Consumer Track

Property of the Estate and Exemption Issues

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I. Exemptions

A. "Surcharging" exempt property[1]

1. *Law v. Siegel*

In a unanimous opinion by Justice Scalia, the Supreme Court on March 4, 2014 held that the bankruptcy court had exceeded its authority when it surcharged the Chapter 7 debtor's homestead exemption for the payment of a portion of the trustee's administrative expense. Although a Chapter 7 case, the holding and reasoning of the Court is important for Chapter 13 cases, its trustees and creditors. The opinion contains significant reminders about the limits of the bankruptcy court's authority, as well as lessons about how the bad result might be avoided in future cases. *Law v. Siegel*, 571 U.S. ____, 134 S. Ct. 1188 (2014).

2. **What is at play?**[2]

In all bankruptcy cases, the individual debtor is entitled to claim exemptions. 11 U.S.C. § 522. "An individual debtor may exempt from property of the estate the property listed" under section 522(d) or applicable state law. Often, the choice will be driven by whether the applicable state law has opted out of the section 522(d) exemptions. Generally, objections to claimed exemptions must be timely, Fed. R. Bankr. P. 4003(b), with failure to timely object leading to allowance of the claimed exemptions. There are, of course, exceptions to the general rule of timely objection, as seen in *Schwab v. Reilly*,

[1] This summary is based on a publication by William Houston Brown on the website of the Academy for Consumer Bankruptcy Education, the education arm of National Association of Chapter 13 Trustees, <www.ConsiderChapter13.org>, subsequently republished with reservation of rights in the materials of the Tennessee Bar Association Bankruptcy Forum, 2014 (adapted here with permission).

[2] This summary restricts itself to the exemption issues addressed in *Law*. See Brown, Ahern & MacLean, Bankruptcy Exemption Manual, for in-depth discussion of exemption issues.

130 S. Ct. 2652 (2010) (discussed below), but the Schwab rationale was not an issue in the *Law* opinion. If allowed, the exemptions, subject to specific statutory exceptions, are protected from pre-bankruptcy claims of creditors; that is, the exemptions survive discharge. 11 U.S.C. § 522(c). The Code specifically protects allowed exemptions from administrative expense claims in the case, again subject to certain exceptions, 11 U.S.C. § 522(k), and this last Code provision was critical to the *Law* decision

3. Overview of facts in *Law*

The debtor's only significant asset was his California home, which he valued at $363,348, and the debtor claimed the California homestead exemption of $75,000. The debtor had a first mortgage, apparently valid, for approximately $147,000, but he asserted that there was a second mortgage held by an individual. After much expensive litigation, the bankruptcy court determined that the second mortgage did not exist. The asserted second mortgage, which would have consumed all equity in the home, was intended to prevent the trustee's sale of the home. In the course of prolonged litigation, including avoidance of the fraudulent deed of trust, the trustee incurred $500,000 in attorney fees. No big surprise under these facts that the bankruptcy court, affirmed by the Ninth Circuit, approved a surcharge of the $75,000 exemption, permitting the trustee to recover a portion of the trustee fees from the real estate. There was appellate authority in that Circuit approving surcharge as an equitable remedy in appropriate cases.[3]

Some were surprised at the Supreme Court's grant of certiorari in a case with such bad facts, but there was a split in Circuit authority on at least portions of the surcharge issue. The First Circuit had followed the Ninth, holding that the bankruptcy court had authority to surcharge when the Chapter 7 debtor had willfully concealed nonexempt

[3] See, e.g., Latman v. Burdette, 366 F.3d 774 (9th Cir. 2004).

funds. *Malley v. Agin*, 693 F.3d 28 (1st Cir. 2012). The Tenth Circuit had earlier concluded that there was no statutory authority to surcharge. *In re Scrivner*, 535 F.3d 1258 (10th Cir. 2009), cert. denied, sub nom. *Mashburn v. Scrivner*, 556 U.S. 1126, 129 S. Ct. 1613 (2009).

4. Basic rule and context

The imposition of a surcharge is not authorized in the Code, and the bankruptcy court exceeded both its section 105(a) and inherent authority when it created a non-Code remedy. The Court concluded that Congress had created "meticulous—not to say mind-numbingly detailed—enumeration of exemptions and exceptions [which] confirms that courts are not authorized to create additional exceptions." *Law*, 556 S. Ct. 1196.

Although the ramifications of the *Law* opinion are not favorable for the trustee, who diligently pursued a deceitful debtor, the reasoning of the Court should not be a surprise. The crux of the opinion is that specific Code provisions prevail over equitable remedies, reasoning we have seen before. See *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197 (1988). As the Court said, "Section 105(a) confers authority to 'carry out' the provisions of the Code, but it is quite impossible to do that by taking action that the Code prohibits." *Law*, 556 S. Ct. 1195. Applying *Taylor v. Freeland & Kronz*, 503 U.S. 638 (1992), the Supreme Court in *Law* observed that no surcharge could be imposed because no timely objection was filed to the claimed homestead exemption. The Court further stated that the surcharge contravened section 522(k), which prevented the allowed exemption from being liable for administrative expenses, and the trustee's attorney fees were clearly an administrative expense.

5. Where does this leave parties and the bankruptcy courts?

First, *Law* is a reminder to timely object to all suspect exemptions. Of course, within the brief time for normal objections, the trustee or creditors may not yet know that the debtor's claimed exemption is improper, but remember that Rule 4003(b)(1) does permit extension of the objection time, provided such a motion is itself timely. Look at the basis for the debtor's exemption claim if made under State law, since there may be statelaw remedies for an improper claim. The Court noted in *Law* that state-law remedies for debtor misconduct may exist when there is no Bankruptcy Code remedy, but such state-law remedies may be limited. There is no indication that any state law remedies were available in *Law*. Of course, the Court alluded to the potential for criminal prosecution, which will not compensate the trustee.

6. Are there other remedies?

Under these types of facts, when the opportunity for objection to allowance has passed, *Law* points to the potential of denial of discharge, although that remedy does the trustee little good in the typical case. More important, the opinion makes a point in closing to say that the bankruptcy court does have authority under section 105(a), Rule 9011(c)(2) and inherent power to "impose sanctions for bad-faith litigation conduct," with such sanctions including reasonable attorney fees and expenses. *Law*, 556 S. Ct. 1198. "And because it arises post-petition, a bankruptcy court's monetary sanction survives the bankruptcy case and is thereafter enforceable through the normal procedures for collecting monetary judgments. See § 727(b)." *Id*. Of course, the reference to section 727(b) is no direct help in Chapter 13 cases, but it seems unlikely that an

appropriate post-petition monetary sanction would be "provided for" in the plan in order to be dischargeable under section 1328(a).

It is not as simple as saying that whether the trustee and/or creditors prevail depends on what they call the remedy, but the concluding portion of *Law* sends a message: The bankruptcy court lacks authority to create an exemption-surcharge remedy, but the court does have authority to award fees as a sanction, including sanctions for litigation misconduct. Fabricating a mortgage to defeat the trustee's sale of property for the benefit of creditors, or to defeat the trustee's avoidance of the fraudulent mortgage, is surely litigation misconduct. When and how to raise the issue of sanctions for such conduct may be the real issue in future cases.

B. The effect of marriage equality on exemptions[4]

On June 26, 2013, the Supreme Court handed down two decisions dealing with same-sex marriage, the effect of which will be interest bankruptcy practitioners. In *U.S. v. Windsor*, --- U.S. ----, 133 S. Ct. 2675 (2013), a taxpayer who, as the surviving spouse of a same-sex couple, was denied the benefit of the spousal deduction due to the definition of "marriage" and "spouse" in the "Defense of Marriage Act," 115 U.S.C. § 1738C ("DOMA"), brought an action for refund of federal estate taxes and a declaration that the pertinent provision of DOMA violated the Fifth Amendment. The Supreme Court held that DOMA's definition of marriage was unconstitutional as a deprivation of the liberty of the person protected by the Fifth Amendment.

[4] Beyond the fundamental issue of availability of joint bankruptcy filing for same-sex spouses, these decisions may affect multiple exemption issues, such as what property comes into the bankruptcy estate, the extent to which each spouse is entitled to claim exemptions and lien avoidance. See Brown, Ahern & MacLean, Bankruptcy Exemption Manual, § 1:6, Supreme Court decisions affecting same-sex marriages and their impact on exemptions (pending for publication, 2014), for a more complete discussion of this issue.

That this issue is of interest to bankruptcy practitioners is illustrated by decisions of two lower courts that have already addressed the DOMA issue in the context of joint filings by legallymarried samesex couples. An opinion signed by 20 bankruptcy judges, *In re Balas*, 449 B.R. 567 (Bankr. C.D. Cal. 2011), held that, when applied to a samesex couple so as to prevent individuals legally married under state law from filing a joint Chapter 13 petition, DOMA did not serve an important or valid governmental interest and thus violated the debtors' right to equal protection embodied in the Due Process Clause of the Fifth Amendment. "[N]o legally married couple should be entitled to fewer bankruptcy rights than any other legally married couple." *Id.* at 569; see also *In re Somers*, 448 B.R. 677 (Bankr. S.D.N.Y. 2011) (holding "cause" did not exist to dismiss joint Chapter 7 case commenced by legally-married same-sex couple, based solely on provisions of DOMA, which executive branch had declined to enforce).

It may be expected that the effect of *Windsor* will be to extend the benefits of federal laws (including bankruptcy) to same-sex spouses married in states recognizing such marriages. However, the Court rendered another decision on the same date as *Windsor*, in which it declined to address the constitutionality of state law restrictions on same-sex couples. *Hollingsworth v. Perry*, 133 S. Ct. 2652 (2013). Thus, the extension of state law benefits and privileges for such couples may still vary by state, depending on whether their marriages have been recognized. However, as of the date of these two Supreme Court decisions, same-sex marriage has been recognized by court order in Massachusetts, Connecticut, Iowa and California. Same-sex marriage has also been recognized by legislative action in Vermont, New Hampshire, New York, Rhode Island,

Delaware, Minnesota, and Washington, D.C. and by referendum in Maine, Maryland and Washington. Additional states have since followed suit.

C. Exemption claims since *Schwab v. Reilly*

1. Trustee entitled to appreciation of oil and gas royalty value

Applying *Schwab v. Reilly*, 130 S.Ct. 2652 (2010), the Chapter 7 debtor in *In re Orton*, 687 F.3d 612 (3d Cir. 2012), was not allowed to exempt the appreciated value of oil and gas lease royalties, after the debtor claimed on Schedule C specific dollar amounts under the section 522(d)(5) wildcard, which grants an exemption for a debtor's interest in assets, rather than the assets themselves. The Debtor's claimed exemption was below the section 522(d)(5) dollar cap, and the debtor did not claim "full" or "100%" interest in the oil and gas lease royalties, but instead noted the exempt amount on schedule C as the same amount listed on Schedule B, with the court noting that Schwab's reference to "FMV" in claiming exemptions was dicta. The Court in *Orton* held that the debtor's dollar amount exemption did not give notice to the Chapter 7 trustee that the debtor was attempting to exempt the entire royalty interest, and the trustee need not have objected to Orton's exemptions to retain the ability to except the lease from abandonment. The bankruptcy estate was entitled to the appreciated value of the lease royalties and the Trustee had the right to sell and administer the lease for the benefit of the bankruptcy estate.

2. Effect of claim of full fair market value

The First Circuit Bankruptcy Appellate Panel joined other courts in holding that the debtors' claims of exemptions under section 522(d) for full market value (FMV), without specifying a dollar amount under statutes with monetary caps, were invalid on

their face. *Massey v. Pappalardo (In re Massey)*, 465 B.R. 720 (B.A.P. 1st Cir. 2012). The trustee's objections were sustained. The debtors misread *Schwab*, which held that if the exemption claim is valid on its face, the trustee would not have to object, so long as the exemption claim was within the statutory cap amount, but the asset itself remained in the estate, subject to sale and paying the debtor's exemption. The *Massey* court commented that no court had construed Schwab as allowing the debtor "unfettered authorization. . . to exempt assets in-kind." The *Massey* court also opined that the proposed amendment to Schedule C is consistent with its opinion.

3. Effect of claim of exemption in specific amount

On schedule C, the Chapter 7 debtors in *Williams v. Biesiada*, 498 B.R. 746 (S.D. Tex. 2013), claimed an $18,000 exemption in a prepetition personal injury claim but in Column 1's description of the property, the debtors described the personal injury claim as "$1.00 - $300,000.00, FULL MARKET VALUE (FMV) exempted." Applying *Schwab*, the court found that Schedule C claimed an exempt amount within section 522(d)(5)'s applicable statutory limit, and the reference in column 1 of Schedule C to "full market value" was "buried" and not repeated in column 3's Value of Claimed Exemption. Nothing in column 3 indicated anything other than the $18,000 exemption claimed; any ambiguity is construed against the debtors. The trustee's lack of objection did not prevent the trustee's recovery of the personal injury claim.

4. Effect of claim of 100% equity

Joining other courts, the bankruptcy court in *In re Luckham*, 464 B.R. 67 (Bankr. D. Mass. 2012), held that the debtors' claim of exemption in "100% of equity" or "100% of FMV" in their residence under section 522(d)(1) did not survive the trustee's objection;

"by claiming a percentage of value as exempt, as opposed to an actual dollar figure, [the debtors] were essentially saying 'Trustee, you figure out what [the dollar amount of the exemption] is supposed to be.'" 464 B.R. at 70. To satisfy the best interests of creditors test, the trustee must be able to calculate the value of assets, less any exemption. Limited asset exemptions, such as section 522(d)(1), permit an exemption only in the debtor's "interest" in the asset, up to a dollar limitation. "As the *Schwab* court explained, and repeatedly emphasized, where the exemption statute provides a limited-interest exemption, only a defined monetary interest in the property is removed from the bankruptcy estate—not necessarily the value of the entire property." For the section 522(d)(1) exemption, a claim of "100% of equity" or "100% of FMV" does not adequately describe the allowed exemption. "At its core, *Schwab* was not about the validity of any particular exemption claim, . . .but about *notice* to interested parties as to what exemption in particular property the debtor had actually claimed, and, consequently, whether it 'constitute[d] a claim of exemption to which an interested party must object under § 522(l).'" *Luckham,* 464 B.R. at 73 (emphasis in original). The example in *Schwab* of 100% of FMV ...

> ... has nothing to do with the "proper" way to claim a particular exemption under a particular exemption statute. The Court was merely demonstrating the type of language that may be used to show the world that the debtor is attempting to exempt an asset in its entirety, regardless of its actual value .... The *Schwab* Court was not, as the Debtors have argued, outlining a procedure by which an exemption claimed under a limited-interest exemption statute could be legitimately converted into an exemption in-kind. Thus, to require the Debtors here to amend Schedule C to state a specific dollar value for their claimed (d)(1) exemption does not "eviscerate" any "rights" established under *Schwab* and does not prevent the Debtors from "employing" any legitimate "strategy" suggested by the Supreme Court.

Id. In a footnote following that statement, the court discusses the preliminary draft of amended Schedule C, then proposed by the Administrative Office of the U.S. Courts, and finds it consistent with its opinion.

5. Effect of cap under state statute

In *Messer v. Maney (In re Messer)*, 2012 WL 762828 (B.A.P. 9th Cir. Mar. 9, 2012), the debtor's reliance on *Schwab* was misplaced when she claimed 100% fair market value of her vehicle, valued at $12,000, as exempt, when the applicable Arizona statute had a cap of $5,000. *Schwab*'s suggestion of claiming 100% FMV did not mean that such an exemption would be valid if the applicable statute had a cap and fair market value exceeded that cap. Also, the debtor's claim that an annuity was excluded from the estate under section 541(c)(2) was invalid, when there was no support in the annuity documents that it was a trust under applicable Arizona law.

6. Effect of trustee's avoidance of second mortgage

At the petition date in *In re Messina*, 687 F.3d 74 (3d Cir. 2012), the debtors had no equity in their home, encumbered by two mortgages, but they scheduled the second mortgage as unsecured and notified the trustee of a defect in its acknowledgement. The Chapter 7 trustee did not object to the exemption claims on the residence under paragraphs (1) and (5) of section 522(d), but the trustee was successful in avoiding the second lien against the home, then moving to value the exemptions on the home at zero, since the avoided lien was for the benefit of the estate under section 551. The property had been sold by the trustee, with some proceeds left after paying the first mortgage. Under *Schwab*, the trustee was not required to object to the exemption, when the debtors had no equity at the time of filing their petition. The debtors' interests are determined as

of the filing date. On the filing date, the second mortgage had not been avoided, and the debtors were not entitled to benefit from the trustee's avoidance of the second mortgage. The avoidance recovery was a separate asset from the home, in which the debtors had claimed no exemption.

D. Exemption planning

Eighth Circuit courts have been implementing a 2008 decision that addressed exemption planning. *Addison v. Seaver (In re Addison)*, 540 F.3d 805 (8th Cir. 2008) ("*Addison*"). The *Addison* court clarified that debtors may transfer non-exempt to exempt assets in order to take advantage of available exemptions as long as the transfer was not intended to hinder, delay or defraud creditors. The Addison decision emphasizes extrinsic evidence of intent; the mere fact or the timing of a transfer cannot prove intent, there must be additional evidence. Subsequent cases have taken four non-exclusive indicia of intent from the *Addison* decision: "(1) conduct intentionally designed to materially mislead or deceive creditors about the conversion of assets; (2) use of credit to buy exempt property; (3) converting a 'very great amount' of nonexempt property to exempt property; and (4) conveyances by the debtor for less than adequate consideration." *In re Montanaro*, 398 B.R. 688, 690 (Bankr. W.D. Mo. 2008) (citing *Addison*); see also *In re Arends*, No. 13-00645, 506 B.R. 516 (Bankr. N.D. Iowa 2014). *Addison* endorses analysis of intent based on the classic badges of fraud, but requires that only evidence to the mechanics of the transfers be considered in sustaining an objection to exemptions.

Applying this guidance, bankruptcy courts have found that mistakes in disclosing transfers from non-exempt to exempt assets do not necessarily indicate fraud. In one

case, a court found no intent to conceal assets where the debtors failed to disclose an IRA an the transfer of funds into the IRA on the schedules but testified credibly that they thought the IRA was included in a different category and they produced records of the transfer to the trustee at the meeting of creditors. *In re Montanaro*, 398 B.R. at 691. In another case, the debtor's attorney's admitted failure to include on the statement of financial affairs a prepetition paydown of $28,000 on a mortgage and the debtors' testimony at their meeting of creditors affirming the accuracy of the bankruptcy papers was not enough to convince the court that they intended to conceal the transfer when the debtors also volunteered bank statements disclosing the transfers and testified credibly that they misunderstood the trustee's questions at the meeting of creditors. *In re Arends*, 506 B.R. at 521-22.

Ambiguity is arising around what constitutes a "very great amount" as an indicium of intent. *Addison* suggests there may be two standards. In its analysis of a prior Eight Circuit decision, the *Addison* court renewed its earlier criticism of a debtor who converted a very great proportion of non-exempt assets to exempt, approximately $700,000 of a total $710,000. *Addison*, 540 F.3d at 817. No subsequent published opinions have employed this proportionality analysis.

Addison also suggests that a transfer of a low absolute amount of transferred non-exempt assets does not indicate intent to hinder, delay or defraud. In *Addison*, the court pointed to $20,000 in transfers. *Id*. Consistent with that analysis, one court found that transfer of $9,000 into IRAs is not offensive, even though no non-exempt assets were available in the case. *In re Montanaro*, 398 B.R. at 690-1. Similarly, the transfer of $28,000 from insurance value (which the debtors mistakenly believed was non-exempt)

to equity in a $90,000 home did not merit analysis under the "very great amount" standard. *In re Arends*, 506 B.R. at 523.

Finally, *Addison* clarified that the analysis of intent to hinder, delay or defraud creditors is the same for objections to exemptions, denial of discharge under 11 U.S.C. § 727(a)(2), and the application of 11 U.S.C. section 522(o) with respect to the homestead. The innovation of the latter section was merely to set a definite look-back period. *In re Wilmoth*, 397 B.R. 915, 921-22 (B.A.P. 8th Cir. 2008).

E. Exemption of inherited IRAs

Sections 522(b)(3)(C) and (d)(12) of the Bankruptcy Code, as amended in 2005, both exempt "retirement funds to the extent that those funds are in a fund or account that is exempt from taxation under section 401, 403, 408, 408A, 414, 457, or 501(A) of the Internal Revenue Code of 1986." Thus, the Bankruptcy Code exempts tax-qualified retirement funds from creditors' claims in bankruptcy, even in a case in which applicable exemption law is governed by a state that has opted out of the federal exemption scheme. Section 408 of the Internal Revenue Code creates a tax exemption for individual retirement accounts (IRAs). Thus, the general rule is that a debtor's IRA is completely exempt from creditors' claims in bankruptcy.

An inherited IRA is one that passes to a beneficiary at the death of the IRA owner. An IRA inherited from a deceased spouse typically becomes fully exempt in the surviving spouse's bankruptcy. That is because the beneficiary-spouse can treat the inherited IRA as his or her own separate IRA or roll it over into an existing IRA. In either event, the separate or existing IRA retains the attributes of a typical retirement account: The beneficiary-spouse may add contributions of his or her own funds to the

IRA, cannot withdraw any IRA funds before age 59½ without paying a penalty tax, and must start withdrawals no later than the year in which he or she reaches age 70½. The IRA funds are still "retirement funds" under the Bankruptcy Code in the same sense as before the original owner-spouse's death, and thus are exempt under paragraph (b)(3)(C) or (d)(12) of section 522.

When the beneficiary is a non-spouse, however, there is a split of authority regarding whether an inherited IRA is exempt in the survivor-beneficiary's bankruptcy. That issue turns on whether funds in a non-spousal inherited IRA constitute "retirement funds" under 11 U.S.C. § 522(b)(3)(C) or (d)(12).

The Fifth Circuit, in *In re Chilton*, 674 F.3d 486 (5th Cir. 2012), held that a $170,000 IRA inherited from the debtor's mother was exempt. *Id.* at 490. The court determined that the phrase "retirement funds" means any funds set apart in anticipation of retirement, and that the Bankruptcy Code does not limit "retirement funds" solely to funds of the debtor so long as the funds were originally set apart for *someone's* retirement. Once set apart as retirement funds, they would maintain that same character for bankruptcy exemption purposes. *Id.* at 489-90.

The Bankruptcy Appellate Panel for the Ninth Circuit, in *Mullen v. Hamlin (In re Hamlin)*, 465 B.R. 863 (B.A.P. 9th Cir. 2012), followed the reasoning of the Fifth Circuit in allowing an exemption in an IRA inherited from the debtor's grandmother under section 522(b)(3)(C), which contained the same language as section 522(d)(12). Hamlin claimed exemption under Arizona statutes, and Arizona had opted out of the section 522(d) exemptions. Section 522(b)(3)(C) has only two requirements: the amount must be retirement funds, and the funds must be in an account that is exempt from taxation

under one of the Internal Revenue Code sections specified in section 522(b)(3)(C). The court found support for its conclusion in section 522(b)(4)(C)'s provision that direct transfer of retirement funds from one account to another does not end qualification for exemption. The court in *In re Seeling*, 471 B.R. 320 (Bankr. D. Mass. 2012), agreed with the emerging consensus, including the Fifth Circuit's *In re Chilton*, 674 F.3d 486 (5th Cir. 2012), holding that an inherited IRA that was tax exempt under 26 U.S.C. § 408, was exempt under section 522(d)(12). "The Bankruptcy Code requires no forensic analysis in order to determine from where those funds arose. All that the Bankruptcy Code requires is that the funds sought to be invested have been placed in a particular form of a retirement investment vehicle in order to be exempt from taxation."

A similar holding can be found in *In re Reinhart*, 267 P.3d 895 (Utah 2011). On certification from Tenth Circuit, the Utah Supreme Court held that strict compliance with IRC qualification of retirement plans was not required for exemption; rather, a retirement plan (here a Keogh) qualified as exempt under state law so long as it substantially complied with IRC requirements or length of service" under California Code of Civil Procedure § 703.140(b)(10)(E).

The Seventh Circuit in *In re Clark*, 714 F.3d 559 (7th Cir. 2013), expressly disagreed with the "emerging consensus" and held that a $300,000 IRA inherited from the debtor's mother was *not* exempt. *Id.* at 560-62. The court observed that although non-spousal inherited IRAs *do* shelter funds from taxes until the account funds are withdrawn, such funds are not "retirement funds" under 11 U.S.C. § 522(b)(3)(C) or (d)(12) because non-spousal inherited IRAs are treated differently under the Internal Revenue Code and therefore lack many of the attributes of a typical retirement account.

In particular, the non-spouse beneficiary may *not* treat the inherited IRA as his or her own, may *not* roll the inherited funds over into his or her own IRA, and may *not* add contributions to the inherited IRA. Further, the non-spouse beneficiary must take distributions from the inherited IRA within a year of the original owner's death, and payout must be completed in as little as five years. "In other words, an inherited IRA is a time-limited tax-deferral vehicle, but not a place to hold wealth for use after the new owner's retirement." *Id.* at 560. The court concluded that non-spousal inherited IRAs "represent an opportunity for current consumption, not a fund of retirement savings," and therefore are not exempt under § 522(b)(3)(C) or (d)(12) of the Bankruptcy Code. *Id.* at 562.

The Seventh Circuit thus created a circuit split on the effect on exemption when the debtor inherits an IRA from someone other than a spouse. The Supreme Court granted certiorari, *Clark v. Rameker*, 134 S. Ct. 678, 187 L. Ed. 2d 544 (2013), and heard oral argument on March 24, 2014.

F. Other tax-advantaged funds

In addition to the plans specifically enumerated in paragraphs (b)(3)(C) and (d)(12) of section 522, another provision, section 522(b)(4)(A), provides that funds in a retirement vehicle that has received a favorable determination of its tax-exempt status from the Internal Revenue Service are presumed to be exempt. Even plans that have not received this favorable determination are exempt so long as the IRS has not found them to be otherwise and there is either substantial compliance with the Internal Revenue Code or the debtor is not materially responsible for such noncompliance. In *In re Daley*, 459 B.R. 270 (Bankr. E.D. Tenn. 2011), the bankruptcy court held that an IRS favorable-

determination letter on the tax exempt nature of the IRA created only a rebuttable presumption of an IRA's tax exemption. Therefore, the trustee could offer proof that the debtor engaged in a prohibited transaction, disqualifying the IRA from tax exempt status, by expressly agreeing in his Client Relationship Agreement (signed when the IRA was established) that the brokerage firm holding the securities account would have a lien against the account for any payment obligations to the firm. The district court agreed, but the Sixth Circuit reversed, noting that no debts ever arose to be secured by the account, whether at the time the debtor opened the account or later, and holding that that the mere existence of such a "cross-collateralization agreement" did not by itself disqualify the IRA from exempt status. *In re Daley*, 717 F.3d 506 (6th Cir. 2013).

The Eighth Circuit Bankruptcy Appellate Panel has held that a debtor's health savings account was not excluded from property of the estate and was not exempt. The court concluded that section 541(b)(7)(A)(ii) applies to a health insurance plan, not a health savings account. *In re Leitch*, 494 B.R. 918 (B.A.P. 8th Cir. 2013).

The interplay of exemption and tax law can be important in state exemption law, as well. Prior to the adoption of section 522(b)(3)(C) in 2005, many states' exemption schemes also provided for the debtor to retain retirement funds and they may continue to do so. For example, the Illinois Code of Civil Procedure provides for exemption of a debtor's interest in assets held in a "retirement plan." 735 ILCS 5/12–1006(a) (2010). Illinois is an opt-out state and this exemption is not bankruptcy-specific. In *In re Bauman*, 2014 WL 816407 (Bankr. N.D. Ill. Mar. 4, 2014), the debtor claimed an exemption under the Illinois exemption and only belatedly under the 2005 federal exemption. The court denied the claimed exemption. State law (similar to the 2005

federal rule) required that the funds have tax-exempt status and specifically that the plan be "intended in good faith to qualify as a retirement plan under applicable provisions of the Internal Revenue Code." 735 ILCS 5/12–1006(a) (2010). The court noted, however, that Bauman's case was "not the ordinary one involving an employee of a large business," and that "the 'good faith' analysis changes accordingly. For someone like Bauman to satisfy the 'good faith' requirement of section 12–1006, substantially more can be expected." *Bauman*, 2014 WL 816407 at *16. The court then concluded that "Bauman did not do what was expected of him," because although "the Plan was intended in good faith to qualify as a retirement plan under the IRC," it failed the good-faith requirement based on the court's extended analysis of "the Plan's operation." *Id*.

G. Bankruptcy-Specific Exemptions

Michigan's bankruptcy-specific exemptions are constitutional. *Richardson v. Schafer (In re Schafer)*, 689 F.3d 601 (6th Cir. 2012). Reversing its Bankruptcy Appellate Panel, 455 B.R. 590 (B.A.P. 6th Cir. 2011), the Sixth Circuit agreed with the bankruptcy court that Michigan's law was constitutional in permitting debtors to choose between the section 522(d) exemptions and state exemptions that were available only to debtors in bankruptcy. The bankruptcy-specific homestead exemption, for example, is more generous than section 522(d)(1) and the state's non-bankruptcy homestead, so it was the trustee who objected to the debtor's choice of the more generous exemption. Under the Uniformity Clause of the Constitution, section 522 and the Michigan statute operated uniformly, with "Michigan's decision to distinguish between debtors in bankruptcy and those outside of bankruptcy mak[ing] sense." Accord, *Williamson v. Westby (In re Westby)*, 2013 WL 415599 (B.A.P. 10th Cir. Feb. 4, 2012) (Kansas' bankruptcy-only

exemption for tax refunds attributable to earned income credit was constitutional); *In re Joyner*, 489 B.R. 292 (Bankr. S.D. Ga. 2012) (Georgia bankruptcy-specific exemption scheme violated neither the uniformity provision of Bankruptcy Clause nor the Supremacy Clause).

II. Property of the estate

Section 541(a) provides a long list of the sorts of property included in the bankruptcy estate: (1) all legal or equitable interests of the debtor in property; (2) all interests of the debtor and the debtor's spouse in community property; (3) any interest in property that the trustee recovers; (4) any interest in property preserved for the benefit of or ordered transferred to the estate under section 510(c) or 551; (5) any interest in property that would have been property of the estate if such interest had been an interest of the debtor on the date of the filing of the petition, and that the debtor acquires or becomes entitled to acquire within 180 days after such date by bequest, devise, inheritance, as a result of a property settlement agreement or final divorce decree, or as a beneficiary of a life insurance policy or of a death benefit plan; (6) proceeds, product, offspring, rents, or profits of or from property of the estate, except such as are earnings from services performed by an individual debtor after the commencement of the case; and (7) any interest in property that the estate acquires after the commencement of the case. 11 U.S.C § 541(a).

The reach of section 541 is expansive. See *U.S. v. Whiting Pools, Inc.*, 462 U.S. 198, 204–05 (1983). The U.S. Supreme Court held that "the term 'property' has been construed most generously and an interest is not outside its reach because it is novel or

contingent or because enjoyment must be postponed." *Segal v. Rochelle*, 382 U.S. 375, 379 (1966).

Exempt property is first included as property of the estate and then claimed as exempt and revested in the debtor.

> When a debtor files a Chapter 7 bankruptcy petition, all of the debtor's assets become property of the bankruptcy estate, see 11 U.S.C. § 541, subject to the debtor's right to reclaim certain property as "exempt," § 522(l). The Bankruptcy Code specifies the types of property debtors may exempt, § 522(b), as well as the maximum value of the exemptions a debtor may claim in certain assets, § 522(d). Property a debtor claims as exempt will be excluded from the bankruptcy estate "[u]nless a party in interest" objects. § 522(l).

Schwab v. Reilly, 130 S. Ct. 2652, 2657 (2010); see also *In re Luttrell*, 313 B.R. 751, 754 (Bankr. E.D. Tenn. 2004) (property comes into estate and then, if exempted, is "subtracted from the bankruptcy estate and not distributed to creditors"); *In re Mazon*, 395 B.R. 742 (M.D. Fla. 2008) (after exemption is allowed, property is removed from estate and available for use by debtor). In addition to being exempted from the bankruptcy estate, property may be excluded from the estate and exclusion, where property never enters the bankruptcy estate, is thus different from exemption.

A. Tax refunds and similar property[5]

In the following cases it was held that the property in dispute should be included in the bankruptcy estate:

- Debtor's interest in simplified employee pension plan (SEP) in absence of applicable exemption. *In re Schreiner*, 255 B.R. 545 (Bankr. S.D. Ohio 2000).
- IRA into which debtor had rolled over proceeds of ERISA-qualified plan. *Phillips v. Bottoms*, 260 B.R. 393 (E.D. Va. 2000).

[5] This section is adapted with permission from Brown, Ahern & MacLean, Bankruptcy Exemption Manual §§ 2:4 & 2:21 (pending for publication 2014).

- Debtor's interest in funds in 401(k) employee benefit plan where funds were held through the employer's purchase of a group insurance annuity contract, not in a trust as required for exemption by section 541(c)(2). *In re Seaton*, 346 B.R. 389 (Bankr. W.D. Pa. 2006).
- Funds rolled over from two valid and qualified IRAs into a third unqualified account. *In re Crum*, 414 B.R. 103 (Bankr. N.D. Tex. 2009).
- Funds held in the ERISA-qualified plan of a debtor's former husband upon distribution to the debtor pursuant to the terms of a qualified domestic relations order. *In re Johnston*, 218 B.R. 813 (Bankr. E.D. Va. 1998).
- Equitable distribution to be made from ex-husband's retirement account. *In re Radinick*, 419 B.R. 291 (Bankr. W.D. Pa. 2009).
- Tuition savings accounts, purchased prepetition for benefit of children, in which debtor retained legal and equitable interests with authority to change the beneficiary or to request immediate distribution. *In re Addison*, 540 F.3d 805 (8th Cir. 2008).
- Funds that the debtor attempted to transfer prepetition by wire in contravention of the debtor-LLC's operating agreement. *In re Louis J. Pearlman Enterprises, Inc.*, 398 B.R. 59 (Bankr. M.D. Fla. 2008) (holding transfer was void and funds remained property of estate)..
- Prepetition partnership interest in law firm. *In re Shearin*, 224 F.3d 346 (4th Cir. 2000).
- Tax refund allocated between prepetition and postpetition periods. *In re Middendorf*, 381 B.R. 774 (Bankr. D. Kan. 2008); *In re Trickett*, 391 B.R. 657 (Bankr. D. Mass. 2008).

- Joint tax refund where the nondebtor spouse did not earn taxable income. *In re Morine*, 391 B.R. 480 (Bankr. M.D. Fla. 2008).

- Portion of child tax credit refund attributable to the prepetition period. *In re Fasarakis*, 423 B.R. 34 (Bankr. E.D. N.Y. 2010); *In re Matthews*, 380 B.R. 602 (Bankr. M.D. Fla. 2007).

- Economic stimulus payment. *In re Schwinn*, 400 B.R. 295 (Bankr. D. Kan. 2009); *In re Thompson*, 396 B.R. 5 (Bankr. N.D. Ind. 2008); *In re Wooldridge*, 393 B.R. 721 (Bankr. D. Idaho 2008); *In re Smith*, 393 B.R. 205 (Bankr. S.D. Ind. 2008); *In re Alguire*, 391 B.R. 252 (Bankr. W.D. N.Y. 2008).

- Federal earned income tax credit. *In re Montgomery*, 224 F.3d 1193 (10th Cir. 2000); *In re Johnston*, 222 B.R. 552 (B.A.P. 6th Cir. 1998), aff'd, 209 F.3d 611 (6th Cir. 2000).

- Debtor's tax refund, based on his prepetition income. *Ellman v. Baer*, 467 B.R. 635 (D. Md. 2012), aff'd, 474 F. App'x 388 (4th Cir. 2012); *In re Ruhl*, 474 B.R. 596 (Bankr. N.D. Ill. 2012); *In re Araj*, 371 B.R. 240 (E.D. Mich. 2007); *In re Parker*, 352 B.R. 447 (Bankr. N.D. Ohio 2006).

- Tax refund payable in connection with joint income tax return filed by debtor and his nondebtor-wife, presumptively based on each spouses' relative contribution to overpaid tax. *In re Edwards*, 400 B.R. 345 (D. Conn. 2008); *In re Gartman*, 372 B.R. 790 (Bankr. D.S.C. 2007).

- Tax refund that debtor and her nondebtor-spouse received in connection with joint income tax return, with rebuttable presumption that the spouses each had an equal

ownership interest. *In re Spina*, 416 B.R. 92 (Bankr. E.D.N.Y. 2009); *In re Marciano*, 372 B.R. 211 (Bankr. S.D.N.Y. 2007).

- At least some portion of state and federal income tax refunds that Chapter 7 debtor received for annual tax period ending exactly seven months subsequent to petition date. *In re Marvel*, 372 B.R. 425 (Bankr. N.D. Ind. 2007).
- Anticipated tax refunds to the extent attributable to prepetition events. *In re Meyers*, 616 F.3d 626 (7th Cir. 2010); *In re Benn*, 491 F.3d 811 (8th Cir. 2007).
- Tax refund resulting from a prepetition application of the debtor's prepetition tax refund to the following year's taxes. *In re Graves*, 609 F.3d 1153 (10th Cir. 2010).
- Child tax credit refund. *In re Minton*, 348 B.R. 467 (Bankr. S.D. Ohio 2006); *In re Parker*, 352 B.R. 447 (Bankr. N.D. Ohio 2006); *In re Law*, 336 B.R. 144 (Bankr. W.D. Mo. 2005), aff'd, 336 B.R. 780 (B.A.P. 8th Cir. 2006); *In re Beltz*, 263 B.R. 525 (Bankr. W.D. Ky. 2001). Contra *In re Schwarz*, 314 B.R. 433 (Bankr. D. Neb. 2004).
- Portion of additional child tax credit attributable to prepetition part of the tax year. *In re Lee*, 415 B.R. 518 (Bankr. D. Kan. 2009).

The corollary to the proposition that the bankruptcy estate is comprised of "all legal or equitable interests of the debtor in property as of the commencement of the case" is that, if the debtor has no legal or equitable interest in certain property as of the commencement of the case, it is not included in the bankruptcy estate. Thus, for example, if the debtor owned property prepetition but had lost it by the time of the filing of the petition, the debtor no longer had an interest in the property, and it would be excluded from the estate. In the following cases, the property at issue was found not to

be property of the bankruptcy estate because the debtor's interest in it was terminated prepetition:

- A tax refund that, prepetition, had been irrevocably applied to prepayment of the debtors' taxes for the next tax year. *In re Graves*, 609 F.3d 1153 (10th Cir. 2010).
- Fee paid pursuant to a sales agreement which required that the payment be made directly from the purchaser to an advisor on the sale and not to the debtor-developer. *Rajala v. Gardner*, 709 F.3d 1031 (10th Cir.2013).
- Debtor's status as qualified subchapter "S" subsidiary. *In re Majestic Star Casino, LLC*, 716 F.3d 736 (3d Cir.2013).
- Payment made to restore funds taken from creditor's trust account or property held by debtor in trust for the benefit of another. *In re Friedman & Wexler, LLC*, 494 B.R. 724 (Bankr. N.D. Ill. 2013).
- Debtor's voluntary prepetition state tax payments. *In re Lakeside Community Hosp.*, 191 B.R. 122 (Bankr. N.D. Ill. 1996).

Similarly, if the debtor acquired property postpetition but had not owned it at the time of the filing of the petition, the property would be excluded from the estate, unless it is brought into the estate in the reorganization chapters under sections 1115, 1207, or 1306. In the following cases, where the debtor obtained the property postpetition, the property was not included in the estate:

- Bonus payments that Chapter 7 debtor received postpetition from her employer. *In re Klein-Swanson*, 488 B.R. 628 (8th Cir. 2013).

• Portion of federal income tax refund attributable to postpetition wages earned during pendency of chapter 11 case but before conversion to chapter 7. *In re Evans*, 464 B.R. 429 (Bankr. D. Colo. 2011).

• Federal income tax refund attributable to prepetition wages but received postpetition and spent during pendency of chapter 13 case before conversion to chapter 7. *In re Salazar*, 465 B.R. 875 (B.A.P. 9th Cir. 2012).

• Tax refunds derived entirely from debtors' postpetition wages. *Taylor v. Burns*, 344 B.R. 523 (W.D. Ky. 2004).

• Portion of Chapter 7 debtor's tax refunds that were attributable to her federal child tax credit acquired postpetition. *In re Schwarz*, 314 B.R. 433 (Bankr. D. Neb. 2004).

• Nonfiling spouse's one-half interest in tax refund payable as result of debtor's and spouse's substantial overpayment of tax. *In re Aldrich*, 250 B.R. 907 (Bankr. W.D. Tenn. 2000).

Of course, if the debtor had no interest in the property at any time, it would be excluded from the estate. In the following cases, the property was not included in the estate:

• Chapter 7 debtor's federal income tax overpayment where, prepetition, the overpayment was applied to a mortgage deficiency owed by the debtor to the United States. *In re Scales*, 477 B.R. 679 (Bankr. N.D. Ohio 2012).

• Tax refund to which debtors were never entitled. *In re Winters*, 485 B.R. 375 (Bankr. M.D. Tenn. 2013); *U.S. Dept. of Agriculture Rural Housing Service v. Riley*, 485 B.R. 361 (W.D. Ky. 2012).

- Joint income tax refund of debtor's nonfiling spouse as calculated by factoring in the Earned Income Tax Credit, the Additional Child Tax Credit, and the "Recovery Rebate Credit." *In re Crowson*, 431 B.R. 484 (B.A.P. 10th Cir. 2010).
- A retirement annuity which was a trust under New York law. *In re Laher*, 496 F.3d 279 (3d Cir. 2007).

B. LLC membership interests and distributions[6]

An increasing number of business entities have moved toward the limited liability company ("LLC") as their form of choice. At the most general level, an LLC is an extremely flexible form of business organization. Similar to a traditional corporation, an LLC is formed by filing Articles of Organization with the Secretary of State and is governed by the LLC's Operating Agreement and the laws of the state in which the LLC was formed. An LLC can be managed by a managing member or by the members acting together.

An individual debtor's membership interest in an LLC can potentially be an important asset in any bankruptcy case. It is important that debtors' attorneys understand the impact of a bankruptcy filing on debtors' membership interests in LLCs and to fully advise their clients as to the impact of a bankruptcy filing on their interests in LLCs once the bankruptcy is filed.

It would seem that the trustee's rights and the extent of those rights should be clearly defined and limited by non-bankruptcy law. However, there are still several important issues for trustees in administering and managing single-member LLCs, which have recently been addressed by bankruptcy courts.

[6] This summary is based on a paper by Deborah J. Caruso and Meredith R. Theisen, LLC Interests and Bankruptcy: The Trustee's Ability to Operate or Liquidate the LLC and Other Recent Developments (adapted here with permission).

1. Single-Member LLCs

Typically, only the debtor's economic interests (i.e., rights to payments distributions) in the LLC are assets of the bankruptcy estate. The trustee does not have authority to manage or control the LLC. In these situations, the trustee typically has the right to a charging order with respect to the LLC, but some courts have given the trustee greater rights when the debtor holds an interest in a single-member LLC, managed by one managing member.

In *In re Modanlo*, 412 B.R. 715 (Bankr. D. Md. 2006), the bankruptcy court applied Delaware state law to conclude that the bankruptcy trustee could assume control of the single-member LLC in question. The court noted that normally a trustee would only be entitled to a debtor's economic interest in an LLC. However, because the debtor in this situation was the sole member of the LLC, the trustee was authorized by Delaware law to consent to the continuation of the LLC as the debtor's personal representative. This allowed the trustee to become the managing member of the LLC and to administer the LLC as an asset of the bankruptcy estate.

A bankruptcy court in Colorado reached a similar conclusion for somewhat different reasons. In *In re Albright*, 291 B.R. 538 (Bankr. D. Colo. 2003), the court concluded that because the trustee had been assigned the debtor's membership interest in the LLC, the trustee could control the governance of the LLC consistent with Colorado's Limited Liability Act. The court rejected the argument that the trustee was only entitled to a charging order and instead noted that because the LLC was a single-member entity, and there were no other members with interests in the LLC that required protection, the trustee could assume control of the LLC. In a footnote, the court stated that sections

541(a)(1) and 548(a) of the Bankruptcy Code could be used to avoid fraudulent transfers of minority interests in an LLC that may have occurred prior to the bankruptcy filing.

A similar result was reached in *In re A-Z Electronics, LLC*, 350 B.R. 886 (Bankr. D. Id. 2006), in which the Chapter 11 trustee moved to dismiss the Chapter 11 case as unauthorized because the managing and sole member of the LLC was himself in the process of a Chapter 7 bankruptcy. The court held that under Idaho law, when the debtor filed his Chapter 7 bankruptcy, his interest in the LLC became personal property of the Chapter 7 bankruptcy estate. *Id*. at 890. Thus, the debtor had no authority to file the Chapter 11 bankruptcy for the LLC because at that point the LLC was "subject to the sole and exclusive authority of the [debtor's] Trustee. That Trustee was the only one entitled to manage the [LLC] and decide inter alia whether the LLC would or would not file bankruptcy." *Id*. at 891.

In an additional case on point, the Bankruptcy Appellate Panel for the Ninth Circuit stated:

> We conclude that all of the Debtors' contractual rights and interest in [the LLC] became property of the estate under § 541(a)(1) by operation of law when they filed their petition. Section 541(c)(1)(A) overrides both contract and state law restrictions on the transfers or assignment of Debtor's interest in [the LLC] in order to sweep all their interests into their estate . . . As a result, the Trustee was not a mere assignee, but stepped into Debtors' shoes, succeeding to all of their rights, including the right to control [the LLC].

Fursman v. Ulrich (In re First Protection, Inc.), 440 B.R. 821, 830 (B.A.P. 9th Cir. 2010).

In contrast to these cases, a bankruptcy court in New Hampshire treated LLC interests differently in *Desmond v. U.S. Asset Funding, LP (In re Desmond)*, 316 B.R. 594 (Bankr. D.N.H. 2004). There, a debtor filed a Chapter 11 petition and listed among

his assets his 100% control of an LLC. Shortly thereafter, the LLC entered into a contract with a creditor which the LLC subsequently breached. The creditor sought to sell the collateral that secured the contract, and the debtor and the trustee sued to enjoin the creditor's sale. The debtor and the trustee cited Albright for the proposition that the debtor's 100% membership rights in the LLC included the right of control and management of the LLC, and thus the automatic stay should protect the LLC and its assets. The court concluded that the LLC was not a debtor in any bankruptcy case and that the agreement between the LLC and the creditor were the actions of two non-debtors. The Court refused to enjoin the creditor from pursuing its full range of remedies.

In addition to the *Desmond* case, other courts have adhered to the traditional principle that the LLC's assets are separate from the debtor's assets. Bankruptcy courts in Iowa, Massachusetts, and Idaho have all agreed that the automatic stay does not protect the assets of an LLC. *In re Calhoun*, 312 B.R. 380 (Bankr. N.D. Iowa 2009); *In re Furlong*, 437 B.R. 712 (Bankr. D. Mass. 2010); *In re Aldape Telford Glazier, Inc.*, 410 B.R. 60 (Bankr. D. Idaho 2009). The court in *Furlong* noted that "unless a corporation is itself a bankruptcy debtor, the automatic stay afforded to an individual debtor under section 362(a) does not extend to the assets of a corporation in which the Debtor has an interest, even if the interest is 100% of the corporate stock." 437 B.R. at 721. In order for an LLC to have the protection of the automatic stay, the LLC would have to file its own bankruptcy petition.

In contrast, some courts have allowed the automatic stay to apply to LLC assets in limited cases. In *In re Ealy*, 307 B.R. 653 (Bankr. E.D. Ark. 2004), the debtors owned and operated a child care center, which was operated out of real estate that was purchased

using an LLC specifically created for that purpose. The bankruptcy court found that the debtors held equitable title to the real estate, holding that the debtors never intended that the LLC would have sole title to the real estate. Therefore, the automatic stay extended to the real estate. Similarly, in *In re Schwab*, 378 B.R. 854 (Bankr. D. Minn. 2007), the bankruptcy court determined that certain LLC assets were property of the debtor for purposes of applying the exemption statute where there was evidence that the debtor had purchased the assets using her own personal line of credit and had not intended the assets to be property of the LLC. Both of these cases are based on equitable principles of ownership intent and their holdings are limited. The court in *Ealy* stressed that the lack of debtor intent was one of the most important factors in its decision, and that appeared to be the case in Schwab as well.

Membership in an LLC is personal property of the debtor, and thus transfers of the membership interest would be subject to normal preference and fraudulent transfer analyses. However, the majority rule is that LLC assets are not property of the bankruptcy estate or the debtor, and therefore would not be subject to the same analyses. In *Nossaman-Petitt v. Adams Enters, Inc. (In re Adams)*, 2009 WL 3681850 (Bankr. D. Neb. 2009), the debtors purchased property and transferred it to an LLC owned exclusively by one of the debtors. Shortly before their bankruptcy filing, the LLC transferred the property to another LLC owned by the debtors' son. The court concluded that because the property was owned by the debtor's LLC at the time of the transfer, it was not property of the debtor and was not subject to the avoidance provisions of the Bankruptcy Code. The trustee could not avoid the transfer and could not recover the property for the bankruptcy estate.

2. Multi-Member LLCs

Unlike a single-member LLC, bankruptcy courts in the past have held that the trustee may only be entitled to the economic benefits of the debtor's membership rights in a multi-member LLC. However, this position is eroding with several recent court opinions. In *In re B&M Land and Livestock LLC*, 498 B.R. 262 (Bankr. D. Nev. 2013), a Nevada bankruptcy court held that section 541 of the Bankruptcy Code, provides that all of the debtor's interest in a LLC is property of the estate, and trumps any conflicting analysis or rules in state law relating to the control of LLCs or partnerships. As a result, a bankruptcy trustee has more rights and remedies than a state court judgment creditor who is only entitled to a charging order. See also *In re Blixseth*, 484 B.R. 360, 369 (B.A.P. 9th Cir. 2012).

Because a trustee has more rights and remedies than a state judgment creditor, a trustee typically has the authority to liquidate the debtor's economic interests. Courts in Massachusetts and Louisiana have held that the trustee can sell the debtor's member interest similar to any other type of personal property and the trustee can sell the member interest to other members of the LLC, depending at least in part on the terms of the operating agreement. *In re Harding*, 2009 WL 161862 (Bankr. D. Mass. Jan. 22, 2009); *In re Rosbottom*, 2010 WL 3294315, at *2 (Bankr. W. D. La. Aug. 19, 2010) (concluding that decision to sell estate's minority interest was within sound business judgment of trustee, on basis of operating agreement restrictions on transferability of membership interests and provisions dealing with mandatory buy/sell rights, mechanics of achieving compelled sale price, right of first refusal and mechanics for obtaining a valuation of interest proposed to be sold, in light of possible cost of marketing estate's interest while

dealing with issue of extent to which restrictions on transfer were enforceable against debtor or estate). In these cases, the courts noted that they will closely scrutinize any sales to other members of the LLC, to ensure that the transactions are being conducted at arm's length and that the other LLC members are not unfairly benefiting at the expense of the debtor's creditors.

In addition to selling the LLC interest, a trustee may force the dissolution of a multi-member LLC in order to obtain value for the estate. In *In re Garbrinski*, 465 B.R. 423, 427 (Bankr. W.D. Pa. 2012), the bankruptcy court held that the trustee was entitled to force the dissolution of a multi-member LLC only partly owned by the debtor. The debtor owned a 49.5% interest in one LLC and 50% interests in two other LLCs. The court held that section 541(c) permitted the trustee to "exercise rights as a partner/member seeking to obtain judicial dissolution and winding up of the entities by invoking state law remedies involving dissolution or liquidation of [the] LLC or limited partnership entities." Id. at 427. Accordingly, section 541 of the Bankruptcy Code may authorize the trustee to participate in the affairs of a debtor's LLC, which may include commencing dissolution actions and removing existing members from management.

In *In re Mays*, No. 10-11132-JKC-7A (Bankr. S.D. Ind. Dec, 3, 2010), the court addressed the issue of exempting an LLC interest. In *Mays*, the debtor attempted to exempt 100% of the LLC interest pursuant to section 23-18-1-1 of the Indiana Business Flexibility Act. The court rejected the debtor's position and held that an LLC interest is properly exempt as intangible personal property pursuant to section 34-55-10-2(c) of the Indiana Code and the $350.00 limit applies to LLC interests. It is interesting to note that in a footnote, the court questioned the trustee's concession that his rights were limited to

those of an assignee/judgment creditor and that the trustee is entitled to only the member's "economic interests" in the LLC. The court questioned why the trustee should be treated as an "assignee" given the expansive wording in section 541(a) of the Bankruptcy Code. As discussed above, many courts would agree that the trustee has much greater rights than an assignee and may have management rights in single-member LLCs and at least the right to sell a debtor's LLC interest.

Courts have grappled with how to treat Operating Agreements after a bankruptcy case has been filed. The major issue is whether the Operating Agreement of an LLC constitutes an executory contract subject to section 365 of the Bankruptcy Code. Courts in Pennsylvania and Nebraska have both held that the Operating Agreement of an LLC is an executory contract which can be assumed by the Trustee -- if these executory contracts remain subject to section 365. *In re Allentown Ambassadors*, 361 B.R. 422 (Bankr. E.D. Pa. 2007); *In re Daugherty Construction, Inc.*, 188 B.R. 607 (Bankr. D. Neb. 1995). Pursuant to section 365(e), the terms of an Operating Agreement stating that the LLC must be dissolved upon a member's bankruptcy, death, etc. are unenforceable "ipso facto" clauses, so long as the contract is executory (i.e., "a contract under which the obligation of both the bankrupt and the other party to the contract are so far unperformed that the failure of either to complete performance would constitute a material breach excusing performance of the other."). *Meiburger v. Endeka Enter., L.L.C. (In re Tsiaoushis)*, 383 B.R. 616, 619 (Bankr. E.D. Va. 2007), aff'd 2007 WL 2156162 (E.D. Va. July 19, 2007) (quoting, in both opinions, Countryman, Executory Contracts in Bankruptcy, 57 MINN. L. REV, 439, 446 (1973)).

Courts holding Operating Agreements not to be executory contracts have concluded that "ipso facto" clauses in LLC operating agreements cannot prevent the debtor's membership interest from becoming an asset of the bankruptcy estate. *Duncan v. Dixie Mgmt. & Inv., L.P. (In re Dixie Mgmt. & Inv., L.P.)*, 474 B.R. 698 (Bankr. W.D. Ark. 2011). In *Duncan*, the court held that the ipso facto clause in the LLC's operating agreement, providing that it would be an event of disassociation for any member to petition for bankruptcy relief, did not prevent the debtor's 62% membership interest in the LLC from being included as property of the estate. The *Duncan* court held that the Arkansas state statute providing that a party ceases to be a member of a LLC when the party "[f]iles a voluntary petition in bankruptcy" was preempted by section 541(c)(1) of the Bankruptcy Code and did not prevent the debtor's membership interest from being included as property of the estate.

III. Lien avoidance[7]

A. Reopening a case to amend Schedule C

The closing of a bankruptcy case and subsequent satisfaction of a judicial lien may render a motion to reopen the case for avoidance purposes tardy, as suggested by the Bankruptcy Appellate Panel in *In re Wilding*, 332 B.R. 487 (B.A.P. 1st Cir. 2005). There, the Chapter 7 debtor received a discharge and the case was closed. Subsequently, the debtor refinanced aloan secured by the residence and satisfied a judicial lien that was unknown to the debtor at the time of the bankruptcy filing. The debtor then moved to reopen the case to avoid the judicial lien. The fact that the lien had been satisfied out of

[7] See Brown, Ahern & MacLean, Bankruptcy Exemption Manual, Ch. 6, Exemptions and Avoidance Powers (Section 522(f), (g), (h), (i), (j)) (pending for publication 2014), from which this section is adapted with permission, for an in-depth discussion of lien avoidance issues.

the proceeds of refinancing made it "too late to employ the benefits of § 522(f)." *Id*, at 491.

The court of appeals disagreed, however, tying avoidance to the time of the bankruptcy filing. *In re Wilding*, 475 F.3d 428 (1st Cir. 2007). Even though the judicial lien had been satisfied after the bankruptcy case was closed, the determinative time for avoidability, according to the Court of Appeals, is the petition date, when the lien was in existence and impaired the debtor's exemption. Section 522(f) uses the present tense "impairs," which must be tied to the petition date; thus, the lien remained avoidable throughout the case and even after closing/reopening. See also *In re Young*, 471 B.R. 715 (Bankr. E.D. Tenn. 2012) (citing other authority and holding that petition date is controlling for all section 522(f) determinations). In this view, if the court looks to the date of filing of the case for valuing the property, as well as the other elements of section 522(f) avoidance, there is no prejudice to the creditor in permitting the debtor to reopen a closed case and avoid a lien that would have been avoidable earlier.

In an unreported decision on January 22, 2014, the Bankruptcy Court for the Northern District of Illinois allowed the debtors to reopen their case, but denied their motion to avoid a lien, because they had never amended their Schedule C to list the property. *In re Dickson*, No. 08 B 16815 (Bankr. N.D. Ill. 2014). The denial was withoug prejudice. In explaining its ruling, the court analyzed the split of authority on the issue of whether a debtor can reopen his or her case to amend Schedule C:

> There is a split of authority as to whether a debtor can amend his schedules to add an exemption after the case has been closed and reopened. This court agrees with those courts that allow such amendment unless the debtor has acted in bad faith or the creditor has been prejudiced, because "there is no difference between an open case and a reopened case ..." and because "the critical date for determining exemption rights is the petition

> date." *Goswami v. MTC Distributing (In re Goswami)*, 304 B.R. 386, 392, 393 (B.A.P. 9th Cir. 2003); see *Brodsky v. Taylor (In re Brodsky)*, 2007 WL 7136477 (Bankr. N.D. Ga. 2007); *In re Dougan*, 350 B.R. 892 (Bankr. D. Id. 2006). See also, *Rosinski v. Boyd (In re Rosinski)*, 759 F.2d 539 (6th Cir. 1985) (debtor allowed to reopen case to amend schedule to add creditor where no prejudice to creditor) and *Stark v. St. Mary's Hospital (In re Stark)*, 717 F.2d 322 (7th Cir. 1983) (same). Contra, *In re Bartlett*, 326 B.R. 436 (Bankr. N.D. Ind. 2005). Simple delay, by itself, does not prejudice creditors; prejudice is shown when "creditors suffer an actual economic loss due to the debtor's delay in claiming her exemptions." Dougan, 350 B.R. at 895. Here, [the creditor holding the lien to be avoided] has not alleged either prejudice or bad faith by the debtor. The debtors are therefore free to amend their schedules after the reopening of the case to assert an exemption in their residence.

Id. at 2. Other reported opinions illustrate this conflict:

• The Bankruptcy Appellate Panel for the Ninth Circuit, in *Green v. Hapo Community Credit Union (In re Green)*, No. EW-12-1486-PaJuTa 2013 WL 4055846 (B.A.P. 9th Cir. Aug. 12, 2013), allowed avoidance of a lien after reopening the case, because the creditor had made no showing of prejudice. The bankruptcy court had simply stated that merely "[t]he length of time between the date of filing the bankruptcy petition and the date of lien avoidance prejudices the creditor ...." *Id*. at *2.

• The bankruptcy court in *In re Ervin*, 2013 WL 1867989 (Bkrtcy. D.S.C. May 12, 2013), held that section 521(a)(2) does not preclude avoidance when the debtor does not timely file a statement of intention with respect to the property of the estate encumbered by the lien to be avoided and perform the stated intention with regard to a judicial lien secured by the property. *Id*. at *1. It was not necessary for the court to reopen the case, under a local rule:

> SC LBR 4003–2(c) permits filing a motion to avoid judicial lien in a closed case without the need to reopen the case pursuant to § 350, thus avoiding imposition of the automatic stay and other concerns that would

have an impact on creditors that are not the subject of the motion.

Ervin, 2013 WL 1867989 at n. 3.

• The district court in *In re Clear*, 1992 WL 1359570 (N.D. Ind. May 26, 1992), provided the precedent on which *Bartlett* (cited in *Dickson*, discussed above) was based. The court held that amendment of Schedule C is precluded by the plain language of Rule 1009 of the Federal Rules of Bankruptcy Procedure: "A voluntary petition, list schedule, or statement may be amended by the debtor as a matter of course at any time *before the case is closed.*" *Clear*, 1992 WL 1359570 at *1 (emphasis in the original).

B. Other recent developments

1. State exception to homestead did not prevent lien avoidance

Applying *Owen v. Owen*, 500 U.S. 305 (1991), the fact that Missouri's homestead exemption had an exception that the homestead was subject to attachment and levy of execution for causes of action existing at thetime of acquiring the homestead did not deprive the Chapter 13 debtor of using section 522(f) to avoid a judgment lien. *J & M Securities, LLC v. Moore (In re Moore)*, 495 B.R. 1 (B.A.P. 8th Cir. 2013). The First Circuit, in *In re Weinstein*, 164 F.3d 677 (1st Cir. 1999), was cited as the only court of appeals to directly address the issue, under Massachusetts' statutory exception to its homestead for liens attaching prior to acquisition. Section 522(c) protects certain debts from the effect of exemption in bankruptcy, but that statute preempts state law, which cannot interfere with the use of section 522(f). The opt out by Missouri does not change the conclusion.

2. Chapter 7 trustee's abandonment did not cut off jurisdiction

The bankruptcy court retained authority under section 522(f) to hear the Chapter 7 debtor's motion to avoid judicial lien, notwithstanding the trustee's prior abandonment of the cause of action. Under 28 U.S.C § 1334(e)(1), the court had jurisdiction over property of the estate and of the debtor. *Ramos v. Negron (In re Ramos)*, 498 B.R. 1 (B.A.P. 1st Cir. 2013).

3. Section 522(f) lien avoidance ended with redemption period

When the Chapter 7 debtor did not redeem a pawned vehicle within the time allowed under Georgia law, as extended by section 108, title to the vehicle vested in Titlemax, and section 522(f) was not available to avoid the lien, assuming that the pawn transaction in fact created a lien rather than transferring title. *In re Chastagner*, 498 B.R. 376 (Bankr. S.D. Ga. 2013).

4. Debtor must have valid exemption that could be asserted

Section 522(f) may not be used to avoid either a judgment lien or a security interest unless the underlying property would have been exempt. See *In re Anderson*, 2012 WL 1110056 (Bankr. D. Mont. Apr. 2, 2012) (citing *In re Morgan*, 149 B.R. 147 (B.A.P. 9th Cir. 1993) (requiring that "there must be an exemption to which the debtor 'would have been entitled' under subsection (b) of § 522")).

5. Application of section 522(f) to not-overencumbered property

"[W]hen the market value of the property exceeds the sum of (1) all consensual (non-judicial) liens on the property and (2) the amount of the debtor's exempt interest under 11 U.S.C § 522(d)," then "section 522(f)(1) permits the avoidance of the targeted judicial lien only in part, not in its entirety." *In re Silveira*, 141 F.3d 34, 35 (1st Cir.

1998); see also *In re Young*, 471 B.R. 715 (Bankr. E.D. Tenn. 2012) (citing *In re Falvo*, 227 B.R. 662, 666 (B.A.P. 6th Cir. 1998) (holding partial lien avoidance appropriate)).

6. Judicial lien in former spouses' separate cases

In *White v. Commercial Bank and Trust Co. (In re White)*, 470 F. App'x. 538 (8th Cir. 2012), the Court of Appeals ruled that a judicial lien, securing a deficiency judgment, was voidable in separate Chapter 7 cases filed by a former husband and wife. The 80-acre parcels that each debtor owned as his or her rural homestead would be totally exempt in absence of the judgment lien, so the lien impaired the debtors' exemptions, assuming that the lien had not attached prior to debtors' acquisition of their interests in the parcels. The court concluded that dissolution of the entireties interest that the debtor-spouses possessed in the property, which they acquired more than a decade prior to entry of the deficiency judgment, and to lender's recording of its judgment, did not create a "break in the chain of title." The fact that they had subsequently divorced, with the tenancy converted to one in common, did not alter the fact that they had ownership interests before the lien attached.

On the other hand, in *McCoy v. Kuiken (In re Kuiken)*, 484 B.R. 766 (B.A.P. 9th Cir. 2013), the creditor recorded a judgment lien against real property owned by the debtor in 2009. On July 5, 2011, the debtor executed a deed, recorded on July 15, conveying fee title to an entity called Bayview for valuable consideration. Less than a month before the October 24, 2011, chapter 7 bankruptcy filing, Bayview executed a deed conveying title back to the debtor as a gift, recorded on October 11. The debtor claimed the property as exempt under California law. Reversing the bankruptcy court, the panel addressed what it described as a question of first impression in the First Circuit,

holding that the debtor was not entitled to avoid the judicial lien under section 522(f)(1), because the debtor had not maintained a continuous interest in the property from the time the lien attached through the date of the filing of his bankruptcy petition. "When the interest once held is entirely extinguished by transfer, voluntary or, as a matter of law, a judicial lien which attached when a debtor had that interest cannot be avoided when the debtor acquires a new interest." *Id*. at 772.

7. Creditor required to return exempt social security benefits

In *Collect Access LLC v. Hernandez (In re Hernandez)*, 483 B.R. 713 (B.A.P. 9th Cir. 2012), the debtor filed a motion requesting, pursuant to section 542, an order requiring the judgment lien creditor to return exempt Social Security benefits levied upon pre-petition. The creditor resisted on the basis that the debtor's interest in the funds was terminated pre-petition when the funds were transferred to the levying officer. The bankruptcy court granted the debtor's motion, and the panel affirmed, noting that the benefits are exempt under state law and therefore not subject to collection efforts, so no transfer of ownership in the funds was effected by the levy, and concluding that the judgment lien creditor merely had a lien on the levied funds, that the debtor maintained an interest in the funds at the time the petition was filed, that the funds constituted property of the debtor's estate, under section 541, and that the debtor could preserve his exemption in the levied funds by invoking section 522(g) and/or (h).

8. Section 522(h) is more limited than section 522(g)

Section 522(h) excludes some of the avoidance power listed in subsection (g):

Section 510(c)(2)	recovery of subordinated liens
Section 542	turnover of property of the estate
Section 543	turnover of property by a custodian
Section 551	automatic preservation of avoided transfers

None of these avoidance and other powers may be exercised by the debtor under section 522(h), but if such transfers are avoided by the trustee, they may be reached by the debtor under subsection (g). See, e.g., *Collect Access LLC v. Hernandez (In re Hernandez)*, 483 B.R. 713 (B.A.P. 9th Cir. 2012), discussed above.

9. Chapter 13 debtor had strong-arm standing under 522(h)

When the debtor had claimed homestead exemption within the statutory limits, the debtor had standing to bring an adversary proceeding under section 522(h) to avoid the fixing of an attorney's lien on the property that would otherwise be exempt. *McCarthy v. Law (In re McCarthy)*, 501 B.R. 89 (B.A.P. 8th Cir. 2013).

10. Debtor's avoidance is subject to defenses against trustee

The debtor who files an avoidance action is essentially stepping into the trustee's underlying statutory authority. An adversary proceeding commenced by complaint is required, rather than merely a motion. *In re Canelos*, 212 B.R. 249, 254, amended, 216 B.R. 159 (Bankr. D. Md. 1997). For the same reason, the defenses available against a trustee are triggered. *In re Sandoval*, 470 B.R. 195 (Bankr. D.N.M. 2012). In *In re Maus*, 282 B.R. 836 (Bankr. N.D. Ohio 2002), for example, the debtor brought a preference action to recover garnishments and was required to show that the garnishments exceeded the $600 limit in section 547(c)(8).

IV. Dollar amount increases April 1, 2013

Along with other dollar amounts subject to automatic adjustment every three years, the various exemption amounts under section 522 increased on April 1, 2013, as reflected in the table on the following page.

Code Section Number	Former (2010) Dollar Amount	Adjusted (2013) Dollar Amount
11 U.S.C § 522(d)(1) homestead exemption	$21,625	$22,975
11 U.S.C § 522(d)(2) vehicle exemption	$3,450	$3,675
11 U.S.C § 522(d)(3) personal property exemption	$550 $11,525	$575 $12,250
11 U.S.C § 522(d)(4) jewelry exemption	$1,450	$1,550
11 U.S.C § 522(d)(5) wildcard exemption	$1,150 $10,825	$1,225 $11,500
11 U.S.C § 522(d)(6) tools of trade exemption	$2,175	$2,300
11 U.S.C § 522(d)(8) life insurance exemption	$11,525	$12,250
11 U.S.C § 522(d)(11)(D) personal injury exemption	$21,625	$22,975
11 U.S.C § 522(f)(3)(B) lien avoidance cap	$5,850	$6,225
11 U.S.C § 522(f)(4)(B) household goods cap	$600 (each time it appears)	$650 (each time it appears)
11 U.S.C § 522(n) IRA cap	$1,171,650	$1,245.475
11 U.S.C § 522(p)(1) homestead exemption cap	$146,450	$155,675
11 U.S.C § 522(q)(1) homestead exemption cap	$146,450	$155,675

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EXEMPTIONS AND PROPERTY OF THE ESTATE: HYPOTHETICALS FOR DISCUSSION

Moderator:

Hon. A. Benjamin Goldgar
U.S. Bankruptcy Court
Northern District of Illinois
Chicago, Illinois

Panel:

Lawrence R. Ahern III
Brown & Ahern
Brentwood (Nashville), Tennessee

Deborah J. Caruso
Dale & Eke, PC
Indianapolis, Indiana

Douglas W. Kassebaum
Fredrikson & Byron
Minneapolis, Minnesota

Basic Facts:

Your client, **Benjamin**, is the trustee in a Chapter 7 case filed in Chicago in early 2014 by **Deborah**. The Judge in the case, **Lawrence**, is notoriously pro-debtor. Benjamin asks you about several (potential?) assets of the estate, which he is disputing with Deborah:

1. LLC Membership Interests and Distributions

Deborah had a successful brokerage/investment firm with over 200 clients. The firm was operated as a sole proprietorship. In the early 2000's, however, Deborah invested in several commercial real estate projects and, after the crash, the investments lost value. Deborah was sued in several foreclosure cases and large deficiency judgments

were entered against her personally. Deborah's partners were not pleased with her predicament and asked her to leave. Deborah started Newco, a single-member LLC, and moved her client list and other assets from the firm into Newco. Although most of Deborah's investments failed, she was a majority member in a multi-member LLC which owned a shopping center that was coming back to life and distributing money to the members, including Deborah.

Benjamin suggested to Deborah and her attorney that Benjamin could liquidate Newco and sell the customer lists and other assets. With respect to the multi-member LLC, it was Benjamin's position that as the majority member of the LLC, Benjamin could liquidate the LLC; at a minimum, Benjamin could sell Deborah's interest.

Benjamin also demanded turnover of Deborah's distributions from the LLC that owned the shopping center.

Consider *Mondanlo,* p. 28, *Fursman*, p. 29, *B&M Land and Livestock*, p. 32, *Garbrinski*, p. 33, *In re Roomstore, Inc.*, 473 B.R. 107 (Bankr. E.D. Va. 2012); *In re: Bay Club Partners-472, LLC,* 2014 WL 1796688 (Bankr. D. Or. 2014).

2. *Schwab* and its Progeny

Deborah owns an old Mustang, free and clear, which had a Blue Book value on the date of the 341 meeting of $5,000. Deborah claimed an exemption in the car under Illinois law, which allows her to exempt up to $5,000. On Deborah's Schedule C, she claimed a "100%" exemption in the car and Benjamin did not object. The deadline to object under Rule 4003(b)(1) has passed. However, since the meeting, the 50th anniversary of the Mustang has caused them to spike in value and Benjamin has an offer to purchase the car for $10,000. Nevertheless, Deborah's counsel says the entire value of the car should be exempt.

Consider *Schwab* and subsequent cases, p. 8, et seq.

3. Inherited IRAs

Deborah's favorite uncle, **Douglas**, left her an IRA in the amount of $50,000 in his will. The account is held by Morgan Stanley Smith Barney (MSSB) and Benjamin has studied the brokerage account documentation that was executed by Douglas and MSSB when the account was established. He says that Douglas had the power to borrow from MSSB and, to secure any debt to MSSB, Douglas granted a security interest in the account. Douglas never borrowed against the fund.

Consider *Clark*, pp. 16-17 and *Daley*, pp. 17-18.

4. Other Tax-Advantaged Funds

Another asset in the estate is a Health Savings Account (HSA), held by Mellon Bank. Deborah has funded it under a high-deductible health insurance plan and it has a current balance of $2,000.

Consider *Leitch*, p. 18.

5. "Retirement Funds"

Benjamin also asks about Deborah's $25,000 "retirement fund," which she set up for herself in Newco. Benjamin has investigated the fund and found that it was set up as a tax-advantaged retirement account with proper documentation provided by the securities affiliate of a large regional bank. However, Deborah commingled the retirement funds with operating funds and frequently "borrowed" from the retirement funds to cover shortfalls in operating funds. The borrowing was paid back if and when money became available from operations.

Consider *Bauman*, pp. 18-19.

6. Tax Refunds

Deborah disclosed at the 341 meeting that she expects a $2,500 tax refund, based on her 2013 earnings. Her lawyer told Benjamin, however, that their position will be that the refund is not property of the estate.

Consider *Meyers* and *Benjaminn*, p. 24; *Manty v. Johnson (In re Johnson),* No. 13-6050 (8th Cir. BAP April 22, 2014).

7. Same-Sex Married Couple: Homestead Exemption; DSO

[Happy Alternative] Deborah married Megan in Iowa in 2010. In 2011 they moved to Wisconsin where they lived until Fall 2013, at which point they moved to Illinois. Together they bought a home worth $400,000 with a 50% down payment that was a gift from Deborah's parents. Deborah and Megan filed a joint chapter 7 bankruptcy case in early 2014 and they exempted $150,000 of home equity, citing Wisconsin's statutory exemption of $75,000 per individual, which can be "stacked" for husband and wife.

[Sad Alternative]. Deborah married Megan in Iowa in 2010 and divorced the same year. Megan remained in Iowa in a house that she owned since 2005, but Deborah moved to Wisconsin in 2011 and then to Illinois in Fall 2014. Deborah filed her chapter 7 case in early 2014. In the 2010 Iowa divorce decree, Deborah was ordered to pay half of Megan's monthly mortgage payment through 2020. Based on the divorce decree, Megan filed a priority claim for unpaid obligations for the six months prior to Deborah's filing.