

Presented:
3rd Annual Consumer Bankruptcy Practice Conference

June 28-29, 2007
Moody Gardens Hotel
Galveston, Texas

Exemptions –
The Debtor's Fresh Start or the Creditor's Recovery

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*93 Years of Value...
Personal Attention.*

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I. INTRODUCTION

The United States Constitution at Article 1, Section 8, Clause 4 calls for “uniform” bankruptcy laws; however, an area of the bankruptcy laws that appears not to be uniform is the area of exemptions. Section 522 of the Code provides a uniform federal exemption scheme; however, state law exemptions vary widely from state to state. Further, some states have opted out of the federal exemption scheme; thereby arguably making even the federal exemption scheme not uniform.

During the middle of the 1800s, Congress attempted and in fact did pass two bankruptcy laws, one in 1841 and one 1867. However, neither of those bills survived for any significant length of time. The 1841 bill was repealed after only two years and the 1867 act was repealed by 1878.

During the debate leading up to the bankruptcy act of 1841, Senators Calhoun, Webster and Clay brought differing beliefs and fears to the floor of the Senate. Many southerners and westerners feared that the large banks, which were predominately located in the north, would use the federal bankruptcy laws as a collection device resulting in the southern and western debtors losing their homesteads. At this time, the northern states typically had very sparse exemptions; however, the southern and western states tended to provide for a homestead exemption.

Webster, a federalist from Massachusetts, wanted strong federal bankruptcy legislation. Calhoun, from South Carolina believed that debtors were better off with state insolvency laws and he opposed federal bankruptcy regulation. Clay, a senator from Kentucky, was willing to support a federal bankruptcy law provided it was limited to only voluntary filings. Being from the south, he was concerned that northern creditors would attempt to utilize the bankruptcy act to displace his constituents.

Given the southern and western fear of the northern banks and the differing exemption laws, the 1867 bankruptcy act was passed with a significant compromise on the issue of exemptions, it allowed for state exemption schemes. The issue of exemptions had created tremendous debate during the process of passing the 1867 act and the compromise to allow each state its own exemptions was the only way of garnering enough votes to allow the bankruptcy act of 1867 to be passed. Interestingly, the President who signed the 1867 act was Andrew Johnson originally from North Carolina and formerly a Senator from Tennessee.

There was not another bankruptcy act passed until 1898. Each attempt at a bankruptcy bill in the 1880s and 1890s granted the states the right to enforce their own exemption scheme, and leading into the 1898 act state regulation of exemptions was viewed as a nonnegotiable element. Skeel, David A. Jr., Debt's Dominion: A History of Bankruptcy Law in America, Princeton: University Press, 2001. The Supreme Court in *Hanover Nat'l Bank of the City of New York v. Moyses*, 186 U.S. 181, 22 S.Ct. 857, 46 L.Ed. 1113 (1902) addressed the issue of uniformity and exemptions and declared “... that uniformity is geographical, and not personal, and we do not think that the provision of the act of 1898 as to exemptions is incompatible with the rule”. *Moyes*, 186 U.S. at 188.

Recently, a trustee challenged Section 522(b)(3) of BAPCPA because it requires the extraterritorial application of another state's exemption law. *In re Urban*, 361 B.R. 910 (Bankr. D.Mont. 2007). The *Urban* decision provides a historical analysis of the clash between local exemptions and the requirement for uniformity. The court recognized the additional burden on trustees in becoming familiar with the exemption laws of other states, but held that the application of §522(b)(3) is uniform as to all debtors in the U.S. who seek bankruptcy protection. *Urban*, 361 B.R. at 924-5.

II. Texas Exemption & Liberally Construed

The social policies underlying exemption laws include: protecting the family unit from impoverishment, relieving society from the burden of supplying subsidized housing, and providing the debtors with a means to survive during the period following their bankruptcy filing when they might have little or no income. *In re Ellingson*, 63 B.R. 271 (Bankr. N.D. Iowa 1986). Exemptions should further one or more of the following social policies:

- (1) To provide the debtor with property necessary for his physical survival;
- (2) To protect the dignity and the cultural and religious identity of the debtor;
- (3) To enable the debtor to rehabilitate himself financially and earn income in the future;
- (4) To protect the debtor's family from the adverse consequences of impoverishment;
- (5) To shift the burden of providing the debtor and his family with minimal financial support from society to the debtor's creditors.

Ellingson, 63 B.R. 271 (Bankr. N.D. Iowa 1986 at 277-78, quoting *Resnick Prudent Planning or Fraudulent Transfer*, 31 Rutgers L.R. 615, 621 (1988); *Local Loan Company v. Hunt*, 292 U.S. 234 (1934).

Almost every opinion construing Texas state exemptions will state that the Texas exemptions are to be liberally construed. The reason for the Texas exemptions and their liberal construction is understandable when one remembers that the original Anglo immigrants to Texas were debtors. To an extent Texas started as a debtor-haven. In the mid 1800s, people from across the south migrated west, into what was then a foreign country to start fresh. Through the economic upheaval of the early and mid 1800s, southern residents had lost their farms, their homes and their shops. Ralph Waldo Emerson had this to say about the Panic of 1837:

Society has played out its last stake; it is checkmated. Young men have no hope. Adults stand like day-laborers idle in the streets. None calleth us to labor The present generation is bankrupt of principles and hope, as to property.

The Texas Constitution protected the homes, the adjacent shop, the tools of trade, and the farm animals and household goods all in an effort to prevent the Texas residents from again losing everything to the lenders. Further, Texas restricted the ability of debtors to pledge their homes limiting liens to purchase money, taxes and improvements. The Texas Constitution in an effort to prevent the lenders from becoming too powerful, also prohibited branch banking. Texas state courts are constrained to liberally construe Texas' exemption statutes.

The settled policy has ever been to make liberal exemptions of property from a forced sale in this state. That liberality has been extended from time to time, until

today Texas, in particular, surpasses all other states of the American Union. The wonderful improvement and progress of the past few years attest the wisdom of that policy which, if continued, will in after years be demonstrated by a commonwealth composed not only of prosperous, free and independent, but also solvent citizens.

Green v. Raymond, 58 Tex. 80 (1882). Recently District Judge Miller of the Southern District of Texas stated in *Sosa*:

... the longstanding admonition of Texas courts that exemption statutes are to be liberally construed in favor of the claimant. The Texas Supreme Court has stated that ‘our exemption laws should be liberally construed in favor of express exemptions, and should never be restricted in their meaning and effect so as to minimize their operation upon the beneficial objects of the statutes. Without doubt the exemption would generally be resolved in favor of the claimant.’

Sosa v. Hill (In re Sosa), 358 B.R. 903, 909 (2006 WL 3358877) (S.D.Tex.)(J. Miller) quoting *Hickman v. Hickman*, 149 Tex. 439, 234 S.W. 2d 410, 413 (1950). Judge Miller, in footnote 3 of the *Sosa* opinion cited the Fifth Circuit decision in *Matter of Fernandez*, 855 F.2d 218 (5th Cir. 1988) as an example of how liberally the Texas exemption statutes should be construed. In *Fernandez*, the Fifth Circuit quoted from *Patterson v. English*, 142 S.W. 18, 19 (Tex.Civ.App. – Amarillo 1911, no writ) as follows:

A dray is a ‘wagon’ ... an automobile is a ‘carriage’ ... a piano is ‘household and kitchen furniture’ ... [and] the word ‘horse’ includes a bridle and saddle, as well as the shoes on its feet and the rope and martingales around its neck.... And this spirit of liberal construction has been indulged until [the courts] have held that an unbroken colt is a ‘horse’ ... and even that a mule, removed as he is one degree by consanguinity, is nevertheless a ‘horse.’ Furthermore, in their effort to extend the humane and beneficial character of [their] exemption statute, [Texas courts] have become so blind to every other consideration that they have looked upon the mule’s father and pronounced him-voice, ears, and all-a horse.

Id. at 219 (quoting *Patterson v. English*, 142 S.W. 18, 19 (Tex.Civ.App. – Amarillo, 1911, no writ)).

Courts “must uphold and enforce the Texas homestead laws even though in so doing we might unwittingly ‘assist a dishonest debtor in wrongfully defeating his creditors’”. *In re Bradley*, 960 F.2d 502, 507 (5th Cir. 1992). “[A] state enjoys broad rights; in fashioning its exemption laws.” *In re Chandler*, 362 B.R. 723 (Bankr. N.D.W.Va. 2007). This extremely liberal exemption scheme as set forth in the Texas Constitution and by the Texas state courts is to be followed and enforced by the federal bankruptcy courts. (“When a debtor selects state exemptions ... the bankruptcy court *must* determine exemption rights according to state law.”) [Emphasis Supplied] *In re Norris*, 413 F.3d 526, 527 (5th Cir. Tex. 2005).

III. Exemptions vs. Excluded Property

Property of the estate is defined in Section 541(a) of the Code and includes all legal and equitable interests of the debtor as of the petition date. 11 U.S.C. §541(a). “Before an exemption can be claimed it must be estate property.” *In re Yonikus*, 966 F.2d 866, 869 (7th Cir. 1993). From that property of the estate, the debtor may exempt property under the federal exemptions (§522(d)) or any other state, local or federal law (§522(b)). *In re Foster*, 360 B.R. 210, 212 (Bankr. E.D.Tex. 2006). Exempt property begins as property of the bankruptcy estate and is excluded only once the exemption is allowed, that is 30 days after the creditors meeting or after an objection is denied. “An exemption is an interest withdrawn from the estate (and hence from the creditors) for the benefit of the debtor. *Owen v. Owen*, 500 U.S. 305, 308, 111 S.Ct. 1833, 114 L.Ed. 2d 350(1991). Once the exemption is allowed, the property ceases to be property of the estate. *In re Cherry*, 341 B.R. 581, 584 (Bankr. S.D.Tex. 2005)(J. Isgur) citing *Taylor v. Freeland & Kronz*, 503 U.S. 638, 642, 112 S.Ct. 1644, 118 L.Ed. 2d 280 1992.

The Fifth Circuit has held that exempt property is not property of the estate. See *Sherk v. Texas Bankers Life & Loan Ins. Co. (In the Matter of Sherk)*, 918 F.2d 1170, 1174 (5th Cir.1990), abrogated on other grounds, *Taylor v. Freeland & Kronz*, 503 U.S. 638, 112 S.Ct. 1644, 118 L.Ed.2d 280 (1992); *Hardage v. Herring Nat'l Bank*, 837 F.2d 1319, 1322 (5th Cir.1988). See also *137 *IRS v. Luongo (In the Matter of Luongo)*, 259 F.3d 323, 338 n. 1 (5th Cir.2001) (Garza, J., dissenting) (citing to numerous opinions for the proposition that exempt property ceases to be property of the estate when exemption is upheld).

In re Day, 292 B.R. 133, 136-7 (Bankr. N.D.Tex 2003).

Excluded property is property that never becomes property of the estate. Excluded property includes that listed in §541(b). BAPCPA recently expanded Section 541(b) with addition of (b)(5), (6), (7) and (8).

Also excluded from property of the estate in Texas, in the event of a non-filing spouse, is i) the non-filing spouses sole management and control community property provided it is not liable for an allowable claim against the debtor 11 U.S.C. §541(a)(2)(A); and iii) the separate property of the non-filing spouse. *In re Bippert*, 311 B.R. 456, 464-5 (Bankr. W.D.Tex. 2004). There is an interesting issue raised by the language of §541(a)(2)(A) because of the use of the term “allowable”. The term “claim” is defined in the Code. A claim not objected to is deemed allowed by §502(a); and a claim sustained after objection is allowed by §502(b). If Congress had meant a claim in Section 541(a)(2)(A), they could have said so, but they modified the word claim and failed to define the term.

Property excluded from the estate under §541 and the exemption scheme of Section 522 does not come into play. *In re Sewell*, 180 F.3d 707, 710 (5th Cir. 1999). Nowhere on Schedule B is the description limited to property of the estate. Since disclosure is paramount in bankruptcy and Schedule B requires that all property be described and disclosed. Therefore, disclose excluded property on an attachment to Schedule B, declare it not property of the estate and also claim it as exempt on Schedule C.

Property which is *excluded* from the bankruptcy estate never becomes property of the bankruptcy estate; it is neither property of the estate at the inception of the bankruptcy case, nor at any later moment therein. Property which *may be exempted* from the bankruptcy estate becomes so *only after first having been property of the estate*.

In re McBride, 347 B.R. 585, 588 (Bankr. S.D.Tex. 2006)(J. Bohm) (Finding that a Debtor's after tax contributions to an ERISA-qualified Savings Plan pursuant to 29 U.S.C. §1056(d)(1) are excluded from the estate under §541(c)(2).

Along with exemption planning, the debtor's counsel must consider maximizing property that is not property of the estate. A spouse's earnings are the sole management and control community property of the wage earner. The separate property of the non-filing spouse and the sole management and control community property (provided it is not liable for claims against the debtor) of the non-filing spouse are not property of the estate. *In re McCloy*, 2001 WL 1338806 (N.D. Tex.) *aff'd In the Matter of McCloy*, 296 F.3d 370, 373 (5th Cir. 2002). In the event of a non-filing employed spouse, a bank account for deposit of the non filing spouse's pay check could be established under that spouse's name and social security number without joinder of the filing spouse. This allows for the debtor's family unit to build up a cash reserve that never becomes property of the estate. Texas law presumes that property possessed by either spouse during a marriage is community property. Tex.Fam.Code Ann. §303(a). Property in one spouse's name "is presumed to be subject to the sole management, control and disposition of a spouse if it is held in that spouse's name ... *Id* §3.104(a).

IV. Timeliness of Objection to Exemptions

B.R. 4003(b) requires an objection to exemption to be filed within 30 days of the *conclusion* of the creditors meeting or 30 days after any amendment to Schedule C. The question then is when is a creditors meeting concluded? If the trustee announces the meeting is concluded, it would seem to be concluded; however, "no statute or rule establishes a specific manner in which a meeting of creditors is to be concluded." *In re Cherry*, 341 B.R. 581, (Bankr. S.D.Tex. 2006) (Isgur). B.R. 2003 governs the creditors meeting. Subpart (e) of Rule 2003 deals with an adjournment, and states:

The meeting may be adjourned from time to time by announcement at the meeting of the adjourned date and time without further notice.

B.R. 2003(e). In *Cherry*, Judge Isgur determined that Rule 2003(e) does not limit the continuation of a meeting only to situations where the adjournment date and time are announced at the meeting. *Cherry*, 341 B.R. at 581.

Judge Isgur analyzed the three approaches courts have taken to determine when a creditors meeting is concluded although the trustee attempted to continue or adjourn the meeting to a later date. Those approaches are i) the "Bright Line Rule"; (ii) the case by case; and iii) an approach that places the burden on the debtor to move the court for a ruling that the meeting has been concluded.

The Bright Line Rule “considers the policy behind the 30-day objection period set forth in Rule 4003(b) which requires that a debtor’s exemptions become final without delay.” *Cherry*, 341 B.R. at 585. The Bright Line Rule requires a trustee to arrive at a date and time for the continued §341 meeting within 30 days of adjournment. This is a reasonable requirement and imposes no great burden on a trustee.” *In re James*, 210 B.R. 368, 371 (Bankr. E.D.N.C. 2001); *In re Smith*, 235 F.3d 472, 476 (9th Cir. 2000); *In re Levitt*, 137 B.R. 881, 883 (Bankr. D.Mass. 1992).

The case by case analysis looks to the particular circumstance of the bankruptcy case and the meeting itself to determine if the objection to exemption was timely and reasonable. In *Cherry*, Judge Isgur adopted this approach because it “...affords the trustee discretion in complex or unique cases but still constrains the trustee’s ability to continue or postpone a meeting of creditors by what is reasonable and necessary to timely move a particular case forward in the bankruptcy process.” *Cherry*, 341 B.R. at 586. However, there is a limit imposed on the trustee under Judge Isgur’s analysis: “a trustee may continue the §341 examination only while there are legitimate grounds for believing that further investigation will prove beneficial or when the circumstances surrounding a case require the meeting to be continued”. *Id* at 587.

The last approach places the burden on the debtor to move the court for an order concluding the meeting. This allows adjournments unless the court finds the adjournment was arbitrary, capricious or an abuse of discretion. *Cherry*, 341 B.R. at 586 quoting *In re DiGregorio*, 187 B.R. 273, 276 (Bankr. N.D. Ill. 1995). In footnote 6 of *Cherry*, Judge Isgur cited *In re Friedheim*, 336 B.R. 110, 112-13 (Bankr. N.D.Tex. 2005) for the proposition that when a trustee announces on the record that the meeting is concluded, but files a continuance on the docket, the meeting is continued and not concluded absent an objection by the debtor.

Because Judge Isgur found the debtor’s counsel had waived the debtor’s right to challenge the trustee’s improper continuation of the meeting of creditors, his opinion regarding the three approaches is probably dicta.

With all due respect to Judge Isgur, when one considers that the trustee knows when he will have future meetings, it places absolutely no burden on the trustee to always set a future date and time for the continuation during the meeting of creditors. Further, notice, in addition to the notice announced at the meeting, may be required when for example the debtor does not appear; however, to require both a reason to continue and a specific time, places no material additional burden on the Trustee. The Bright Line Rule is consistent with the Supreme Court’s decision in *Taylor v. Freeland & Kronz*, 503 U.S. 638, 644, 112 S.Ct. 1644 (1992) (“Deadlines may lead to unwelcome results, but they prompt parties to act and they produce finality.”) The Bright Line Rule is also consistent with the policy considerations of Section 522 and B.R. 4003 gests the issue of exemptions resolved promptly and allows the debtor to have his exempt property outside of the estate.

V. When is the Determination Made?

The Fifth Circuit has held that the debtor’s right to an exemption is generally determined as of the date of the bankruptcy filing. *In re Zibman*, 268 F.3d 298, 302 (5th Cir. 2001). *In re Battle*, 2006 WL 3702734 (Bankr.W.D.Tex.) (“it is the *facts of the commencement of the case* that control the application of exemption law. *In re Orso*, 283 F.3d 686, 692 (5th Cir. 2002 (en

banc)"). Section 522(h)(g)(1) expands the property available for exemption by allowing the debtor to exempt property recovered by the trustee provided the debtor could have exempted that property had it not been transferred. *In re Salaymeh*, 361 B.R. 822, 2007 WL 325333 (Bankr. S.D.Tex.) (J. Isgur).

While the determination of what property can be claimed as exempt is made as of the filing date, the debtor can freely amend the exemptions. B.R. 1009(a). Possibly even switching homestead exemption from one house to another. *Lowe v. Sandoval (In re Sandoval)*, 103 F.3d 20 (5th Cir. 1997); *In re Ronk*, 2006 WL 2385240 (Bankr.N.D.Tex.). The debtor can shift from state exemptions to federal exemptions. *Salaymeh*, 361 B.R. at 829. This right may be limited depending on the debtor's behavior leading up to and during the bankruptcy case. *Salaymeh*, citing *In re Williamson*, 804 F.2d 1355, 1358 (5th Cir. 1986).

Section 522(b)(3) provides that the applicable state exemption scheme is that of the state where the debtor resided for the prior 730 days prior to filing. 11 U.S.C. §522(b)(3). If the debtor has lived in multiple states during that period, then the applicable exemption law is that where the debtor spent the greater amount of time during the 180 day period prior to the 730 day period.

In *Battle* a Texas resident was subject to the Florida exemption scheme. However, Florida is an opt-out state, so the federal exemptions were unavailable. Since the debtor was not as of the filing date a Florida resident, the Florida state exemptions were unavailable. Judge L. Clark resolved this "catch 22" by allowing the debtor the federal exemptions "because Florida's opt-out law does not bar non-residents from claiming federal exemptions". *Battle*, 2006 WL 3702734, p.2.

VI. Whose Burden

Under Texas law, the exemption claimant must prove that property claimed as exempt actually qualifies for exemption. *In re Foster*, 360 B.R. 210 (Bankr. E.D.Tex. 2006); *Parks v. Buckeye Retirement Co., Inc., LLC*, 2006 WL 1662945 (S.D.Tex.) ("The burden to establish that property as a homestead is on the party asserting the protection. *Burk Royalty Co. v. Riley*, 475 S.W. 2d 566, 568 (Tex. 1972)"). However, under federal law a debtor must merely file a Schedule C to claim the exemptions. 11 U.S.C. §522(l). With no objection, the property claimed as exempt is exempt. 11 U.S.C. §522(l); *Taylor v. Freeland & Kronz*, 503 U.S. 636, 642 (1992). The objecting party bears the burden of proof when objecting to an exemption. B.R. 4003(c).

This issue was addressed by Judge Parker in the *Foster* case. *In re Foster*, 360 B.R. 210 (Bankr. E.D.Tex. 2006). In 1996, the debtor won \$4,000,000.00 in the Colorado lottery, which the debtor elected to have paid out over time. To satisfy its obligation, Colorado unilaterally purchased an annuity for the debtor's benefit. In 2005, the debtor filed for Chapter 13 in the Eastern District of Texas claiming the annuity as exempt under the Texas exemption scheme. Judge Parker ruled that while the objecting party has the ultimate burden of persuasion under B.R. 4003(e), the debtor must initially sustain the burden to establish that the property is exempt. *Foster* at 214. Judge Parker found this to be consistent with Texas law which requires the party claiming the exemption to prove the exemption is qualified. *Id.* Judge Parker determined that the debtor had carried his burden because the annuity was issued by an insurance company.

Presumably a debtor by carefully identifying the property and accurately articulating the statutory exemption on Schedule C has carried the initial burden. Fed.R.Bankr.P. 4003(c); *In re Sissom*, ___ B.R. ___, 2007 WL 1406449 (Bankr. S.D.Tex. 2007); *In re Durban*, 2004 WL 3728576 (Bankr. N.D.Tex.); *Perry v. Dearing (In re Perry)*, 45 F.3d 303, 311 (5th Cir. 2003).

VII. Can Bankruptcy Courts Determine Whether Plans are Qualified

The Fifth Circuit has previously held that when the IRS had determined a plan to be qualified, the bankruptcy court was precluded from disagreeing. *Youngblood v. FDIC (In re Youngblood)*, 29 B. 3d 225 (5th Cir. 1994). This year the Fifth Circuit allowed the “camel’s nose under the tent” and determined that in limited circumstances the bankruptcy court may “... undertake its own analysis of the plan’s qualified status ...”. *In the Matter of Plunk*, 481 F.3d 302, 306 (5th Cir. 2007). The Fifth Circuit held that “... when disqualifying events occur after the IRS has last determined that a plan is qualified, a court may, under Section 42.0021 of the Texas Property Code, determine that a plan is no longer qualified based on those events.” *Id.*

In *Plunk*, the debtor had a self administered pension plan that was previously determined by the IRS to be a qualified plan. *Plunk* asserted that since the IRS had determined that the plan was “structurally qualified”, the bankruptcy court could not make its own determination. The objecting trustee and creditor asserted that the debtor had “abused” and “misused” the plan and therefore the plan lost its qualified status. The bankruptcy court found the debtor had used Plan assets to pay personal bills and that the Plan was no longer qualified. The Fifth Circuit found that “... it had been years since the IRS determined the Plan was qualified, and then only as to its structure. The IRS never considered Plunk’s abuse of Plan assets or audited the Plan to determine whether it was operationally qualified despite Plunk’s actions. Therefore, the bankruptcy court and district court were permitted to reach an independent decision regarding the Plan’s qualified status and were not bound by the previous IRS determination under *Youngblood*.” *Plunk*, 481 F.3d at 307. Debtor counsel, enjoy sleeping with the camel.

Does an IRA, qualified as to the decedent, and subsequently inherited by a non spouse retain its exempt status? No! *In re Jarboe*, ___ B.R. ___, 2007 WL 987314 (Bankr. S.D.Tex.)(J. Bohm) citing *In re Kirchen*, 344 B.R. 908 (Bankr. E.D.Wisc. 2006); *In re Taylor*, 2006 WL 1275400 (Bankr. C.D.Ill.); *In re Navarre*, 332 B.R. 24 (Bankr. M.D.Ala. 2004); *In re Greenfield*, 289 B.R. 146 (Bankr. S.D.Cal. 2003); *In re Sims*, 241 B.R. 467 (Bankr. N.D.Okla. 1999).

In *McBride*, Judge Bohm held that after-tax contributions to an ERISA-qualified savings plan are *excluded* from the bankruptcy estate by Section 541(c)(2) of the Code. *In re McBride*, 347 B.R. 585 (S.D.Tex. 2005). The debtor had saved in excess of \$300,000.00 in her company sponsored ERISA-qualified savings plan, she scheduled the asset and claimed it as exempt. Judge Bohm relied on the anti-alienation clause of the savings plan and extend the Supreme Court holding in *Patterson v. Shumate*, which had excluded pre-tax contributions to an ERISA-qualified savings plan. 504 U.S. 753, 112 S.Ct. 2242, 119 L.Ed 2d 519(1992).

The Fifth Circuit held that deemed distributions from an individualized annuity alternative plan are not exempt. *In re Coppola*, 419 F.3d 323 (5th Cir. 2005).

VIII. Homestead

What category of property may constitute a homestead? A mobile home, although connected to a utilities, on blocks and anchored to the ground was personalty; and therefore, §1322(b)(2) did not prohibit the debtors from modifying the creditor's secured claim because at the time the debtors purchased the home, the applicable state law provided such a home was personal property unless the home was permanently attached to the realty and the manufacturer's certificate of origin or certificate of title was surrendered for cancellation and a certificate of attachment was filed with the county clerk. *In re Tirey*, 350 B.R. 62 (Bankr. S.D.Tex. 2006).

In *Norris*, the Fifth Circuit certified the following question to the Texas Supreme Court: "Does a motorized waterborne vessel, used as a primary residence and otherwise fulfilling all of the requirements of a homestead except attachment to the land, qualify for the homestead exemption under Article 16, §§ 50 and 51 of the Texas Constitution?" The Texas Supreme Court, in a 5-4 decision, held that a boat does not qualify as a homestead. *Norris v. Thomas*, 215 S.W.3d 851 (Tex. 2007). To answer the question, the Texas Supreme Court analyzed prior cases involving mobile homes. Consider this paragraph from *Norris*:

In *Clark*¹, setting a trailer home on four wooden blocks and connecting it to electrical service was sufficient to attach the trailer to real property. In *Gann*², where the house trailer remained on wheels, merely parking the movable trailer on real property was insufficient to attach the trailer to the property. In *Walker*³, removing the wheels of a mobile trailer home, setting it on cement blocks, and connecting it to water, sewer, and gas service was sufficient to attach the mobile trailer to real property. And in *Ditto*⁴, removing the wheels of a mobile home, setting it on concrete blocks with eight-foot buried anchors, and connecting it to electrical and plumbing service was sufficient to give it homestead protection.

Norris v. Thomas 215 S.W.3d at 857 (O'Neill, dissent). The rationale for the yacht not constituting a homestead is that its "... attachment to the land is too slight ..." *Norris* at 859. Or as the federal district court held, the boat "by virtue of its self-powered mobility" was not entitled to homestead protection. *Norris*, 316 B.R. 246, 251 (W.D.Tex. 2004).

The Texas Supreme Court dissent in *Norris*, largely relying on the same cases as the majority, stated:

Of greater import than the type of structure and its ability to move or be moved is whether the structure comes within the "overruling purpose of the constitution to secure to the family" a home. *Cullers*, 1 S.W. at 315; *see also Clark*, 190 S.W.2d at 738 (holding that a trailer set apart from a residence house was included in the homestead exemption because it "was devoted to such use as brought it within the spirit and purpose of the homestead exemption statute"). So long as there is a residence-dependent attachment to land, the salient question becomes whether

¹ *Clark v. Vitz*, 190 S.W. 2d 736 (Tex. Cir. App. – Dallas 1945, writ ref'd).

² *Gann v. Montgomery*, 210 S.W. 2d 255 (Tex. Cir. App. – Fort Worth 1948, writ ref'd n.r.e.).

³ *Capitol Aggregates, Inc. v. Walker*, 448 S.W. 2d 830 (Tex. Civ. App. – Austin 1969, writ ref'd n.r.e.)

⁴ *Minnehoma Financial Co. v. Ditto*, 566 S.W. 2d 354 (Tex. Civ. App. – Fort Worth 1978, writ ref'd n.r.e.)

granting the homestead exemption to the home would serve the policy of the exemption, to preserve the family home for a fresh start.

Norris v. Thomas 215 S.W.3d at 861 (O’Neill, dissent). Now that is liberal construction.

Must a debtor file a formal notice under the Texas Tax Code to avail himself of the Texas homestead exemption? No, says Judge Lynn. *In re Durbin*, 2004 WL 3728576 (Bankr.N.D.Tex.). In *Durbin* the debtors owned two separate tracts of land, the Bridgeport Property served as the debtors’ homestead for a number of years, but the debtors moved to the Decatur Property and filed with the County Clerk a Voluntary Designation of Homestead for the Decatur Property. About six months prior to the bankruptcy, the debtors moved back to the Bridgeport Property and claimed the Bridgeport Property as their homestead on Schedule C. Just prior to the bankruptcy filing, the Decatur Property was foreclosed upon. The creditor objected to the debtors’ homestead exemption asserting that the debtors were required to file a homestead designation to claim the Bridgeport Property as exempt pursuant to the Texas Tax Code; and also that the debtors had not cancelled the prior designation on the Bridgeport Property. Judge Lynn, citing *Nichols v. Lincoln Trust Co.*, S.W. 3d 346, 350 (Tex.App. –Amarillo 1999, no pet.), held that failure to file a designation was inconsistent with the legislative intent and that the earlier designation was ineffective where the ownership changed; therefore, the debtors were entitled to their exemption in the Bridgeport Property. This decision is consistent with the filing date being the determining date. See *Zibman*; *Orso*; and *Sandoval*.

In *Ronk*, the debtors claimed a house in which they resided as exempt. No objection was made and presumably the exemption was allowed. Subsequently the debtors converted to Chapter 7 from Chapter 13 (presumably they lost the house in the Chapter 13) and amended their Schedules, but not Schedule C. At the Chapter 7 meeting of creditors on March 1, the debtors stated they intended to claim certain unimproved property (the Property) as their homestead. The debtors amended their Schedule C to so reflect the change on April 4 and filed a 522(f) motion to avoid liens of the creditor on April 24. The debtors again amended their Schedule C on April 13, but for reasons unrelated to the Property. On May 11, the creditor objected to the exemption. The Court found the amendment of Schedule C, even though it did not affect the Property, restarted the time period under B.R. 4003(b). *Ronk* at 5. Most courts do not find that an amended Schedule C reopens the exemption period. *In re Hickman*, 157 B.R. 336 (Bankr. N.D. Ohio 1993). However, most courts allow a creditor to raise the validity of the debtor’s exemption as a defense to a motion to avoid a lien. *In re De Carolis*, 259 B.R. 467 (B.A.P. 1st Cir. 2001); *In re Heintz*, 198 B.R. 581 (B.A.P. 9th Cir. 1996). But see *In re Chinosorn*, 248 B.R. 324 (N.D.Ill. 2000). Lastly, if one considers the debtors’ intent and use of the property as of the filing date, the unimproved property was not a homestead at that time.

In the case of *Tate*, joint debtors in Oregon attempted to utilize the Texas homestead exemption for their Oregon home; however, the Court denied the claim because i) the Texas homestead exemption is not a product of the Texas choice of law statute, but part of the Texas exemption statute; and ii) under Texas law, only property in Texas is eligible for the Texas homestead exemption. *In re Tate*, 2007 WL 81835 (Bankr.D.Or.).

IX. Section 522(o)and (p)

BAPCPA added Sections 522(o) and (p) to the Code; and they state as follows:

(o) For purposes of subsection (b)(3)(A), and notwithstanding subsection (a), the value of an interest in—

- (1) real or personal property that the debtor or a dependent of the debtor uses as a residence;
- (2) a cooperative that owns property that the debtor or a dependent of the debtor uses as a residence;
- (3) a burial plot for the debtor or a dependent of the debtor; or
- (4) real or personal property that the debtor or a dependent of the debtor claims as a homestead;

shall be reduced to the extent that such value is attributable to any portion of any property that the debtor disposed of in the 10-year period ending on the date of the filing of the petition with the intent to hinder, delay, or defraud a creditor and that the debtor could not exempt, or that portion that the debtor could not exempt, under subsection (b), if on such date the debtor had held the property so disposed of.

(p)

(1) Except as provided in paragraph (2) of this subsection and sections 544 and 548, as a result of electing under subsection (b)(3)(A) to exempt property under State or local law, a debtor may not exempt any amount of interest that was acquired by the debtor during the 1215-day period preceding the date of the filing of the petition that exceeds in the aggregate \$125,000 in value in—

- (A) real or personal property that the debtor or a dependent of the debtor uses as a residence;
- (B) a cooperative that owns property that the debtor or a dependent of the debtor uses as a residence;
- (C) a burial plot for the debtor or a dependent of the debtor; or
- (D) real or personal property that the debtor or dependent of the debtor claims as a homestead.

(2)

(A) The limitation under paragraph (1) shall not apply to an exemption claimed under subsection (b)(3)(A) by a family farmer for the principal residence of such farmer.

(B) For purposes of paragraph (1), *any amount of such interest does not include any interest transferred from a debtor's previous principal residence* (which was acquired prior to the beginning of such 1215-day

period) *into the debtor's current principal residence, if the debtor's previous and current residences are located in the same State.*

[Emphasis Supplied] 11 U.S.C. §522(o)(p).

Subsection (o) provides for a reduction of the homestead's equity value to the extent the value is attributable to any property disposed of by the debtor:

- a) within 10 years of the filing date;
- b) the property was disposed with intent to hinder, delay or defraud a creditor; and
- c) the property was not exempt when disposed.

In re Cherry, Ch. 7 Case No. 05-44629 [Docket No. 96] slip op. at 4 (Bankr. S.D.Tex. 9-7-06)(J. Isgur). What does the phrase "disposed of" mean? Judge Isgur decided that the phrase does not include borrowing funds secured by a lien against the property. Judge Isgur stated:

The Court does not believe that the plain meaning of the phrase 'any property that the debtor disposed of' includes the granting of a lien against property. Second, the Court is guided by Judge Hale's decision in *In re Blair*, 334 B.R. 374 (Bankr. N.D.Tex. 2005). In *Blair*, Judge Hale determined that the reduction of debt was not an acquisition of an interest in property for the purposes of §522(p). If the reduction of debt is not an acquisition of an interest, this Court is loathe to understand how the increase in debt can be a disposition of an interest. Third, the Court will narrowly construe restrictions on exempt property.

Id at 5.-6., 05-44629, docket # 96 (9-7-06).

Section 522(p)(1) states: "... a debtor may not exempt any amount of interest that was acquired by the debtor during the 1215-day period ... that exceeds in the aggregate \$125,000.00 in value ...". [Emphasis Supplied] 11 U.S. C. §522(p)(1). If a married debtor files without the spouse, does the debtor get to exempt \$125,000.00 and the non-filing spouse get to utilize the unlimited Texas exemption, or can the non-filing spouse file a Schedule C of her own to exempt only the \$125,000.00? *See* 11 U.S.C. §522(l). Since all joint community property becomes property of the estate, the non-filing spouse should not be eligible for an unlimited exemption.

Are joint debtors entitled to \$250,000.00 in exemptions? That is, can joint debtors stack the \$125,000.00 exemption of §522(p)(1)? Congress seems to allow stacking. "'Stacking' (or more properly doubling) exemptions is clearly permissible." *In re Bippert*, 311 B.R. 456, 471 n.25 (Bankr. W.D.Tex. 2004). Section 522(m) of the Code states: "Subject to the limitation in subsection(b), this section shall apply separately with respect to each debtor in a joint case." In the case of *In re Rasmussen*, the court held that §§302 and 522(m) of the Code, and B.R. 1015 provide joint debtors separate estates. 349 B.R. 747, 753-54 (Bankr. M.D. Fla. 2006). *In re Bippert*, 311 B.R. 456, 462 (Bankr. W.D.Tex. 2004) (J. L. Clark) (...section 302 contemplates *one* case involving joint debtors, it still recognizes the legal fiction of *two* estates, which are not necessarily *consolidated* ...). Since Florida like Texas has an unlimited homestead exemption, the rationale of *Rasmussen* should apply in Texas, thereby allowing Texas spouses at least a

\$250,000.00 exemption for a homestead. Although a pre-BAPCPA case, the analysis of *Bippert* would allow the federal limit imposed on the Texas unlimited exemption to be stacked in joint cases. “This is the sort of stacking that is permissible. Joint debtors can effectively ‘double’ the value of the exemption ... but only when they are seeking to exempt property coming out of *their* basket of property.” *Bippert*, 311 B.R. at 472.

In *Rasmussen* the debtors acquired a \$350,000.00 house using \$30,000.00 in equity from their earlier homestead. Upon the filing, the house had a value of \$750,000.00 with a mortgage debt of \$575,000.00. The debtors claimed the \$175,000.00 of equity as exempt. The bankruptcy judge allowed the stacking of the exemptions and further found that the appreciation of the homestead was not an “interest acquired by the debtors”. *Id.* “Passive market appreciation is not an interest that a debtor ‘acquires’ during the 1,215 – day period.” *In re Chouinard*, 358 B.R. 814, 815 (Bankr. M.D.Fla. 2006).

Is the change in characterization of property to homestead during the 1215-day period an “interest acquired” and therefore limited by Section 522(p)? In the case of *In re Rogers*, the court was faced with a debtor’s claim of exemption of a \$359,000.00 homestead. The property was acquired by the debtor more than 10 years prior to the filing date, but established as a homestead within the 1,215 – day period. The district court found that the term “interest” means a legal or equitable interest which can be quantified. Whether a property was classified as a homestead is a legal construction provided by the relevant statute or constitution. 354 B.R. 792, 796-97 (N.D.Tex. 2006). In other words, the title was acquired prior to the 1215 day period and that is the “interest” Congress was concerned with, the classification of the property as homestead was not an interest. This conclusion seems consistent with the Fifth Circuit’s holding that it is possible, even post petition, to change homestead designations. *Sandoval*.

Is the equity which is built up by reduction of the secured debt through normal and ordinary payments of principal and interest during the 1215 day period prior to the filing date subject to attack? In the case of *In re Blair*, the debtors acquired title to the home prior to the 1215 day period; however, a creditor objected to the exemption in the homestead as to “any and all interest that the Debtors acquired”, that is to the equity build up, during the 1215-day period. Judge Hale found the term “interest” undefined in the Code, but concluded that:

one does not actually ‘acquire’ equity in a home. One acquires title to a home.
...The ‘interest’ the Debtors acquired was the actual purchase of the home, which
was completed well before the 1215-day period.

In re Blair, 334 B.R. 374, 376-77 (Bankr. N.D.Tex. 2005). Market appreciation during the 1215-day period is “not within the purview of Section 522(p)”. *In re Chouinard*, 358 B.R. 814, 815 (Bankr. M.D.Fla. 2006).

Judge Bohm has ruled that Section 522(o) allows for the placing of an equitable lien in favor of the Trustee on a debtor’s homestead acquired with non-exempt funds and that the trustee can foreclose that equitable lien. *In re Sissom*, 2007 WL 1406449 (Bankr. S.D.Tex.). In *Sissom* the debtor sold approximately \$225,000.00 of stock within 90 days of bankruptcy and used \$50,000.00 to purchase a home. The debtor claimed the home as his homestead. The trustee did not object to the homestead designation or the exempt status of the homestead but did bring an action under §522(o). Judge Bohm stated that:

... under § 522(o), four elements must be proven: (1) the debtor disposed of property within 10 years preceding the bankruptcy filing; (2) the property that the debtor disposed of was nonexempt; (3) some of the proceeds from the sale of the nonexempt property were used to buy a new homestead, improve an existing homestead, ...

... and (4) the debtor disposed of the nonexempt property with the intent to hinder, delay, or defraud a creditor.

In re Sissom, 2007 WL 1406449 (Bankr. S.D.Tex.).

The Trustee carried his burden and the Court granted the Trustee an equitable lien against the homestead. *Sissom*, p. 23. Judge Bohm recognized the conflict between the granting of an equitable lien and the Texas constitution's protection of homestead from forced sales. This conflict was previously recognized by the Fifth Circuit in *Reed* and in that case the Fifth Circuit affirmed the lower court decision that the debtor would lose his discharge but retain the exemption. *Matter of Reed*, 700 F.2d 986 (5th Cir. 1983). Judge Bohm attempted to harmonize Section 522(o) and the Texas Constitution by finding the debtor was liable to the trustee for conversion of the non-exempt property into cash which was used to purchase the homestead. Having traced the funds to what should have been property of the estate, Judge Bohm found the equitable lien was similar to a purchase money security interest. Alternatively, Judge Bohm pulled out the Supremacy Clause, which states:

This Constitution, and the Laws of the United States ... shall be the supreme Law of the land; and the Judges in every State shall be bound thereby, any thing in the Constitution or Laws of any State to the contrary notwithstanding.

Judge Bohm found that the trustee had a duty under §704(a)(1) of the Code to "collect and reduce to money the property of the estate ... and close such estate as expeditiously as compatible with the best interests of parties in interest". 11 U.S.C. §704(a)(1). The granting of an equitable lien without the ability to reduce the lien to money would hinder the trustee in his duties. The Judge balanced the duty of the trustee to expeditiously close the case with the debtor and his family's homestead interest and granted the trustee an equitable lien which could not be foreclosed on for 120 days to allow the debtor and his family to pay off the lien, failing which the trustee could foreclose on the equitable. *Id*, p. 25. Judge Bohm concluded that:

...a sea change with respect to protection of homesteads has occurred with the passage of BAPCPA-or, more specifically, with the enactment of §522(o)....

...The enactment of §522(o) means that some debtors may lose their homesteads through forced sales undertaken by successfully objecting trustees or creditors who are awarded an equitable lien on the real property.

In re Sissom, 2007 WL 1406449 (Bankr. S.D.Tex.).

Section 522(o) and Judge Bohm’s decision in *Sissom* overrides *Reed*. Interestingly, the debtor in *Sissom* had already waived his discharge presumably in an attempt to retain the exemption in his homestead.

The facts in *Sissom* are horrible and debtor’s counsel are well advised to keep the following rulings in mind when assisting debtors with exemption planning:

1. *In re Bowyer*, 916 F.2d 1056 (5th Cir. 1990) (“[T]he mere conversion of non-exempt property into exempt property on the eve of bankruptcy [is] not itself such fraud as will deprive the bankrupt of his right to exemptions.”)
2. *In re Bowyer*, op. on reh’g, 932 F.2d 1100 (5th Cir. 1991) (sale of personal property and use of proceeds to repair homestead were not transfers made with intent to defraud, hinder or delay creditors).
3. *Sosa*, 358 B.R. 903, 2006 WL 3358877 (S.D.Tex.) (“... absent other indicia of fraud, a transfer on the eve of bankruptcy alone does not establish fraudulent intent under Section 1108.053 [of the Texas Insurance Code]”).
4. *Swift v. Bank of San Antonio (In re Swift)*, 3 F.3d 929 (5th Cir. 1993) (and the very clear standard of exemption planning stated by the Fifth Circuit “there is a principle of too much; phrased colloquially, when a pig becomes a hog it is slaughtered.”).

X. Section 548(e)

With the passage of the BAPCPA, Congress added Section 548(e) to the Bankruptcy Code. Section 548(e) states:

(e)

(1) In addition to any transfer that the trustee may otherwise avoid, the trustee may avoid any transfer of an interest of the debtor in property that was made on or within 10 years before the date of the filing of the petition, if—

(A) such transfer was made to a self-settled trust or similar device;

(B) such transfer was by the debtor;

(C) the debtor is a beneficiary of such trust or similar device; and

(D) the debtor made such transfer with actual intent to hinder, delay, or defraud any entity to which the debtor was or became, on or after the date that such transfer was made, indebted.

(2) For the purposes of this subsection, a transfer includes a transfer made in anticipation of any money judgment, settlement, civil penalty, equitable order, or criminal fine incurred by, or which the debtor believed would be incurred by—

(A) any violation of the securities laws (as defined in section 3(a)(47) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(47))), any State securities laws, or any regulation or order issued under Federal securities laws or State securities laws; or

(B) fraud, deceit, or manipulation in a fiduciary capacity or in connection with the purchase or sale of any security registered under section 12 or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78l and 78o(d)) or under section 6 of the Securities Act of 1933 (15 U.S.C. 77f).

11 U.S.C. §548(e). In this case the phrase “self-settled” and the words “trust”, “similar” and “device” are of utmost importance in understanding the limitations of Section 548(e) of the Bankruptcy Code, yet those terms are undefined in the Code.

The word “trust” is defined as “... a property interest held by one person (the trustee) at the request of another (the settlor) for the benefit of a third person (the beneficiary). BLACK’S LAW DICTIONARY 1552 (8th ed. 2004). A self-settled trust is different than most forms of a “trust”. A “trust”, by definition, involves three entities; one as Trustee, one as settlor and one as beneficiary.

A “self-settled trust” is a trust in which the person providing the corpus of the trust is also the one to receive the benefits of that corpus which is set up as an asset protection device. “A self-settled trust may be defined as a trust in which the settlor is also the person who is to receive the benefits from the trust, often established in an attempt to protect assets from creditors.” Lawrence R. Ahern, III, *Homestead and Other Exemptions Under the Bankruptcy Abuse and Prevention and Consumer Protection Act: Observations on “Asset Protection” After 2005*, 13 Am. Bankr. Inst. L. Rev. 585, 608 (Winter 2005) (hereinafter “Ahern”). “BAPCPA makes one more attempt to limit the use of fiduciary accounts for asset protection.” Ahern at 607. The phrase has been defined similarly by other authoritative sources. A self-settled trust is “[a] trust in which the settlor is also the person who is to receive the benefits from the trust, usu. set up in an attempt to protect the trust assets from creditors ... Also termed *asset protection trust*” BLACK’S LAW DICTIONARY 1552 (8th ed. 2004). “[A] self-settled trust is one in which the grantor is or may become a beneficiary.” *Randall J. Gingiss, Putting a Step to “Asset Protection Trusts*, 51 Baylor L.Rev. 987, 1007 (1999); Ahern at 608, n. 97. In effect, what Congress was attempting to deal with were Domestic Asset Protection Trusts (“DAPTs”). The statute requires that a transfer is avoidable if to a “self settled trust” established with the intent to hinder, delay or defraud a creditor. Asset protection self-settled trusts were the aim of the legislation creating §548(e).

The Texas Trust Code prohibits self settlor restrictions and provides: “[i]f the settlor is also a beneficiary of the trust, a provision restraining the voluntary or involuntary transfer of his beneficial interest does not prevent his creditors from satisfying claims from his interest in the trust estate.”

Tex.Prop.Code §112.035(d). This policy is further explained as follows: “Public policy does not continece devices by which one frees his own property from liability for his debts or restricts his power of alienation of it; and it is accordingly universally recognized that one cannot settle upon himself a spendthrift or other protective trust ...” *Glass v. Carpenter*, 330 S.W.2d 530, 533-34 (Tex.App. – San Antonio 1959, writ ref. nre).

The word “similar” in Section 548(e) means “nearly corresponding; resembling in many respects; somewhat like; having a general likeness, although allowing for some degree of difference. [cite omitted] Word ‘similar’ is generally interpreted to mean that one thing has a resemblance in many respects, nearly corresponds, is somewhat like, or has a general likeness to some other thing but is not identical in form and substance, although in some cases ‘similar’ may mean identical or exactly alike.” BLACK’S LAW DICTIONARY, 1240 (5th ed. 1979). The concept of a similar device was used by Congress to pick up the Foreign Assets Protection Trusts (“FAPTs”) and such offshore devices to protect assets.

Black’s Law Dictionary defines “device” as “A scheme to trick or deceive; a stratagem or artifice, as in the laws relating to fraud. BLACK’S LAW DICTIONARY, 407 (8th ed. 2004).

While Congress did not define the terms contained in the phrase “self-settled trust or similar device”. Congress has defined, in the Bankruptcy Code, broader terms, such as “entity”, “corporation”, “person”, “relative” and “insider”. 11 U.S.C. §101(9), (15), (41), (45) and (31). The term “entity” “... includes person, estate, trust, governmental unit, and United States Trustee”. 11 U.S.C. §101(15). Also, Congress has defined “person” to include “...individual, partnership, and corporation, but not include governmental unit ...”. 11 U.S.C. §101(41). Congress defined “relative” to be an “...individual related by affinity or consanguinity within the third degree...” See 11 U.S.C. §101(45). Congress also defined the term “insider” to be:

(A) if the debtor is an individual—

- (i) relative of the debtor or of a general partner of the debtor;
- (ii) partnership in which the debtor is a general partner;
- (iii) general partner of the debtor; or
- (iv) corporation of which the debtor is a director, officer, or person in control;

(B) if the debtor is a corporation—

- (i) director of the debtor;
- (ii) officer of the debtor;
- (iii) person in control of the debtor;
- (iv) partnership in which the debtor is a general partner;
- (v) general partner of the debtor; or
- (vi) relative of a general partner, director, officer, or person in control of the debtor;

(C) if the debtor is a partnership—

- (i) general partner in the debtor;
- (ii) relative of a general partner in, general partner of, or person in control of the debtor;
- (iii) partnership in which the debtor is a general partner;
- (iv) general partner of the debtor; or
- (v) person in control of the debtor;

(D) if the debtor is a municipality, elected official of the debtor or relative of an elected official of the debtor;

(E) affiliate, or insider of an affiliate as if such affiliate were the debtor;
and

(F) managing agent of the debtor.

See 11 U.S.C. §101(31).

In Section 548(e), Congress chose to use the term “trust” to be modified by the phrase “self settled”; therefore, one must assume that Congress did not mean any of the other types of entities making up the definition of the term “entities”. Had Congress wanted a broad approach in Section 548(e), it would have used the word “entity” instead of “trust”. That is, Congress was excluding from the applicability of Section 548(e) “person”, “estate”, “governmental unit” and “United States Trustee”; and since the term “person” is defined to include “individual”, “partnership” and “corporations”, those type of entities are also excluded from Section 548(e). Congress could have included, in Section 548(e), the term “relative” or “insider” but chose a more limited approach.

Based on the definitional schemes established by Congress, the objecting trustee or creditor cannot pursue a Section 548(e) action against an a) individual, b) partnership or c) corporation. A limited liability company (“LLC”) is a “person” as defined by the Bankruptcy Code because an LLC fits within the definition of “corporation”. A limited liability company draws its character from both the corporate and partnership form of business. In *Smith v. State ex rel. Dept. of Public Safety*, 89 P.3d 1062 (Okla. 2004). An LLC has “some of the characteristics of partnerships and some of corporations.” *Id.*, citing *Lieberman v. Wyoming.com LLC*, 11 P.3d 353, 357 (Wyo. 2000) (describing an LLC as a hybrid between a corporation and a partnership). LLC has corporation-like protection for its members, and flow-through entity protection for taxation purposes, much like a partnership. Likewise LLCs generally require member votes tied to ownership interests and member votes to approve significant actions by the LLC.

Therefore, a limited liability company is within the definition of “person”. *In re ICLNDS Notes Acquisition, LLC*, 259 B.R. 289, 293-94 (Bankr. N.D. Ohio 2001). *In re Deluca*, 194 B.R. 65 (E.D. Va. 1996) (stating that an LLC might be considered a corporation in certain circumstances, citing 11 U.S.C. § 101(9)(A)(i)). Limited liability companies are also treated as corporations for venue purposes under the Bankruptcy Code. See 2-301 COLLIER ON BANKRUPTCY at P 4.01 (2004). Standards for piercing the veil of a limited liability company are the same that are applied to corporations. See 2-105 COLLIER ON BANKRUPTCY at P 105.09 (2004) (listing court cases showing that the same piercing factors are used for an LLC).

Since LLCs have filed for bankruptcy, they must be a “person” to meet the eligibility requirements of Section 109 of the Bankruptcy Code.

The intent of the amendment to BAPCPA which became §548(e) was to deal with the advent of various forms of asset protection trusts and counter various states legislative attempts to authorize “domestic asset protection trusts” (DAPTs) and certain offshore asset protection vehicles. Ahern at 588-589; *R. Glen Ayers Sr., Asset Protection in the Aftermath of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005* presented to the State Bar of Texas May 25, 2005 (“Although there were many comments that the early versions of the statute did not attack the self-settled trust protection schemes available in Alaska and certain other states, new 11 U.S.C. §548(e)(1) seem crystal clear.”).

As noted by Mr. Ahern in his article, “[d]uring the debate on Senate Bill 256, which became BAPCPA, the *New York Times* published an article describing asset protection trusts as the “millionaires loophole” in the legislation. Senator Charles Schumer introduced an amendment that would have protected only \$125,000.00 in a DAPT. That amendment was defeated and the language offered by Senator Talent became Section 548(e). Ahern at 608, n. 96. Senator Talent explained his amendments to Senate Bill 256, which became Section 548(e) of the Bankruptcy Code, thusly;

Mr. HATCH. Mr. President, one can have self-settled trusts. What the amendment of the distinguished Senator from New York does is do away with essentially all self-settled trusts. Frankly, Senator *Schumer's* amendment is so broad that it covers all settled trusts, not just fraud.

The amendment of the distinguished Senator from Missouri covers fraud, and he does it in the appropriate way, a legal way, the way it should be done.

I yield the remainder of my time to the distinguished Senator from Missouri.

The PRESIDING OFFICER. The Senator from Missouri.

Mr. TALENT. I thank the Senator from Utah.

Very briefly,

we should not allow criminals to hide their assets and avoid paying their bills. This amendment makes certain that dishonest people can't hide their assets, especially if they have caused others to lose their jobs, retirement pensions, health care benefits and, in some cases, their life savings.

One of the reasons the economy plunged into a recession a few years back was because of corporate fraud. And those crimes caused companies to fail, eliminating thousands of jobs. It is fundamentally unfair to allow these crooks to abuse the trust laws of certain States to hide their wealth.

My amendment is simple. It closes the asset protection trust loophole by empowering bankruptcy courts to go back 10 years to take away fraudulent transfers that criminals have sheltered away in an attempt to avoid paying back their debts.

Here is a little background on the problem. Asset protection trusts are trusts that a person forms to shield assets for his or her own benefit.

Although the law has historically allowed property owners to create trusts for others, courts have historically refused to permit someone to tie up his or her own property in such a way that he or she can still enjoy it but prevent his or her creditors from ever reaching it.

My amendment states clearly that these trusts cannot be used in bankruptcy to allow a person to shelter their assets to avoid repaying their debts because of a judgment in criminal, civil, or bankruptcy court.

In addition, my amendment closes the loophole that the New York Times wrote a good article about. That article noted how difficult it is to determine how much money these crooks have sheltered into these asset protection trusts. Some estimate that criminals have stashed away billions of dollars in these types of trusts.

This amendment allows victims to go after any resource transferred into the trust by a corporate criminal over the previous 10 years. Current laws says that if a corporate executive is convicted of a crime, victims can only go after resources transferred into these trusts over the last year. The bankruptcy bill, without my amendment, would have made it only 2 years.

But, that is still not enough time to go after the criminals who set up these asset protection trusts.

There is a gap of several years where criminals could have put billions in assets into these trusts and the Federal and State bankruptcy courts might not be able to touch them. My amendment closes the loophole for criminals.

I urge my colleagues to support this amendment--it simply cracks down on criminals.

I yield back my time.

[Emphasis Supplied] 151 Cong.Rec. S2427-28 (3-10-05).

When the House, considered Senate Bill 256 with Senator Talent's amendment, Representative Delahunt submitted his own amendment which would have limited to \$125,000 the amount of assets in a DAPT which could have been protected from creditors. H.Rep't 109-031, Part 1; David G. Shaftel and David H. Bundy, *Impact of New Bankruptcy Provision on Domestic Asset Protection Trusts*, 32 Est.Plan.28, 29 (2005), 2005 Westlaw 1485226 (hereinafter, "Shaftel and Bundy"). The Delahunt amendment would have limited all DAPTs, regardless of why they were created. The Delahunt amendment was defeated in the House. H.Rep't 109-031, Part 1; and the Talent amendment passed. *Id*; Shaftel & Bundy at 30. "DAPTs are commonly used in estate planning, not only for asset protection purposes, but also for a variety of tax and non tax planning purposes, including transfer tax minimization, state tax planning and prenuptial planning. The legitimate use of DAPTs for asset protection planning is to set aside a 'nest egg' at a time when the settlor does not have existing liabilities or such liabilities are covered by other assets. The amendments proposed by Senator Schumer and Representative Delahunt would have had the practical effect of eliminating the effectiveness of DAPTs for these purposes. Therefore, this Bankruptcy Act debate placed squarely before Congress, the question of whether DAPTs, formed without fraudulent transfers, should be allowed. Congress decided affirmatively by a wide margin. Shaftel & Bundy at 30.

Generally living trusts are not asset protection trusts; therefore they are not self-settled trusts as defined in Section 548(e). A living trust is generally subject to the claims of creditors and is merely an estate planning device for probate and tax purposes. *Eskridge v. Nalls*, 852 P.2d 818 (Okla. App. Div. 1 1993)(Transfer of property cannot be a fraudulent transfer unless it illegally prevents grantor's creditors from collecting a valid debt). If living trusts do not contain spendthrift or other asset protection provisions, they should be outside the reach of Section

548(c). The purpose of Section 548(e) as stated by Senator Talent is to prohibit by statute what courts had historically prohibited, that is to prohibit someone from tying “up his or her own property in such a way that he or she can still enjoy it but prevent his or her creditors from ever reaching it.” 151 Cong. Rec. S 2428 (3-10-05).

XI. Zibman, Jones & Zavala

In *Zibman*, the Fifth Circuit was faced with the following factual scenario. The debtors sold their Houston home on November 27 and deposited the proceeds into a non segregated bank account. On February 9, 1999 (74 days after sale) the debtors filed bankruptcy and claimed the proceeds as exempt. In May, just more than 6 months after the debtors sold their homestead, the Trustee objected to the debtors’ exemptions. *Zibman v. Tow (In re Zibman)*, 268 F.2d 298, 300-301 (5th Cir. 2001). We do not know from the opinion when the creditors meeting was held or when the B.R. 4003 deadline for objection was, but are left to presume that the trustee’s objection was timely and that the exemptions claimed by the debtors had not yet been allowed either by the running of time or court order.

The Fifth Circuit, held “that the law and facts existing on the date of filing the bankruptcy petition determine the existence of available exemptions, but ... it is the *entire* state law applicable on the filing date that is determinative”. *Zibman* at 304 citing *White v. Stump*, 266 U.S. 310, 312, 45 S.Ct. 103, 69 L.Ed. 301 (1924) and *Myers v. Matley*, 318 U.S. 622, 63 S.Ct. 780 87 L.Ed. 1043 (1943). The Fifth Circuit believed that its decision was consistent “with the objective of the Texas exemption for proceeds from the sale of a homestead”. *Zibman* at 304. Since the Debtor’s exemption had not been allowed and the six month period had expired, the decision of *Zibman* is probably consistent with Texas law; however, the Fifth Circuit felt compelled to continue its analysis. And to prove its point, it quoted not from a Texas state court opinion, but from its own earlier decision that “the object of the proceeds exemption statute was *solely* to allow the claimant to invest the proceeds in another homestead, *not to protect the proceeds, in and of themselves*. *Id* at 305 quoting *In re England*, 975 F.2d 1168, 1174-75 (5th Cir. 1992) (first emphasis is original; second emphasis added in *Zibman*).

In the case of *Matter of England*, 975 F.2d 1168 (5th Cir. 1992), the Fifth Circuit in dicta legislated from the bench and arguably imposed a new requirement, that being that the proceeds were exempt solely for the purpose of a new homestead. *Id* at 1175-6. In *England* the debtor sold his homestead and took a note. Shortly after the sale he bought a ranch as a new homestead and then filed bankruptcy claiming both the ranch and the note as exempt assets. The question was whether both were exempt. *Id* at 1173. The court found that the sale proceeds were exempt but once a new homestead was acquired the old one because the former homestead and lost its exemption. The Fifth Circuit held that “Just as the former homestead loses its homestead character when its owner abandons it, so the proceeds of the sale of the former homestead lose their homestead character and become proceeds of former homestead.” *Id* at 1173.

The Fifth Circuit by its own admission ventured into uncharted territory and inexplicably, without any legislative or judicial support, stated: “The object of the proceeds exemption statute was *solely* to allow the claimant to invest the proceeds in another homestead, not to protect them in and of themselves.” *Id* at 1174-75. The Fifth Circuit then went on to discuss abandonment of the exemption such as by the acquisition of a new homestead and concluded that:

“when one abandons a homestead by acquiring another homestead, the proceeds of the former homestead are not covered by section 41.002, and are therefore not exempt.... Had Mr. England not claimed his ranch as homestead, the proceeds ... would be exempt ... However, both cannot be exempt at the same time.

Matter of England, 975 F.2d 1168 (5th Cir. 1992).

The Texas statute being interpreted by the Fifth Circuit in *Zibman* in Section 41.001(c) of the Texas Property Code provides: “The homestead claimant’s proceeds of a sale of a homestead are not subject to seizure for a creditor’s claim for six months after the date of sale.” Tex.Prop.Code §41.001(c). One will note that no where in the statute is the exemption limited except to a 6 month time period. The “unchartered waters” of *England* did not exist. Texas Court’s had weighed in on this issue before *England* and since.

Furthermore, the note being a part of the consideration for the sale of the homestead of W. A. Hill and wife, it was exempt from creditors...and the husband had the right to have the note given in part payment therefor made payable to the wife as her separate estate even as a present gift, to the exclusion of any creditor of the community estate; and the exercise of that legal right could not give rise to the cause of action asserted by plaintiff...

Graham Nat. Bank v. First Nat. Bank et al., 48 S.W.2d 358, 359-360 (Tex.Civ.App.—Fort Worth 1932).

...the taking of the note in controversy made payable to Mrs. Hill as her separate property, as between them, would have operated as a valid gift of funds which W. A. Hill had the legal right to make to the exclusion of plaintiff's claim, because plaintiff had no right in law or equity to have the same applied to its debt; as is well established by such decisions as *Wood v. Chambers*, 20 Tex. 247, 70 Am. Dec. 382; *Cox v. Shropshire*, 25 Tex. 113; *Willis v. Mike*, 76 Tex. 82, 13 S. W. 58; *Lewis v. Goldthwaite Nat'l Bank*, 36 Tex. Civ. App. 437, 81 S.W. 797 (writ refused).

Graham Nat. Bank v. First Nat. Bank et al., 48 S.W.2d 358, 359-360 (Tex.Civ.App.—Fort Worth 1932).

In 1998, a Texas appeals court addressed whether a debtor could spend proceeds from the sale of their homestead as they saw fit. *Fitzgerald v. Antoine Nat'l Bank*, 980 S.W. 2d 228 (Tex. App. – Houston [14 Dist.] 1998). The debtor sold their homestead, paid off the first lien and granted the buyer a 25% discount, leaving \$162,500.00 unpaid from the purchaser. A creditor sued claiming conspiracy and fraud in that if the purchaser had paid the full contract price, the creditor’s \$80,000.00 judgment could have been paid. The debtor claimed the proceeds from the homestead were exempt and that during the six month period the debtor “could spend them in any manner they saw fit”. The Court agreed, concluding:

...the proceeds therefrom were at least partly exempt from seizure for creditors’ claims and would remain so for six months. Therefore, any failure to pay or collect the exempt funds could not be attacked as being made in fraud of [the

creditor] because it deprived [the creditor] of no right it had in the funds at the time of the [homestead] sale or for the next six months.

Id at 231.

In 2002, the Texarkana Court of Appeals stated:

It is well settled that a conveyance of exempt property may not be attacked on the ground that it was made in fraud of creditors. *Chandler v. Welborn*, 156 Tex. 312, 294 S.W.2d 801 (1956); *Crow v. First Nat'l Bank of Whitney*, 64 S.W.2d 377, 379 (Tex.Civ.App.-Waco 1933, writ ref'd); *Dulaney v. Lawler*, 282 S.W. 321, 322 (Tex.Civ.App.-Texarkana 1926, no writ). The rationale for this rule is that because the law already has removed the homestead property from the reach of creditors, the conveyance of the property, whether fraudulent or not, does not deprive the creditors of any right they had against the property. *Wood v. Chambers*, 20 Tex. 247, 254 (1857); *Radney v. Clear Lake Forest Cmty. Ass'n, Inc.*, 681 S.W.2d 191, 197 (Tex.App.-Houston [14th Dist.] 1984, writ ref'd n.r.e.); *Matador Land & Cattle Co. v. Cooper*, 39 Tex.Civ.App. 99, 87 S.W. 235, 236 (1905, no writ). It follows that a debtor may sell exempt property or give it away and pass title as against his creditors. See, e.g., *Willis v. Mike*, 76 Tex. 82, 13 S.W. 58 (1890); *Johnson v. Echols*, 21 S.W.2d 382, 384 (Tex.Civ.App.-Eastland 1929, writ ref'd); *Russell v. Adams* 293 S.W. 264, 270 (Tex.Civ.App.-Dallas 1927), aff'd, 299 S.W. 889 (Tex. Comm'n App.1927, holding approved).

Duran v. Henderson, 71 S.W. 3d 833, 842-3 (Tex.App. – Texarkana 2002).

The *Jones* case is a dischargeability case, wherein the trustee sought to bar the debtors' discharge for fraudulently conveying his assets. Jones sold his homestead and transferred \$18,000.00 to his fiancée for the purchase of a vehicle in her name and spent the other \$57,000.00. In *Jones*, Judge Bohm took *Zibman* a step further to state that "... assets (other than a homestead) which are purchased with the remaining proceeds, even within the six-month exemption period, are not covered by Section 41.001 [of the Property Code] and are therefore not exempt". *Jones* at 302 quoting *England*.

All of a sudden one risks his or her discharge for spending exempt proceeds; however, to an exempt asset even on the eve of bankruptcy. The intent of Congress with respect to the allowance of pre-bankruptcy planning is set forth in the legislative history:

the debtor [be] permitted to convert non-exempt property into exempt property before filing a bankruptcy petition. The practice is not fraudulent as to creditors, and permits the debtor to make full use of the exemptions to which he or she is entitled under the law.

H.R. Rep. No. 595, 95th Cong., 1st Se. 361 (1977), reprinted in 1978, U.S. Code Cong. & Ad. News 5963, 6317; S. Rep. No. 989, 95th Cong. 2d Sess. 76 (1978), reprinted in 1978, U.S. Code Cong. & Ad. News 5787, 5862.

As under current law, the debtor will be permitted to convert non-exempt property into exempt property, before filing a petition. The practice is not fraudulent as to creditors and permits the debtor to make full use of the exemptions to which he is entitled under the law.”

S. REP. NO. 989, 95th Cong., 2d Sess. 76 (1978), reprinted in 1978 U.S. CODE CONG. & AD. NEWS 5787, 5862, H.R. REP. NO. 595, 95th Cong., 1st Sess. 361 (1977), reprinted in U.S. CODE CONG. & AD. NEWS 5963, 6317.

Accordingly one may exercise a legal right regardless of the motive actuating him, and the fact that an act not otherwise amounting to a legal injury is done with evil intent or improper motives does not render it actionable.

Graham Nat. Bank v. First Nat. Bank et al., 48 S.W.2d 358, 359 (Tex.Civ.App.—Fort Worth 1932). Judge Bohm’s decision in *Jones* is contrary to the holding of the Texas Supreme Court.

It is well settled that a conveyance of exempt property may not be attacked on the ground that it was made in fraud of creditors. *Sorenson v. City Nat. Bank*, 121 Tex. 478, 49 S.W.2d 718; *Crow v. First Nat. Bank of Whitney*, Tex.Civ.App., 64 S.W.2d 377 (wr. Ref.); *Johnson v. Echols*, Tex.Civ.App., 21 S.W.2d 382 (wr. Ref.).

Chandler v. R.C. Welborn, 156 Tex. 312, 316, 294 S.W.2d 801 (Tex. 1956).

...this fund was the proceeds of a fire insurance policy on the homestead and its contents. Six months had not elapsed since its receipt at the time the garnishment was served.

...such proceeds were exempt from execution. The husband therefore had a perfect right to give it to the wife without committing any fraud against his creditors. ...the fact that they money was deposited in the wife’s name under the circumstances above detailed make it presumptively her property, and we find absolutely no evidence in the record even remotely tending to rebut such presumption. ...we think the uncontroverted evidence above detailed shows in law a gift from the husband to the wife.

Sorenson v. City Nat. Bank, 121 Tex. 478, 484-5, 49 S.W.2d 718. The Fifth Circuit has repeatedly required that state law be applied when state exemptions are chosen. *Norris* at 527.

In *Zavala*, joint debtors filed a Chapter 13 on November 3, 2003 proposing a payout of 60 months. The debtors claim their homestead as exempt and no objections were filed. (Therefore the homestead ceased being property of the estate). In December 2004, the husband died and in December 2005 the wife lost her job. To reduce expenses she sold the exempt homestead in January 2006. When the debtor tendered her final plan payment, the trustee filed for a modification of the plan to require a 100% payout to creditors. The trustee’s rationale, citing *Zibman*, was that because the proceeds from the sale were not fully invested in a new homestead, the difference became non-exempt. The court relying on *Zibman* and *Jones* found

“that the portion of the proceeds from the sale of the [homestead] in excess of the amount reinvested in a Texas homestead ... became non-exempt in February of 2006, when that mortgage was paid off. *Zavala* at p. 9. Presumably by the time the property became non-exempt it had already been allowed as exempt and passed from the estate. Since the Court did not require modification, the opinion relying on *Zibman* and *Jones* is dicta.

XII. Miscellaneous

A. Lottery Winnings Exempt if in an Annuity

In *Foster*, Judge Parker compared lottery winnings to be paid out over time and unilaterally placed in an annuity by the state, to an annuity contract in favor of the debtor by tort defendants as part of a structure settlement. Judge Parker held that: “The statute [Tex. Ins. Code §1108.002] does not restrict the source of funds used to purchase the annuity.” *Foster* at 215.

B. Cash from Surrendered Policy Not Exempt

Section 1108.051(a) of the Texas Insurance Code provides an exemption for benefits of an insurance policy including cash value and proceeds. Faced with a debtor who had cancelled and surrendered an insurance policy prior to the petition date and received cash which was maintained in a segregated account, the court held that such cash was non a “benefit” covered by Section 1108.051. *Milligan v. Trautman*, 340 B.R. 773 (W.D.Tex. 2006).

C. Home Equity

A home equity lender may require a borrower to pay a third party creditor with proceeds from a home equity loan. However, a borrower may not voluntarily agree to pay an unsecured obligation to the lender making the home equity loan if that is a condition to the loan. *Box v. First State Bank*, 340 B.R. 782 (S.D.Tex. 2006).

D. Waiver of Time Limits

Judge Isgur also found that the time limits of B.R. 4003 as those of B.R. 4004 and 4007 may be waived. *Cherry*, 341 B.R. at 590.