause of § 1322(b)(2) does not apply and the rights of the creditor holding such a claim may be modified by the debtors' Chapter 13 plan. In re Griffey, 335 B.R. 166 (10<sup>th</sup> Cir. BAP 2005).

Only judicial liens are subject to avoidance under § 522(f)(1)(A). Bankruptcy law preempts state law in determining what liens may be avoided in bankruptcy. A state may elect to control what property is exempt under state law, but federal law determines the availability of the lien avoidance provision. A creditor cannot use a state exemption exception to prevent lien avoidance. In re Strother, 328 B.R. 818 (10<sup>th</sup> Cir. BAP 2005).

Property claimed as exempt is property of the estate on a debtor's petition date. It reverts in the debtor when the exemption is allowed, either by court order or because of the lack of a timely objection. Property of the estate also reverts in the debtor upon confirmation of a Chapter 13 plan under § 1327(b). Such property is property of the estate upon conversion to Chapter 7. The time to object to claimed exemptions under Rule 4003(b) recommences when a Chapter 13 case is converted to Chapter 7. In re Campbell, 313 B.R. 313 (10<sup>th</sup> Cir. BAP 2004).

A judgment lien obtained by creditor post-petition under § 523 is avoidable by the debtor under § 522(f) notwithstanding that the pre-petition debt upon which the judgment lien is based was ruled by a bankruptcy court as nondischargeable. Fees attributable to the prosecution of the dischargeability proceeding (although incurred postpetition), constitute a contingent or unmatured pre-petition claim and are therefore avoidable under § 522(f). In re Vaughan, 311 B.R. 573 (10<sup>th</sup> Cir. BAP 2004).

A bankruptcy court must interpret state exemption laws under the state's rules of statutory construction. Even though the involuntary debtor consented to relief, the debtor did not "file a bankruptcy petition" within one year of issuance of a life insurance policy and therefore the debtor may exempt the policy under Kansas law. In re Hodes, 308 B.R. 61 (10<sup>th</sup> Cir. BAP 2004).

Owning the land surrounding a mobile home is not a prerequisite to claiming the

mobile home exempt as homestead under Utah Code § 78-23-3. In re Carlson, 303 B.R. 478 (10<sup>th</sup> Cir. BAP 2004).

A debtor's claimed homestead is presumed to be valid, and objecting creditor bears the burden of producing evidence to rebut that presumption. Once the presumption has been rebutted, the burden shifts to the debtor to produce evidence in support of the claimed homestead. The petition date is the appropriate date on which to determine debtor's exemption rights. In re Robinson, 295 B.R. 147 (10<sup>th</sup> Cir. BAP 2003).

The bankruptcy code makes no provision for a non-debtor to claim an exemption from the estate. In re Duncan, 294 B.R. 339 (10<sup>th</sup> Cir. BAP 2003).

In Utah, an equitable interest in property awarded under a divorce decree is not a judicial lien; it is the dispossessed party's share of the assets. Utah courts imply that such a lien is consensual. Unless the debtor had the property interest to which the lien attached at some point before the lien attached to that interest, the debtor cannot avoid the fixing of the lien under the terms of § 522(f)(1). Under Farrey, a debtor cannot use § 522(f)(1) to avoid a spouses lien created by a divorce decree. In re Busch, 294 B.R. 137 (10<sup>th</sup> Cir. BAP 2003).

Bankruptcy courts must determine co-ownership from the evidence of intent and conduct of the party claiming title. Tax returns are relevant but not controlling in the context of tools of the trade exemption. The general rule regarding exemption laws is that they are to be liberally construed in favor of those intended by the legislature to be benefitted and favorable to the purposes of enactment. Where one spouse is employed and the other is not, both spouses are entitled to the tool of the trade exemption in order to further the policy of exemption statutes, to protect debtors and their dependents by giving them a means to avoid destitution. Once an exemption has been claimed by the debtor, it is the objecting party's burden to prove that the exemption is not properly claimed. In re Lampe, 278 B.R. 205 (10<sup>th</sup> Cir. BAP 2002), *aff'd*, 331 F.3d 750 (10<sup>th</sup> Cir. 2003).

Funds that have already been paid from an exempt fund are no longer "payable" within the meaning of the exemption. The fact that a debtor's wife did not have a qualified domestic relations order (QUADRO) was not fatal to her claim that she had an ownership interest in the debtor's retirement plans. In re Carbaugh, 278 B.R. 512 (10<sup>th</sup>

Cir. BAP (2002).

A consensual mortgage lien, even one that is not properly notarized, is not transmuted into a judgment lien upon foreclosure and therefore cannot be avoided under § 522(f)(1). It is the origin of the creditor's interest rather than the means of enforcement that determines the nature of the lien. The fact that the lien may not be properly perfected has no bearing on a § 522 lien avoidance analysis. In re Nichols, 265 B.R. 831 (10<sup>th</sup> Cir. BAP 2001).

Adjacent parcels of real property acquired by separate deeds but used identically are both be considered to be "occupied" under the Wyoming exemption statute even though the debtors' home is located on only one of the two adjacent parcels. In re Kwiecinski, 245 B.R. 672 (10<sup>th</sup> Cir. BAP 2000).

Once an exemption has been claimed, it is the objecting party's burden to prove that the exemption is not properly claimed. Rule 4003(c). Initially, this means that the objecting party has the burden of production and persuasion. If the objecting party can produce evidence to rebut the exemption, the burden then shifts back to the debtor to come forward with evidence to demonstrate that the exemption is proper. A Colt pistol used for practice by a security guard, but not required by the employer is not exempt. Gregory v. Zubrod, 245 B.R. 171 (10<sup>th</sup> Cir. BAP 2000), *aff'd* 246 F.3d 681 (10<sup>th</sup> Cir. 2000).

It is the origin of the creditor's interest rather than the means of enforcement that determines the nature of the lien. Just because a creditor resorts to the judicial process to enforce the lien, does not mean the lien is a judicial lien. Liens created by settlement agreements which are incorporated into divorce decrees are consensual liens. Thompson v. Unruh, 240 B.R. 776 (10<sup>th</sup> Cir. BAP 1999).

While federal law permits states to define what property is exempt, federal law governs the availability of lien avoidance, and pre-empts any state law that limits the scope of its exemptions in a way that would interfere with the "fresh start" policy served by the avoidance of certain types of liens under § 522(f). Whether a lien "impairs" an exemption may be determined in every case by applying the § 522(f)(2) formula, regardless of the state law limitations on the exemption. In re Coats, 232 B.R. 209 (10<sup>th</sup> Cir. BAP 1999).

A tax refund payable to the debtor did not retain its character as "earnings from personal services" and for that reason lost its exempt status once paid to the taxing authority. In re Annis, 229 B.R. 802 (10th Cir. BAP 1999).

Funds payable to the debtor from the IRS as a result of the debtor qualifying for an earned income credit are in the nature of an overpayment of a tax rather than "earnings from personal services" and as such are not exempt as earnings from personal services necessary for the maintenance of the debtor's family or other dependents. In re Dickerson, 227 B.R. 742 (10th Cir. BAP 1998).

When interpreting exemption statutes, the interpretation must further the spirit of such laws. Exemption statutes are to be liberally construed so as to effect their beneficent purposes. In re Bechtoldt, 210 B.R. 599 (10th Cir. BAP 1997).

For purposes of lien avoidance under § 522, all liens on the property are to be added to the debtor's statutory exemption. That total is then compared to the value of the property. If the total of the liens plus debtor's exemption exceeds the value of the property, the amount of excess is avoidable pursuant to § 522. In re Cozad, 208 B.R. 495 (10th Cir. BAP 1997).

Section 522(c)(2)(B) overrides the general exemption and avoidance powers granted in § 522(g) and (h) and precludes avoidance of tax liens on exempt property. In re Straight, 207 B.R. 217 (10th Cir. BAP 1997).