

# Exemptions and Problems from the Chapter 7 Trustee's Perspective

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## Thorny Issues in Consumer Bankruptcy Cases

Based on a series of successful webinars ABI held in various cities that discussed consumer bankruptcy topics, *Thorny Issues in Consumer Bankruptcy Cases* addresses some of the “hot and not-so-easy” issues arising in today’s consumer bankruptcy practice. A compilation of materials that was presented during some of the sessions, the book covers such topics as getting the discharge, paying debtor and creditor counsel in chapter 13, credit counseling and debtor education, and post-confirmation modifications. For those wading through the sometimes murky world of modern consumer case law, *Thorny Issues in Consumer Bankruptcy Cases* is a must-have addition to any consumer bankruptcy practitioner’s library.



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## EXEMPT PROPERTY - TO BE OR NOT TO BE

11 U.S.C. §522 establishes an individual debtor's right to exempt property. The choice of which exemptions a debtor may choose is also in the Code Section, either under the federal statute or under the appropriate state statute, if the state opted out of the federal exemptions or in other fact patterns established by the Code. Code §522(b)(3)(A) establishes the residency time period for a debtor to be eligible to claim a state exemption and if the debtor does not meet the requirements, the exemptions default to the federal ones. Exempt property does not become property of the estate under §522. See *In re Lofton* (Bankr. N.D. Ga. 2010). Under §§541 and 554, property not scheduled remains property of the estate. *Id.* at 3. Also, property not scheduled cannot be exempted and the debtor may be denied an exemption for undisclosed property.

Federal Rules of Bankruptcy Procedure Rule 4003(a) allows the debtor or dependent of debtor to file a claim of exemptions. Rule 4003(b) states who may object to the exemptions, the time period in which to do so, which is within thirty (30) days of conclusion of §341 meeting or thirty (30) days after amendment. As a trustee, if there is an issue with the exemptions, do not conclude the §341 meeting to extend the time period or file for extension within the time period.

Objection now is to item claimed or amount claimed by debtor, but no longer to stated value of asset. *Schwab v. Reilly*, 130 S. Ct. 2652 (2010). When Trustee sells asset for more than debtor exempted, pay debtor allowed amount of exemption and estate retains difference.

How often and how long into a case may a debtor amend and claim exemptions is an interesting question. B.R. 1009(a) provides for amendments by debtors "...at any time before the case is closed." Bankruptcy Courts are now limiting that right in certain fact patterns. A few examples are:

*In re Wilson*, 446 B.R. 555 (Bankr. M.D.Fl. 2011), the Court addresses the issue and denies debtor the right to amend his exemption claims. After trustee filed objections, turnover requests and motion to compel, debtor filed amended Schedule C, to which trustee responded with res judicata, collateral estoppel and lack of good faith. *Id.* at 4. "...[a]n unlimited number of amendments certainly cannot be allowed right up until a chapter 7 bankruptcy case is closed. *Id.* at 6. This court relies on *Doan* to deny the right to amend where there is bad faith by debtor or prejudice to creditors. *Id.* at 6.

*In re Romano*, 378 B.R. 454 (Bankr. E.D.Pa. 2007) held debtor barred by res judicata from amending exemptions. The Court explains that where debtor exempts property, trustee objects, "...and there has been a final, non-appealed ruling sustaining the trustee's objection, all of the elements of claim preclusion have been established, and so the debtor cannot later amend

her exemptions to relitigate that issue...” *Id.* at 9. The Court suggests that debtor should amend immediately after objection served rather than waiting for ruling on objection. *Id.* at 10. Suggests this is similar to trustee’s requirement to object within prescribed time or be barred citing *Taylor v. Freeland & Kronz*, 503 U.S. 638 (1992).

Another issue is when debtors fail to list asset and claim exemption that is later discovered, often right before a hearing on the motion in another court to bar the undisclosed claim based on judicial estoppel. There are two cases with different outcomes to be resolved on this issue, which seem to differ because one is a chapter 13 and one a chapter 7.

*Love v. Tyson Foods, Inc.*, 677 F. 3d 258 (5<sup>th</sup> Cir. 4/12/12) is a Chapter 13 where debtor does not schedule or disclose District Court claim. District Court granted Summary Judgment, dismissing Love’s suit against Tyson Foods due to judicial estoppel and Circuit Court affirmed.

*Reed v City of Arlington*, 650 F.3d 571 (5<sup>th</sup> Cir. 2011) is a Chapter 7 where debtor does not disclose District Court claim. The Court held that the general rule, absent unusual circumstances, allows an innocent Chapter 7 Trustee to pursue an undisclosed claim for the benefit of creditors, including a judgment or cause of action the debtor fails to disclose in bankruptcy.

Just when you thought IRA accounts were safe, consider the following decisions:

*In re James*, LEXIS #0313-114 (Bankr. E.D. Tn. 2013) held IRA did not lose exempt status by agreements debtor signed when opened accounts. Court held that agreement states that if in conflict with ERISA or IRS, lien provisions do not apply, so debtor did not grant lien.

*In re Daley*, 459 B.R. 270 (Bankr. E.D. Tn. 2011) Court held that IRA account at Merrill Lynch was not exempt because account pledged to Merrill Lynch in paper work signed by debtor when account opened.

*In re Heffron-Clark*, LEXIS #0513-044 (7<sup>th</sup> Cir. 2013) is a very recent decision regarding inherited non-spousal IRA where the Seventh Circuit decided that these are not protected as exempt, primarily because the account is not the same in nature, has different requirements and different tax treatment.

*In re Chilton*, 674 F. 3d 486 (5<sup>th</sup> Cir. 2012), where this Circuit Court upheld the exemption for an inherited IRA account under §522(d)(12).

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EXEMPTIONS

There are two United States Supreme Court cases which have a substantial impact on how and when exemptions are claimed. *Taylor v. Freeland & Kronz et al.*, 112 S. Ct. 1644, was decided in 1992. In that case, the Debtor was pursuing an employment discrimination lawsuit in state court when the bankruptcy case was filed. In her Chapter 7 petition, the Debtor claimed the money she expected to win in the discrimination suit as proceeds from her lawsuit and said that the value of the claim was “unknown”. The Trustee was told that the estimated recovery was between \$90,000.00 and \$110,000.00 which was substantially in excess of the exemption amount to which the debtor was entitled. The Trustee did not think much of the claim and did not object to the exemption. Bankruptcy Rule 4003(b) gives a Trustee and creditors 30 days from the conclusion of the meeting of creditors to object to the Debtor’s claim of exemptions. The Debtor was awarded a recovery of \$110,000.00, and the Trustee asked for turnover of the funds in excess of the small amount the Debtor was entitled to exempt. The Supreme Court held that because the objection was not filed within 30 days of the meeting of creditors, the Debtor was entitled to retain the entire \$110,000.00.

The United States Supreme Court decided *Schwab v. Reilly*, 130 S. Ct. 2655 in 2010. In that case, the Debtor provided the value of various items of personal property with dollar amounts in her Schedule B. In her Schedule C, the Debtor claimed the same amounts as exempt. The Trustee had the personal property appraised and found that its value was in excess of the values the Debtor had scheduled. The Trustee did not file an objection to the exemptions within 30 days of the meeting of creditors. The Debtor claimed that listing the claimed exemption in exactly the same amount as the value shown in her Schedule B was sufficient to alert the Trustee that she was claiming 100% of the value of the items. The Supreme Court held that it was not necessary for the Trustee to object to an exemption in order to preserve the

estate's ability to recover value in assets beyond the dollar amount the Debtor had declared to be exempt. The Court confined the Debtor's exemption to the market value estimate she had placed on the property. The Court distinguished *Taylor* because the Debtor in *Taylor* had not listed the dollar value of the claimed exemption. A trustee or other interested party must object if the claimed exemption is for an "unknown" amount. According to the Court, a Debtor should schedule the value as "full market value (FMV)" or "100% of FMV" in order to claim the entire value of property. The Trustee will then be alerted to the fact that the entire value of the property will be claimed as exempt. As long as a Debtor schedules the value of property within the range allowed by law, interested parties can rely on that value as evidence of the amount of the exemption claim.

TABLE OF TENNESSEE EXEMPTIONS

Category of Exempt Property	Extent of Exemption Under Tennessee Law	Authority (Citation is to Tennessee Code Annotated Unless Indicated)
Homestead (Principal Property)	\$5,000 for individual who is under 62; \$7,500 for husband and wife; individual 62: \$12,500; if married and one is over 62 and other is less than 62: \$20,000; both husband and wife over 62: \$25,000; individual with one or more minors: \$25,000; married couple with minors: \$50,000.	§ 26-2-301
<p>The property must be both “owned...and used” as a Debtor’s principal place of residence. In Re: <u>Dilbek</u>, 2008 WL 867897 (Bankr. ED Tenn 2008). The right of a Debtor to claim a homestead exemption is to be determined as of the date of the filing of the bankruptcy petition.</p> <p>The question sometimes arises as to whether or not a homestead exemption can be claimed in property not presently occupied due to fire, flood, or tornado. Whether the property is the Debtor’s principal place of residence depends both on the Debtor’s use and intent. TCA § 26-2-304 grants an exemption not to exceed five thousand dollars (\$5,000.00) in all moneys arising from insurance on a homestead which is destroyed by fire or other disaster.</p>		
Family Cemeteries and Burial Lots	Family cemeteries limited to one acre	§ 26-2-305
Personal Property	\$10,000.00	§ 26-2-103
Certain Retirement Plans, State Pension Moneys	Certain retirement plans are exempt from all creditors with the exception of the state of Tennessee or an alternate payee under a qualified domestic relations order. State pension funds are	§ 26-2-105

entirely exempt before and after receipt, except from an order for assignment of support.

Don't assume that an IRA is necessarily exempt. See In re James L. Daley, Jr., 459 BR 270 E. TN, 2011) and the Memorandum Opinion and Order from the US District Court for the Eastern District of Tennessee found at Docket 3:11-CV-565 affirming the Bankruptcy Court. The Debtor opened a roll-over, self-directed IRA account with Merrill Lynch under a plan which had been approved by the IRS. Although the Debtor had never borrowed on his IRA or requested an advancement of a margin loan against his funds, the courts held that the Debtor had agreed that Merrill Lynch had a lien on his accounts to secure any obligation to Merrill Lynch which was a prohibited transaction under the IRC. The account was self-directed, so the Debtor qualified as a fiduciary, and he granted a lien on the IRA assets as security for his obligations to Merrill Lynch. The decision has been appealed to the 6<sup>th</sup> Circuit Court of Appeals.

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College Education Savings Plans	All assets, income, and distributions	§ 49-7-822
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Disposable Earnings	75% of weekly disposable earnings or an amount up to 30 times the federal minimum hourly wage for the pay period	§ 26-2-106
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The Legislature did not forget the wage earner's responsibility to support his or her children when establishing this exemption. TCA § 26-2-107 gives the wage earner the added allowance of \$2.50 per week for each dependent child under sixteen (16) who is a resident of this state. Under TCA § 26-2-108 personal earnings are not exempt from orders of support.

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Insurance Benefits	Health, accident, or disability insurance proceeds are fully exempt	§ 26-2-110
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Life Insurance	Cash surrender value is Exempt	§56-7-201; 56-7-202; 56-7-203
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If either an insured or spouse obtains insurance on the insured's life, the proceeds on the intestate insured's death passes free of the insured's debts. If the proceeds pass by will or into a trust, the proceeds pass free of the claims of creditors unless the

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will or trust provides otherwise. If a married person obtains insurance on the spouse's life, the proceeds will not be subject to the insured's debts. Insurance proceeds in the hands of the beneficiary are subject to the debts of the beneficiary.

Fraternal Benefit Society	Unlimited	§ 56-25-1403
Benefit Payments, Alimony, and Child Support	Unlimited	§ 26-2-111(1)
Workers' Compensation	Unlimited	§ 50-6-223
Criminal Victims' Reparations; Personal Injury, Wrongful Death Payments	\$15,000 aggregate	§ 26-2-111(2)
Payment for loss of Future Earnings	To the extent reasonably necessary for the support of the debtor and any dependent	§ 26-2-111(3)
Trade Implements	\$1,900	§ 26-2-111(4)
Health Care Aids	Unlimited	§ 26-2-111(5)
Liquid Assets, Stocks or Bonds	To the extent of the amount of any obligations owed by the debtor pursuant to any final court order or judgment for child support	§26-2-111(6)

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Partnership Property	Not liable for individual debts	§ 61-1-124(3)
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Tenancy by the Entirety	Exempt from process by the creditors of an individual debtor	<i>Ray v. Dawson</i> , 14 B.R. 822, 8 Bankr. Ct. Dec. (CRR) 273, 5 Collier Bankr. Cas. 2d (MB) 404, Bankr. L. Rep. (CCH) P 68422 (E.D. Tenn. 1981); <i>In re Walls</i> , 45 B.R. 145, 12 Bankr. Ct. Dec. (CRR) 663, Bankr. L. Rep. (CCH) P 70175 (Bankr. E.D. Tenn. 1984)
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Funds Recovered in Wrongful Death Action	100% "free from the claims of creditors"	20-5-106(a) & (b)
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Spendthrift Trusts		§ § 35-15-501 to 35-15-507
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Unless the trust is self-settled, a creditor of a beneficiary of a spendthrift trust is only entitled to seize the beneficiary's share once it is in the hands of the beneficiary. For trusts which are self-settled to be exempt, must comply with provisions of Investment Services Trusts.

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Investment Services Trusts		§ § 35-16-101 et seq.
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Property in a self settled trust is safe from creditors if there is compliance with the provisions of the Tennessee Investment Services Act of 2007. Before transfer of assets to the trust, the transferor must execute an affidavit that the transferor has full right to transfer the property, the transferor will not be rendered insolvent by the transfer, the transferor has no intention to defraud a creditor, there are no pending or threatened court actions or administrative proceedings against the transferor other than those listed in an affidavit, bankruptcy is not contemplated, and the property was not derived from unlawful activities. The trust can include spendthrift provisions.

**TABLE OF MISSISSIPPI EXEMPTIONS**

Category of Exempt Property	Extent of Exemption Under Mississippi Law	Authority (Citation is to Mississippi Code Ann. Unless Otherwise Indicated)
Homestead (Principal Residence)	\$75,000 and no more than 160 acres	§ 85-3-21
Tangible Personal Property	\$10,000	§ 85-3-1(a), (d)
Income from Disability Insurance	Unlimited	§ 85-3-1(b)(ii)
Health Savings Account Assets	Unlimited	85-3-1(g)
Senior Residents Aged 70+ Additional exemption of any real, personal or intangible property, or any combination thereof	\$50,000	85-3-1(h)
Earned Income Tax Credit Proceeds	\$5,000	85-3-1(i)
Federal Tax Refund Proceeds	\$5,000	85-3-1(j)
State Tax Refund Proceeds	\$5,000	85-3-1(k)

**MEMPHIS CONSUMER BANKRUPTCY CONFERENCE 2013**

Workers' Compensation or Benefits Due or Payable Under the Workers' Compensation Law, 71-3-1, et seq.	Unlimited, unless waived	§ 71-3-43
Public Assistance Benefits Under the Adjustment Center for the Blind Law, 43-3-1, et seq., Old Age Assistance 43-9-1, et seq., and Disability payments, 43-29-1, et seq.	Unlimited	§ § 43-3-71, 43-9-19 and 43-29-15
Assets held in, or monies payable under, pension plans, profit sharing plans, stock bonus, or similar plans or contracts to provide retirement benefits	To the extent "qualified"	§ 85-3-1(e)
Unemployment Compensation	Unlimited (if not commingled), except as to liens for debts incurred for necessities furnished to debtor, spouse, or dependents during unemployment	§ 71-5-539
Property Subject to Foreign Governmental Income Tax Liens	Unlimited	§ 85-3-1(c)
Monies Relating to Qualified Tuition Plans	Unlimited	§ 85-3-1(f)

Wages, Salaries, or Other Compensation	For weekly earnings, the lesser of (1) 25% of disposable earnings for that week; or (2) the amount by which disposable earnings for that week exceed 30 times the federal minimum hourly wage in effect at the time the earnings are payable In the case of earnings for other than weekly periods, the amount by which disposable earnings exceed the multiple of the federal minimum hourly wage, which is equivalent in effect to 25% of disposable earnings for that pay period (the number of workweeks or fractions thereof multiplied by 30 multiplied by the applicable federal minimum wage).	§ 85-3-4
Life Insurance Proceeds	Unlimited, except as noted below	§ 85-3-11
Personal Injury Judgment	\$10,000	§ 85-3-17
Real Property of Railroad Authorities	Unlimited, except as to voluntary liens	§ 19-29-41
Descent of Exempt Property	Depends on law applicable to property at issue; same exemptions apply as did to decedent	§ 91-1-19

**MEMPHIS CONSUMER BANKRUPTCY CONFERENCE 2013**

Criminal Judgment Awards	Unlimited, except may be subject to: (1) orders for child support; and (2) claims of creditors who provided products, services, or accommodations, the costs of which are included in the award	§ 99-41-23
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Fraternal Benefit Society Benefits	Unlimited	§ 83-29-39
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