

UNITED STATES BANKRUPTCY COURT

DISTRICT OF IDAHO

In Re:

CHRISTOPHER T.
MATSUURA and ERIN
MATSUURA,

Debtors.

Bankruptcy Case
No. 13-40226-JDP

MEMORANDUM OF DECISION

Appearances:

Jay A. Kohler, Idaho Falls, ID, Attorney for Debtors.

R. Sam Hopkins, pro se, Pocatello, ID, Chapter 7 Trustee.

Introduction

The chapter 7¹ trustee, R. Sam Hopkins (“Trustee”) objects to the claim of exemption by debtors Christopher T. Matsuura and Erin Matsuura

¹ Unless otherwise indicated, all chapter and section references are to the Bankruptcy Code, 11 U.S.C. §§ 101 – 1532, all Rule references are to the Federal Rules of Bankruptcy Procedure, Rules 1001 – 9037, and all Civil Rule references are to the Federal Rules of Civil Procedure 1 – 86.

("Debtors") pursuant to Idaho Code § 11-603(4) in a portion of certain tax refunds. Dkt. No. 30. Trustee contends that because any potentially exempt portion of the tax refunds was commingled by Debtors in a bank account with other, non-exempt funds, Debtors are not entitled to an exemption. *Id.* Debtors responded to Trustee's objection. Dkt. No. 31. The Court conducted a hearing concerning the matter on November 12, 2013. Based upon the record, and after duly considering Trustee's objection, Debtors' response, along with their Pre-Hearing Memorandum, Dkt. No. 43, the oral arguments of counsel, and the applicable law, this Memorandum disposes of Trustee's objection. Fed. R. Bankr. P. 7052; 9014.

*Facts*²

In February 2013, Debtors filed their 2012 federal and state tax returns. According to the federal return, Debtors were entitled to receive an Earned Income Credit ("EIC") of \$3,990, and a Child Tax Credit ("CTC") of \$4,252, for a total refund of \$8,242. They were to receive a state

² At the hearing, the parties stipulated that the relevant facts were as stated in Trustee's Objection, Debtors' Response and Debtors' Pre-Hearing Memorandum.

tax refund of \$620.

Anticipating receipt of the tax refunds, and needing to file a bankruptcy case,³ Debtors desired to segregate the refunds from their other funds. They therefore opened a new checking account with ISU Credit Union⁴ (“Credit Union”) with the required minimum deposit of \$1. When they received their refund checks, on February 22, 2013, they deposited the state tax refund of \$620, and the federal tax refund of \$8,242, into the Credit Union account.

On February 25, 2013, Debtors withdrew \$3,000 in cash from the Credit Union account, the maximum allowed by the Credit Union in one day. They withdrew another \$1,872 the following day. By so doing, Debtors intended to withdraw, and to spend, both the \$4,252 federal CTC,

³ As Debtors candidly acknowledge in their Pre-Hearing Memorandum, they carefully thought out their bankruptcy filing strategy. Since mid-December, Mr. Matsuura’s wages were being garnished, and so Debtors were motivated to file their bankruptcy case as soon as possible. They timed that filing to both obtain relief from the garnishment, while still protecting their exemptions in the EIC. Dkt. No. 43 at ¶¶ 4-9. Trustee has not taken issue with Debtors’ “bankruptcy planning” in connection with his objection to Debtors’ exemptions, and thus, the Court declines to comment on the propriety of Debtors’ conduct.

⁴ Credit Union account number ending in 079.

and the \$620 state tax refund. This left \$3,990 in the Credit Union account, which Debtors intended to represent the EIC.

Debtors filed a chapter 7 petition on March 7, 2013. In their initial bankruptcy schedules, Debtors listed the Credit Union account, but indicated it contained only \$100. However, the Court finds that the account actually contained \$3,991.06 on that day.⁵ Moreover, Debtors initially did not claim the EIC portion of the tax refund exempt. They later

⁵ While the parties attempted to stipulate to the facts, there is some disagreement among the facts they each recited in their pleadings, chiefly with regard to the amount on deposit in the Credit Union account on petition day. Trustee's Objection indicates the account contained \$3,616.56 on petition day. Dkt. No. 30. On the other hand, Debtors' Pre-Hearing Memorandum indicates the account contained \$3,991.06 on March 7, 2013. Dkt. No. 43. The Court resolved this inconsistency by reviewing the daily balance information in the Credit Union account bank statements. Attached to Debtors' Pre-Hearing Memorandum is a statement dated February 28, 2013, which shows a previous balance of \$1 (the minimum deposit), the tax refund deposits totaling \$8,862, and a dividend of \$.06. It also shows cash withdrawals of \$3,000 and \$1,872, leaving a balance in the account on February 28, 2013 of \$3,991.06. Admitted into evidence as Exhibit 100 at the hearing, and attached to Dkt. No. 44, is a bank statement for the Credit Union account dated March 31, 2013. It shows the previous balance of \$3,991.06, but lists no account activity of any kind until March 9, 2013, which is two days *after* the bankruptcy filing. With no evidence to support Trustee's claim that the account contained \$3,616.56 on petition day, the Court determines that the Credit Union account contained \$3,991.06 on March 7, 2013.

amended their schedule B to show the Credit Union account contained \$3,991.06 on petition day, and their schedule C to claim \$3,990 of those funds exempt pursuant to Idaho Code § 11-603(4). Dkt. No. 28. It is to that exemption claim that Trustee has objected. Dkt. No. 30.

Analysis and Disposition

A. Exemptions, Generally

Upon commencement of a bankruptcy case, all property in which the debtor has a legal or equitable interest becomes property of the bankruptcy estate, available for liquidation and distribution to creditors. § 541(a). However, § 522(b)(1) allows individual debtors to exempt certain property from the bankruptcy estate, thereby shielding it from administration by a chapter 7 trustee. Because Idaho has “opted out” of the Code’s exemption scheme, debtors in this state may claim only those exemptions allowable under Idaho law, as well as those listed in § 522(b)(3). Idaho Code § 11-609; § 522(b)(3).

A debtor's entitlement to exemptions is determined as of the petition date. *Culver, L.L.C. v. Chiu (In re Chiu)*, 226 B.R. 743, 751 (9th Cir. BAP

2001); *In re Carlson*, 09.4 IBCR 131, 132 (Bankr. D. Idaho 2009). In Idaho, exemption statutes are liberally construed in favor of the debtor. *In re Wiley*, 352 B.R. 716, 718 (Bankr. D. Idaho 2006); *In re Kline*, 350 B.R. 497, 502 (Bankr. D. Idaho 2005) (citing *In re Steinmetz*, 261 B.R. 32, 33 (Bankr. D. Idaho 2001)). Finally, as the objecting party, Trustee bears the burden of proving Debtor's claim of exemption is not proper. Rule 4003(c); *Carter v. Anderson (In re Carter)*, 182 F.3d 1027, 1029 n.3 (9th Cir. 1999); *In re Katseanes*, 07.4 IBCR 79, 79 (Bankr. D. Idaho 2007).

B. EIC and CTC Exemptions

Idaho Code § 11-603(4) provides that “[a]n individual is entitled to exemption of the following property . . . (4) [b]enefits the individual is entitled to receive under federal, state, or local public assistance legislation[.]” This Court has previously decided whether EIC and CTC amounts refunded may be exempted under this statute for bankruptcy purposes. In *In re Jones*, 107 B.R. 751, 752 (Bankr. D. Idaho 1989), the Court held that the EIC, “due to its nature as social welfare relief is exempt property pursuant to Idaho Code § 11-603(4).” In contrast, the Court

decided that the CTC “was not adopted with a legislative purpose of public assistance within the contemplation or reach of [Idaho Code] § 11-603(4),” and is therefore not exempt in bankruptcy proceedings. *In re Dever*, 250 B.R. 701, 706 (Bankr. D. Idaho 2000). And, of course, state tax refunds are not exempt. *In re Virgin*, 04.2 IBCR 64, 65-66 (Bankr. D. Idaho 2004).

The Court presumes these holdings provided the basis for Debtors’ decision to spend the CTC portion of their federal refund, as well as the state refund, prior to filing for bankruptcy relief, while preserving and claiming the EIC portion of the federal refund exempt.⁶

C. Application of Law to Facts

Debtors contend that the funds remaining in the Credit Union account when they filed their bankruptcy petition represent the EIC portion of the federal tax refund, and are therefore exempt under Idaho Code § 11-603(4). As discussed *In re Dever*, if the funds indeed represent

⁶ Though not discussed in their submissions, the Court also presumes that Debtors’ decisions were guided by the advice of their bankruptcy counsel.

the EIC, they would be exempt.

Objecting to Debtors' claim of exemption, Trustee argues that it is impossible on this record to determine whether the funds are EIC, or non-exempt CTC funds. Because they can not be definitely identified, Trustee urges that Debtors' claim of exemption be disallowed.

In *Hooper v. State of Idaho*, 908 P.2d 1252 (Idaho Ct. App. 1996), the Idaho Court of Appeals considered whether funds in an inmate's prison account were exempt pursuant to Idaho Code § 11-207, which protects a portion of a debtor's wages from the reach of creditors. Both wages paid to the inmate by the Idaho Department of Corrections, as well as funds from an outside source, had been deposited in the debtor's prison account. As a result, the debtor's potentially exempt wages had been commingled in the prison account with nonexempt funds. No attempt to trace the funds representing wages was made by the debtor. In holding that none of the funds in the account were exempt, the court observed that "[t]here is authority that statutorily exempt wages do not lose their exempt status when deposited in a personal checking account, as long as the proceeds of

the account are traceable to those wages.” *Id.* at 1258 (quoting 31 AM.JUR.2d, *Exemptions*, § 45 (1989) (footnotes omitted)). However, the court noted a limitation on this rule: “If it is impossible to separate out exempt funds from nonexempt funds, the general rule is that an exemption cannot lie.” *Id.* at 1258 (quoting 31 AM.JUR.2d, *Exemptions*, § 224) (footnotes omitted).

In its analysis in *Hooper*, the Idaho Court of Appeals noted that a different exemption statute, Idaho Code § 11-604(1), which protects certain kinds of payments made to a debtor on account of disability, illness, as support, and as compensation for bodily injuries, lose their exempt status if commingled with other, nonexempt funds. Specifically, the court observed that the Idaho Legislature, in Idaho Code § 11-604(3), had declared that “exemptions allowed by [§ 11-604(1)] shall be lost immediately upon the commingling of any of the funds or amounts described in this section with any other funds.” However, because the exemption statute in play in *Hooper* contained no specific prohibition on commingling, the court held that general tracing rules were applicable.

The statute which exempts public assistance monies, Idaho Code § 11-603, at issue here, also contains no express restriction on commingling. Nevertheless, this Court has held that whether exempt and nonexempt funds have been commingled is a relevant consideration to determining exempt status, and a debtor's inability to trace the exempt funds may defeat a his or her claim of exemption even when the enabling statute does not so specifically provide. *See, e.g., In re Santillanes*, 05.4 IBCR 92 (Bankr. D. Idaho 2005) (funds deposited in a credit union account to secure vehicle loans were exempt as wages because they were traceable and because there was no evidence that the funds had been commingled with funds from other sources); *In re Virgin*, 04.2 IBCR 64 (Bankr. D. Idaho 2004) (denying a claim that tax refund monies were exempt as wages, holding that during the time debtors' withheld tax money was in the hands of the federal and state governments, "it was presumably commingled with other government funds. In other words, the debtors lack the ability to trace the source of funds" and thus they were not exempt as wages); *In re Colling*, 03.1 IBCR 58 (Bankr. D. Idaho 2003) (funds deposited in a bank account

were exempt where trustee did not dispute that all the funds in the account were indeed wages).

In this case, Debtors' federal tax refund was comprised of two distinct components: the EIC and the CTC. The EIC was exempt; the CTC was not exempt. The state tax refund was wholly nonexempt. All of these funds were deposited by Debtors in the same Credit Union account (along with the nonexempt \$1 deposited to open the account). Debtors contend that commingling the funds in this single account did not impair their ability to exempt some, but not all, of the funds. Indeed, they correctly note that the EIC and CTC monies were already commingled when they received them, and they were deposited in a single transaction into the Credit Union account. Trustee, on the other hand, argues that, regardless of whether the funds could be traced when they were deposited, once Debtors began to spend money from the account, tracing the source of the funds spent was impossible, and the exemption was lost. In other words, in Trustee's view, because it was impossible to determine whether Debtors spent EIC, CTC or state tax refund money, Debtors can not trace the source

of the funds remaining in the account on bankruptcy day.

To be precise, Trustee does not argue the commingling of the funds doomed Debtors' exemption claim. Indeed, the Court presumes that when the Idaho Legislature determines that commingling of exempt and nonexempt funds is not to be tolerated at all, it knows how to say so, as evidenced by Idaho Code § 11-604(3). As noted above, there is no express statutory prohibition on commingling in Idaho Code § 11-603. Because of this, the fact that Debtors received the federal tax refund in one deposit, and that the federal and state tax refunds were deposited in a single bank account, does not alone defeat Debtors' exemption claim. Instead, as the court in *Hooper*, and this Court in its own decisions has instructed, the Court must consider whether the EIC funds are "reasonably traceable." Under these facts, the Court finds that they are.

As noted above, Debtors opened the Credit Union account with the \$1 minimum deposit. The tax refunds were deposited into the account on February 22, 2013. Debtors withdrew \$3,000 on February 25, 2013, the maximum amount the Credit Union would allow them to withdraw in one

day. The following day they withdrew \$1,872. This left exactly \$3,990 in the account, excluding the \$1 initial deposit. It was no coincidence that the amount Debtors left in the Credit Union account was equal to the EIC portion of the tax refund. It is undisputed that through this process, Debtors intended to spend the non-exempt refunds, and to preserve the EIC to exempt in their bankruptcy case.

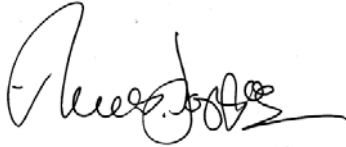
The case law does not require “absolute” tracing. Here, the Court finds the source of the funds in the account may be “reasonably traced” as to the non-exempt and exempt portions. While there may have been other, more transparent methods to accomplish Debtors’ goal of spending only the non-exempt portion of the tax refund, while keeping the remaining funds exempt in the impending bankruptcy case, the Court concludes that the evidence here is sufficiently clear to withstand the Trustee’s challenge.

Conclusion

The Court finds the funds remaining in the Credit Union account on the date Debtors filed their bankruptcy petition are reasonably traceable to the EIC portion of Debtors’ federal tax refund. Trustee’s objection to

Debtors' claim of exemption will be denied in a separate order.

Dated: December 16, 2013



Honorable Jim D. Pappas
United States Bankruptcy Judge