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KIMBELL D. GOURLEY
-SECTION CHAIR
KATIE DULLEA
-NEWSLETTER EDITOR

Boise Attorney Helps Others Help People in Need

A new legal clinic in southern Idaho provides irrefutable evidence that people will step up when asked to help their neighbors in need.

The twice-a-month clinic in downtown Boise provides free legal services to people who need to file for bankruptcy but cannot afford an attorney. It opened its doors April 1 and was very well received.

It's the brainchild of Boise Inc. attorney Bob Meek and a solution to a top unmet legal need in the area. The need developed after a new federal bankruptcy law went into effect in 2005. "The law is so complicated that people can't fill out the forms correctly," Bob says.

After two decades of providing volunteer help in bankruptcy cases, Bob had to quit. In fact, volunteer work by attorneys who don't specialize in bankruptcy law virtually came to a halt overnight. "I really liked doing that kind of work," Bob says of helping single parents and people facing mountains of unexpected medical bills. "You're giving hope to people who have lost hope. It's very fulfilling. People should not be robbed of hope."

Over the intervening years, Bob says he felt worse and worse about being unable to help people he knew were in need. When he saw bankruptcy at the top of a list of unmet legal needs a few months ago, he felt compelled to act.

He went to Legal Aid, which agreed to host a clinic and prescreen clients if Bob could pull together the other resources. The makers of a software program to help file bankruptcy cases promised to donate the necessary software. Boise Inc. and others donated computers. Finally, Bob asked to speak at a meeting for bankruptcy attorneys. He told his story and passed around a sign-up sheet. "I told them, 'If it's not filled up, I'm going to cancel the clinic,'" he says.

Every bankruptcy attorney in the area signed up for a two-hour shift, thus staffing the clinic through November. "The outpouring was almost overwhelming," Bob says.

"It's the first time I've ever done anything like this," Bob says. "It's just so not like me. I just said, 'I'm going to keep going until someone says no.' Everywhere I turned, I was expecting to get a no... and everybody kept saying yes. I couldn't believe it. It was just meant to be."

In This Issue:

A Word From the Editor

By Katie Dullea

When I volunteered to be on the Board of Directors for the Commercial and Bankruptcy Law Section, I had no idea what would be involved. We meet by conference call monthly. The first two years on the Board are mostly just attending the meetings, and contributing occasionally to the Tip of the Month. The third year of service is being the editor for this Newsletter. The fourth year is being secretary and taking minutes of the monthly meetings. The fifth year is the coordination and running of the Annual Winter Bankruptcy Conference. The sixth year is spent being President of the Board and presiding over the monthly meetings. The seventh year we get to bask in semi-retirement. It's quite a commitment, but extremely satisfying. The Idaho State Bar helps hugely with many of these functions and duties, making the Board members' jobs much more manageable.

I want to thank the contributors to this issue, Ken Anderson, Howard Foley, Loren Messerly, Marty Martelle and Bob Meeks. I hope to publish three more newsletters before next year's Conference, and I am actively soliciting articles for the next issue. Randy French is also soliciting articles for an upcoming Advocate devoted to bankruptcy, which can focus more on issues that non-bankruptcy attorneys as well as bankruptcy practitioners might find useful.

Does Idaho Law Protect The Unwise Business Borrower Against "Unfair" Default Interest and/or Late Fees?

By Loren Messerly

If you ever had the pleasure of meeting with a business person or entity who signed a promissory note that obligates the borrower to 30% default interest that compounds monthly or a late fee on a balloon payment that results in a lump sum fee of $50,000, then you know the words that quickly pop into your head but you have to prevent from popping out of your mouth: "What were you thinking!"

A business can feel desperate for funds for many reasons. Sometimes the investment opportunity seems too good to miss. Other times cash is needed to avoid shutting down. With the current shortage of investment dollars, lenders have significant leverage in the terms offered to a borrower. A borrower can feel compelled to accept default interest and late fee provisions that are "unfair" in the sense that they are well above market rates and/or provide a windfall. A borrower may also convince itself that the "unfair" provisions are irrelevant because the debt will be repaid on time. When the borrower subsequently defaults, the default interest rate and late fees may suddenly be at issue and the borrower's counsel is left with the challenge of trying to unwind the "unfair" interest and fees.

Creditors Typically Have No Problem Enforcing Default Interest and Late Fees That Were Clearly Detailed in the Promissory Note

From my experience as mostly a creditor attorney in Idaho, creditors stand on solid ground in enforcing the default interest and late fees that are in the contract. As an initial matter, Idaho's usury laws were abolished in 1983, sending the message that freedom to contract is king and parties have no limitation on the interest rates they can charge to a willing borrower. The website for the Idaho Department of Finance even states, under Frequently Asked Questions, "[T]here is no cap on the interest you can be charged. The binding rate is whatever is agreed upon by both parties."

Idaho case law points out that unwise contracts are not to be rewritten by courts: "Courts do not possess the roving power to rewrite contracts in order to make them more equitable. . . . 'While a court of equity will not relieve a party from a bargain merely because of hardship, yet he [or she] may claim the interposition of the court if an unconscionable advantage has been taken of his [or her] necessity or weakness.' It is not sufficient, however, that the contractual provisions appear unwise or their enforcement may seem harsh." *Lovey v. Regence BlueShield of Idaho*, 139 Idaho 37, 41-42, 72 P.3d 877, 881-82 (2003) (citations omitted).

Difficulty of Challenging "Unfair" Late Fees and Default Interest through Unconscionability Doctrine

Idaho, like all other states, does provide a common law legal doctrine for escape from contractual provisions that appear to be "unfair". If any contractual term, including default interest and late fee provisions, is unconscionable then it will not be enforced by the court. In practice, however, Idaho unconscionability case law is extremely limited in its application to debtor-creditor situations. Idaho case law requires that the contract terms be both procedurally and substantively unconscionable. Therefore, even if the amount of late fees and the rate of default interest "shocks the conscience," an Idaho court could not refuse to enforce those provisions without first finding that the procedures for getting the debtor to sign the contract were also unfair. See *Wattenbarger v. A.G. Edwards & Sons, Inc.*, 246 P.3d 961, 976 (Idaho 2010) ("Accordingly, under Lovey, the district court's finding that the agreement to arbitrate is not procedurally unconscionable is affirmed. As a result, the clause cannot be voided on the basis of unconscionability because it is not both procedurally and substantively unconscionable. Consequently, we find that the agreement to arbitrate is not unconscionable without reaching the issue of substantive unconscionably."). Idaho's requirement of both procedural and substantive unconscionability is different from other states where case law allows courts to strike down provisions solely on the basis of substantive unconscionability. See, *e.g., Resource Management Co. v. Weston Ranch and Livestock Co., Inc.*, 706 P.2d 1028, 1043 (Utah 1985) ("Gross disparity in terms, absent evidence of procedural unconscionability, can support a finding of unconscionability.").

Proving procedural unconscionability can be extremely difficult. See, *e.g., Wattenbarger v. A.G. Edwards & Sons, Inc.,* 246 P.3d 961, 976 (2010); *Doughty v. Idaho Frozen Foods Corp.*, 112 Idaho 791, 793, 736 P.2d 460, 462 (Ct. App. 1987); see also *Primary Health Network, Inc. v. State, Dept. of Admin.*, 137 Idaho 663, 668, 52 P.3d 307, 312 (Idaho 2002) (discussing the related issue of economic duress).

Proving procedural unconscionability is especially difficult for a business debtor who obtains a loan and signs a promissory note. A sophisticated lender will be careful to avoid any actions that could appear coercive and the promissory note will contain clear language regarding the late fees and default interest. See *Lovey v. Regence BlueShield of Idaho*, 139 Idaho 37, 42, 72 P.3d 877, 882 (2003) ("Indicators of procedural unconscionability generally fall into two areas: lack of voluntariness and lack of knowledge. Lack of voluntariness can be shown by factors such as the use of high-pressure tactics, coercion, oppression or threats short of duress, or by great imbalance on the parties' bargaining power with the stronger party's terms being nonnegotiable and the weaker party being prevented by market factors, timing, or other pressures from being able to contract with another party on more favorable terms or to refrain from contracting at all. Lack of knowledge can be shown by lack of understanding regarding the contract terms arising from the use of inconspicuous print, ambiguous wording, or complex legalistic language; the lack of opportunity to study the contract and inquire about its terms; or disparity in the sophistication, knowledge, or experience of the parties."). The business borrower will want to argue that it was forced to accept the unfair terms because it had no other options to obtain the financing, but the creditor will always be able to argue that the borrower had the option to "refrain from contracting at all." Without some procedural unfairness, the Court has no legal justification for addressing any unfair substantive terms that a debtor may have unwisely accepted.

Requiring procedural unconscionability in addition to substantive unconscionability would appear to leave the unwise business borrower unprotected. It would seem that Idaho courts will only protect business borrowers where the creditor is shown to have dirty hands in how it negotiated the loan, not where the debtor is unwise in signing the contract.

Bankruptcy, a Federal Exception to Idaho's Rule That an Unwise Borrower Is Bound by Contract Terms

The Bankruptcy Code is one clear exception to the rule that a "court of equity will not relieve a party from a bargain merely because of hardship . . . [or where] contractual provisions appear unwise or their enforcement may seem harsh." In bankruptcy, debtors are able to wipe away liability on debts without proof of either procedural or substantive unfairness. Rather, in the name of allowing a debtor a fresh start, courts, through their discharge orders, eliminate creditor contract rights. Debtors and debtor-advocates can name numerous reasons why creditors do not have clean hands and therefore no one should feel sorry for a creditor in bankruptcy, but the bankruptcy system does not require a showing of any creditor fault in order for the debtor to eliminate the creditor's contract rights. For many unwise business borrowers, however, bankruptcy is not the right solution to the problem of unfair interest and late fees. A bankruptcy discharge is a tool to eliminate all debt rather than just eliminating "unfair" late fees and default interest on one debt.

Liquidated Damages Doctrine, Idaho's Potential Protection for Unwise Business Borrowers

There is a second possible exception to the rule that a "court of equity will not relieve a party from a bargain merely because of hardship . . . [or where] contractual provisions appear unwise or their enforcement may seem harsh." Many courts from various jurisdictions have refused to enforce "unfair" default interest rates and late fees through the doctrine of liquidated damages. These courts have determined that the default interest and late fee provisions do not reasonably reflect true damages that a creditor can anticipate suffering upon default. See, e.g., In re Market Center East Retail Property, Inc., 433 B.R. 335, 358 -359 (Bankr. D.N.M. 2010) (5% late fee held unenforceable on balloon payment); In re 201 Forest Street LLC, 409 B.R. 543, 565-69 (Bank. D. Mass. 2009) (noting that riskiness of debt was "already factored into establishing the underlying contract rate"); North Water, LLC v. North Water Street Tarragon, LLC, 2009 WL 3740632 (Conn. Super. 2009) (finding plaintiff failed to show why interest should increase from 8% to 18% upon default and therefore Court would only enforce 8% interest); Poseidon Development, Inc. v. Woodland Lane Estates, LLC, 62 Cal. Rptr. 3d 59, 65–66 (2007) (noting that late fees on installment payments are enforceable but a late fee applied to a balloon payment is unenforceable because it is merely a penalty).

Idaho courts have not addressed

whether default interest and late fee provisions can be challenged as unenforceable liquidated damages provisions. But see In *re Pheasant Cove, LLC.*, 2008 WL 187529, *3-4 (Bankr. D. Idaho 2008) (enforcing 21% interest and finding it was not a penalty as that term is used in a section of the bankruptcy code). Idaho law does, however, recognize that liquidation damages provisions will not be enforced when they are a penalty:

> Generally speaking, parties to a contract may agree upon liquidated damages in anticipation of a breach, in any case where the circumstances are such that accurate determination of the damages would be difficult or impossible, and provided that the liquidated damages fixed by the contract bear a reasonable relation to actual damages. But, where the forfeiture or damage fixed by the contract is arbitrary and bears no reasonable relation to the anticipated damage, and is exorbitant and unconscionable, it is regarded as a 'penalty', and the contractual provision therefor is void and unenforceable.

Graves v. Cupic, 75 Idaho 451, 456, 272 P.2d 1020, 1023 (1954); see also *Magic Valley Truck Brokers, Inc. v. Meyer*, 133 Idaho 110, 117, 982 P.2d 945, 952 (Ct. App. 1999) ("Historically, courts . . . developed a rule . . . that contractual clauses prescribing penalties for a breach of the contract would not be enforced because of the potential for over-reaching and unconscionable bargains. Modern courts continue to refuse to enforce contract clauses that appear designed to deter a breach or to punish the breaching party rather than to compensate the injured party for damage occasioned by the breach.").

Applying the liquidated damages doctrine, the court would potentially rewrite the default interest and late fee provisions based solely on substantive unconscionability

Thus, it would appear that unwise business borrowers in Idaho do have a potential avenue for challenging "unfair" default interest and late fee provisions. Under the liquidated damages doctrine, the business borrower can argue that the late fees and/or default interest result in a recovery for the creditor that far surpasses any damages that the creditor might have expected upon default. The debtor can subpoena the creditor and require the creditor to describe its anticipated damages and try to justify its fees and interest.

Liquidated Damages Doctrine: In Conflict with Idaho's Unconscionability Doctrine?

Applying the liquidated damages doctrine, the court would potentially rewrite the default interest and late fee provisions based solely on substantive unconscionability, i.e. the fees are unenforceable solely based on their substance in not reflecting anticipated damages. In this way, the liquidated damages doctrine would appear to conflict with Idaho's unconscionability doctrine and with the language from Lovey that Idaho courts will not protect borrowers from unwise or harsh contractual provisions without a showing of lack of voluntariness or lack of knowledge. Even if the business borrower signed the contract voluntarily, with full knowledge of the high default interest and late fees, Idaho courts may still protect that unwise borrower if the borrower can show that the default interest or late fees are improper liquidated damages that are windfalls to the creditor and do not reflect true anticipated damages.

The Role of Social Security Income in Bankruptcy Reorganization Cases: An Unresolved Question?

By Ken Anderson

Prof. Daniel A. Austin of Northeastern University School of Law in Boston, penned an article entitled "State Laws, Court Splits, Local Practice Make Consumer Bankruptcy Anything but Uniform" in the December/January 2011 issue of the ABI Journal. He cites three main reasons for this: (1) Code provisions utilize state law in some situations, (2) differences in interpretation of the federal statutes by bankruptcy courts, BAPs, and Courts of Appeal, and (3) a multitude of differing local rules and written and unwritten local practices established by bankruptcy courts and trustees. In addition to splits among the circuits (a major basis for Supreme Court issuances of writs of *certiorari*) there are even splits within districts, as in the E.D.N.Y.

Prof. Austin illustrates this point in a discussion of the split of authority on how to calculate projected disposable income involving, among others, the 9th and 10th Circuits. Even after the Supreme Court supposedly put that issue to rest, courts are now divided on how to interpret *Lanning*. E.g., is Social Security income to be included in the Schedule I and J analysis to calculate projected disposable income? Courts in Missouri, Utah, and Idaho have reached completely different conclusions. Idaho holds that it can be included as a factor in the good faith analysis. Montana went the opposite direction.

In re Welsh, Montana, slip 10-61285-13 (16 November 2010). We all know that §101(10A)(B) specifically excludes payments under the Social Security Act from the Means Test. (Whether or not that includes unemployment compensation payments is a whole other issue). But is SS money also exempt from the Schedules I and J analysis, i.e., from inclusion in "disposable income" or "projected disposable income?" According to Judge Kirscher, it is. He cites 42 USC §407:

(a) The right of any person to any future payment under this title shall not be transferable or assignable, at law or in equity, and none of the moneys paid or payable, or rights existing under this title shall be subject to execution, levy, attachment, garnishment, or other legal process, or to the operation of any bankruptcy or insolvency law.

(b) No other provision of law, enacted before, on, or after the date of the enactment of this section, may be construed to limit, supersede, or otherwise modify the provisions of this section except to the extent that it does so by express reference to this section.

(c) Nothing in this section shall be construed to prohibit withholding taxes from any benefit under this title, if such withholding is done pursuant to a request made in accordance with section 3402(p)(1) of the Internal Revenue Code of 1986 by the person entitled to such benefit or such person's representative payee.

Judge Kirscher noted that "Neither §1325(b) nor the good faith requirement of §1325(a)(3) includes such an express reference to §407, which is required to override its restriction against "other legal process, or to the operation of any *bankruptcy* or insolvency law. (Emphasis added)" *Ibid*. at 12. Next, the court cited §101(10A)'s definition of "current monthly income" for the proposition that this term "...excludes benefits received under the Social Security Act..." *Ibid*. at 13.

Turning then to the role of §707 in this matter, the court quoted from Lanning:

> We decline to infer from §1325's incorporation of §707 that Congress intended to eliminate, sub silentio, the discretion that courts previously exercised when projecting disposable income to account for known or virtually certain changes. Accord, in re Liverman, 383 B.R. 604, 613, and n. 15 (Bkrtcy. N.J. 2008)." Lanning, 130 S.Ct. at 2475, quoted in Welsh at 17.

The trustee also objected on the grounds of good faith and the totality of the circumstances, citing that they proposed to keep two ATVs, a vehicle loaned to a daughter doing her residency and unable to afford a vehicle of her own due to large student loan payments, and an Airstream travel trailer. The court examined and rejected these objections also, noting that the evidence showed the debtors needed at least one ATV for plowing snow from a long driveway. Further, all these items were secured claims due and owing on the date of filing per §707(b)(2)(A)(i) and (iii). Where payments on secured claims are current, the court will refrain from determining whether their payment to secured claims are reasonable. *Ibid.* at 21. (Judge Kirscher explained his views on this issue at length in the *Dement* case, 2010 WL 231750 (Bankr. D. Mt., 14 January 2010.) Further, since SSI is excluded from CMI, considering it again in a good faith test would be duplicative and would render §1325(b)'s ability-to-pay test meaningless.

BAPCPA has proven to be an endless stream of riddles for bench and bar. Perhaps this issue will be resolved in developing caselaw over the next few years.

In conclusion, the court noted that where a specific and a general statue address the same subject matter, the specific takes precedence regardless of the sequence of the enactment. §101(10A)(B) and §407 are two separate federal statues, each more specific than §1325(a)(3) regarding SSI benefits. With regard to subsection 407 (c), Judge Kirscher could also have cited the canon of construction called *inclusio unius exclusio alterius* (inclusion of one implies exclusion of others). Subsection 407(c) specifically excepts tax withholding. By implication, therefore, this is the only exception to its restriction.

Chief Judge Myers went the other direction with a case last July. *In re Westing*, 2010 Westlaw 2774829 (Bankr. D. Idaho, 13 July 2010, case number 09-03594). Debtors sought to exclude SSI benefits in the Schedules I and J analysis. The court sustained the trustee's objection on grounds of lack of good faith. However, there is a world of difference between the behavior of the debtors in these two cases. On the other hand, the 8th Circuit BAP agreed with Judge Kirscher but without the aid of §407. Briefly, based on §§101(10A),(B), 1325(a)((3), and 1325(b)(2), the panel held that considering exclusion of Social Security benefits from disposable income as part of a good faith analysis would render meaningless the ability-to-pay test, which already addressed whether Social Security income should be included in plan payments. *In re Thompson*, 2010 WL 3583400 (8th Cir. BAP, 16 September 2010).

BAPCPA has proven to be an endless stream of riddles for bench and bar. Perhaps this issue will be resolved in developing caselaw over the next few years. Then *new* BAPCPA issues will take their place.

When Do and When Don't Exemptions Apply Under 11 U.S.C. 522

By Howard Foley

One of the significant changes Congress made with the passage of the Bankruptcy Abuse Prevention and Consumer Protection Act ("BAPCPA") in 2005 was in an effort to prevent exemption forum shopping, is sometimes referred to as the O.J. Simpson amendment. The amendment to Section 522(b)(3) increased the length of time a debtor must be domiciled in a given state in order to avail himself of that state's exemption statutes. O.J., as we all recall, beat the criminal charge but Ron Goldman's parents recovered a civil judgment. O.J. known for his speed and deft moves while playing in the NFL to avoid being caught, sold his mansion in California and moved to Florida where there was no limit on the amount of equity one could have in the Florida mansion, thus protecting his equity from the reach of the creditor.

Prior to BAPCPA, the time to establish domicile in a new state was 180 days and BPCPA extended that time to 730 days. 522 (b)(3)(A) now reads:

> (3) Property listed in this paragraph is
> (A) subject to subsection (o) and (p), any property that is exempt under Federal law, other than subsection (d) of this section or State or local law that is applicable on the date of the filing of the petition at the place in which the debtor's domicile has been located for the 730 days immediately preceding the date of the filing of the petition, ***

So when counsel is preparing a petition for his/her debtor client who has recently moved to Idaho, the attorney must determine how long the debtor has lived in Idaho. If it is more than two years, the Idaho homestead and other exemptions are available to that debtor and if it is less than two years, the Idaho exemptions are not available unless (read on).

So if the Idaho exemptions are not available, what exemptions are? 522 (b)(3)(A) continues:

> ***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 180 days immediately preceding the 730 day period or for the longer portion of such 180 day period than in any other place.

So if the client moved from Colorado one year ago and had resided in Colorado the preceding three years, the attorney must look at the exemption statutes for Colorado to see if that state has opted out of the Federal Exemption scheme as the Code allowed the states to do and which Idaho did, see Idaho Code § 11-609, to determine if and to what extent Colorado exemptions are available to the client.

The final Code provision that should be considered is what I consider the "escape clause" of 522 (b)(3)(C) which in pertinent part provides:

> If the effect of the domiciliary requirement under subparagraph (A) is to render the debtor ineligible for any exemption, the debtor may elect to exempt property that is specified under subsection (d).

Subsection (d) of 522 is the Federal or Bankruptcy Code exemption statute.

There are a number of cases which have interpreted 522 (b)(2) and (3) with the following results.

In re Underwood 342 B.R. 358 (Florida 2006) the debtor had moved to Florida from Colorado less than 730 days before filing her bankruptcy petition. Both Florida and Colorado are opt-out states. Colorado's exemption statute, however, did not allow a non-resident to claim any of its exemptions and because she did not meet the 730 day domicile requirement in Florida, its exemptions were not available to her the court held:

> "Since the Debtor may not claim Colorado exemptions because she is not a Colorado resident, and since the 730-day domiciliary requirement in the Bankruptcy Code renders her ineligible to claim exemption under any state's laws, the Debtor may claim federal exemptions."

Here note the Colorado exemptions were only available to Colorado residents.

In a case out of New York, *In re Jewell*, 347 B. R. 120 (W.D. New York) the debtors again had moved from Colorado to New York and filed their bankruptcy petition less than 730 days after their move. New York is also an opt-out state and the court held:

> "Under this interpretation, when debtors have moved from one "opt-out" state where the exemption is not available to a nonresident to another "opt-out" state within 730 days of the filing of their petition, as these Debtors did, the effect of Section 522 (b)(3)(A) is to prevent them in the first instance from being eligible for any exemptions. However the saving provision at the end of Section 522 (b)(3) allows such debtors to elect the Federal Exemptions, even though they now reside in an "opt-out" state."

In a pre-BAPCPA case, the facts were that the debtor had moved from Florida to Wisconsin but he had not resided in Wisconsin for 180 days or the majority of 180 days so he was required to file his petition in Florida. This is a venue issue, 11 U.S.C. § 1408 which provides:

> Except as provided in Section 1410 of this title, a case under Title 11 may be commenced in the district court for the district:
> (1) In which the domicile, residence, principal place of business in the United States, or principal assets in the

United States, of the person or entity that is the subject of such case have been located for one hundred and eighty days immediately preceding the commencement, or for a longer portion of such one-hundred-and-eighty day period****

So the debtor here files in Florida where he no longer lives and where the Florida exemptions are only available to residents of Florida, the court reasoned:

Section 522 (b)(2)(A) provides that the applicable exemption law is the "state or local law that is applicable on the date of the filing of the petition at place in which the debtor's domicile has been located for the 180 days immediately preceding the date of the filing of the petition, or for a longer portion of such 180 days than in any other place;". The provision appears to place the debtor in a "catch 22" since the Florida exemption is not available to a non-resident and it appears that he can only claim the Florida exemption. Thus, as the trustee argues, this debtor is not entitled to any exemptions whatsoever.

We do not agree that the debtor in this situation is precluded from availing himself of any exemptions. Section 522 (b)(1) allows the debtor to claim the federal exemptions of § 522 (d), "unless the state law that is applicable to the debtor under paragraph (2) (A) of this subsection specifically does not so authorize;".

There are other cases worth looking at if the issue arises: *In re: Battle* 366 B.R. 635 (Texas, 2006); *In re: West* 352 B.R. 905 (Florida 2006); *In re: Chandler,* 362 B.R. 723 (N. D. West Virginia, 2007); *In re: Crandall* 346 B.R. 220 (M. D. Florida); *In re: Segen* 2010 WL-4453315 (Bankr. E.D. PA) where Pennsylvania had not opted out.

Idaho has its own cases on the subject. In a case of first impression in Idaho Judge Pappas ruled that a homestead exemption was not available to the debtors. In re Katseanes, 07.4 I.B.C.R. 79 decided October 9, 2007 where the facts were that the Katseanes moved from Idaho to Utah on November 30, 2004 and remained there until December 8, 2006 after which they moved back to Idaho according to their Statement of Financial Affairs. The debtors then filed a bankruptcy in Idaho on March 19, 2007 bringing 522 (b)(3)(A) into play. The debtors initially claimed an Idaho exemption and the trustee objected because they had not lived in Idaho for the requisite 730 days. Debtors amended their Schedule C to claim Utah's homestead exemption and the trustee again objected. The Utah Homestead Code provided:

...the Bankruptcy Abuse Prevention and Consumer Protection Act ("BAPCPA") in 2005 was in an effort to prevent exemption forum shopping...sometimes referred to as the O.J. Simpson amendment.

"An individual is entitled to a homestead exemption *consisting of property in this state* in an amount not exceeding … $20,000."

The real property the debtors sought to exempt was located in Idaho and the Utah homestead, by its terms, could not be used. The debtors then amended Schedule C to apply the "escape clause" language of 522 (3)(C) – "If the effect of the domiciliary requirements under subparagraph (A) is to render the debtor ineligible for any exemption, the debtor may elect to exempt property that is specified under subsection (d)".

In this case, however, the Utah personal property exemptions were available to them and in addition, the trustee had failed to object to the personal property claim under Idaho law within the 30 days after the 341 as required by 11 U.S.C. § 522 (1) Fed R Bankr 4003(b). Judge Pappas then reasoned that there were exemptions available to the debtors and they did not meet the INELIGIBLE FOR "ANY" EXEMPTION test.

So as alluded to earlier under the "read on" section there was a scenario under which these debtors could have used the Idaho homestead and personal property laws. Recall that "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 the longer portion of such 180 day period than in any other place" language of 522 (b)(2)(A), and recall that the state in which the debtors had resided prior to moving to Utah was Idaho, and if their petition had been filed on February 27, 2007 or before the Idaho exemptions were available. Counting December 1, 2004 as the first of the 89 days (a minority of the 180 days) then 31 days in December, 2004 plus 31 days in January, 2005 equals 62 days and an additional 27 days to February 27, 2005 is 89 meaning that the state of residence for the 91 days prior to the November 30 move from Idaho to Utah was Idaho.

In a more recent Idaho case *In re: Capps*, 10.4 I.B.C.R. 99 (Bankr. D. Idaho 2010) debtors moved from Colorado (doesn't everybody?) to Idaho three years prior to their petition and claimed a homestead exemption in Colorado real property. Here the debtors had lived in Idaho for more than 730 days and the exemption laws that applied were Idaho's, 522 (b)(3). The claim was made under I.C. § 55-1003 which is silent as regards the applicability of Idaho homestead laws applying extraterritorially and the court found no state law on point. The court reasoned that the policy behind the 2005 amendment to 522 (b)(3) was to discourage the O.J.'s of this world from engaging in shopping and held Idaho's homestead exemption does not apply to real property in other states. The court noted additionally that even if Idaho's law had applied by operation of I.C. § 55-1006 the homestead was likely abandoned.

Discharging Taxes in Bankruptcy

By Marty Martelle

This will provide an overview of bankruptcy discharge of taxes. It is important to learn the principles of tax discharge in bankruptcy if you represent clients with tax problems. This is a complicated area of law. The information provided below is only the basics of Bankruptcy Discharge of Taxes and should not be relied on for specific fact situations due to the nuances involved.

I. PRINCIPLES OF CHAPTER 7 DISCHARGE

1. The tax must be over three years old from when the return first came due.
   a. Beware of extensions to file the taxes if you are filing after April 15, but before October 15. The tax comes due when the extension runs out.
2. Two years since the tax return was filed.
   a. The tax return must have actually been filed by the taxpayer. Substitute returns filed by the IRS do not count.
3. Two hundred and forty days since the tax was assessed.
   a. This issue often arises if there is an examination and an assessment after the return has been filed.
4. Obtain and review tax transcripts to show your client's history.
   a. We always obtain tax transcripts when there are taxes involved. They will show whether a return has been filed, when it was filed and other necessary information.
5. Tolling events on the time periods. There are numerous events which will toll the periods required for discharge. They may include (depending on which principle they apply to):
   a. Prior bankruptcy
   b. Offer in Compromise
   c. IRS administrative appeals
   d. These tolling events are complicated and research is needed to see if a particular event is applicable to individual cases.

II. ASSESSABLE BUT NOT ASSESSED

1. 11 USC §507 (a) (8) (A) (iii) provides that if a tax is not assessed, but is assessable, it is a priority tax. This usually occurs when Debtor has taxes which are over 3 years old. If the taxpayer filed the return between 2 and 3 years before the bankruptcy petition, the tax remains assessable until the tax is over 3 years old. (The IRS has 3 years from when the tax return was filed to assess the tax, with some exceptions). There may be a gap where the IRS can assess the tax and if so, the tax is assessable but not assessed. This may arise in a situation where the IRS is doing an examination of the taxpayer's returns.

III. TAX CLAIMS IN BANKRUPTCY

The Internal Revenue Service in Chapter 11 and 13 cases will file a Proof of Claim breaking down their claim into Priority Claims, Secured Claims, and Unsecured General Claims.

1. Priority Taxes: Priority taxes are those taxes which do not meet the test for discharge. That is, they are:
   a. Less than three years old, or;
   b. Less than two years since the tax return has been filed,or;
   c. Less than 240 days since assessment
   d. Payroll withholding taxes
   e. Other priority taxes
2. Secured Tax Claim: If the IRS has filed a valid tax lien, the taxes subject to the lien may be treated as secured. In Chapter 11 or 13, the secured portion of the claim is only up to the value of the Debtor's property. It should be noted that the security for the claim includes ALL of the Debtor's property, without any deduction for the exemptions which the Debtor may otherwise claim.
3. Unsecured General Claims: This is the category that we try to fit as much of the tax as possible into. This category of tax is treated the same as any other general unsecured debt. That is, the IRS will receive its pro rata share of any dividend to unsecured creditors.
4. Payroll Taxes: The general rule is that payroll taxes are trust fund taxes and are not subject to bankruptcy discharge. They are treated as priority taxes or secured if a tax lien has been filed. They must be paid through the Chapter 11 or 13 plan and are not subject to discharge in a Chapter 7. Priority Taxes are not paid interest in Chapter 11 or 13, however. Penalties are sometimes treated as unsecured. This favorable treatment often allows a Chapter 11 or 13 plan to deal with the taxes on a more favorable basis.
5. Sales Tax: If the sales tax is a tax on the buyer (it is in Idaho), it is treated as a trust fund tax which is not subject to discharge. In some states it is a tax on the seller and may be subject to discharge.

IV. TAX LIENS AND BANKRUPTCY

1. The rule in Chapter 7, where the taxes owed exceed the value of the Debtor's property, that the lien may NOT be stripped down to the value of the Debtor's

property.

2. The lien survives bankruptcy and even though the tax might have been discharged, the lien remains on the Debtor's property for its full amount. This creates a trap for the unwary.

3. If a lien is not released, it remains and attaches to all of the Debtor's property. The issue may arise years later. An example of how onerous this can be arises where a client has real property, there is a tax lien and a bankruptcy is filed. In that situation, if the lien is not released and the property appreciates (not likely these days), or the Mortgage is paid down, significantly, the lien creditor (the IRS or ISTC) gains the benefit of the appreciation or principal reduction in the property value.

4. For a thorough discussion, holding that the lien is not stripped down to the value of the collateral see Dewsnup v. Timm 112 S.Ct. 773.

5. Methodology for dealing with Tax Liens:
   a. Challenge the validity of an invalid tax lien.
   b. Request a Certificate of Release from the IRS.
   c. Negotiate a release for an amount to be paid.
   d. Advise client to wait out the statute of limitations.
   e. Liquidate the assets and pay the funds to the IRS.

V. OTHER BANKRUPTCY TAX ISSUES

Means testing does not apply to tax discharge matters.
   a. Taxes are not consumer debt.
   b. Taxes are involuntary.

The BNK Section produces this semi-quarterly newsletter. If you would like to include an item in an upcoming newsletter, please contact Katie Dullea at katied@nctv.com.

Commercial Law & Bankruptcy Section Officers

Chairperson

Kimbell David Gourley
Trout Jones Gledhill Fuhrman, PA
PO Box 1097
Boise, ID 83701
Phone: (208) 331-1170
kgourley@idalaw.com

Vice Chairperson

James Chris Meservy
Williams, Meservy & Lothspeich, LLP
PO Box 168
Jerome, ID 83338
Phone: (208) 324-2303
jcmeservy@cableone.net

Secretary/Treasurer

Janine Patrice Reynard
Hawley Troxell Ennis & Hawley, LLP
PO Box 1617
Boise, ID 83701
Phone: (208) 344-6000
jreynard@hawleytroxell.com

Past Chairperson

Donald Ray Barker
PO Box 9408
Moscow, ID 83843
Phone: (208) 882-6749
d.raybarker@turbonet.com

CLE Chairperson

James Chris Meservy
Williams, Meservy & Lothspeich, LLP
PO Box 168
Jerome, ID 83338
Phone: (208) 324-2303
jcmeservy@cableone.net

Newsletter Chairperson

Catherine Louise Dullea
Catherine L. Dullea, Chtd.
101 N. 4th Avenue, Ste. 204
Sandpoint, ID 83864
Phone: (208) 265-2276
katied@nctv.com

At Large Council Members

Randal Jay French
Bauer & French
PO Box 2730
Boise, ID 83701
Phone: (208) 383-0030
rfrench@bauerandfrench.com

Robert John Maynes
PO Box 3005
Idaho Falls, ID 83403
Phone: (208) 552-6442
mayneslaw@hotmail.com

PO Box 895
Boise, ID 83701
Phone: (208) 334-4500
Fax: (208) 334-4515
isb.idaho.gov