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EXEMPTION ISSUES IN CHAPTER 7

I. Property of the Estate

- a. The first step in your analysis is to determine if the asset in question is property of the estate. (See attachment on page 9 of this outline)
- b. Property of the estate has a very broad definition found in 11 U.S.C. §541(a.) In short, property of the estate includes all legal or equitable interests of the debtor in property as of the commencement of the case.
 - 1. Examples include:
 - A. Accounts receivable. (see 11 U.S.C. §541(a)(1))
 - B. Improperly perfected liens. (see 11 U.S.C. §541(a)(3))
 - C. Causes of action, often personal injuries. (see 11 U.S.C. §541(a)(1))

II. Property Exempted from the Estate

- a. Step two; after you have determined that a specific asset is property of the estate, determine if the asset is covered by one of the state or federal exemptions which has the effect of removing property from the estate. (see 11 U.S.C. §522(b)(1))
- b. The State and federal exemptions are set forth in Wisconsin Statutes Chapter 815 and 11 U.S.C. §522(d) respectively.
- c. **Example**: The Debtors list in Schedule B an account receivable of \$2,000.00 owed to them. In Schedule C The Debtors exempt the entire \$2,000.00 value using 11 U.S.C \$522(d)(5) effectively removing this asset from the estate and preserving it for the debtors' benefit.

III. Exemption Errors and Property that Cannot be Exempted

a. The "Best Case" Glitch – Walters-Kluwer Law and Business produces bankruptcy software called Best Case Solutions. The software will allow the user to make two exemption errors.

- 1. 11 U.S.C. §522(d)(1) is the homestead exemption. This exemption allows a debtor to protect the equity in their home up to \$21,625.00 in value. IF the debtor does not use the full homestead exemption, she may apply up to \$10,825.00 of the <u>unused</u> homestead exemption to any of her other property interests. This unused portion of the homestead is generally referred to as the "wild card" exemption as set forth in 11 U.S.C. §522(d)(5). The problem: "Best Case" will allow the debtor to use the full \$21,625.00 homestead exemption <u>AND</u> an additional \$10,825.00 in "wild card" this is in direct contravention of 11 U.S.C. 522(d)(5). This produces crazy results that allow the debtor to double dip on the \$10,825.00. (See example on following page)
 - A. EXAMPLE: The debtor's homestead is worth \$100,000.00. The debtor owes \$78,375.00 on the first mortgage. Therefore, the equity in the debtor's home is \$21,625.00. The Debtor also has a checking account containing \$11,975.00. The debtor applies all \$21,625.00 of the homestead exemption (§522(d)(1)) to protect the equity in her home. The debtor has used all of her homestead and does not have any available to apply to her other property but the "Best Case" software has still allowed her to exempt all \$11,975.00. in the bank account. Unfortunately, \$10,825 has not been exempted and is now property of the estate.

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Case	T.T

Debtor(s)

SCHEDULE C - PROPERTY CLAIMED AS EXEMPT

Debtor claims the exemptionsI to which debtor is e (Check one box) 11 U.S.C. §522(b)(2) 11 U.S.C. §522(b)(3)	ntitled under: Check if debt \$146,450.*	or claims a homestead exe	mption that exceeds
Description of Property	Specify Law Providing Each Exemption	Value of Claimed Exemption	Current Value of Property Without Deducting Exemption
Real Property			
Homestead located at 1234 5th Street, Racine, WI 53403	11 U.S.C. § 522(d)(1)	21,625.00 100	
Checking, Savings, or Other Financial Acc	ounts, Certificates of Deposit		
Checking account at Bank	11 U.S.C. § 522(d)(5)	11,975.00	11,975.00
	Total:	33 600 00	111 975 00

Problem: under 11 U.S.C. §522(d)(1),(d)(5) the debtor is only entitled to a total combined exemption of \$22,775.00 but the software has allowed him to exempt \$33,600.00. This gives the appearance that the money in the debtor's bank account has been exempted when in reality \$10,825 has not been exempted and is now property of the estate. Schedule C should be carefully reviewed in every case in order to avoid a conversation in which you must tell your client to write a check to the trustee for \$10,825.00.

2. Motor vehicle error – 11 U.S.C. §522 (d) states as follows: the debtor may exempt an interest not to exceed \$3,450.00 in value, **in one motor vehicle**. One motor vehicle means **one motor vehicle**. You cannot apply \$2,000.00 to the debtor's Toyota and the remaining \$1,450.00 to the debtor's Ford pick-up truck. Once any portion of the \$3,450.00 has been applied, you cannot use any unused portion for another vehicle. Similarly, married debtors filing jointly each receive \$3,450.00 for a combined total of \$6,900.00. Husband may apply any portion of his \$3,450.00 to his Volkswagen Jetta and wife may also apply her full \$3,450.00 to the Volkswagen Jetta and the remaining \$2,900.00 to the family's Ford Focus.

The problem: the "Best Case" software will allow you to divide the \$3,450.00 into as many portions as you like to apply to multiple vehicles – this is in direct contravention of 11 U.S.C. §522(d)(2). No matter how many vehicles the debtor(s) may have, they can only use this exemption once per debtor. (See Examples on the two following pages)

- 3. Why does this happen? I spoke with a representative of Walters Kluwer Law and Business regarding this issue. He told me they are aware of both problems, and they have not corrected them for two reasons:
 - A. The unauthorized practice of law: The good people at Best Case Solutions are not attorneys, and they do not wish to be held liable for offering a legal opinion regarding the application of either of these laws. They believe it is their job to write the program and the lawyers' job to apply the law.
 - B. Too expensive to fix.: I was informed that to craft a fix for this problem in such a way that the user cannot apply more than the allowable value without treading on 50 different state laws regarding unauthorized practice would consume too much time and resources.
 - C. How to avoid this problem: Review Schedule C in every single case to ensure that the dollar value limits listed above have not been exceeded.

Case No.

Debtor(s)

SCHEDULE C - PROPERTY CLAIMED AS EXEMPT

Debtor claims the exemptions to which debtor is entitled under: (Check one box) 11 U.S.C. §522(b)(2) 11 U.S.C. §522(b)(3) Check if debtor claims a homestead exemption that exceeds \$146,450.*					
Description of Property	Specify Law Providing Each Exemption	Value of Claimed Exemption	Current Value of Property Without Deducting Exemption		
Automobiles, Trucks, Trailers, and Other Ve	ehicles				
2004 Ford Focus	11 U.S.C. § 522(d)(2)	2,900.00	2,900.00		
2002 Volkswagon Jetta	11 U.S.C. § 522(d)(2)	4,000.00	4,000.00		
	Total:	6,900.00	6,900.00		

Incorrect

Husband may apply any portion of his \$3,450.00 to his Volkswagon Jetta and wife may also apply her full \$3,450.00 to the Volkswagon Jetta. What these debtors cannot do is apply \$4,000.00 to the Volkswagon Jetta and the remaining \$2,900.00 to the family's Ford Focus.

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Ca	ase No.		

Debtor(s)

SCHEDULE C - PROPERTY CLAIMED AS EXEMPT

Debtor claims the exemptions to which debtor is ent (Check one box) 11 U.S.C. §522(b)(2) 11 U.S.C. §522(b)(3)	itled under: Check if debt \$146,450.*	or claims a homestead exe	mption that exceeds
Description of Property	Specify Law Providing Each Exemption	Value of Claimed Exemption	Current Value of Property Without Deducting Exemption
Automobiles, Trucks, Trailers, and Other Ve	ehicles		
2004 Ford Focus	11 U.S.C. § 522(d)(2)	2,900.00	2,900.00
2002 Volkswagon Jetta	11 U.S.C. § 522(d)(2)	3,450.00	4,000.00
	11 U.S.C. § 522(d)(5)	550.00	
	Total:	6,900.00	6,900.00

Correct

In the example seen above, the debtors have correctly applied the "wild card" exemption to cover the remaining value in the Volkswagen. The failure to correctly apply this exemption can become an issue when the debtor does not have sufficient "wildcard" value remaining to cover the value of the vehicle

- b. Non-marital Property Wisconsin is a marital property state. However, not all property is marital property. The exceptions to the general rule of marital property are set forth in Wis. Stat. §766.31(7)(a)-(f). A list of these exceptions can be found in the Addendum at the end of the materials. The two most common exemption areas regarding marital property are inheritance and personal injuries.
 - 1. Inheritance One of the most common exemption errors trustees see is as follows. A married debtor inherits \$20,000.00 from her mother, and she has not yet received the funds as of the date of filing. She then attempts to exempt the entire \$20,000.00 using 11 U.S.C. §522(d)(5) by applying her exemption and her spouse's exemption. **The problem:** Pursuant to 11 U.S.C. §522, a debtor may exempt **her** interest in property only. In Wisconsin, inheritance is not marital property [see Wis. Stat. §766.31 (7)(a)]. Therefore, the spouse does not have an interest in this property and cannot exempt it. This occasionally results in attorneys informing their clients that an expected inheritance can be fully exempted when, in fact, it is only partially exempted.
 - 2. Personal Injuries Personal injury damages resulting from pain and suffering are also an exception to marital property in Wisconsin (see Wis. Stat. §766.31(7)(f)). The problem: Debtors occasionally use not only their personal injury exemption but also their spouse's exemption (see 11 U.S.C. §522(d)(11)(D)). As is the case with inheritances, personal injury damages arising from pain and suffering are not marital property and cannot be protected with a spouse's exemption.
- c. Preferences A preference occurs when an insolvent debtor pays or gives security to a creditor all or part of the at creditors claim to the exclusion or detriment of other creditors. (See Black's Law Dictionary, Sixth Edition.) Preferences are defined in 11 U.S.C. §547(b). Common examples of preferences:
 - 1. Repayment These preferences are generally non-exemptible pursuant to 11 U.S.C. §§550, 551:
 - A. Payment to a personal creditor in excess of \$600.00 within 90 days of filing (see 11 U.S.C. §547(b)(4)(A)).
 - i. There is an exception to the payment preference rule stated above. Pursuant to 11 U.S.C. §522(g), the debtor may exempt and recover a preference to the extent that the transfer was not voluntary (garnishment) and not concealed.

- B. Payment to a friend, relative, or other insider of \$600.00 or more within one year of filing (see 11 U.S.C. §547(b)(4)(B)).
- C. A payment in a case filed by a debtor whose debts are not primarily consumer debts, the aggregate value of all property transferred to a creditor in excess of \$5,850.00 (see 11 U.S.C. \$547(c)(9)).

2. Improperly Perfected Liens:

- A. Mortgages This type of preference can occur when the lending institution or title company fails to properly record their mortgage within 30 days of execution (or never records it) and the debtor proceeds to file for bankruptcy within 90 days (see 11 U.S.C. §547(b)). When this situation arises, the trustee may step into the creditor's shoes and avoid the lien preserving its value for the benefit of the bankruptcy estate (see 11 U.S.C. §§550, 551). This is why trustees ask for recorded mortgages. Debtor's counsel should carefully review these documents for potential preferences **prior to filing.**
- B. Vehicle Titles The same process described above is also applicable to vehicle titles. If the bank or finance company has not recorded their lien upon the title within 30 days of execution, the vehicle may be subject to an avoidable preference (see 11 U.S.C. §547(b)). This is why trustees ask for vehicle titles. Debtor's counsel should carefully review these documents for potential preferences **prior to filing.**
- C. Case Law For an excellent discussion and analysis of a preference arising from an unrecorded lien, see <u>In re Moeri</u>, 300 B.R. 326 (Bkrtcy E.D. Wis., 2003)

ADDENDUM

11 U.S.C. §541(a) Property of the Estate

- (a) The commencement of a case under section 301, 302, or 303 of this title creates an estate. Such estate is comprised of all the following property, wherever located and by whomever held:
- (1) Except as provided in subsections (b) and (c)(2) of this section, all legal or equitable interests of the debtor in property as of the commencement of the case.
- (2) 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.
- (3) Any interest in property that the trustee recovers under section 329(b), 363(n), 543, 550, 553, or 723 of this title.
- (4) Any interest in property preserved for the benefit of or ordered transferred to the estate under section 510(c) or 551 of this title.
- (5) Any interest in property that would have been property of the estate if such interest had been an interest of the debtor on the date of the filing of the petition, and that the debtor acquires or becomes entitled to acquire within 180 days after such date -
- (A) by bequest, devise, or inheritance;
- (B) as a result of a property settlement agreement with the debtor's spouse, or of an interlocutory or final divorce decree; or (C) as a beneficiary of a life insurance policy or of a death benefit plan.
- (6) Proceeds, product, offspring, rents, or profits of or from property of the estate, except such as are earnings from services performed by an individual debtor after the commencement of the case.
- (7) Any interest in property that the estate acquires after the commencement of the case.

11 U.S.C. §522(d) Exemptions

- (d) The following property may be exempted under subsection (b)(2) of this section:
- (1) The debtor's aggregate interest, not to exceed \$15,000 in value, in real property or personal property that the debtor or a dependent of the debtor uses as a residence, in a cooperative that owns property that the debtor or a dependent of the debtor uses as a residence, or in a burial plot for the debtor or a dependent of the debtor.
- (2) The debtor's interest, not to exceed \$2,400 in value, in one motor vehicle.
- (3) The debtor's interest, not to exceed \$400 in value in any particular item or \$8,000 in

- aggregate value, in household furnishings, household goods, wearing apparel, appliances, books, animals, crops, or musical instruments, that are held primarily for the personal, family, or household use of the debtor or a dependent of the debtor.
- (4) The debtor's aggregate interest, not to exceed \$1,000 in value, in jewelry held primarily for the personal, family, or household use of the debtor or a dependent of the debtor.
- (5) The debtor's aggregate interest in any property, not to exceed in value \$800 plus up to \$7,500 of any unused amount of the exemption provided under paragraph (1) of this subsection.
- (6) The debtor's aggregate interest, not to exceed \$1,500 in value, in any implements, professional books, or tools, of the trade of the debtor or the trade of a dependent of the debtor.
- (7) Any unmatured life insurance contract owned by the debtor, other than a credit life insurance contract.
- (8) The debtor's aggregate interest, not to exceed in value \$8,000 less any amount of property of the estate transferred in the manner specified in section 542(d) of this title, in any accrued dividend or interest under, or loan value of, any unmatured life insurance contract owned by the debtor under which the insured is the debtor or an individual of whom the debtor is a dependent.
- (9) Professionally prescribed health aids for the debtor or a dependent of the debtor.
- (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, profit sharing, 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 \$15,000, 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.

(12) 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.

Exceptions to Marital Property Wis. Stat. §766.31(7):

- (7) Individual property after determination date. Property acquired by a spouse during marriage and after the determination date is individual property if acquired by any of the following means:
- (a) By gift during lifetime or by a disposition at death by a 3rd person to that spouse and not to both spouses. A distribution of principal or income from a trust created by a 3rd person to one spouse is the individual property of that spouse unless the trust provides otherwise.
- (b) In exchange for or with the proceeds of other individual property of the spouse.
- (c) From appreciation of the spouse's individual property except to the extent that the appreciation is classified as marital property under s. 766.63.
- (d) By a decree, marital property agreement or reclassification under sub. (10) designating it as the individual property of the spouse.
- (e) As a recovery for damage to property under s. <u>766.70</u>, except as specifically provided otherwise in a decree or marital property agreement.
- (f) As a recovery for personal injury except for the amount of that recovery attributable to expenses paid or otherwise satisfied from marital property and except for the amount attributable to loss of income during marriage.