

UNITED STATES BANKRUPTCY COURT

District of Arizona



EXEMPTIONS IN ARIZONA

May 2010

IMPORTANT WARNINGS

Neither the Bankruptcy Court nor the Clerk's office can give you legal advice. This pamphlet is not intended to give you legal advice, and is not a substitute for the legal advice specific to your situation that you should obtain from a qualified attorney. To find an attorney who has been certified as a specialist in bankruptcy, you may go to the State Bar of Arizona website at www.azbar.org, click on "Legal Resources" in the top menu bar, then click on "Find a Certified Specialist," and then click on "Bankruptcy."

This pamphlet addresses only the filing of bankruptcy cases by individuals and married couples. It does not address the very different chapters, law and rules that apply to bankruptcy cases filed by corporations, partnerships and LLCs (which, for example, cannot claim any property as exempt). If a corporation, partnership or LLC is considering filing bankruptcy, it will absolutely need a lawyer because the law of this Circuit is that such organizations can be represented in court only by a lawyer, not by a nonlawyer individual such as the president of the corporation.

One of the schedules of assets and liabilities which will be filed by the individual debtor is a schedule of “exempt” property, Schedule C. Federal bankruptcy law provides that an individual debtor can protect some property from the claims of creditors either because it is exempt under federal bankruptcy law or because it is exempt under the laws of the debtor’s home state. 11 U.S.C. § 522(b). Arizona is an “opt-out” state and has taken advantage of a provision in the bankruptcy law that permits each state to adopt its own exemption law, in place of the federal exemptions. Thus, those debtors filing bankruptcy in Arizona are allowed the exemptions as set forth in the Arizona statutes and federal non-bankruptcy statutes. Check the second box on the top of Schedule C (11 U.S.C. § 522(b)(3)), because Arizona law does not allow debtors to claim the exemptions provided by 11 U.S.C. § 522(d).

Legal counsel should be consulted to determine what property can be claimed as exempt and how to apply the value limitations found in the Arizona statuteAs of October 17, 2005, Arizona residents may claim the exemptions made available by Arizona law only if they were domiciled in Arizona for all of those two years before the bankruptcy filing. If the debtor was not domiciled in Arizona for all of those two years, then the debtor must claim the exemptions provided by the state where the debtor was domiciled for the greater part of the six months between two years and two and a half years before the bankruptcy filing. 11 U.S.C. § 522(b)(3)(A) (effective for cases filed after October 17, 2005). If the debtor is ineligible to claim exemptions provided by that state’s law, then the debtor may claim exemptions provided in Bankruptcy Code § 522(d), which are not listed in this pamphlet. Legal counsel must be consulted if the debtor was not an Arizona resident for all of the two years before filing bankruptcy.

| Asset | Exemption Description | Statutory Provision |
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| HOMESTEAD | Interest in real property upon which debtor's house sits, condominium or cooperative, mobile home, or mobile home in which debtor resides plus the land upon which the mobile home is located in the amount of \$150,000 . May not be doubled by husband and wife. | A.R.S. § 33-1101 |

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| <p>PERSONAL PROPERTY</p> <p><i>Husband and wife may double all personal property exemptions</i></p> | <p>Household furniture, furnishings and appliances personally used by debtor in an amount not to exceed \$4,000 (fair market value):</p> <ul style="list-style-type: none"> - one kitchen and one dining room table with four chairs each, plus one additional chair for each dependent of the debtor who resides in the household if the debtor and dependents exceed four in number - one living room couch - one living room chair, plus one additional chair for each dependent of the debtor who resides in the household - three living room coffee or end tables - three living room lamps - one living room carpet or rug - two beds, plus one additional bed for each dependent of the debtor who resides in the household - one bed-table, dresser and lamp for each bed allowed above - bedding for each bed allowed above - pictures, oil paintings and drawings, drawn or painted by debtor and family portraits in their necessary frames - one television set or radio or stereo - one radio alarm clock - one stove - one refrigerator - one washing machine - one clothes dryer - one vacuum cleaner | <p>A.R.S. § 33-1123</p> |
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| | All food, fuel and provisions for debtor's individual or family use to last up to six months | A.R.S. § 33-1124 |
| | All wearing apparel used primarily for personal, family or household purposes with a fair market value not to exceed \$500 | A.R.S. § 33-1125(1) |
| | All musical instruments for debtor's individual or family use with an aggregate fair market value not to exceed \$250 | A.R.S. § 33-1125(2) |
| | Domestic pets, horses, milk cows and poultry with a fair market value not to exceed \$500 | A.R.S. § 33-1125(3) |

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| | All engagement and wedding rings with a fair market value not to exceed \$1,000 | A.R.S. § 33-1125(4) |
| | Debtor's library, including books, manuals, published materials and personal documents not with a fair market value not to exceed \$250 | A.R.S. § 33-1125(5) |
| | One watch with a fair market value not to exceed \$100 | A.R.S. § 33-1125(6) |
| | One typewriter, one bicycle, one sewing machine, a family bible, a burial plot, one shotgun or one rifle or one pistol, with a fair market value not to exceed \$500 | A.R.S. § 33-1125(7) |

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| | One car with a fair market value not to exceed \$5,000 . If debtor is physically disabled, the fair market value of the motor vehicle shall not exceed \$10,000 . | A.R.S. § 33-1125(8) |
| | Professional prescribed prostheses for debtor or a dependent of the debtor, including a wheelchair | A.R.S. § 33-1125(9) |
| MONEY, BENEFITS OR PROCEEDS | Life insurance proceeds not to exceed \$20,000 if payable to surviving spouse or child upon the life of a deceased spouse, parent or legal guardian. | A.R.S. § 33-1126(A)(1) |
| | Minor child's earnings unless debt to be discharged was contracted for the special benefit of the minor child. | A.R.S. § 33-1126(A)(2) |

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| | Child support or spousal maintenance received pursuant to a court order. | A.R.S. § 33-1126(A)(3) |
| | All money, proceeds or benefits from employer health, accident, disability insurance benefits or similar employer benefit program | A.R.S. § 33-1126(A)(4) |
| | All proceeds from destruction of or damage to exempt property and all proceeds or benefits arising from fire or other insurance on exempt property. | A.R.S. § 33-1126(A)(5) |

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| | <p>Cash surrender value of life insurance policies where for a continuous unexpired period of two years such policies have been owned by a debtor and have named as beneficiary the debtor's surviving spouse, child, parent, brother or sister, or any other dependent family member, except for the amount of any premium that is avoidable by a creditor as a fraudulent transfer.</p> | <p>A.R.S. § 33-1126(A)(6) and A.R.S. § 20-1131(D) (effective April 20 2005)</p> |
| | <p>An annuity contract where for a continuous unexpired period of two years such contract has been owned by a debtor and has named as beneficiary the debtor, debtor's surviving spouse, child, parent, brother or sister, or any other dependent family member, except for the amount of any premium that is avoidable by a creditor as a fraudulent transfer</p> | <p>A.R.S. § 33-1126(A)(7)</p> |

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| | <p>Any claim for damages for levy upon or sale under execution of exempt personal property or for wrongful taking or detention of exempt personal property. Does not apply to annuities, nor to cash surrender values increased by premium payments made within two years in excess of the average annual premium paid during the previous three years.</p> | <p>A.R.S. § 33-1126(A)(8)</p> |
| | <p>Bank deposit not to exceed \$150. This sum is not exempt from normal service charges assessed by the bank holding the funds.</p> | <p>A.R.S. § 33-1126(A)(9)</p> |
| | <p>Benefits from ERISA-qualified retirement plan or deferred compensation plan except those amounts contributed within 120 days before a debtor files for bankruptcy. Does not apply to an alternate payee under a qualified domestic relations order. Does not apply to assets of bankruptcy proceedings filed before July 1, 1987. Not exempt from orders resulting from a judgment for child support arrearages or child support debt.</p> | <p>A.R.S. § 33-1126(B)</p> |

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| | <p>Prepaid rent, including security deposits as provided in § 33-1321(A) for debtor's residence, not exceeding the lesser of \$1,000 or 1½ month's rent where debtor has not claimed a homestead exemption. Not exempt from orders resulting from a judgment for child support arrearages or child support debt.</p> | <p>A.R.S. § 33-1126(C)</p> |
| | <p>Exemptions listed in § 33-1126 are not exempt property from orders resulting from a judgment for child support arrearages or child support debt</p> | <p>A.R.S. § 33-1126(D)</p> |
| | <p>Group life insurance policy or proceeds</p> | <p>A.R.S. § 20-1132</p> |

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| <p>SCHOOL EQUIPMENT</p> | <p>Library and philosophical and chemical or other apparatus used for instruction of youth in any university, college, seminary of learning, or school</p> | <p>A.R.S. § 33-1127</p> |
| <p>FIRE FIGHTING EQUIPMENT</p> | <p>All fire engines, hooks and ladders, with the carts, trucks, carriages, hose, buckets, implements and apparatus, all furniture and uniforms of any fire company or department formed under Arizona law</p> | <p>A.R.S. § 33-1128</p> |
| <p>PUBLIC PROPERTY</p> | <p>All court houses, jails, public offices, buildings, lots, grounds and personal property, the fixtures, furniture, books and papers and appurtenances belonging and pertaining to the jail and public offices belonging to any county or any city of this state and all cemeteries, public squares, parks and places, public buildings, town halls, markets, buildings for the use of fire departments and military organizations, and the lots and grounds thereto belonging and appertaining, owned or held by any town or city or dedicated by such town or city to health, ornament or public use, or for the use of any fire or military company organized under Arizona law</p> | <p>A.R.S. § 33-1129</p> |

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| <p>TOOLS AND EQUIPMENT</p> | <p>Tools, equipment, instruments and books of debtor or debtor's spouse primarily used and necessary to carry on the commercial activity, trade, business or profession of debtor or debtor's spouse, with a fair market value not to exceed \$2,500. Tools does not include a motor vehicle primarily used for personal, family or household purposes such as transportation to debtor's employment.</p> | <p>A.R.S. § 33-1130(1)</p> |
| | <p>Farm machinery, utensils, implements of husbandry, feed, seed, grain and animals belonging to debtor, with a value not to exceed \$2,500, where debtor's primary income is derived from farming</p> | <p>A.R.S. § 33-1130(2)</p> |
| | <p>All arms, uniforms and accoutrements required by law to be kept by a debtor</p> | <p>A.R.S. § 33-1130(3)</p> |

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| <p>WAGES, SALARY, COMPENSATION</p> | <p>Seventy-five percent (75%) of disposable earnings. Only one-half of disposable income may be claimed exempt in response to an order for support of any person. These exemptions do not apply in a Chapter 13 bankruptcy filing. “Disposable earnings” means that remaining portion of a debtor’s wages, salary or compensation for his personal services, including bonuses and commissions, or otherwise, and includes payments pursuant to a pension or retirement program or deferred compensation plan, after deducting from such earnings those amounts required by law to be withheld.</p> | <p>A.R.S. § 33-1131(B), (C), (D)</p> |
| <p>WAIVER</p> | <p>Waiver of exemption rights void and unenforceable unless specifically provided in § 33-1122 and when done with notice</p> | <p>A.R.S. § 33-1132</p> |
| <p>PENSIONS</p> | <p>Arizona Board of Regents members – benefits, annuities and employee and employer contributions established by the Arizona Board of Regents pursuant to A.R.S. § 15-1628</p> | <p>A.R.S. § 15-1628(I)</p> |

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| | IRAs | <i>In re Herrscher</i> , 121 B.R. 29 (D. Ariz. 1990) |
| | Police Officers Pension. Exemption does not apply to court orders which are the result of a judgment for arrearages of child support or for a child support debt. | A.R.S. § 9-931 |
| | Fire Fighters' Relief and Pension Fund and distributive portions therefrom. Exemption does not apply to court orders which are the result of a judgment for arrearages of child support or for a child support debt. | A.R.S. § 9-968 |
| | Arizona State Retirement System – state employee's survivor benefits before retirement | A.R.S. § 38-762 |

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| | Public Safety Personnel Retirement System – benefits, employee contributions or employer contributions, including interest, earnings and all other credits | A.R.S. § 38-850(C) |
| | Arizona Rangers’ Pension | A.R.S. § 41-955 |
| PUBLIC BENEFITS | Unemployment compensation benefits are exempt where proceeds are not commingled with other funds, except debts incurred for necessities furnished to the individual or his or her spouse or dependents during the time when the individual was employed | A.R.S. § 23-783 |
| | Workers’ compensation benefits | A.R.S. § 23-1068 |

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| | Welfare assistance benefits | A.R.S. § 46-208 |
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Federal Non-bankruptcy Exemptions

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| RETIREMENT BENEFITS | Government employees' retirement payments | 5 U.S.C. § 8346(a) |
| | Annuities paid to members of the armed services, based on retirement or retainer pay | 10 U.S.C. § 1440 |
| | Foreign service employees – Benefits, annuities, or payments to survivors of foreign service employees under the Foreign Service Retirement and Disability System | 22 U.S.C. § 4060(c) |

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| | Special pensions awarded to persons on the Army, Navy, Air Force and Coast Guard Medal of Honor roll | 38 U.S.C. § 1562(c) |
| | Payments of benefits due or to become due under any law administered by the Veterans' Administration | 38 U.S.C. § 3101 |
| | Retirement annuities paid pursuant to the Railroad Retirement Act of 1974, 45 U.S.C. §§ 231 et seq. | 45 U.S.C. § 231m |
| | Social security benefits | 42 U.S.C. § 407 |

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| | Central Intelligence Agency retirement benefit payments | 50 U.S.C. § 403 |
| SURVIVORS' BENEFITS | Military survivor annuities paid pursuant to the Survivor Benefits Plan | 10 U.S.C. § 1450(i) |
| | Annuities paid to survivors of a Justice or judge of the United States, a Director of the Administrative Office of the United States Courts, a Director of the Federal Judicial Center, or an administrative assistant to the Chief Justice of the United States. | 28 U.S.C. § 376(n) |
| | Benefits paid to surviving spouses of lighthouse service personnel | 33 U.S.C. § 775 |

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| DEATH & DISABILITY BENEFITS | Disability and death benefits paid to federal government employees as a result of work injuries | 5 U.S.C. § 8130 |
| | 75% of earned but unpaid wages | 15 U.S.C. § 1673 |
| | Death and disability payments paid pursuant to the Longshoremen's and Harbor Workers' Compensation Act | 33 U.S.C. § 916 |
| | Seamen's clothing | 46 U.S.C. § 1110 |

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| | Seamen's wages exempt except from execution other than for the support of a spouse or minor children | 46 U.S.C. § 1111(a) |
| | Compensation paid for injury or death resulting from a war risk hazard under the War Hazards Compensation Act, 42 U.S.C. § 1701 et seq. | 42 U.S.C. § 1717 |
| MONEY, BENEFITS, PROCEEDS | A United States service member's deposits in a savings institution while the depositor is on permanent duty outside of the United States | 10 U.S.C. § 1035(d) |
| | Payments of benefits due or to become due under Servicemen's Group Life Insurance or Veterans' Group Life Insurance | 38 U.S.C. § 770(g) |

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| | Benefits due or to become due under servicemen's group life insurance | 38 U.S.C. § 1970(g) |
| | Veterans' benefits | 38 U.S.C. § 5301(a) |
| | Exempts from offset by federal government agencies an amount not to exceed \$9,000 owing to a debtor under the Social Security Act, the Black Lung Benefits Act, or laws administered by the Railroad Retirement Board. | 31 U.S.C. § 3716(c)(3)(A)(i) |

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| | The Secretary of Treasury “shall exempt from administrative offset ... payments under means-tested programs when requested by the head of the respective agency,” and the Secretary is given discretion to exempt from administrative offset such other payments that are requested for exemption by the “head of a payment certifying agency.” | 31 U.S.C. § 3716(c)(3)(B) |
| | Railroad workers’ unemployment insurance benefits | 45 U.S.C. § 352(e) |
| PERSONAL PROPERTY | Personal property exempted from levy for collection of federal taxes | 26 U.S.C. § 6334 |

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| | Property of organizations designated by the President of the United States as being entitled to the privileges, exemptions, and immunities provided by the International Organizations Immunities Act (22 U.S.C. §§ 288, et seq.) | 28 U.S.C. §§ 1609-1611 |
| MISCELLANEOUS | Credits given to members of the Klamath Indian tribes in Oregon by the Secretary of the Interior | 25 U.S.C. §§ 543, 545 |
| | Money accruing from any lease or sale of lands held in trust by the United States for any Indian. | 25 U.S.C. § 410 |

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| | Homesteads purchased out of the trust or restricted funds of individual Indians from taxation and title to such homesteads shall be held subject to restrictions against alienation or encumbrance except with the approval of the Secretary of the Interior. | 25 U.S.C. § 412a |
| | Debts incurred by a seaman while on a voyage | 46 U.S.C. § 11111 |

ARIZONA BANKRUPTCY AMERICAN INNS OF COURT

Exemption Planning

Team One

5501 North Hacienda Del Sol Road
Tucson, AZ 85718

November 8, 2012

Alec Baldwin and Bob Basinger

A lawyer (Jim Cross) is meeting with his clients, Alec Baldwin (Cody Jess) and his brother-in-law, Bob Basinger, Kim Basinger's brother (Robert Warnicke). Alec and Bob own a company, Wonka's Wiggly Widgets ("WWW"). WWW manufactures undulating widgets. Alec and Bob each own 50% of WWW. WWW is operated out of Bob's house. After investigation, the FDA has determined that certain of the materials WWW uses to manufacture its widgets contain ridiculously high levels of lead, arsenic, and melamine. As such, WWW's operations have come to a standstill, causing WWW serious financial problems. Bob and Alec are therefore thinking about putting WWW in Chapter 11. Additionally, Bob is also thinking about filing for Chapter 7 because he has guaranteed a significant amount of WWW's debt. Alec is concerned about what is going to happen to his interest in WWW if both WWW and Bob file for bankruptcy, while Bob is wondering what property he gets to keep if he files.

QUESTION 1

Bob has patented certain procedures WWW uses in manufacturing widgets. Are those patents exempt if both Bob and WWW file for bankruptcy?

- A. Yes, both WWW and Bob may claim the patents as exempt under Arizona law.
- B. Yes, but only WWW may claim the patents as exempt under Arizona law.
- C. Yes, but only Bob may claim the patents as exempt under Arizona law.
- D. No, neither WWW nor Bob may claim the patents as exempt under Arizona law.

QUESTION 2

Because WWW is operated out of Bob's house, and because Bob has a big family, Bob has significant food, fuel, and utility bills each month. Bob would like to prepay for some of those items and services before filing. May Bob do so?

- A. Yes, Bob can prepay all those expenses, but only enough to cover six months' worth of food, fuel, and provisions for his family.
- B. No, the only exemption Bob may legitimately claim is any food, fuel, or provisions that he has on hand, for his or his family's use, as of the petition date.
- C. Yes, Bob can prepay all those expenses to cover six months' worth of food, fuel, and provisions for his family, as well WWW's expenses for a six month period.
- D. No, Bob is not entitled to any exemption for food, fuel, and provisions.

QUESTION 3

Bob owns two significant life insurance policies: one policy names his adult, nondependent daughter as the beneficiary, while the other names Alec as the beneficiary. If Bob files for Chapter 7 bankruptcy, may Bob claim the life insurance policies as exempt?

- A. Yes, Bob may claim both policies as exempt.
- B. No, Bob may only claim the policy on Alec as exempt.
- C. No, Bob may only claim the policy on his daughter as exempt.

- D. No, Bob may not claim either policy as exempt.

QUESTION 4

Due to having a brother-in-law as the official spokesman for the Capital One Venture Card®, Bob has accumulated 100,000 credit card bonus points that are worth about \$500. Are those bonus points exempt? If they are not exempt, may Bob legitimately trade them the night before he files for bankruptcy for a \$500 shotgun he's been eyeing, and claim the shotgun as exempt?

- A. Yes, the credit card bonus points are exempt.
- B. No, the credit card bonus points are not exempt.
- C. No, the credit card bonus points are not exempt, and Bob may not legitimately trade them for the shotgun and claim it as exempt.
- D. No, the credit card bonus points are not exempt, but Bob may legitimately trade them for the shotgun and claim it as exempt.

QUESTION 5

Part of Bob's house, and, most upsetting to Bob, his comic book collection, were damaged when one of the widget manufacturing machines exploded. Bob has filed a claim with his insurance company and expects a large check any day now. Are the insurance proceeds exempt?

- A. Yes, but only as far as the damage to Bob's comic book collection is concerned.
- B. Yes, but only as far as the damage to Bob's house is concerned.
- C. Yes, the entire amount of the insurance proceeds are exempt.
- D. No, none of the insurance proceeds are exempt.

Brad Pitt and Angelina Jolie-Pitt

Angelina Jolie-Pitt and Brad Pitt (recently married at their house in France) moved from California to Arizona two years and one day prior to coming to see you for advice on filing for bankruptcy. The couple has six children, with one on the way.

Prior to moving to Arizona two years ago, Mr. and Mrs. Jolie-Pitt split their time between their homes in Beverly Hills, California, New Orleans and France. The Beverly Hills home is currently rented (“California Property”). Their current home in Paradise Valley, Arizona (“PV Property”) was purchased two years ago.

The lease for the California Property expires in six months. The current rent is \$5,000 per month which Mr. and Mrs. Jolie-Pitt have received and use to pay the mortgage of \$4,500/month. There is no assignment of rents clause in the deed of trust on the California Property. The California Property has equity of approximately \$50,000. They want to move back to California in the next two years because they do not like the summer heat in Arizona, and want to keep the house in Beverly Hills. The Arizona property is located in PV and has minimal equity. The home in New Orleans is leased by the couple. The home in France has no equity in excess of the \$5,000,000.00 lien.

Mr. Pitt recently began working as designer in Arizona specializing in eco-friendly homes, as he did in New Orleans after hurricane Katrina. His income has dropped dramatically in the last two years since his break from acting to focus on his true passion of architecture. Mrs. Jolie-Pitt’s income has also decreased due to the time she has spent away from acting to have children, adopt children and to work as an UN Ambassador.

Mr. and Mrs. Jolie-Pitt have the following assets (with corresponding liability listed for each):

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| California Property: | \$2,000,000.00 |
| Equity: | \$50,000 |
| Rental Income: | \$500/month (net) |
| PV Property: | \$1,500,000.00 |
| Mortgage: | (\$1,450,000.00) |
| Equity: | \$50,000 |
| France Property: | \$5,000,000.00 |
| Mortgage: | (\$5,010,000.00) |
| Joint Checking Account: | \$300.00 |
| Joint Savings Account: | \$100,000.00 |
| Pitt’s 401k Plan: | \$500,000.00 |
| Pitt’s 401k Plan Loan: | (\$300,000.00) |

QUESTION 6

Brad: Can we claim the home in the Beverly Hills exempt as our homestead, even though we haven't lived there for two years, since we intend to move back there?

- A. Yes, because they intend to reside there.
- B. Yes, because even though they live in Arizona, they travel to and reside in the California property a few weeks each year
- C. No, because Arizona has a residency requirement that prohibits a debtor from claiming real property located in another state exempt as a homestead

QUESTION 7

Angelina: If we cannot claim the Beverly Hills house exempt, what will happen to it? Can we keep it even though there is \$50,000 of equity and \$500 per month in net rental income?

- A. No, the Trustee will sell the house and request turnover of all rental income
- B. No, once the Trustee collects the rent, the lender will likely obtain relief from the stay and foreclose on the property even though there is equity in it
- C. Yes, the equity is only \$50,000 and the Trustee will likely not want to hassle with finding a California broker
- D. Yes, if Debtors make a reasonable offer to the Trustee for the equity (depending on the Trustee of course) and cooperate in turning over the rental income to the Trustee in the meantime

QUESTION 8

Brad: Can we take out a loan against the California property to eliminate the \$50,000 in equity so that we can keep it?

- A. Yes. You can borrow money from a relative or friend for the amount of equity in the Property and use that money to pay down the 401k Loan or the mortgage on the Arizona property. You would then give the lender a note and deed of trust secured against the California property.
- B. No. You may not take out more debt prior to filing bankruptcy.
- C. I cannot provide any advice on that matter.

QUESTION 9

Angelina: What about the money in our savings account? Can we keep that? If not, what are our options?

A. No, you are only allowed up to \$300 in a bank account between the two of you.

Yes – Select from the following options:

B. Debtors can keep it by transferring the funds to their six children's bank accounts until a few months after filing. Then Debtors can transfer the funds back to your account.

C. Debtors can transfer the funds to Jennifer Aniston to hold for them until the case is over and contend it is payment pursuant to Brad's divorce/settlement agreement with Ms. Aniston. Given all of the tabloid stories about the ill feelings between you, the Trustee will likely not question this.

D. Debtors can repay the 401k Loan

E. Debtors can pay down the mortgage on the Arizona Property

F. Both D & E above.

G. None of the above.

Tom Cruise and Katie Holmes

Tom and Katie Cruise, both natives of Arizona, have been married for over 25 years. They have lived in Fountain Hills, Arizona since they were married and enjoyed the financial perks of Tom Cruise's former employment as Vice President of Sales for Dream Homes. In addition to caring for their 3 children, Katie Cruise has taken her hobby of taking pictures of their children and turned it into a small wedding photography and videographer business. Katie Cruise operates her "Capture the Memories Forever" business out of their home, and usually has 1 to 2 events per month. Due to the decline of real estate sales and new construction, Tom Cruise was terminated from Dream Homes.

About 2 years ago, unable to find a job in Arizona, Tom Cruise took a job with Go Green Now, selling solar panels in California. Tom Cruise rented a small apartment in California, obtained a California driver's license, and opened a bank account with California Credit Union. Tom Cruise travels between California and Arizona on the weekends to see his family. Go Green Now pays its employees on a commission basis with the premise that everyone will be investing on "green" alternatives. Tom and Katie Cruise increased their dependency on credit cards to maintain their former lifestyle and not wanting to deplete their "nest egg" they worked so hard to maintain while Tom Cruise worked at Dream Homes.

The time apart and continued financial struggles of Tom and Katie Cruise have taken a toll and they have determined that they cannot reconcile their marriage. Tom and Katie Cruise schedule a consultation with Attorney Flat Fee to determine what their options are if they were to file bankruptcy.

Assets:

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| 5321 Hollywood Drive, AZ | \$350,000.00 |
| Mortgage: | \$60,000.00 |
| Checking Account: | \$3,000.00 |
| Savings Account: | \$10,000.00 |
| Money Market Account: | \$40,000.00 |
| Photography / Video Equipment: | \$5,000.00 |

QUESTION 10

Tom: *Can you file bankruptcy for us?*

- A. Yes if Attorney Flat fee informs Tom and Katie of the potential of a future conflict of interest and effect of a joint filing under Chapter 7, 13, or 11.
- B. No Attorney Flat Fee should never represent Tom and Katie jointly.
- C. Tom and Katie should file divorce first, then seek separate counsel to file bankruptcy.
- D. Yes only if Tom and Katie qualify to file to Chapter 7.

QUESTION 11

Katie: *Will I be able to keep my photography equipment?*

- A. Yes Katie and Tom may claim up to \$5,000.00 for the photography equipment.
- B. No Katie only uses the equipment for a hobby.
- C. Yes, but only equipment up to an aggregate value of \$2,500.00

QUESTION 12

Tom: *What if we set up an account for our kids, you know like one of those 529 Plans? Can we protect the money in the 529 account?*

- A. Yes the 529 Plan is a qualified plan under the Internal Revenue Code; therefore, it is excluded from the bankruptcy Estate.
- B. No transfers into a 529 Plan are not protected.
- C. Yes if there have been no contributions to the 529 plan the two years prior to the petition date.

QUESTION 13

Tom: *Can Katie and I claim the Arizona property as our joint homestead?*

- A. Yes because Tom intends on moving back to Arizona.
- B. No because Tom has not procured employment in Arizona.
- C. Katie can, but Tom must use California's exemptions.
- D. Katie can, but Tom must use Federal Exemptions.

**ARIZONA BANKRUPTCY AMERICAN INNS OF
COURT**

Exemption Planning

Team One

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November 8, 2012

I. Introduction.

Before one can even start to “exemption plan¹”, you must determine which exemptions are applicable to the Debtor(s) potential bankruptcy filing. On or about July 31, 1980, Arizona opted out of the use of 11 U.S.C. § 522(d)². Coincidentally this enactment by the State of Arizona and many other states was within four years of the enactment of the 1978 Bankruptcy Code.

“Notwithstanding subsection, in accordance with 11 U.S.C. 522 (b), residents of [Arizona] are not entitled to the federal exemptions provided in 11 U.S.C. 522 (d). Nothing in this section affects the exemptions provided to residents of [Arizona] by the constitution or statutes of [Arizona].”

See A.R.S. § 33-1133(B).

Although commonly utilized to mean the same thing, one must determine the debtor(s)' domicile v. residence when evaluating which exemptions to apply. Courts have utilized several factors to determine a debtor(s)' domicile: location of debtor(s)' including: location of family property; employment; bank accounts; voter registration; vehicle registration; or membership to certain organizations³.

To provide potential debtor(s) with effective exemption planning, the potential debtor(s) must be made aware of the necessity of full and complete disclosure of all their property whether it is personal, real, or intangible⁴. Not only must the potential debtor(s) be made aware of their duty to disclose; but also the sanctions that could be imposed for failing to disclose, such as (i) loss of otherwise allowable exemptions⁵; (ii) denial of discharge; or fine and/or imprisonment⁶.

II. Bob and Alec.

Tools of Trade.

Bob may be able to claim the patents as exempt under Arizona law. If Bob, and not WWW, owns the patents, he may be able to claim them as "tools of the trade" and exempt under A.R.S. § 33-1130(1). A.R.S. § 33-1130(1) provides that tools, equipment, instruments and books of a debtor, or a debtor's spouse, primarily used and necessary to carry on the commercial activity, trade, business or profession of a debtor or a debtor's spouse are exempt. Bob's exemption in the patents is, however, capped at a fair market value not to exceed \$2,500. *Id.*

¹ Exemptions In Arizona enclosed in materials.

² A.R.S. § 33-1133(B).

³ In re Tanzi, 297 B.R. 607 (9th Cir. BAP).

⁴ 11 U.S.C. § 521.

⁵ 11 U.S.C. § 522(g); *See Also In re Tetrosine*, 2012 WL 4070038 (Bankr.D.Alaska).

⁶ 18 U.S.C. § 152.

WWW, a limited liability company, is not ordinarily entitled to exempt any of its assets. There are, however, certain exceptions, including A.R.S. § 33-1128 ("[a]ll fire engines, hooks and ladders, with the carts, trucks, carriages, hose, buckets, implements and apparatus appertaining thereto, and all furniture and uniforms *of any fire company* or department *organized under any law of this state* shall be exempt from execution, attachment or sale on any process issued from any court.") (emphasis added).

Although the Bankruptcy Appellate Panel of the Ninth Circuit held that under California law, patents are not automatically exempt (*In re McCarthy*, BAP CC-07-1083-MOPAD, 2008 WL 8448338, at *15 (B.A.P. 9th Cir. Feb. 19, 2008), the B.A.P. did not directly decide the issue, nor has any Arizona court. Given the liberality of the exemption statutes, the patents may be exempt. "Under either federal or state law, exemptions are to be liberally construed in favor of the debtor who claims the exemption." *In re Thiem*, 443 B.R. 832, 837 (Bankr. D. Ariz. 2011) (citing *In re Arrol*, 170 F.3d 934, 937 (9th Cir.1999); *Gardenhire v. Glasser*, 26 Ariz. 503, 503, 226 P. 911, 912 (1924); *In re Herrscher*, 121 B.R. 29, 31 (Bankr. D. Ariz. 1989) (citing A.R.S. § 1-211(B) ("[s]tatutes shall be liberally construed to effect [sic] their objects and promote justice."))). "The exemption laws in Arizona 'were not created merely for the purpose of conferring a privilege on a debtor, but to shelter the family and thereby benefit the state.'" *In re Thiem*, 443 B.R. at 837-38 (quoting *In re Hummel*, 440 B.R. 814, 820 (B.A.P. 9th Cir. 2010) (quoting *In re Foreacre*, 358 B.R. 384, 390 (Bankr. D. Ariz. 2006))).

More specifically, courts in the Ninth Circuit have held that the "tools of the trade" exemption should be broadly construed.

'In this age when it is extremely common, especially for those experiencing financial difficulties, to work at two jobs or trades, recognizing a broader tools of the trade exemption would appear to constitute a more realistic means of encouraging the fresh start policies of the Code . . . [T]he legislature has inserted an express device in the statutes to prevent debtor abuse in the form of the dollar limitations on the value of tools exempted. When this restriction on value is combined with the requirement noted in [*In re Robinson*, 206 F. 176 (D. Idaho 1913)] that the tools be actually used by a debtor in making a living, there is little room for abuse.')

In re Hairston, 95-02970, 1996 WL 34363079, at *4 (Bankr. D. Idaho Aug. 13, 1996) (quoting *In re Liebe*, 92 I.B.C.R. 145, 146 (Bankr. D. Idaho. 1992)).

'Because the term 'tools of the trade' is not defined by statute or legislative history, decisions among bankruptcy courts are inconsistent. Courts have based their analysis on such diverse rationale as the plain meaning of the word 'tool,' the value of the property in question, the interaction between the federal exemption and the lien avoidance statutes and the ratio of the property to the total capital

assets of the debtor . . . The [*In re*] *Bulger* [91 B.R. 129 (Bankr. M.D. Ala.1988)] court rejected all these tests in favor of the 'use' test set forth in *Walkington v. PCA*, 42 B.R. 67 (Bankr. W.D. Mich. 1984) . . . This quote 'use' test is compatible with Kansas exemption law . . . the Kansas Supreme Court accepted the 'use' test when it defined 'tools of the trade' as found in the Kansas exemption statute: '[4] tools and implements . . . [to come within] the operation of the statute . . . It is enough that they belong to the . . . [debtor], that they are necessary and are personally used for the purpose of the carrying on his trade or business.'

It is the view of this court that Congress intended [Section 522(f)(2)(B)] to have a common sense interpretation on a case by case basis with the key inquiry focusing on the necessity of an item to the individual debtor's particular business or employment . . . while cattle are not generally considered a 'tool' in common parlance, nevertheless 'the description of a object as a 'tool' necessarily implies a classification based upon that objects functional and utilitarian purpose in the hands of its owner or user.' . . . ***Congress did not place any limit on the kinds of property that may constitute a 'tool' since to do so would unfairly discriminate against particular professions and undermine the fresh start policy the Code seeks to promote.***

In re Stewart, 110 B.R. 11 (Bankr. D. Idaho 1989) (quoting *Heape v. Citadell Bank of Independence*, 886 F.2d 280 (10th Cir.1989)), and ultimately holding that horses were tools of the trade) (emphasis added).

Therefore, although the issue is only partially patent, it is likely that Bob may be able to claim up to \$2,500 of the value of the patents as exempt.

Food Fuel and Provisions.

Pursuant to A.R.S. § 33-1124, "[a]ll food, fuel and provisions actually provided for the debtor's individual or family use for six months are exempt from process." However, Bob may only claim as exempt such food, fuel, or provisions for his or his family's use that he "ha[s] on hand as of the petition date." *In re Gietl*, 4-09-BK-08828-EWH, 2009 WL 3872153, at *1 (Bankr. D. Ariz. Nov. 16, 2009). "Arizona law does not provide an exemption for . . . any receivable or prepaid deposit other than a bank deposit of \$150 and certain insurance and annuity proceeds." *In re Glimcher*, 458 B.R. 549, 550 n.1 (Bankr. D. Ariz. 2011).

In *In re Glimcher*, the debtor had purchased two Safeway grocery store gift cards in the amount of \$10,000 prepetition. The debtor did not schedule the gift cards, and upon the trustee discovering that the debtor had purchased them, the debtor claimed one of the gift cards as exempt. Rejecting the debtor's arguments that, among other things, Arizona law favors liberal construction of the exemption statutes, and that few individuals have the capability to store six months' worth of food, and that it would be dangerous to expect a debtor store six months' worth

of fuel, the court held that "[t]he legislature has been very explicit in identifying the specific assets, and form of assets, that are exempt. *Id.* at 551. Prepaid gift cards were not one of them. Looking at other states' exemption statutes, the court reasoned that "Arizona's limitation to food and fuel 'actually provided' was intended to exclude all potentially future food or fuel, whether in a potential state of 'growing' or a potential state represented by a gift card." *Id.* at 552.

As to the debtor's argument that it is impracticable and unsafe for a debtor to store six months' worth of food, fuel, and provisions, the court stated:

This unambiguous plain language meaning of the statute precludes the bankruptcy court from even considering the Debtor's argument that it is inconvenient to store six months' of food, and unsafe to store six months of fuel. It is not for a court, especially a federal court, to provide more convenient or safer exemptions than did the legislature. But even if that argument were to be considered, it would not be convincing. ***The Court may take judicial notice that many members of at least one religious faith that is prominent in Arizona do in fact store far more than six months of food. I myself routinely store more than six months' of fuel at my house, in a 500 gallon propane tank that is filled only about once per year.*** And when the exemption statute was first written in 1913, the legislature probably had in mind either coal or wood, which are not inherently dangerous to store. The limitation of the exemption statutes to the actual, present forms of assets is certainly not absurd, even if most debtors do not own such assets.

Id. (emphasis added).

Therefore, if both Judge Haines and Mitt Romney *et al.* can store six months' worth of provisions at their respective homes, so can Bob, which he must do if he is to claim the exemption under A.R.S. § 33-1124.

Life Insurance.

Bob may only claim the policy on his adult, nondependent daughter as exempt. A.R.S. § 33-1126(A)(7) provides that the cash surrender value of life insurance policies where, for a continuous, unexpired period of two years, such policies have been owned by a debtor and have named as beneficiary the debtor's surviving spouse, child, parent, brother or sister, or any other dependent family member, is exempt (except for the amount of any premium that is avoidable by a creditor as a fraudulent transfer). Although Alec is Bob's brother-in-law, he is not his familial brother, and there is nothing to suggest that Alec is dependent upon Bob (particularly given Alec's status as a multimillionaire celebrity). *See also* 11 U.S.C. § 101(45) (defining "relative" as an "individual related by affinity or consanguinity within the third degree as determined by the common law, or individual in a step or adoptive relationship within such third degree").

That Bob can claim the policy on his adult, nondependent daughter as exempt had been a given for many years. This changed when the Bankruptcy Appellate Panel of the Ninth Circuit issued its opinion in *In re Hummel*, 440 B.R. 814 (B.A.P. 9th Cir. 2010), *rev'd and remanded sub nom. In re Tober*, 688 F.3d 1160 (9th Cir. 2012). In *In re Hummel*, the B.A.P. held that the exemption in A.R.S. § 33-1126(A)(6) and (A)(7) applied only if the spouse, child, parent, brother, sister or other family member named as beneficiary of the insurance policy or annuity contract was a **dependent** of the debtor. Examining both the legislative history and the statute itself, the B.A.P. reasoned that the word "other" in the statute operated as a connecting modifier, referring to the dependent nature of both the residual class of family members **and** the family members delineated in the statute.

The debtors in *In re Hummel* appealed. Reversing the B.A.P., the Ninth Circuit Court of Appeals held in *In re Tober* that "the word 'other' in the text of this statute is a word of differentiation, establishing that a beneficiary can be either a listed beneficiary or some 'other' family member who is dependent." *Id.* at 1162. Among other things, the appellate court noted that

If the legislature had wanted only dependent family members to be exempted, then the legislature could have exempted 'dependent family members,' rather than list certain close family members *and* exempt other dependant [sic] family members. The Trustees' interpretation renders the enumeration of specific family members irrelevant. In contrast, Appellants' argument makes sense of the list by distinguishing immediate family members as safe harbors who need not prove dependency, in contrast to extended family members covered by the other' clause.

Id. at 1162-63 (emphasis in original).

Thus, Bob may claim the policy on his adult, nondependent daughter as exempt, but unless Bob can prove Alec's dependency (on Bob, not illicit substances), Bob may not claim the policy on Alec as exempt.

Conversion of Assets Pre-Petition.

There is no exemption that would permit Bob to exempt the credit card bonus points. Bob may, however, trade the credit card bonus points for the shotgun prepetition and exempt the shotgun. See A.R.S. § 33-1125(7) (one typewriter, one bicycle, one sewing machine, a family bible, a burial plot, **one shotgun** or one rifle or one pistol, **with a fair market value not to exceed \$500 is exempt**) (emphasis added); see also *In re McCabe*, 280 B.R. 841 (Bankr. N.D. Iowa 2002) (on the advice of counsel, prepetition, debtor purchased a \$10,000 Belgian Browning shotgun with funds from an account owned by him and his wife; under Iowa law, which had no dollar limit on the exemption for a family gun, debtor was permitted to exempt the shotgun).

Prebankruptcy exemption planning is permissible in the Ninth Circuit. *Coughlin v. Cataldo (In re Cataldo)*, 224 B.R. 426, 429 (B.A.P. 9th Cir. 1998) ("[I]t is clear that in the Ninth Circuit a debtor may convert non-exempt property into exempt property *even on the eve of bankruptcy.*") (quoting *Roosevelt v. Ray (In re Roosevelt)*, 176 B.R. 200, 208 (B.A.P. 9th Cir. 1994)) (emphasis added).

This is because such a conclusion would be contrary to the very purpose of providing exemptions, and because the ability to make intelligent use of the exemptions was specifically addressed and permitted by the legislative history of the Code:

'As under current law, the debtor will be permitted to convert nonexempt property into exempt property before filing of the bankruptcy petition. This practice *is not* fraudulent as to creditors, and permits the debtor to make full use of the exemptions to which he is entitled under the law.'

In re Crater, 286 B.R. 756, 761 (Bankr. D. Ariz. 2002) (citing H.R. REP. 95–595, at 361 (1977), reprinted in 1978 U.S.C.C.A.N. 5963, 6317; S. REP. No. 95–989 at 76 (1978), reprinted in 1978 U.S.C.C.A.N. 5787, 5862) (emphasis in original).

Absent extrinsic fraud, exemption planning is permissible. *Id.* at 762 ("a conversion of nonexempt into exempt assets can result in the denial of the discharge if there was extrinsic evidence of actual intent to defraud."). "Neither timing factors nor uneconomic decision-making by debtors is sufficient to deny a discharge on account of knowledgeable exemption planning." *Id.* at 771. Therefore, provided there is no extrinsic evidence that the debtor intended to defraud his creditors, *i.e.*, no "deception or concealment, an insider transaction, a fraudulent conveyance, a secretly retained possession or benefit, or debtor explanations that lack credibility" (*id.* at 772), exemption planning is permissible "even if all of the debtor's nonexempt assets were converted into exempt assets just after being sued and just before filing bankruptcy." *Id.*

Thus, Bob can legitimately trade the credit card bonus points for the shotgun without having to worry about an extended conversation with those genial folks referred to as "trustees."

Proceeds of Damaged Exempt Assets.

Proceeds from the destruction of, or damage to, exempt property, and all proceeds or benefits from fire or other insurance on exempt property, are exempt. A.R.S. § 33-1126(A)(5). However, "the statutory language of A.R.S. § 33-1126(A)(5) limits the exemption to the proceeds of *personal property.*" *In re Plant*, 300 B.R. 22, 24 (Bankr. D. Ariz. 2003) (emphasis added). In *In re Plant*, the trustee moved to reopen a debtor's bankruptcy case to compel turnover of proceeds related to work that was negligently performed on the debtor's homestead. The debtor moved for declaratory judgment, arguing that the proceeds were exempt under A.R.S. § 33-1126(A)(5). After examining the statutory language and history of A.R.S. § 33-1126(A)(5),

the court held that the debtor was not entitled to exempt settlement proceeds related to the work negligently performed on her exempt homestead under that section:

The section has been amended, and has importantly added the language 'under this article' at the end thereof. The word 'article' refers to Article 2, Chapter 8, Title 33, which only pertains to personal property exemptions. As such, ***Section 33–1126 deals specifically with exempt money proceeds as to personal property; nowhere does the language refer to money arising from the damage to homestead property.***

Id. at 22 (emphasis added).

Further, the court held that there was nothing in the homestead statute that would protect the settlement proceeds:

There is no comparable language in the homestead statutes. *See* A.R.S. § 33–1101[,] *et seq.* If the Legislature wished to include the proceeds of damage claims relating to homesteaded property, it would have done so in its revisions of the homestead and personal property exemptions. As noted by this Court in the decision of *In re Hoffpauir*, 125 B.R. 269 (Bankr. D. Ariz. 1990):

[']The Legislature's omission of words of unmistakable meaning which it used in other enactments compels the conclusion that the omission was intentional.' [quoting *Richman v. Pratt*, 174 N.J. Super. 1, 414 A.2d 1371, 1372 (N.J. Super A.D.1980)]. The better argument is that the Statute to be reviewed must contain unequivocal language that the property, claim or asset is exempt. Moreover, A.R.S. § 33–1133(B) clearly states that Arizona debtors are only entitled to the exemptions set forth in the Constitution or Statutes of Arizona.

Id. at 271. Here the statutory language of A.R.S. § 33–1126(A)(5) limits the exemption to the proceeds of personal property. As such, it cannot be used to exempt the settlement proceeds from a damage claim relating to her residence. The plain and unambiguous language of the statute prevents such a construction.

In re Plant, 300 B.R. at 24.

Thus, Bob may not claim that portion of the insurance proceeds related to the damage to his house as exempt. Bob may, however, claim that portion of the insurance proceeds related to the damage to his comic book collection under A.R.S § 33-1125(5), but only up to \$250. A.R.S § 33-1125(5) provides that the debtor's library, including books, manuals, published materials and personal documents with a fair market value to not exceed \$250 is exempt. While they are not the highly stimulating "published materials" our federal judges routinely pen, comic books

are certainly books, and would likely be exempt under A.R.S. § 33-1125(5). Thus, Bob may likely be able to exempt at least \$250 of the insurance proceeds.

III. Brad and Angelina.

Which State's Exemption Law Applies?

11 U.S.C. § 522(3)(A) provides that, if state law precludes the use of federal exemptions or if a debtor chooses to claim state exemptions (where permitted), the applicable exemptions are those of the state in which the debtor's domicile was located for the 730 days (2 years) "immediately preceding the date of the filing of the petition or if the debtor's domicile has not been located in a single State for such 730-day period, the place in which the debtor's domicile was located for 180 days immediately preceding the 730-day period or for a longer portion of such 180-day period than in any other place."

Arizona is an "opt out" state under 11 U.S.C. § 522(b)(2), meaning that in Arizona, debtors must use state law exemptions, not those provided by the Bankruptcy Code. *See* A.R.S. 33-1133(B) ("in accordance with 11 U.S.C. 522 (b), residents of this state are not entitled to the federal exemptions provided in 11 U.S.C. 522 (d)"). Thus, 11 U.S.C. § 522(3)(A) applies to determine which state's set of exemptions should be used. Brad and Angelina lived in Arizona for the 2 years immediately preceding their petition filing, so Arizona's exemptions apply.

Claiming a Homestead Exemption in Another State

A.R.S. 33-1101 governs Arizona's homestead exemption. It provides, in pertinent part, that, "Any person the age of eighteen or over, . . . who resides within the state may hold . . . a homestead exempt from attachment, execution and forced sale. . ." in specified property in which the person "resides" of a value not exceeding \$150,000. The key is that the homestead may only be claimed in property in which the person "resides," and to claim the homestead the person must "reside[] within the state." "The term 'reside' requires at least the physical presence of the individual claiming a homestead exemption." *In re Elia*, 198 B.R. 588, 597 (Bankr.D.Ariz. 1996) (discussing the definition of "reside" under Arizona law for purposes of claiming an Arizona homestead exemption). Therefore, under Arizona state law, a homestead can only be claimed in property in which a debtor resides, and such property must be in the state of Arizona.

Keeping Non-Exempt Real Property and Rental Income in a Chapter 7

Under Arizona law, an assignment of rents in a deed of trust is enforceable by a lender. *See* A.R.S. 33-702(B). However, Brad and Angelina's deed of trust does not contain any assignment of rents, and therefore they are the only parties with an interest in the rents. 11 U.S.C. § 541(a) creates a bankruptcy estate upon the filing of a bankruptcy petition that includes "all interests of the debtor in property as of the commencement of the case." *Id.* (a)(2). Therefore, the property of the estate includes the rents. Pursuant to 11 U.S.C. § 704(a)(1), it is the Chapter 7 trustee's duty to, among other things "collect and reduce to money the property of the estate." Therefore, all non-exempt property (including the rents) must be turned over to the trustee.

Debt-Relief Agencies and Advising Debtors to Incur Debt

An attorney advising an "assisted person"—a person⁷ whose debts are primarily consumer debts, when the person's non-exempt property is worth less than \$175,750⁸—is a "debt relief agency" under 11 U.S.C. § 526 that is subject to certain mandatory disclosure requirements and certain restrictions. *See* 11 U.S.C. §§ 101(3), 101(12A), 526(a). One of those restrictions involves the kind of advice the debt relief agency can give a debtor.

Pursuant to 11 U.S.C. § 526(a)(4), a debt relief agency shall not advise an assisted person "to incur more debt in contemplation of such person filing a [bankruptcy case] or to pay an attorney or bankruptcy petition preparer a fee or charge for services performed as part of preparing for or representing a debtor in [such] a case." The Supreme Court upheld the provisions of this Section as they apply to debtors' attorneys, and held that the restrictions on the attorneys' speech under (a)(4) were constitutional. *Milavetz, Gallop & Milavetz, P.A. v. U.S.*, 130 S.Ct. 1324 (2010). However, the Court clarified that (a)(4) must be read narrowly, and applies only to prohibit advice to incur debt "because the debtor is filing for bankruptcy, rather than for a valid purpose." *Id.* at 1336. For example, it precludes advising a debtor "to 'load up' on debt with the expectation of obtaining the discharge—*i.e.*, conduct that is abusive *per se*." *Id.* The restrictions in (a)(4) do not, however, preclude attorneys from "talking fully and candidly *about* the incurrence of debt in contemplation of filing a bankruptcy case . . . [(a)(4)] requires professionals only to avoid instructing or encouraging assisted persons to take on more debt in that circumstance." *Id.* at 1337.

Using Non-Exempt Funds to Claim Exemptions

Under the old Bankruptcy Act, "the purposeful conversion of non-exempt assets into exempt assets immediately prior to bankruptcy [was] not fraudulent *per se*." *In re Jackson*, 472 F.2d 589, 590 (9th Cir.1973). "The Code did not substantively alter the law in this regard." *In re Cataldo*, 224 B.R. 426, 429 (9th Cir. B.A.P. 1998). The legislative history of the Code states, "As under current law, the debtor will be permitted to convert non-exempt property into exempt property before filing a bankruptcy petition. The practice is not fraudulent as to creditors, and permits the debtor to make full use of the exemptions to which he is entitled under the law." S.Rep. No. 95–989, at 76 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5860; H.R.Rep. No. 95–595, at 361 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6317. Moreover, "it is clear that in the Ninth Circuit a debtor may convert non-exempt property into exempt property even on the eve of bankruptcy." *Cataldo* at 429, quoting from *In re Roosevelt*, 176 B.R. 200, 208 (9th Cir. B.A.P. 1994).

Because this practice is detrimental to creditors, courts in Arizona have reviewed cases in which debtors have converted non-exempt assets into exempt ones on a case-by-case basis. *In re Elia*, 198 B.R. 588, 596 (Bankr.D.Ariz. 1996). Judge Haines has held that such conversion does not give rise to a denial of discharge under 11 U.S.C. § 727 unless "extrinsic fraud" is shown; a

⁷ Recall that under 11 U.S.C. § 101(41), a "person" may be an individual OR a corporation or partnership.

⁸ This amount is subject to change pursuant to 11 U.S.C. § 104(a). The next adjustment to this amount will occur in April, 2013.

showing of the badges of fraud is insufficient. *In re Crater*, 286 B.R. 756, 761-67 (Bankr.D.Ariz. 2002). And even where "precise" planning was used to convert non-exempt cash assets into an increased homestead exemption by paying down a mortgage, such planning is acceptable when it is "substantially prior" to filing a bankruptcy case in order to "claim exemptions" on non-exempt funds. *Elia* at 596. The same conclusion pertains when paying down a 401(k) loan, so long as such payments are mandatory and made regularly prior to filing bankruptcy. See *In re Loomer*, 222 B.R. 618 (Bankr.D.Neb. 1998).

IV. Tom and Katie.

Representing Tom and Katie:

Attorney Flat Fee should consider the ethical rules of Arizona before attempting to represent both Tom and Katie. Ethical Rule 1.7 provides as follows:

“(a) Except as provided in paragraph (b), a lawyer shall not represent a client if the representation involves a concurrent conflict of interest. A concurrent conflict of interest exists if:

- (1) the representation of one client will be directly adverse to another client; or
- (2) there is a significant risk that the representation of one or more clients will be materially limited by the lawyer's responsibilities to another client, a former client or a third person or by a personal interest of the lawyer.

(b) Notwithstanding the existence of a concurrent conflict of interest under paragraph (a), a lawyer may represent a client if each affected client gives informed consent, confirmed in writing, and:

- (1) the lawyer reasonably believes that the lawyer will be able to provide competent and diligent representation to each affected client;
- (2) the representation is not prohibited by law; and
- (3) the representation does not involve the assertion of a claim by one client against another client represented by the lawyer in the same litigation or other proceeding before a tribunal.”⁹

An attorney for Chapter 7 debtor may not be able, fully and adequately, to assist a debtor with her duty of cooperation with the trustee, for the benefit of the bankruptcy estate while simultaneously representing debtor's non-debtor former husband, whose interests are adverse to trustee and bankruptcy estate, in adversary proceeding brought against him by trustee to avoid alleged fraudulent transfer. At least one court has stated that there is a clear and irreconcilable, conflict of interest warranting the attorney's disqualification from representing former husband in an adversary proceeding.¹⁰

⁹ E.R. 1.7.

¹⁰ Rule 1.7. *In re Morey*, 416 B.R. 364 (Bankr. D. Mass. 2009).

Attorney should be aware when considering representing prospective debtors in a joint bankruptcy filing the potential for conflicts arising during the pendency of the bankruptcy case. An attorney should explain, in detail, to the potential debtors of the potential for a conflict of interest and advise the potential debtors to seek independent legal advice regarding the same.

Generally, an attorney could represent prospective debtors in a Chapter 7 case where most unsecured community debts are discharged quickly. However, the potential for conflict of interest increases if the prospective debtors jointly qualify for a Chapter 13 or individual Chapter 11. Issues may arise as to which party is responsible for the Plan payment during the 3- to 5-year life of the Plan.

Tools of the Trade:

As to the claim of the photography equipment as tools of the trade, we should review the following statutory provisions:

“Except as prohibited in section 25-214, either spouse may ... otherwise act for the benefit of the community.”¹¹

“In the case of married persons, each spouse is entitled to the exemptions provided in this article, which may be combined with the other spouse’s exemption in the same property or taken in different property.”¹²

“The following tools and equipment of a debtor used in a commercial activity, trade, business or profession shall be exempt from process:

(1) The tools, equipment, instruments and books of a debtor or the spouse of a debtor primarily used in, and necessary to carry on, the commercial activity, trade, business or profession of the debtor or the debtor’s spouse, not in excess of an aggregate fair market value of [\$2,500.00].”¹³

Courts have generally construed exemption liberally in favor of the debtors. Each claimed exemption and/or objection that may be filed in relation thereto will be determined by facts supporting the same. Judge Haines overruled the Chapter 13 Trustee’s objection to exemptions asserted by the debtor on behalf of his non-filing spouse.¹⁴ Judge Haines determined that based on the above Arizona Statutes, the debtor is permitted to assert the state law exemptions on behalf of his non-filing spouse.

Qualified Tuition Programs:

The Internal Revenue Code exempts qualified tuition programs from taxation as provided in Title 26. The Internal Revenue Code defines a qualified tuition program as “a program established and maintained by a State or agency or instrumentality thereof or by 1 or more

¹¹ See A.R.S. § 25-215.

¹² See A.R.S. § 33-1121.01.

¹³ See A.R.S. § 33-1130(1).

¹⁴ In re Perez, 302 B.R. 661 (Bkrtcy. D. AZ 2003).

eligible educational institutions....”¹⁵ Congress created the tax exempt set forth under 26 U.S.C. § 529 in an effort to encourage taxpayers to save for future college expenses.¹⁶

As many attorneys that practice bankruptcy are aware, property of the Estate is defined as “all legal and equitable interests of the debtor in property as of the commencement of the case.”¹⁷ However, separated from assets that are “exempt” pursuant to Federal or State law, there are certain exceptions to property of the Estate that are defined as being excluded from the Estate.¹⁸

Property of the estate does not include –

(6) fund used to purchase a tuition credit or certificate of contributed to an account in accordance with section 529(b)(1)(A) of the Internal Revenue Code of 1986 under a qualified State tuition program...**no later than 365 days before the date of the filing of the petition** in a case under this title, but –

(A) only if the designated beneficiary of the amounts paid or contributed to such tuition program was a child, stepchild, grandchild, or stepgrandchild of the debtor for the taxable year for which funds were paid or contributed;

(B) with respect to the aggregate amount paid or contributed to such program having the same designated beneficiary, only so much of such amount as does not exceed total contributions permitted under section 529(b)(6) of such Code with respect to such beneficiary, as adjusted beginning on the date of the filing of the petition in a case under this title by the annual increase or decrease (rounded to the nearest tenth of 1 percent) in the education expenditure category of the Consumer Price Index prepared by the Department of Labor; and

(C) in the case of fund 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 \$5,000;”¹⁹

Although the language of 11 U.S.C. § 541(b)(6) may appear as an algebraic equation, as Chief Judge Terry L. Myers held in In re Bourguignon, 416 B.R. 745 (Bkrtcy. D. Idaho 2009), the statute is unambiguous. “Assuming the qualifying conditions of § 541(b)(6)(A) and (B) are met, any such contributions made to a 529 account more than 720 days prior to bankruptcy are fully excluded from property of the estate.”²⁰

Any amounts contributed to a 529 account between the time frame of 2 years prior to the petition date and one year prior to the petition date that are in excess of the statutory amount are property of the Estate.²¹ Additionally, any payments or contributions to a 529 account during the 1 year prior to the petition date or are property of the Estate.²²

¹⁵ See 26 U.S.C. § 529(b)(1)(A).

¹⁶ See S.Rep. No. 104-281 at 105-107 (1996).

¹⁷ See 11 U.S.C. § 541(a).

¹⁸ See 11 U.S.C. §§ 541(b) and (c).

¹⁹ See 11 U.S.C. § 541(b)(6).

²⁰ In re Bourguignon, 416 B.R. 745 at 752.

²¹ *Id.*

²² *Id.* at 752-753.

It is also important to note that in In re Bourguignon, not only were the contributions by the Debtor(s) to the 529 account determined to be property of the Estate, but also the contributions by a non-debtor third party to the 529 account during the year prior to the petition date. Judge Myers held that 11 U.S.C. § 541(b)(6) makes no distinction between as to the source of the contributions, rather it is the **timing** of the contributions. Therefore, the \$40,000.00 contributed to the 529 account during the year prior to the petition date by a non-debtor third party had to be turned over to the Chapter 7 Trustee.²³

Homestead and Application of Exemptions:

The relevant statutory provisions are:

“A. Any person the age of eighteen or over, married or single, who resides within the state may hold as a homestead exempt from attachment, execution and forced sale, not exceeding one hundred fifty thousand dollars in value, any one of the following:

1. The person's interest in real property in one compact body upon which exists a dwelling house in which the person resides.
2. The person's interest in one condominium or cooperative in which the person resides.
3. A mobile home in which the person resides.
4. A mobile home in which the person resides plus the land upon which that mobile home is located.

B. Only one homestead exemption may be held by a married couple or a single person under this section. The value as specified in this section refers to the equity of a single person or married couple. If a married couple lived together in a dwelling house, a condominium or cooperative, a mobile home or a mobile home plus land on which the mobile home is located and are then divorced, the total exemption allowed for that residence to either or both persons shall not exceed one hundred fifty thousand dollars in value.

C. The homestead exemption, not exceeding the value provided for in subsection A, automatically attaches to the person's interest in identifiable cash proceeds from the voluntary or involuntary sale of the property. The homestead exemption in identifiable cash proceeds continues for eighteen months after the date of the sale of the property or until the person establishes a new homestead with the proceeds, whichever period is shorter. Only one homestead exemption at a time may be held by a person under this section.”²⁴

A married couple filing a joint petition but living apart were not permitted to each claim a full homestead exemption under Nevada law, even though the total of the two exemptions would

²³ *Id.* at 754-755.

²⁴ A.R.S. § 33-1101

not exceed the state-law maximum homestead.²⁵ The Ninth Circuit BAP upheld Judge Zive's ruling sustaining Chapter 7 Trustee's objection to Debtor's exemption. The Debtors were married but living separately in the State of Nevada. Nevada has opted out of the federal exemptions. The Debtors filed for divorce approximately one month after filing a joint bankruptcy petition. Mr. Rowe filed a motion to amend his exemptions and claim real property he was separately living in as exempt. Federal exemptions may apply separately to each debtor in a joint bankruptcy case, but this application does not apply where a state has opted out of the federal exemptions.²⁶ However, this case was determined prior to the domiciliary requirements the debtor may use federal exemptions, even in an opt out state.²⁷

In contrast, Judge Leonard in the Eastern District of North Carolina sustained the Chapter 13 Trustee's objection to exemption where joint debtors asserted federal exemptions.²⁸ Debtor had resided in North Carolina for the requisite time period; however, joint debtor had not. Judge Leonard held that 11 U.S.C. § 522(b)(1) "prohibits married debtors from *electing* the federal and state exemptions."²⁹ However, in opt out states, debtors do not elect to claim state exemptions, they are required to do so. Therefore, the debtor was required to amend his exemption in accordance with those provided by North Carolina state and the joint debtor was permitted to claim the federal exemptions. Although this decision was not within the Ninth Circuit it provides guidance as to requisite analysis to determine the proper exemptions to schedule.

²⁵ In re Rowe, 236 B.R. 11 (9th Cir. BAP 1999).

²⁶ *Id.* at 13; *See Also* 11 U.S.C. § 522(m).

²⁷ In re Connor, 419 B.R. 304 (Bkrcty. E.D. N.C. 2009); *Citing* William Houston Brown et al., *Bankruptcy Exemption Manual* § 4:5 (2009).

²⁸ In re Connor, 419 B.R. 304 (Bkrcty. E.D. N.C. 2009).

²⁹ *Id.* at 306.