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Non-Homestead Exemption Issues

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Property that Never Becomes Property of the Estate

The filing of a bankruptcy case creates an estate. With exceptions, property of the estate includes "all legal or equitable interests of the debtor in property as of the commencement of the case." 541(a)(1). Texas is a community property state and there is a common misconception about what marital property comes into a bankruptcy estate. Just because property is "community property" does not mean that it comes into the estate and/or that community property of a non-filing spouse is subject to claims against a filing spouse. In addition, property which does not come into the estate is not required to be exempted, thereby allowing a debtor (and non-filing spouse) to effectively increase or avoid the exemption limits.

Since enactment of the federal Equal Credit Opportunity Act in 1974, there has been a significant change in how couples obtain credit. Prior to 1974, it was common (and perfectly legal) for a creditor extending credit to a woman to require her husband to join in the credit application. The 1974 Act was intended to allow women (who were working in ever increasing numbers) to obtain greater access to credit by providing that a creditor extending credit could not decline to extend credit based upon marital status. If a woman would otherwise qualify for credit (i.e., based on her income and credit score), granting her credit cannot be conditioned on her also husband being liable for the debt. One of the results of this is that many couples have very little joint debt and their joint debt tends to be limited to secured major purchases like houses and cars. These are typically assets the clients will desire to retain, so the debt will be paid. Most couples do not have a large amount of joint unsecured debt. They may each ***individually*** have a large amount of unsecured debt so they may both need to file, but it will not be because of ***joint*** unsecured debt. There is a great deal of confusion on this issue. I routinely see potential clients who are convinced that they both need to file because they are married and Texas is a community property state or because they went to see another lawyer who told them they both have to file. My firm files a large percentage of what we call "non-filing spouse" cases because we review their debts to determine whether both spouses actually need to file.

Property of the Estate: 541(a)(2) and 541(a)(5)

541(a)(2) provides that property of the estate includes "all interests of the debtor and the debtor's spouse in community property as of the commencement of the case that is -

> (A) under the sole, equal, or joint management and control of the **debtor**; or
> (B) liable for an allowable claim against the **debtor,** or for both an allowable claim against the debtor **and** an allowable claim against the **debtor's spouse**, to the extent that such interest is so liable." [Emphasis added.]

The issues of (1) what interest in community property is under the sole or joint management of the debtor or (2) is liable for a claim against the debtor or the debtor and the debtor's spouse is an issue of **state** law. There are no Bankruptcy Code provisions which purport to address this issue.

Remember that 541 has an "after acquired property" provision which brings specified assets into the estate if they are acquired within 180 days of filing of the bankruptcy case. 541(a)(5) provides

that property of the estate includes: “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 –

> (A)…
> (B) as a result of a property settlement agreement with the debtor’s spouse, or of an interlocutory or final divorce decree; or
> (C) ….”

Finally, if only one spouse files and elects to use the federal exemptions, the non-debtor spouse is not entitled to claim any exemptions. In re Kim, 748 F.3d 647 (5th Cir.2014). 522(b)(1) provides “…an individual debtor may exempt from property of the estate the property listed in either paragraph (2), or in the alternative, paragraph (3) of this subsection.” The rule for using Texas exemptions is different as the Texas exemptions allow one set of amounts for a single person and a higher set of amounts for “a member of a family.”

Texas Marital Property Law:

Texas common law generally provided that a husband was not only empowered to manage his separate property and community property, but the income generated by his wife’s separate property, as well. It was not until Texas passed the Matrimonial Property Act of 1967 that spouses (women in particular) were granted the right to manage the income from their separate property and sole management community property. These changes were codified in the first version of the Texas Family Code enacted in 1969. The “current” version of the Texas Family Code enacted in 2000 expanded these rights. (It has since been amended, but primarily with respect to other issues.)

The relevant Texas Family Code sections are:
3.002
3.102
3.104
3.201
2.501
3.202

All of the foregoing sections are contained in Texas Family Code, Title 1. The Marriage Relationship, Subtitle B. Property Right and Liabilities, Chapter 3 Marital Property Rights and Liabilities. As we go down the list of cited sections, the subchapters become more specific. For instance, 3.002 is contained in Subchapter A. General Rules for Separate and Community Property. 3.102 and 3.104 are contained in Subchapter B. Management, Control and Disposition of Marital Property. 3.201 and 3.202 are contained in Subchapter C. Marital Property Liabilities.

The general rule that property acquired during marriage is presumed to be community is contained in Tex. Fam. Code Sec. 3.002 which provides that “Community property consists of the property, other than separate property, acquired by either spouse during marriage.” That presumption is rebuttable by clear and convincing evidence that the property was ***not*** intended to be community property.

Just because property is community does **not** mean that it is liable for every debt of either spouse. Community property which is subject to the **sole management** of the non-debtor spouse is **not liable** for the **non-tortious debts** of the debtor spouse. Tex. Fam. Code Sec. 3.102 provides:

> "(a) During marriage, each spouse has the sole management, control, and disposition of the community property that the spouse would have owned if single, including:
> (1) personal earnings...
>
> (b) If community property subject to the sole management, control, and disposition of one spouse is mixed or combined with community property subject to the sole management, control, and disposition of the other spouse, then the mixed or combined community property is subject to the joint management, control, and disposition of the spouses, unless the spouses provide otherwise by power of attorney in writing or other agreement."

Practice Point: If the non-debtor spouse deposits sole management community property, i.e., wages, in a joint management checking account, the sole management community property becomes joint management. Simple answer: keep separate bank accounts.

With respect to personal earnings, see In re Nahat, 278 B.R. 108 (Bankr.N.D.Tex.2002), which held that the post-petition earnings of a non-filing spouse are not property of the estate, and that the debtor's failure to include all of the non-filing spouse's future earnings did not cause the debtor's plan to fail the best interest of creditors test. The court specifically cites to Sec. 3.102(a)(1) in holding that the non-filing spouse's personal earnings are not property of the estate.

Tex. Fam. Code Sec. 3.104(a) provides:

> "During the marriage, **property is presumed to be subject to the sole management, control, and disposition of a spouse if it is held in that spouse's name, as shown by muniment, contract, deposit of funds, or other evidence of ownership**, or if it is in that spouse's possession and is not subject to such evidence of ownership." [Emphasis added.]

Remember, the basic rule is that if the debtor only owes contractual debts, property of the estate includes:

1. The debtor's separate property;
2. Community property in the sole management of the debtor; and
3. Community property in the joint management of the debtor and the debtor's spouse.

Property of the estate ***does not*** include:

1. The separate property of the non-filing spouse; and
2. Community property in the sole management of the non-filing spouse.

See, e.g., In re Bounds, 2013 WL 2245140 (D.W.D.Tex.2013).

Section 3.104(a) identifies what property is under the sole management of one of the spouses. Basically, if the property has a title – a deed to real property, a certificate of title on a car or boat, a bank account, etc – and the asset in question is titled in the name of only one spouse, it is under the sole management of that spouse, even though it is community property. See, e.g., In re McCloy, 296

F.3d 370 (5th Cir.2002). In McCloy, the debtor spouse purchased a parcel of real property in her name only and she was the only party to the note and deed of trust which encumbered the property. Notwithstanding the fact that the property was purchased with community funds, it was still her sole management community property based on the title.

But, the community property issues are not always as easy to resolve as one might think. See, e.g., In re Chestnut, 422 F.3d 298 (5th Cir.2005). (Which started out in the Dallas Bankruptcy Court.) In that case, Ms. Chestnut acquired a piece of real property approximately 3 years after she married Mr. Chestnut. The court recites the simple facts:

> Mrs. Chestnut attended the closing without her husband and signed all of the relevant legal documents alone, including the real estate lien note, the deed of trust, the title policy and the warranty deed. Although the warranty deed recites that the Eastland property was acquired by 'Jacqueline Chestnut, as her sole and separate property and estate,' Mr. Chestnut contended that the Eastland property was paid for with community funds, and Texas law provides for a rebuttable presumption that property purchased during marriage is community property.

Mrs. Chestnut fell behind on the note, the note was transferred, and the new lienholder posted the property for foreclosure. Mr. Chestnut filed a Chapter 13, in large part to stop the foreclosure, but the lienholder proceeded to foreclose having determined in its own mind that Mr. Chestnut had no ownership interest in the property. The Bankruptcy court entered judgment against the foreclosing creditor for willfully violating the stay. The District court reversed. The Fifth Circuit reversed the district court and affirmed the ruling of the bankruptcy court. The court explained:

> The Eastland property was not clearly part of Mr. Chestnut's bankruptcy estate at the time of the foreclosure, but neither was it clearly *not* part of his estate. Whether an asset is property of the estate is a legal determination which frequently entails complex analyses involving a number of legal elements and a variety of facts. Here, the status of the Eastland property hinged on the application of Texas's legal presumptions regarding separate and community property as well as an examination of the factual bases underlying the transaction, including the text of the title documents, the source of purchasing funds, and even the possible existence of fraud. [Citations omitted.] These questions concerning the characterization of the Eastland property can only be answered with finality through the judicial process, which was not initiated here until after the foreclosure of the Eastland property. Regardless of whether the Eastland property is ultimately held to have been Mrs. Chestnut's separate property or the Chestnut's community property, at the time that Brown foreclosed on the Eastland property, it was uncertain whether it was property of Mr. Chestnut's estate and, therefore, was arguable property. [Emphasis in original.]

(I think the Circuit reached the correct result, but I think the opinion reflects a lack of understanding of Texas community property law. The issue was not whether the property was separate or community, but whether the property was Mrs. Chestnut's sole management community property.)

See, also, In re Trammell, 399 B.R. 177 (Bankr.N.D.Tex.2007), which involved a car which was purchased during marriage with community funds, but titled only in the name of one of the spouses. The court held that the vehicle was the sole management community property of the non-filing spouse so it was not property of the estate. The court also engaged in a lengthy analysis of whether the vehicle was liable for an allowable claim against the debtor or the debtor and her spouse, in which case it would become property of the estate pursuant to 541(a)(2)(B). The court concluded that it was not property of the estate based upon Tex. Fam. Code Sec. 3.201, rejecting the line of cases following Cockerham v. Cockerham, 527 S.W.2d, 162 (Tex.1975.) Section 3.201 was enacted in 1987 (then numbered as Sec. 4.031), many years after Cockerham.

In an interesting twist see In re Martin, 2009 WL 1911760 (Bankr.N.D.Tex.2009) and In re Lummus, 2000 WL 33912318 (Bankr.N.D.Tex.2000), both of which deal with whether tax refunds constitute property of the estate when one of the spouses did not join in the bankruptcy filing. In both cases, the debtor and their spouse filed a joint federal income tax return which generated a refund payable to both spouses, but in both cases all of the income reported during the year in question was from the earnings of the non-filing spouse. In both cases, the court held that because the refund was a refund of the sole management wages of the non-filing spouse, the refund was also sole management property of the non-filing spouse and was not included in property of the estate.

Tex. Fam. Code Sec. 3.201 provides:

> "(a) A person is personally liable for the acts of the person's spouse **only if**:
>
> > (1) the spouse acts as an agent for the person; or
> >
> > (2) the spouse incurs a debt for necessaries as provided by Subchapter F, Chapter 2.
>
> (b) Except as provided by this subchapter, community property is not subject to a liability that arises from the act of a spouse.
>
> (c) A spouse does not act as an agent for the other spouse solely because of the marriage relationship."

Tex. Fam. Code Sec. 2.501 [Subchapter F, Chapter 2, referenced in 3.201(a)(2) above] provides:

> "(a) Each spouse has the duty to support the other spouse.
>
> (b) A spouse who fails to discharge the duty of support is liable to any person who provides necessaries to the spouse to whom support is owed."

I hear a lot of talk about going after the other spouse for debts for "necessaries," but it seems to be all talk. There is virtually no case law on the issue, with one result being that I am unable to articulate what constitutes a "necessary." I am fairly certain that it would include groceries, clothing and medical care, but what are the limits? Food is necessary, but filet mignon is not. What about rent? Does it matter how expensive the rent is for it to be "necessary"? I would note that in almost 30 years of practice, I have never had a creditor actually pursue a "necessaries" claim.

For one of the few cases which even talk about necessaries, see Fallin v. Williamson Cadillac Co., 40 S.W.2d 243 (Tex.Civ.App. – San Antonio, 1931). In that case, the issue was whether the separate estate of the wife was bound where the creditor extended credit to the wife, having refused to extend credit to the husband. At the time, the law was "that a note or other document executed by the wife,

not joined by the husband, is a nullity." Because the wife could not be bound by contract, the court then looked at the issue of whether her Cadillac was a necessary. The court stated: " The guide as to what are necessities is not a thing that is settled. What is a necessity for one family would be a luxury for another. The needs of the family with reference to social position, wealth, surrounding circumstances, etc., are the determining factors." Apparently, under the facts of this case, a Cadillac was a necessity. (This whole line of cases is awful as there is absolutely no guidance. I would suggest that a car ***might*** be a necessary ***if*** the debtor lives in a rural area and there is no public transportation, but a Honda Civic will get you back and forth to work. A Cadillac would seem to be a luxury.)

Tex. Fam. Code Sec. 3.202 provides:

> "(a) A spouse's separate property is not subject to liabilities of the other spouse unless both spouse's are liable by other rules of law.
>
> (b) Unless both spouse's are personally liable as provided by this subchapter, the **community property subject to a spouse's sole management, control, and disposition is not subject to:**
>
> > (1) any liabilities that the other spouse incurred before marriage; or
> >
> > (2) **any nontortious liabilities that the other spouse incurs during marriage**.
>
> (c) The community property subject to a spouse's sole or joint management, control and disposition is subject to the liabilities incurred by the spouse before or during marriage.
>
> (d) All community property is subject to tortious liability of either spouse incurred during marriage." [Emphasis added.]

I have been unable to find a single Texas case which addresses the application of 3.202(d). (There is one case which simply recites that because there was state court judgment which found tortious conduct, the non-debtor spouse's sole management community property was liable.) The issue of concern is whether fraud constitutes a tort for the purposes of this section. The most common scenario is one spouse owns a business and there is a claim of fraud under 523(a)(2)(A) or (B) or a claim of fraud in a fiduciary capacity under 523(a)(4). If the bankruptcy court determines that a debtor's debt is nondischargeable under one of these sections, does that expose the non-filing spouse's sole management community property to collection efforts arising out of conduct solely undertaken by the debtor?

Pay attention to cased law cited for the proposition that a spouse is liable for the debts of the other spouse. Most of this case law is ancient. One of the cases I am cited to regularly is Walling v. Hannig, 11 S.W. 547 (Tex.1889.) That's right folks: 1889. This is a case where the husband and wife went to a store and wife purchased "many articles of house furnishing goods." Wife made payments for a time, but then defaulted. Store owner sues husband who denies liability because he did not authorize the purchases. The Court ruled in favor of store owner stating: "Where a husband is living in the same house with his wife, he is liable to any extent for goods which he permits her to receive there. She is considered as his agent, and the law implies a promise on his part to pay the value." A few things have changed since 1889. Like Texas Family Code Sec. 3.201(c), which specifically provides that a spouse is ***not*** the other spouse's agent just because they are married.

* There really is no such thing in Texas as "community debt." Texas Family Code Sec. 7.001 provides that in a divorce decree, the court "shall order a division of the estate of the parties in a manner that the court deems just and right, having due regard for the rights of each party and any children of the marriage." **The phrase "community debt" does not appear anywhere in the Texas Family Code**. (Try a Westlaw search of the Family Code for the phrase "community debt" and you get "no results match your request.") This is an unfortunate term that gained common usage **before** there was a Family Code and has survived as a shorthand abbreviation when it is really just a lazy way of saying "debt incurred during marriage" ***in the context of dividing the marital estate***. Note, however, that the Texas Estates Code does include the phrase "community debt" in the context of estate/probate proceedings, but it is not a defined term.

There are some very specific and limited exceptions to a Texas spouse's future income being liable for the other spouse's debts. See, e.g., Medaris v. U.S., 884 F.2d 832 (5th Cir. 1989) which held that one-half of the non-filing spouse's earnings were subject to levy to satisfy the debtor's tax liability, but that resulted from application of the Internal Revenue Code, not the Texas Family Code.

Practice Point: Remember, property of the estate includes "all legal or equitable interests of the debtor in property as of the commencement of the case". That includes the retainer paid to the family law attorney but not yet earned by that attorney. If there is a divorce pending (particularly an ugly divorce), make sure to verify whether or not there is such a retainer.

529 Plans/Education IRAs

§541(b)(6) provides that 529 plans are ***not*** property of the estate with several limitations. One of the limitations provided for in §541(a)(6) is that funds contributed "not later than 365 days before the date of filing of the petition" ***are*** property of the estate.

§541(b)(6)(C) provides a further limitation: "in the case of funds paid or contributed to such program having the same designated beneficiary not earlier than 720 days nor later than 365 days before such date, only so much of such funds as does not exceed $6,225" are ***not*** property of the estate. (There is an identical provision in §541(b)(5)(C) for education IRAs as defined in IRC §530.)

In summary:

1. If the money was contributed within 365 days prior to filing, it ***is*** property of the estate.
2. If the money was contributed between 366 days and 720 days prior to filing, it ***is*** property of the estate, but ***only to the extent*** that the contributions during that period exceed $6,225.
3. If the money was contributed more than 720 days prior to filing, it **is not** property of the estate. (Note that the time period is 720 days, ***not*** 730 days. (Congressional typo perchance?)
4. The time and monetary limits apply to each beneficiary, so if there are multiple children, the limits apply with respect to each plan for each beneficiary.

Although I like to think I know what I am talking about, our judges occasionally inform me that I am less than fully correct, so I did a Westlaw search and found In re Bourguignon, 416 B.R. 745 (Bankr.D.Idaho 2009). It is the only case Westlaw found for §541(b)(6)(C). I also searched Westlaw for §541(b)(5)(C) and did not find a single case. The facts in Bourguignon are important to the result. In that case, the debtor opened a 529 account for her daughter on March 10, 2009 and contributed $14,500 to the account. After that, the debtor's mother contributed an additional $40,000 to the account. On March 27, 2009, the debtors filed Chapter 7. The court basically concluded that the analysis I set out above is correct, but the sit up and take notice part of the result is that the court held that ***all*** of the funds in the account were property of the estate, ***including the $40,000 contributed by the debtor's mother.***

The court's entire analysis of this issue in the opinion is as follows:

> Section 541(b)(6) makes certain funds contributed into a 529 account property of the estate and excludes others, but that distinction is based on the *timing* of the contribution, not the *source* of the contribution. Indeed, during the September 3 hearing, Debtors conceded the Code makes no distinction based on the source of the contributions. Debtors instead rely on the language of their College Account's plan description, which states that "Contributions… by an Account Owner" made within a year of filing bankruptcy are a part of the account owner's bankruptcy estate and are available to creditors, but which does not mention a third party's contributions. See Ex. 201 at 13. The plan description's silence on the subject of third party contributions does not suggest differential treatment under §541(b)(6). More importantly, the description cannot alter the language and operation of the Code. The Court concludes that the source of the funds in the 529 account is immaterial. [Emphasis in original.]

The IRC allows the "account owner" to withdraw funds from the plan subject to certain financial penalties. The "oops" factor in this case is that grandmother made a contribution to an account owned by her daughter – the future debtor. If grandma had opened her own 529 plan and contributed the money to her own plan rather than the daughter's plan, the $40,000 would not have been an issue.

Remember, if property is ***not*** property of the estate, you don't have to exempt it because it never came in to the estate. If it does come into the estate, there may still be an exemption available.

> If the debtor is using federal exemptions, the wildcard under §522(d)(5) (which allows an exemption for "any property") should apply to the extent available.
>
> If the debtor is using Texas exemptions, Property Code § 42.0022 exempts 529 plans (which are established under Texas Education Code Subchapters F and G of Chapter 54), but ***not*** education IRAs. In addition, Texas Education Code Sec. 54.769 also exempts money in 529 plans from claims against the purchaser or a beneficiary.

With that said, Schedule B.11. requires disclosure of "Interests in an education IRA as defined in 26 U.S.C. §530(b)(1) or under a qualified State tuition plan as defined in 26 U.S.C. § 529(b)(1). Give particulars. (File separately the record(s) of any such interest(s). 11 U.S.C. §521(c)." In an attempt to reconcile §541(b)(6) and Schedule B.11, we list the 529 plan on Schedule B.11., and in the description column we list the full balance of the account and state that the amount listed in the "current value" column is the amount that is property of the estate under 541(b)(6). I had a recent case where the parents had been contributing $100 each to 529 plans for their two children. We listed a 529 plan for "minor child #1" and another 529 plan for "minor child #2" with a current balance of $12,000 each in the description column, but a value of $1,200 each in the current value column. (The $1,200 represented the contributions within the last year. Although they made contributions of $100 per month to each plan within the 366 day to 720 day period, the amounts totaled less than $6,225 per beneficiary.)

As a final note, 521(c) provides: "In addition to meeting the requirements under subsection (a), a debtor shall file with the court a record of any interest that the debtor has in an educational retirement account (as defined in section 530(b)(1) of the Internal Revenue Code of 1986) or under a qualified State tuition program (as defined in section 529(b)(1) of such Code." This is a 2005 amendment to the Code. When those amendments went into effect, I called our clerk's office and asked what kind of "record" they wanted us to file. Their response was "What are you talking about?" I cited them to the statute and their response was "We don't want that, send it to the trustee." Just FYI. (This is not one of the documents that must be filed to avoid automatic dismissal under 521(i)(1), so I am not sure there are any real consequences for failure to comply.)

Disclaimer of Inheritance

If a debtor is the beneficiary of the estate of a deceased person, whether by will or intestate succession, that interest is property of the debtor's estate. A debtor may disclaim an inheritance ***prior*** to filing and the interest never comes into the bankruptcy estate. The debtor may not disclaim the inheritance ***after*** filing or the disclaimer is an avoidable post-petition transfer.

Fraudulent Transfer Issues

* A ***pre-petition*** disclaimer of an inheritance ***is not*** avoidable as a fraudulent transfer under 548(a)(1). In re Simpson, 36 F.3d 450 (5th Cir.1994). (Note that the disclaimer in this case happened ***one day before*** the debtor filed Chapter 7.) This is THE Fifth Circuit case on this issue, ***but*** it only applies:

    1. IF the disclaimer complies with the procedural requirements of the Texas Estates Code, Chapter 122:
        * The disclaimer must be evidenced by a "written memorandum";
        * The disclaimer must be notarized;

- * The disclaimer must contain a statement of whether the beneficiary is a child support obligor;
- * The disclaimer must be filed with the clerk of the probate court or with the county clerk if there is no probate proceeding; and
- * The disclaimer must be filed timely. (Timely varies. See §122.055).

2. Texas also allows for disclaimer of an interest in a trust. Tex. Prop. Code §112.010 provides that a beneficiary may disclaim an interest "in the manner and with the effect for which provision is made in the applicable probate law."

3. Potential large exception: the disclaimer is not valid IF the debtor has accepted property by taking possession or exercising dominion and control over the property in his capacity as a beneficiary, rather than in his capacity as executor. See Texas Estates Code Sec. 122.104 and Badouh v. Hale, 22 S.W.3d 392 (Tex.2000). In that case, the daughter/beneficiary exercised control over her expectancy interest in her mother's home by pledging it for a loan prior to her mother's death and then disclaiming the inheritance after her mother passed away.

   For a comprehensive analysis of these exceptions, see In re Womble, 289 B.R. 836 (Bankr.N.D.Tex.2003). If you have an ugly inheritance case, read this case. It is 40 pages +/- and I would suggest that any trial court will cite it with approval.

   In re Stevens, 112 B.R. 175 (Bankr.S.D.Tex.1989) and In re Brajkovic, 151 B.R. 402 (Bankr.W.D.Tex.2003) both held that a pre-petition renunciation of an inheritance was a fraudulent transfer. Stevens and Brajkovic were at least implicitly overruled by Simpson, so they are of limited or no precedential value.

- * The Texas version of the Uniform Fraudulent Transfers Act provides that a "transfer" does not include a disclaimer filed under the Estates Code or the Property Code. See Tex. Bus. & Comm. Code §24.002(12).

- * Bankruptcy Code Sec.101(54)(D) defines transfer as "each mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing or parting with – (i) property; or (ii) an interest in property."

- * The debtor's "interest in property" is determined by state law. Butner v. U.S., 440 U.S. 48 (1979); Simpson, infra.

- * A ***post-petition*** disclaimer of an inheritance ***is*** avoidable as an unauthorized post-petition transfer under 549(a). In re Schmidt, 362 B.R. 318 (Bankr.W.D.Tex.2007). [In a footnote, Laughlin states "It has been recognized by several courts and commentators that post-petition disclaimers of inheritance are not valid under 11 U.S.C. Sec. 541(a)(5)." The court then goes on to cite one commentator, but no reported opinions.]

Discharge Issues

* A ***pre-petition*** disclaimer of an inheritance ***does not*** constitute a transfer of an interest in property of the debtor for the purposes of 727(a)(2)(A). In re Laughlin, 602 F.3d 417 (5th Cir.2010). This is a case based on Louisiana law, not Texas law, but the law appears to be substantially the same for the purposes of determining the effect of a renunciation.

* A ***post-petition*** disclaimer of an interest ***does*** constitute a transfer of an interest in property of the estate for the purposes of 727(a)(2)(B). I don't have a cite for this, but see Laughlin, infra, which at least implies this conclusion.

Exemption of Marital Obligations: 522(d)(10)(D)

522(d)(10)(D) allows a debtor to exempt "alimony, support, or separate maintenance, to the extent reasonably necessary for the support of the debtor and any dependent of the debtor." There is no exemption under 522(d) for amounts owed pursuant to a property division order or agreement.

Texas Property Code Section 42.001(b)(3) provides that "alimony, support or separate maintenance received or to be received by the debtor for the support of the debtor or a dependent of the debtor" is exempt and is ***not*** included in the aggregate dollar limits contained in 42.001(a). There is no exemption under 42.001 for amounts owed pursuant to a property division order or agreement.

The fight here is whether an obligation is in the nature of alimony or support or is in the nature of property division. Note that 522(d)(10)(D) does not use the defined term "domestic support obligation," so courts are permitted/required to look more broadly at what the parties and/or the divorce court intended the obligation to be. See In re Evert, 342 F.3d 358 (5th Cir.2003). This is THE case in the Fifth Circuit on this issue. In Evert, the debtor (Evert) and her husband (Colvin) were divorced in 1999. Under the terms of the divorce decree, there were three separately identified financial obligations owed by Colvin to Evert: (1) a section labeled "Child Support" which required Colvin to pay Evert $1,000 per month until the oldest child turned 18 with a reduction to $800 until the second child reached 18; (2) a section labeled "Property Settlement" which purported to divide the assets and liabilities of the parties, pursuant to which Evert was awarded a promissory note in the amount of $65,000 to be executed by Colvin payable at 8% interest in 60 monthly installments of $1,317.97; and (3) a section labeled "Post-Divorce Spousal Support (Alimony) Agreement" pursuant to which Colvin was to pay to Evert $1,350 per month for four years.

Evert filed Chapter 7 in March, 2001. She initially failed to disclose the existence of the note or to claim it as exempt, but amended Schedules B and C to exempt the note approximately 60 days later. The basis for the claimed exemption was 522(d)(10)(D), which exempts debts for "alimony, support or separate maintenance." The Chapter 7 trustee objected to the exemption of the note. The debtor then converted to Chapter 13 while the objection to exemptions worked its way through the legal

process. In October, 2001, the bankruptcy court issued its opinion holding that the note was exempt as the parties intended the debt to be in the nature of support, regardless of how it was characterized. The trustee appealed. In April, 2002, the District Court affirmed. The trustee appealed. In April, 2003, approximately two years after the original bankruptcy filing, the Fifth Circuit reversed, holding that the note was not in the nature of support and was intended to be part of the division of the community estate. At that point, the trustee sued Colvin, but there was only approximately $2,000 left due on the note. None of the parties had ever moved to have the payments escrowed or deposited in the registry of the court.

The Evert court decided that it was not required to decide whether the Nunnally "test" for dischargeability purposes should be adopted to determine whether a payment due under a divorce decree was intended to be in the nature of support ***for exemption purposes***. (Discharge issues will be discussed later in this paper.) In Evert, the Fifth Circuit found that the agreement entered into between the parties contained clear indication of the party's intent. There were separate provisions for "non-trivial" payments of child and spousal support in addition to the payment for property division. The spousal support payments ended on the death of the obligee (when she would no longer require support), but the payments on the note ended only on full payment of the debt. The court also noted that the dollar division of the estate (the house and note to Evert, the equity in the business to Colvin) was substantially equal, further evidence that the property settlement was actually a property settlement.

Other than Evert, there is no published authority from Texas on 522(d)(10)(D).

For a glimpse at how other courts have struggled with this issue, see In re Diener, 483 B.R. 196 (9th Cir. BAP 2012) (Bankruptcy court did not clearly err in finding that a nonqualified retirement account was not alimony, support, or separate maintenance.); In re Brown, 391 B.R. 210 6th Cir. BAP 2008) (Remanded for further hearing to determine whether, because of an ambiguity in the decree, amounts owed were intended to be in the nature of spousal support or property division.); In re Harbaugh, 257 B.R. 485 (D.E.D.Mich.2001) (Debtor was entitled to exempt $48,500 payable over 7 years as in the nature of alimony given that both parties and court identified the payments as alimony, payments terminated upon the death of the debtor, and the debtor had no other substantial income so she needed the payments for "sustenance.")

The Diener court reached the interesting conclusion that "Although the *Evert* court said it was not deciding the issue of whether the same criteria should be applied in case of nondischargeability and exemption, by rejecting the *Nunnally* factors… we believe the court essentially did decide the issue (in the negative) by its rejection of the notion that the same test should apply in both circumstances." I would suggest that the Diener court is reading too much into the Evert decision. Evert seems to say that if the decree meets these four criteria, the court doesn't need to look at the Nunnally factors, which suggests that if those four criteria are not met, then the court would look to the Nunnally factors. (But we are all guessing until the Fifth Circuit tells us.)

Exception to Exemptions: 522(c)(1)

Section 522(c)(1) provides:

> "(c) Unless the case is dismissed, property exempted under this section is not liable during or after the case for any debt of the debtor that arose… before the commencement of the case, except -
> (1) a debt of a kind specified in paragraph (1) [certain tax claims] or (5) [DSO claims] of section 523(a) (in which case, notwithstanding any provision of applicable nonbankruptcy law to the contrary, such property shall be liable for a debt of a kind specified in section 523(a)(5))."

This provision existed pre-BAPCPA, but was reworded slightly.

Although there are many cases which refer to 522(c)(1), most of them do so for comparison purposes. See, e.g., In re Galtieri, 172 Fed.Appx. 397 (3rd Cir.2006). There are only a few Texas cases on Section 522(c)(1) and most of them contain very little analysis. See, e.g., In re Crum, 414 B.R. 103 (Bankr.N.D.Tex.2007) and In re Gregory, 214 B.R. 570 (Bankr.S.D.Tex.1997). Gregory is a 522(c)(3) case, not a 522(c)(1) case, but the analysis is the same.

The one case worthy of note is the Cullen Davis Chapter 11 in which he fought with his ex over, among other things, whether she could reach his homestead to satisfy obligations owed to her under a divorce decree. There are two opinions on this subject, Matter of Davis, 105 F.3d 1017 (5th Cir.1997) and Matter of Davis, 170 F.3d 475 (5th Cir.1999). (The second opinion was *en banc* with three justices dissenting.) In the first opinion, the court concluded that 522(c)(1) did supersede the Texas homestead exemption and in the second opinion, the court concluded that 522(c)(1) did not "impliedly" preempt Texas homestead law. Clear as mud, apparently. I am not sure what the end result may be, but it seems that 522(c)(1) may apply if the debtor uses federal exemptions, but may not apply if the debtor uses state exemptions. (Note the use of the word "may." No warranties are expressed or implied.)

I am a little (pleasantly) surprised that this section is not used (and abused) more frequently. In (far too) many cases I see, there is a DSO creditor who hates the debtor and wants them to "pay." (With money, but if there is no money available, torture is an acceptable substitute.) If there is a pre-petition arrearage claim, a DSO creditor could beg, request or demand that a Chapter 7 trustee auction off the debtor's clothes and dishes or object to a Chapter 13 plan which does not pay the full value of all non-exempt property. Taking the debtor's clothes isn't really about payment, it's about payback.

The Community Property Discharge: Section 524(a)(3)

Section 524(a)(3) provides:

> A discharge in a case under this title -
> -operates as an injunction against the commencement or continuation of an action, the employment of process, or an act, to collect or recover from, or offset against, property of the debtor of the kind specified in section 541(a)(2) of this title that is acquired after the commencement of the case, on account of any allowable community claim, except a community claim that is excepted from discharge under section 523, 1228(a)(1), or 1328(a)(1), or that would be so excepted, determined in accordance with the provisions of sections 523(c) and 523(d) of this title, in a case concerning the debtor's spouse commenced on the date of the filing of the petition in the case concerning the debtor, whether or not discharge of the debt based on such community claim is waived.

Probably because there are only a limited number of community property states, there really aren't that many reported opinions on the community discharge. For some reason, however, when I talk to creditor's attorneys about non-filing spouse issues, they always want to talk about the community discharge like it is depriving their clients of significant substantive rights on a frequent basis. In very few of my cases is it an issue because (being in Texas) all of the "affected" property is typically exempt in any event.

The only Fifth Circuit case I could find which mentions this issue is In re Gauthier, 349 Fed. Appx. 943 (5th Cir.2009), which really addressed the issue of whether fraud by one spouse could be imputed to the other spouse for the purpose of contesting dischargeability of a debt. (The court held that it could not absent any evidence that the non-debtor spouse participated in the fraud.) The creditor also complained that a discharge as to the wife would effectively preclude any recovery from the husband - specifically, that the creditor would be unable to garnish the husband's future wages which are community property under Louisiana law. Calling that argument "questionable," the court declined to rule on the issue as it was not before the court on appeal.

There are only a handful of Texas bankruptcy court cases addressing 524(a)(3). One of the first was In re Karber, 25 B.R. 9 (Bankr.N.D.Tex.1982). In that case, the husband filed Chapter 7 as a result of a failed business. No creditor filed an adversary under 523 or 727. After his discharge, his non-filing spouse sold a separate property asset (an apartment complex), paid off all of the debt related to the asset, paid a substantial IRS liability, and refused to tell the bank what she did with the other $140,000. As a result, the bank sued the wife in state court and later filed an involuntary Chapter 7 against her. Because her husband received a discharge in his Chapter 7, Judge Brister held that his creditors were enjoined from attempting to collect their debt from her after-acquired community property. (But not necessarily from her separate property.)

In re Braziel, 127 B.R. 156 (Bankr.W.D.Tex.1991), was a case where the husband filed Chapter 7 and a creditor filed an adversary objecting to both his discharge and her hypothetical discharge under 727. Judge Monroe made the candid admission: "At the hearing, counsel for all parties, and

the Court, confessed a certain amount of uncertainty with regard to the effect that should be given Section 524(a)(3) in this case." After taking the matter under advisement, the court concluded that she was a necessary party to the adversary because if the adversary proceeded without her and her husband was discharged, the creditor would thereafter be precluded from proceeding against her after-acquired community property. Apparently finding very little authority, the court cited Collier as "the clearest statement of the purpose of this section, and therefore what Congress intended." Collier states:

> In short, Congress has chosen to grant fresh-start protection for after-acquired community property when *both* spouses are *innocent* of any wrong doing, although one spouse chooses not to file a bankruptcy case. In the other situation, when a *wrongdoer seeks to hide behind* his or her *spouse's discharge*, a partial *discharge for the non-debtor is denied*, and after-acquired community property remains liable for the debts of the non-discharged spouse thereby frustrating the innocent spouse's fresh start.

Inherited IRAs

On June 12, 2014, the U.S Supreme Court issued an opinion in Clark v. Rameker, 13-299 (2014). In that case the court affirmed a decision by the 7th Circuit determining whether an inherited IRA is exempt under 522(b)(3)(C) and, in 9-0 decision, concluded that it is ***not exempt***. I have all kinds of problems with this decision, but the Supremes have spoken and they get the final say. (Unless Congress disagrees and "overrules" the Supremes. Or the case is distinguishable on its facts. Or some brilliant lawyer can come up with something nobody thought of yet. Or…..)

Although Clark determined whether inherited IRAs are exempt ***under state law***, the decision also applies to whether inherited IRAs are exempt ***under 522(d)(12)***. Both statutes 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." The Clark court concluded that funds in an inherited IRA are not "retirement funds," although that term is not defined in either the Bankruptcy Code or the Internal Revenue Code.

Note that Texas Property Code Sec. 42.0021(a) specifically provides that inherited IRAs are exempt to the same extent as they would be in the hands of the original owner of the IRA. Notwithstanding this clear expression of state law, the Supremes sidestep the issue by simply saying that the funds are not retirement funds, so we never have to decide the issue of whether the funds are exempt under ERISA or state law.

In Clark, the IRA was inherited by a daughter from her mother. This is (potentially) significant because the IRC provides substantially different treatment for inherited IRAs if the beneficiary is the spouse of the decedent or if the beneficiary is someone other than a spouse. Although the Supremes held that inherited IRAs are not exempt, I would suggest that the actual holding is limited to cases

where the beneficiary is ***not a spouse***. In interpreting the phrase "retirement funds," the court ignored the substantial statutory framework contained in the IRC regarding various types of retirement plans , but because "retirement funds" is not a defined term, the court chose to defer to the 2000 edition of the American Heritage Dictionary. (Not even Black's.) In their construction, "retirement funds" are only retirement funds for the person who sets them aside for their own retirement. Apparently, none of the judges on the court has ever been in a long term, committed, loving relationship. In the real world, spouses save for "their" joint retirement, not for their individual retirements.

It appears clear that the "holding" in Clark is that funds inherited by someone ***other than a spouse*** are not retirement funds and are not exempt under 522 (b)(3)(C) or 522(d)(12), notwithstanding the court's unequivocal statement that "The text and purpose of the Bankruptcy Code make clear that funds held in inherited IRAs are not "retirement funds" within the meaning of 522(b)(3)(C)'s bankruptcy exemption." To the extent that the quoted statement extends to spouses it is dicta, not holding, and I would suggest is clearly open to dispute.

IRAs and Related Plans

The Supreme Court in Clark stated that the Bankruptcy Code allows a debtor to obtain a fresh start, in part by allowing "debtors to exempt from the estate limited interests in certain kinds of property" and that "exemptions serve the important purpose of 'protecting the debtor's essential needs.'" The court concluded that allowing an exemption for inherited IRAs "would convert the Bankruptcy Code's purposes of preserving debtors' ability to meet their basic needs and ensuring that they have a 'fresh start' into a free pass." The Supremes fail to mention 522(n) which allows an exemption for IRAs in the amount of $1,245,475, not including any rollovers. 522(m) provides that amount is doubled that in a joint filing. It is also worthy of note that 522(n) provides that the cap "may be increased if the interests of justice so require." Notwithstanding the court's concern that the exemption should be limited to provide for the debtors' "essential needs", the reality is that Congress has provided for an exemption far in excess of "essential needs." (And I want to hear the argument that the interests of justice "require" that a couple needs more than $2.5 million. I don't "require" that much for my retirement, but I should would like to have it.)

Texas Property Code Sec. 42.0021(a) exempts a wide variety of retirement plans, IRAs, HSAs, annuities and similar plans. (This includes inherited IRAs, but this may be preempted by the holding in Clark if the debtor files a bankruptcy case.) Never assume that retirement exemptions are limited to the Property Code. For instance, the Texas Government Code provides an exemption for Texas teachers which is broader than the Property Code exemption. The Government Code exemption applies not only to amounts in a retirement plan, but provides: "All retirement allowances, annuities, refunded contributions, optional benefits, money in the various retirement system accounts and right s accrued or accruing under this subtitle to any person are exempt from garnishment, attachment, state and municipal taxation, sale, levy, and any other process, and are unassignable." Tex. Govt. Code Sec. 821.005. I do not have a reported opinion on this issue, but I won this issue in In re Do,

12-11908-hcm-7 (Bankr.W.D.Tex.2013). In that case, the debtor withdrew $50,000 (+/-) just before filing Chapter 7. The funds were sitting in a bank account on the date of filing. Because we could show that all of the money was proceeds of teacher retirement, Judge Mott held that it was exempt.

Note that the Texas Government Code also provides for exemptions for retirement plans for many state and local retirement employees. See., e.g., Texas Government Code Sec. 851.006 which applies to municipal employees. The exemption is for "All retirement annuity payments, other benefit payments, and a member's accumulated contributions are unassignable and are exempt from execution, garnishment, attachment, and state and local taxation." See, also, Texas Government Code Sec. 811.005 which applies to state employees. The exemption is for "All retirement annuity payments, optional benefit payments, member contributions, money in the various retirement system funds, and rights accrued or accruing under this subtitle to any person are exempt from garnishment, attachment, state and local taxation, levies, sales, and any other process, and are unassignavle except as provided by Section 813.103." Note that neither of these statutes provides an exemption as broad as the exemption for teacher retirement funds. There are too many specific exemptions for me to research, but if you have s debtor who has significant funds in a bank account, you should look at the Texas Government Code to see if there is a specific exemption for your class of employee and whether or not it provided for an expanded exemption for amounts already distributed.

522(d)(10) and 522(d)(11)

522(d)(10) and (11) exempt the debtors' rights with respect to several categories listed below that we might not generally think of as "assets." And many of our clients absolutely do not think of them as assets. Disclosure is very important for several reasons. For instance, if it is not listed as an assets, it can't be claimed as exempt. If it is not disclosed, collateral estoppel may prevent the client from pursuing the claim. If the court concludes the omission was intentional, it may result in denial of the debtor's discharge.

Note that (d)(10) refers to the "debtor's right to receive" which suggests some form of future payment. If the debtor has already received the funds resulting from this type of claim, they may not be exemptible under this subsection. Note that (d)(11) refers to the "debtor's right to receive, or property that is traceable to" which would suggest that funds already received from these types of claims are protected in addition to funds which might be received in the future. This is an important distinction which your clients will not recognize.

Note also that (d)(10)(D), (d)(10)(E), (d)(11)B), (d)(11)(C), and (d)(11)(E) all contain a potentially significant limitation they all contain the phrase "to the extent reasonably necessary for the support of the debtor and any dependent of the debtor." I have never had to litigate the issue of what is reasonably necessary for the support of a debtor or a dependent of the debtor, and would suggest the issue would be very fact intensive and determined based upon the totality of the circumstances in each case. (I.e., the amounts involved, the particular needs of the debtor or dependent, whether those needs will continue or a temporary situation,…)

(10) The debtor's right to receive—

(A) a social security benefit, unemployment compensation, or a local public assistance benefit;

(B) a veterans' benefit;

(C) a disability, illness, or unemployment benefit;

(D) alimony, support, or separate maintenance, to the extent reasonably necessary for the support of the debtor and any dependent of the debtor;

(E) a payment under a stock bonus, pension, profitsharing, annuity, or similar plan or contract on account of illness, disability, death, age, or length of service, to the extent reasonably necessary for the support of the debtor and any dependent of the debtor, unless—

(i) such plan or contract was established by or under the auspices of an insider that employed the debtor at the time the debtor's rights under such plan or contract arose;

(ii) such payment is on account of age or length of service; and

(iii) such plan or contract does not qualify under section 401(a), 403(a), 403(b), or 408 of the Internal Revenue Code of 1986.

(11) The debtor's right to receive, or property that is traceable to—

(A) an award under a crime victim's reparation law;

(B) a payment on account of the wrongful death of an individual of whom the debtor was a dependent, to the extent reasonably necessary for the support of the debtor and any dependent of the debtor;

(C) a payment under a life insurance contract that insured the life of an individual of whom the debtor was a dependent on the date of such individual's death, to the extent reasonably necessary for the support of the debtor and any dependent of the debtor;

(D) a payment, not to exceed $22,975, on account of personal bodily injury, not including pain and suffering or compensation for actual pecuniary loss, of the debtor or an individual of whom the debtor is a dependent; or

(E) a payment in compensation of loss of future earnings of the debtor or an individual of whom the debtor is or was a dependent, to the extent reasonably necessary for the support of the debtor and any dependent of the debtor.

Social Security Benefits

42 USC Sec. 407 provides:

(a) In general

> The right of any person to any future payment under this subchapter shall not be transferable or assignable, at law or in equity, and ***none of the moneys paid or payable*** or rights existing under this subchapter shall be subject to execution, levy, attachment, garnishment, or other legal process, ***or to the operation of any bankruptcy or insolvency law***. [Emphasis added.]
> (b) Amendment of section
> No other provision of law, enacted before, on, or after April 20, 1983, may be construed to limit, supersede, or otherwise modify the provisions of this section except to the extent that it does so by express reference to this section.
> (c) Withholding of taxes
> [Not relevant to this article.]

522(d)(10)(A) exempts "the debtor's right to receive – a social security benefit…" The ***right to receive*** language suggests that it is intended to protect ***future*** benefits (there is no mention of ***"received"***), but the language of 407 is: (1) more specific; (2) says that it is not subject to the operation of any bankruptcy law; and (3) says that no other law may limit, supersede or modify that section unless it expressly refers to that section. 522(d)(10)(A) does not refer to 407.

Although social security benefits already received may be claimed as exempt, there will be tracing issues if the social security benefits are comingled with other funds. See Philpott v. Essex County Welfare Board, 93 S.Ct. 590 (1973). The debtor will have the burden of proof on what portion of the funds are social security benefits, so if there is sufficient time to plan, have the debtors open separate accounts for their social security benefits and their other (non-exempt) funds. (The debtor will want to spend the non-exempt funds rather than the exempt funds prior to filing.)

There is some dispute regarding whether a debtor electing federal exemptions under 522(d) may also claim other federal exemptions not included in the Bankruptcy Code. The majority of courts have held that a debtor may claim either (1) the federal exemptions contained in 522(d) or (2) state exemptions and other federal exemptions not provided for in 522(d). See, e.g., In re Treadwell, 699 F,2d 1050 (11th Cir.1983). Note that Treadwell was decided prior to the amendments to 407 which became effective April 20, 1983. By contrast, see In re Carpenter, 614 F.3d 930 (8th Cir.2010). In Carpenter, the court adopted the two tier analysis outlined above, but concluded "Sec. 407 must be read as an ***exclusion*** provision, which automatically and completely excludes social security proceeds from the bankruptcy estate, and ***not as an exemption*** provision which must be claimed by the debtor." [Emphasis added.]

Veterans Benefits

38 USC Sec. 5301(a)(1) provides:

> Payments of benefits due or to become due under any law administered by the Secretary shall not be assignable except to the extent specifically authorized by law, and such payments made to, or on account of, a beneficiary shall be exempt from taxation, shall be

> exempt from the claim of creditors, and shall not be liable to attachment, levy, or seizure by or under any legal or equitable process whatever, ***either before or after receipt by the beneficiary***. [Emphasis added.]

See Porter v. Aetna Casualty & Surety Co., 82 S.Ct. 1231 (1962), which held that veterans' benefits already paid were now held as funds in an account at a savings and loan were exempt from attachment.

522(d)(10)(B) exempts "the debtor's right to receive – a veterans' benefit."

I could not find a reported case on point which addressed the competing exemption schemes with respect to veterans' benefits. If a court were required to address the issue, it might be inclined to follow the Carpenter rationale, but I would note that there is a small but significant difference in the language of the statutes. 38 USC Sec. 5301(a)(1) uses the word "exempt", but 42 USC Sec. 407 does not.

Health Savings Accounts

Texas Property Code Sec. 42.0021(a) exempts, other things, "a person's right to the assets held in or to receive payments, whether vested or not, under… a health savings account." I was unable to find any reported case which addresses application of the Teas exemption statute for HSAs. This is a state law issue. Not every state has a statutory exemption for HSAs. See, e.g., In re Mooney, 503 B.R. 916 (Bankr.M.D.Ga.2014) which held that money in HSAs are not exempt under Georgia law.

There is no corresponding federal exemption. See, In re Leitch, 494 B.R. 918 (8th Cir. BAP [Minn.] 2013). In that case, the court held: (1) that funds in an HSA are not excluded from property of the estate under 541(b)(7)(A)(ii) as contributions to "a health insurance plan regulated by State law" and (2) that funds in an HSA are not subject to exemption under 522(d)(10)(C) ["right to receive a disability, illness or unemployment benefit"] or 522(d)(11)(D) ["right to receive a payment on account of personal bodily injury"].

Exemption for Certain Insurance and Annuity Benefits

Texas Insurance Code Sec. 1108.051 provides:

(a) Except as provided by Section 1108.053, this section applies to any benefits, including the cash value and ***proceeds*** of an insurance policy, to be provided to an insured or beneficiary under:

> (1) an insurance policy or annuity contract issued by a life, health, or accident insurance company, including a mutual company or fraternal benefit society; or
>
> (2) an annuity or benefit plan used by an employer or individual.

b) Notwithstanding any other provision of this code, insurance or annuity benefits described by Subsection (a):

> (1) inure exclusively to the benefit of the person for whose use and benefit the insurance or annuity is designated in the policy or contract; and
>
> (2) are fully exempt from:
>
> > (A) garnishment, attachment, execution, or other seizure;
> >
> > (B) seizure, appropriation, or application by any legal or equitable process or by operation of law to pay a debt or other liability of an insured or of a beneficiary, ***either before or after the benefits are provided***; and
> >
> > (C) *a demand in a bankruptcy proceeding of the insured or beneficiary.*
> >
> > [Emphasis added.]

Proceeds of an Insurance Policy for Damages to a Homestead

Apparently, the first case to address the issue of whether proceeds of a homeowners insurance policy are exempt was Cameron v. Fay, 55 Tex. 58 (1881) which simply concluded "…we are of the opinion that the proceeds of the policy of insurance upon the homestead, effected for its protection and preservation as such, should, for a reasonable time at least, be exempt for reimbursement in a new homestead which may or not be upon the same lot." This conclusion was based upon the general principle that "… the homestead exemption should be liberally construed according to its spirit and intention, and should not be defeated by too literal a construction."

Cameron v. Fay was followed by a subsequent Texas Supreme Court opinion in Swayne v. Chase, 30 S.W. 1049 (1895). Citing Cameron, the Swayne court stated: "That decision is vigorously attacked and severely criticised [sic], but, whatever may be said of it, an examination of the authorities will show that it is abundantly supported by the decisions of the ablest courts in the Union, and opposed by but few." Swayne, at 1050.

Swayne reviewed the history of the Texas homestead exemption and noted the following:

- In 1839 The Republic of Texas adopted a homestead exemption which included "one lot in a town, including the improvements, not to exceed in value $500."

- In 1845, the State of Texas adopted a homestead exemption which included "a lot or lots in a town or city not to exceed $2,000 in value." The $2,000 limit was construed to include the value of the improvements.
- In 1860, the State of Texas clarified that the $2,000 value limit applied to the lot or lots, but that no subsequent increase in the value of the homestead, "by reason of improvements or otherwise," would subject the homestead to forced sale.
- The effect of all of these changes was to increase protection of the homestead by increasing the area and value that could be protected.

Since Swayne, the Texas legislature has eliminated the value issue by changing the homestead limit to area rather than value.

Swayne has been followed by Texas courts for the more than a century. See, e.g., Johnson v. Hall, 163 S,W. 399 (Tex.Civ.App.—Texarkana 1914) and Price v. Price, (Tex.Civ.App.—Tyler 1965).

In In re Brooks, 415 B.R. 287 (Bankr.S.D.Tex.2009), the debtor received an insurance check for damage to his homestead, which he deposited in a bank account prior to filing. No other funds were deposited in the account, so there were no commingling issues. The Chapter 13 trustee objected to the debtor's claimed exemption focusing on the "to be provided" language in subsection 1108.051(a), contending that the exemption does not extend to benefits already provided. Judge Isgur overruled the objection holding that the more generous "***before or after the benefits are provided***" language in 1108.051(b)(2)(B) controlled.

More recently, there have been several cases where the issue was whether proceeds of litigation alleging failure of an insurance company to pay under the terms of the policy were protected. In In re Hill, 2011 WL 6936357 (Bankr.S.D.Tex.2011), the debtor and his spouse suffered damage to their homestead from Hurricane Ike on September 13, 2008. They made a claim on their homeowners' policy and their carrier paid them $5,000. They obtained estimates for the cost of repairs significantly higher than $5,000. On October 3, 2008 the debtor filed Chapter 13. In his schedules the debtor listed their homestead and claimed it as exempt, but he did not disclose a claim or potential claim against the insurance carrier and did not claim any such claim as exempt. In January, 2010 the debtor and his wife signed an engagement letter with a law firm pursuant to which the firm agreed to represent them in a dispute with their insurance carrier based upon a 40% contingency fee. On May 10, 2010, the firm filed suit on behalf of the debtor and his spouse against their insurance carrier in state district court.

On May 19, 2011, almost three years after the case was filed and a year after the state court suit was filed, the debtor amended his Schedule A to disclose the claim and amended his Schedule C to claim it as exempt, but with no dollar value listed. On June 3, 2011, approximately two weeks later, the case settled and the insurance carrier agreed to pay the Hills $27,000 and to pay $25,000 jointly to the Hills and their mortgage company. On June 22, 2011, the trustee filed an objection to the amended exemptions asserting that the asset was not exempt as a homestead but was simply a breach of contract claim.

After addressing jurisdictional issues under Stern v. Marshall 131 S.Ct. 2594(2011) which are not relevant here, the court next addressed whether the debtor should be estopped from amending his Schedule C almost three years after the filing. Citing In re Unruh, 265 Fed.App'x 148 (5th Cir.2008), the court stated that a debtor may be estopped from amending his exemptions if the court finds that he acted in bad faith. Judge Bohm concluded:

> Here, the Debtor acted inadvertently in failing to initially schedule his claim against Standard Insurance, and later failing to amend his Schedules in order to list the Lawsuit once it was filed. The Debtor was not intentionally deceptive; he is an unsophisticated individual whose testimony convinced the Court that he did not understand the need to notify the Court of his potential cause of action against Standard Insurance or the Lawsuit once it was filed. Based on the "difficult standard" necessary to show bad faith, the Debtor's failure to timely disclose his claim against Standard Insurance was a "mistaken failure" rather than deception." [Citation omitted.]

The court also went on to address the issue of whether the debtor would be estopped due to prejudice to creditors from the failure to disclose. This prejudice requires a showing that a creditor has changed its litigation posture based upon the position previously asserted by the debtor. There was no such evidence presented. (And based upon many years of practice, I would suggest that such evidence rarely exists and is almost never offered.) See, also, In re Colquitt, 2012 WL 3262764 (Bankr.S.D.Tex.2012) and In re Navarette, 2012 WL 3262759 (Bankr.S.D.Tex.2012), which reached the same result as Brooks and Hill.

Finally, see In re Carlew, 2012 WL 3002197 (D.S.D.Tex.2012) in which the trustee objected to the exemption of insurance proceeds because they were not reinvested in repairs to the homestead within 180 days, citing Texas Property Code Sec. 41.001(c) which exempts proceeds of a sale of a homestead. The Carlew court rejected this argument as the Texas exemption for proceeds only applies to proceeds of a sale. A claim for damages to a homestead has nothing to do with a sale of the homestead.

Practice Point: If the debtor has a claim under a homeowners' policy for damages to a homestead at the time of filing, we list it as an asset on B.35 and claim it as exempt using the Texas homestead exemption. If it a small enough amount, you may be able to wildcard it under 522(d)(5).

Practice Point: In many cases the deed of trust will give the mortgage company a security interest in any insurance proceeds for damage to its collateral and the mortgage company will be named as an additional loss payee. In that situation, the insurance check will be payable to both the homeowner and the mortgage company. List the mortgage company as a secured creditor on Schedule D with the collateral as the insurance claim. (In addition to listing the mortgage company as a creditor with a security interest in the home.)

Exemptions: Texas v. Federal v. Other State

In my practice, the key issue which decides whether a debtor claims state or federal exemptions is how much equity they have in their homestead, or whether they own a homestead. The Texas

homestead is limited by land area, not value, and we routinely see clients with substantial amounts of equity in their homestead. The federal homestead exemption is $22,975, or $45.950 in a joint case, so if the debtor(s) has more than those amounts, their homestead is at risk of sale to satisfy creditor claims. Most of my clients are more concerned about protecting their homestead and less concerned about protecting other assets.

Although the Texas exemptions are more generous overall with respect to personal property, the federal exemptions may be more generous under the facts of a debtor's case. 522(d)(5) allows a debtor to exempt $1,225 in "any property" and to exempt up to $11,487 of any unused amount of the homestead exemption. "Any property" can include cash, bank deposits, ESOPs, and stocks not in a qualified retirement plan. Texas exemptions do not protect any of those assets. If a debtor has no or minimal equity in a homestead ***and*** only basic household possessions ***and*** minimal equity in autos, the federal wildcard may allow them to protect substantial cash or cash equivalents.

Although the amounts that a debtor may exempt differ with respect to specific categories of personal property under 522(d)(2), (3),(4), (6), and (9) and Texas Property Code Sec. 42.002, they do protect substantially the same types of assets. For instance, 522(d)(4) allows a debtor to exempt up to $1,550 worth of jewelry ($3,100 for a couple), while 42.002(a)(6) allows a single person to exempt up to $7,500 and a member of a family to exempt up to $15,000 worth of jewelry.

I must say that I rarely see a true exemption fight in the sense of determining whether a specific type of asset qualifies for a specific exemption. Much more commonly I see cases where an inexperienced attorney claims an exemption which clearly does not apply or where an attorney fails to claim an exemption which should apply. (And, much to my dismay, I see far too many cases where a debtor does not disclose an assets based upon some nonsensical legal theory that it is not property of the estate. This debtor is not only risking the asset, but his discharge, as well. The particularly unsettling thing that these cases have in common is that the nonsensical legal theory was dreamed up by the lawyer, not the client.)

The reason this subheading includes "v. other state" is because of the 730 day residency requirement contained in 522(b)(3)(A). I still hear cases at 341 meetings where the attorney clearly did not ask the right questions as the debtor had resided in Texas for less than 730 days and either claimed Texas exemptions or federal when the debtor resided in an opt out state730 days ago. This can be a very large surprise to a client who has elected incorrect exemptions.

Objections to Amended Exemptions

The basic rule is that creditors and parties in interest have 30 days from conclusion of the creditors' meeting to object to the debtor's claimed exemptions or the claimed exemptions are allowed by operation of law. There is a potentially huge exception, however, as creditors get a second bite at the exemption apple as FRBP 4003(b)(1) also provides that if the debtor amends his/her schedules, creditors have 30 days from the filing of "any amendment to the list or supplemental schedules is

filed" to object to the debtor's claimed exemptions.

Courts have struggled with application of this rule where a debtor files a Schedule C, no one timely objects to the claimed exemptions and they are allowed by operation of law, but the debtor later amends or supplements Schedule C to disclose and exempt a previously undisclosed asset, and a creditor then objects to an exemption which was claimed and allowed in the first instance and was not impacted by the amendment.

The majority view has been that if the debtor files ***any*** amendment to Schedule C, that amendment allows creditors to object to ***any*** of the debtor's claimed exemptions, even if they were previously allowed and not affected by the amendment. There is no controlling authority in the Fifth Circuit, but there is a fairly recent case by Judge Gargotta that follows the majority view. See In re Woerner, 483 B.R. 106 (Bankr.W.D.Tex.2012). (I am not particularly fond of this ruling, but I cannot articulate a specific legal reason why it is wrong.)

Practice Tip: Do a better job of filing schedules in the first instance. If the debtor's Schedule C is never amended, the deadline to object to the amended exemptions is never extended. As a debtor's attorney, it is very important that we make a serious effort to interview (not interrogate) our clients to make sure that every asset is disclosed. This is most common where the "asset" is an unliquidated claim for personal injury or property damage or wrongful termination or employment discrimination or ………..

Practice Tip: My firm ***rarely*** amends our client's schedules. We try very hard to do them right the first time. If you do them right, you won't have to amend. Just saying.