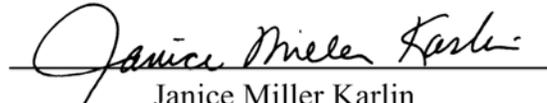


**SO ORDERED.**

**SIGNED this 7th day of May, 2015.**



  
Janice Miller Karlin  
United States Bankruptcy Judge

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**IN THE UNITED STATES BANKRUPTCY COURT  
FOR THE DISTRICT OF KANSAS**

**In re:  
Denise Annette Jones,**

**Case No. 14-40876  
Chapter 7**

**Debtor.**

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**Order Overruling the Trustee's Objection to Exemption and Denying the  
Trustee's Motion for Authority to Allocate  
Debtor's Federal Tax Refund**

The Chapter 7 Trustee, Robert L. Baer (hereinafter the "Trustee"), objects to the exemption of Debtor Denise Jones's earned income tax credit ("EIC") pursuant to § 60-2315 of the Kansas statutes. The Trustee argues Debtor has waived her exemption because she delayed claiming the exemption and because of her "pattern of inexcusable conduct."<sup>1</sup> Because Kansas does not recognize the waiver of state-created personal property exemptions based on the stipulated facts,<sup>2</sup> the Court overrules the Trustee's

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<sup>1</sup> Doc. 44.

<sup>2</sup> The facts detailed here are either stipulated to by the parties, *see* Doc. 54, or are present in the bankruptcy case record.

objection to exemption and denies his motion to allocate Debtor's federal tax refund.

## **I. Background and Procedural History**

This case has a convoluted procedural history, which impacts the substantive analysis of the issues. When Debtor filed her Chapter 7 bankruptcy petition on August 5, 2014, she did not claim an EIC exemption. Four months later, in December 2014 (and four months before any returns were due), the Trustee sent a letter to Debtor's attorney requesting that Debtor provide him a copy of her 2014 state and federal tax returns once they were filed. Debtor's attorney forwarded a copy of the Trustee's letter to Debtor. The Trustee also sent a tax refund intercept letter to the Internal Revenue Service ("IRS"), requesting that the IRS forward to him, as Trustee, Debtor's entire federal refund.<sup>3</sup>

In January 2015, Debtor prepared and filed her 2014 state and federal tax returns. On January 29, 2015, according to the Kansas Department of Revenue ("KDOR") website, the state sent Debtor her \$678 tax refund. Shortly thereafter, on February 12, 2015, the Trustee received Debtor's intercepted federal income tax refund of \$3855 from the IRS.

The same date the Trustee received the intercepted federal tax refund, he filed a motion to compel Debtor to provide him a copy of her tax returns. She supplied those

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<sup>3</sup> The form for Chapter 7 trustees to request intercept of a debtor's federal tax refund, titled "Application and Authorization for Internal Revenue Service Refund Turnover to Chapter 7 Trustee Pursuant to 11 U.S.C. § 542," is available at [http://www.justice.gov/ust/eo/private\\_trustee/library/chapter07/docs/ch7hb2012/Ch7\\_IRS\\_Refund\\_Turnover\\_Request\\_Form.pdf](http://www.justice.gov/ust/eo/private_trustee/library/chapter07/docs/ch7hb2012/Ch7_IRS_Refund_Turnover_Request_Form.pdf) (last visited May 7, 2015).

returns to the Trustee only five days later—on February 17, 2015, and as a result, the Trustee withdrew his motion to compel. Of the \$3855 federal tax refund, \$1548 is attributable to the EIC; none of the \$678 state tax refund is attributable to the EIC.

The next day, on February 18, 2015, the Trustee filed a motion (and an amended motion) for authority to allocate the federal tax refund between the estate, Debtor and Debtor's attorney.<sup>4</sup> Within his amended motion, the Trustee proposed to allocate the \$3855 in intercepted funds as follows: \$2100.44 to the bankruptcy estate, \$1000 to Debtor's attorney,<sup>5</sup> and the remainder (\$754.56) to Debtor.

Two days later, on February 20, 2015, Debtor filed an amended Schedule C, for the first time claiming her 2014 EIC as exempt.<sup>6</sup> The same date, Debtor also filed a response to the Trustee's motion to allocate the intercepted funds, arguing that his calculations failed to take into account Debtor's EIC exemption.<sup>7</sup>

In response to Debtor's amended Schedule C, the Trustee then promptly filed an objection to Debtor's EIC exemption, arguing that Debtor waived the exemption based on her delay in claiming it and her "pattern of inexcusable conduct."<sup>8</sup> Debtor responded that she should not be penalized for not knowing in advance of preparing

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<sup>4</sup> Docs. 35, 37.

<sup>5</sup> Debtor's attorney claimed a tax refund assignment for \$1000, a copy of which assignment was filed on the same date as the petition. Doc. 4.

<sup>6</sup> Doc. 39. This document states Debtor's 2014 EIC is \$1811, although the Court is unsure where this number comes from.

<sup>7</sup> Doc. 40.

<sup>8</sup> Doc. 44.

her tax returns that she would be able to claim the EIC exemption, and that the information was transmitted to the Trustee in a reasonable time.<sup>9</sup> Debtor also filed an amended response, informing the Court that her 2014 tax returns filed in January 2015 had to be amended, and that she was obligated to return \$687 of her federal refund to the IRS and \$85 of her state return to the KDOR.<sup>10</sup>

The parties have stipulated to the following computations regarding division of Debtor's 2014 federal tax returns. Based on the originally filed tax return, *without* considering the EIC exemption, the tax refund would be divided as follows: \$2100.44 to the bankruptcy estate, \$1000 to Debtor's attorney, and \$754.46 to Debtor. Based on the originally filed tax return, *with* the allowance of the EIC exemption, the tax refund would be divided as follows: \$1180.12 to the bankruptcy estate, \$1000 to Debtor's attorney, and \$1674.88 to Debtor. As pertinent here, Debtor's amended 2014 federal tax return reduced her EIC by \$384 and reduced her net refund by \$687. Debtor's amended 2014 state tax refund still shows no EIC, and Debtor's net refund is reduced by \$85.

To date, neither taxing authority has indicated they have accepted the amended tax returns or demanded repayment of the potentially overpaid portions of the 2014 tax refunds. In addition, neither entity has filed a proof of claim in Debtor's bankruptcy

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<sup>9</sup> Doc. 48.

<sup>10</sup> Doc. 50.

case to recover any portion of Debtor's 2014 tax refunds.<sup>11</sup>

## II. Analysis

The Trustee, as the party objecting to Debtor's exemption, bears the burden of proving that the exemption is not properly claimed.<sup>12</sup> Kansas has opted out of using the federal exemptions provided in 11 U.S.C. § 522,<sup>13</sup> and in 2011 created the following exemption of the EIC:

An individual debtor under the federal bankruptcy reform act of 1978 (11 U.S.C. § 101 et seq.), may exempt the debtor's right to receive tax credits allowed pursuant to section 32 of the federal internal revenue code of 1986, as amended, and K.S.A. 79-32,205, and amendments thereto. An exemption pursuant to this section shall not exceed the maximum credit allowed to the debtor under section 32 of the federal internal revenue code of 1986, as amended, for one tax year. . . .

Generally stated, bankruptcy courts "look to applicable state law when determining the validity of a debtor's claim to a state law exemption."<sup>14</sup>

The Trustee argues that Debtor waived her EIC exemption by her bad conduct in delaying to claim the exemption until after the Trustee had already intercepted her federal tax refund. All parties agree that the Supreme Court's 2014 opinion in *Law v. Siegel*<sup>15</sup> is the starting point for the analysis of this issue. The debtor in *Law* filed a

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<sup>11</sup> The Trustee filed a notice that Debtor's case was an asset case on October 20, 2014. Doc. 16.

<sup>12</sup> Fed. R. Bankr. P. 4003(c); *In re Westby*, 473 B.R. 392, 399 (Bankr. D. Kan. 2012).

<sup>13</sup> See *Westby*, 473 B.R. at 398–99 (discussing Kansas's opt-out from the federal exemption scheme and the adoption of the Kansas EIC exemption). All future statutory references are to title 11 of the United States Code, unless otherwise specified.

<sup>14</sup> *In re Hall*, 441 B.R. 680, 685 (10th Cir. BAP 2009).

<sup>15</sup> \_\_\_ U.S. \_\_\_, 134 S. Ct. 1188 (2014).

Chapter 7 bankruptcy petition and claimed the California homestead exemption for the equity in his home.<sup>16</sup> The debtor reported to the bankruptcy court, apparently inaccurately, that liens on his home exceeded the value of his house.<sup>17</sup> The alleged liens were ultimately found to be fraudulent, and the Chapter 7 trustee spent more than \$500,000 in attorney's fees overcoming the debtor's fraudulent misrepresentations.<sup>18</sup> The bankruptcy court permitted the Chapter 7 trustee to "surcharge" all of the debtor's \$75,000 California homestead exemption to help pay a portion of the fees.<sup>19</sup>

The Supreme Court acknowledged a bankruptcy court's general powers under § 105(a) and its inherent power to sanction abusive litigation practices, but stated that "in exercising those statutory and inherent powers, a bankruptcy court may not contravene specific statutory provisions."<sup>20</sup> The Court then concluded that the bankruptcy court's surcharge of the debtor's exemption was unauthorized because it contravened § 522 of the Bankruptcy Code, which permitted the debtor to claim his exemption under California's homestead exemption law and made exempt assets not liable for the payment of administrative expenses.<sup>21</sup> The Court expressly noted:

[Section] 522 does not give courts discretion to grant or withhold exemptions based on whatever considerations they deem appropriate.

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<sup>16</sup> *Id.* at 1193.

<sup>17</sup> *Id.*

<sup>18</sup> *Id.*

<sup>19</sup> *Id.*

<sup>20</sup> *Id.* at 1194.

<sup>21</sup> *Id.* at 1195.

Rather, the statute exhaustively specifies the criteria that will render property exempt. *See* § 522(b), (d). . . .

Moreover, § 522 sets forth a number of carefully calibrated exceptions and limitations, some of which relate to the debtor's misconduct. . . . The Code's meticulous—not to say mind-numbingly detailed—enumeration of exemptions and exceptions to those exemptions confirms that courts are not authorized to create additional exceptions.<sup>22</sup>

The Court ultimately concluded that no *federal law* provided “authority for bankruptcy courts to deny an exemption on a ground not specified in the Code.”<sup>23</sup>

The Supreme Court then noted, however, that “when a debtor claims a *state-created* exemption, the exemption's scope is determined by state law, which may provide that certain types of debtor misconduct warrant denial of the exemption.”<sup>24</sup> The Court opined that bankruptcy courts may, therefore, apply “state law to deny an exemption on a ground not specified in the Code.”<sup>25</sup>

As a result of the Supreme Court's recent holding in *Law v. Siegel*,<sup>26</sup> it is clear that there is no federal authority to deny Debtor's EIC exemption due to her alleged

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<sup>22</sup> *Id.* at 1196.

<sup>23</sup> *Id.* at 1197.

<sup>24</sup> *Id.* at 1196–97.

<sup>25</sup> *Id.* at 1197. The Supreme Court also pointed to a variety of other remedies that exist to respond to a debtor's misconduct, including 1) the denial of discharge provisions in the Code in § 727(a)(2) through (6); 2) the ability of a bankruptcy court to impose sanctions under Federal Rule of Bankruptcy Procedure 9011 for “bad-faith litigation conduct” or other litigation sanctions under § 105(a) or the court's inherent power; and 3) the possibility of criminal prosecution for fraudulent conduct. *Id.* at 1198. The Trustee does not seek any of these remedies here.

<sup>26</sup> The Tenth Circuit Court of Appeals has not yet addressed or analyzed the Supreme Court opinion in *Law v. Siegel*. The Tenth Circuit Bankruptcy Appellate Panel has addressed the case, but only as to whether it should be extended to deal with the recharacterization of a claim, *see Redmond v. Cimarron Energy Co. LLC (In re Alternate Fuels, Inc.)*, 507 B.R. 324, 333–34 (10th Cir. BAP 2014), an issue not present here.

bad faith delay in claiming the exemption. But, if the Trustee could point to some Kansas law that permits the exemption to be denied under these facts, then the Trustee could proceed.

The Trustee relies on three Kansas cases to support his position that Kansas would recognize waiver of the EIC exemption under the facts present herein. The first Kansas case cited by the Trustee is *Frey v. Butler*,<sup>27</sup> a very old Kansas Supreme Court case. In *Frey*, a judgment was obtained against a debtor, and the sheriff executed on that judgment by taking the debtor's horses and other personal property.<sup>28</sup> In Kansas at that time, an exemption existed for "a span of horses."<sup>29</sup> At the time of the sheriff's levy, the debtor informed the officer that he would *not* then claim his full exemption, and when the debtor later (but before sale) attempted to claim his full exemption, the sheriff claimed the debtor had waived the exemption.<sup>30</sup> The Kansas Supreme Court first noted that the claim of exemption was properly made because it was asserted prior to sale, further citing the "liberal view" in Kansas for claiming exemptions.<sup>31</sup> Importantly, the Court stated that, although it is possible for a debtor to waive his exemption, the mere silence or failure to assert the right to an exemption would "not

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<sup>27</sup> 52 Kan. 722 (1894).

<sup>28</sup> *Id.* at 722.

<sup>29</sup> *Id.*

<sup>30</sup> *Id.*

<sup>31</sup> *Id.*

ordinarily constitute a waiver.”<sup>32</sup> The Court went on to hold that “[u]nless the debtor has, by express declaration or unequivocal acts, waived the privilege, he may exercise it at any time prior to sale.”<sup>33</sup> In that case, because there had been no unequivocal waiver, and the debtor had left open the possibility of claiming the full exemption later—and did, in fact, claim the exemption prior to sale—there was no waiver.<sup>34</sup> The Trustee apparently discusses this case only for the proposition that it is *possible* for a personal property exemption to be waived in Kansas.

The Trustee next relies on *Iowa Mutual Ins. Co. v. Parr*,<sup>35</sup> a case that concludes that a Kansas debtor cannot waive his constitutionally established homestead exemption.<sup>36</sup> The Trustee cites the case for its brief discussion that Kansas personal property exemptions are established by statute and thus *could* be waived, and that an individual can dispose of exempt property as he or she wishes until that property is “seized” in execution.<sup>37</sup>

And finally, the Trustee relies on *State v. Goering*.<sup>38</sup> In *Goering*, a criminal case, the defendant was arrested for obstructing and ultimately assaulting officers who were

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<sup>32</sup> *Id.*

<sup>33</sup> *Id.*

<sup>34</sup> *Id.*

<sup>35</sup> 189 Kan. 475 (1962).

<sup>36</sup> *Id.* at 481–82.

<sup>37</sup> *Id.* at 478–79.

<sup>38</sup> 193 Kan. 307 (1964).

levying upon his personal property. He claimed the officers were unlawfully attempting to levy on exempt property.<sup>39</sup> The Court recognized prior decisions recognizing waiver of personal property exemptions: a debtor could sell exempt personal property, pledge exempt personal property as security, or turn over exempt personal property to an officer and permit sale of that property in satisfaction of a judgment execution.<sup>40</sup> The Court ultimately upheld the jury's finding that the defendant had waived his exemption in a vehicle when he told the officers that they could take the vehicle when they came to his property to execute the judgment at issue, and as a result, upheld the defendant's conviction for resisting the officers.<sup>41</sup>

As should be clear from this review of the case law relied upon by the Trustee, none of the cited cases actually support the Trustee's position on the stipulated facts of this case. The Trustee here sent a routine letter in December 2014 reminding Debtor to provide him copies of her 2014 tax returns once completed. This letter is a routine matter, presumably done in each and every one of the Trustee's cases, to timely remind debtors of their responsibility to provide a copy of pertinent tax returns to the Trustee. Debtor then filed her tax returns in January 2015, three months before they were due in April 2015. Within a month of learning she was actually eligible for the EIC, Debtor claimed the EIC exemption on February 20, 2015.

The cases cited by the Trustee all discuss the affirmative waiver of a personal

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<sup>39</sup> *Id.* at 307–08.

<sup>40</sup> *Id.* at 311.

<sup>41</sup> *Id.* at 311–12.

property exemption. The stipulated facts here simply do not constitute such a waiver. While it would have been preferable for Debtor to exempt her potential EIC earlier, Debtor was actually rather prompt in claiming the EIC upon learning that she was eligible for that exemption. Like in *Frey*, Debtor here properly claimed the exemption, as Federal Rule of Bankruptcy Procedure 1009(a) allows amendment of a debtor's exemptions on Schedule C "as a matter of course at any time before the case is closed."<sup>42</sup> And she made no "express declaration or unequivocal act" waiving that exemption.

The Trustee's reliance on *Iowa Mutual Ins. Co.* is also misplaced, as it provides no basis for finding a waiver here. There has been no seizure in execution of some judgment by the Trustee—the Trustee merely intercepted Debtor's tax refund, as the Trustee does regularly in all his Chapter 7 cases. Similarly, the *Goering* case is unhelpful to the Trustee, as this Debtor never affirmatively waived the exemption as the debtor did in that case.

The Court's independent research yields no Kansas case law supporting the Trustee's position here. As the Supreme Court has instructed that the Court must look to Kansas law to determine whether denial of a state-created exemption would be permitted based on the facts at issue,<sup>43</sup> and no such Kansas law is present supporting a finding of waiver based on the facts of this case, the Trustee's objection to exemption

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<sup>42</sup> See also *Calder v. Job (In re Calder)*, 973 F.3d 862, 867 (10th Cir. 1992) (stating that Rule 1009(a) permits amendment as a matter of course, but that amendment may be denied "if there is bad faith by the debtor or prejudice to creditors").

<sup>43</sup> *Law*, 134 S. Ct. at 1197.

must be denied. The Trustee has not carried his burden of proving that Debtor's EIC exemption is not properly claimed.<sup>44</sup>

Because the Trustee's motion to allocate Debtor's federal tax refund does not take into account Debtor's EIC exemption, it must also be denied. The Trustee should, within fourteen days, file a new motion to allocate and disburse Debtor's intercepted federal tax refund that takes into account Debtor's EIC exemption if he seeks to retain any portion of that refund for the estate.<sup>45</sup>

### **III. Conclusion**

The Trustee's objection to Debtor's exemption of the EIC<sup>46</sup> is overruled and his motion for authority to allocate Debtor's federal tax refund<sup>47</sup> is denied. If the Trustee intends to retain any portion of the intercepted refund, he shall file a new motion for authority to allocate Debtor's federal tax refund within fourteen days.

**It is so ordered.**

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<sup>44</sup> Fed. R. Bankr. P. 4003(c); *In re Westby*, 473 B.R. 392, 399 (Bankr. D. Kan. 2012).

<sup>45</sup> Debtor's brief did not address her amended tax returns or the amounts she may owe as a result thereof. As a result, the Court will likewise not address those amended returns here. The parties stipulate that neither the IRS nor the KDOR have accepted the amendments or demanded repayment, so the status of the amendments is in flux.

<sup>46</sup> Doc. 44.

<sup>47</sup> Doc. 35, as amended by Doc. 37.