

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE EASTERN DISTRICT OF TEXAS
SHERMAN DIVISION

IN RE: § Case No. 14-40512
 § (Chapter 7)
HOWARD ROSENBERG, §
 §
Debtor. §

MEMORANDUM OPINION REGARDING
TRUSTEE’S MOTION FOR TURNOVER

The chapter 7 trustee seeks to compel the debtor to pay him a sum of money equaling the amount the debtor withdrew, post-petition, from his Individual Retirement Account (“IRA”) and spent on living expenses. This case is before the Court on a motion for turnover filed by the chapter 7 trustee pursuant to § 542 of the Bankruptcy Code. The Court exercises its core jurisdiction over this contested matter, *see* 28 U.S.C. §§ 157(b)(2)(B) and 1334, and makes the following findings of fact and conclusions of law pursuant to Federal Rules of Bankruptcy Procedure 7052 and 9014.

BACKGROUND

The debtor, Howard Rosenberg, filed for bankruptcy on March 5, 2014. Howard’s wife, Kathy, did not join him in his bankruptcy petition. Howard and Kathy were in the midst of a bitter divorce and battle over the custody of their three children.

When Howard filed for bankruptcy, he valued the assets held in, and his right to receive proceeds from, the IRA at \$210,000. He claimed his interest in the IRA as exempt from his creditors under Texas law. The extent of his interest in the IRA, however, was subject to equitable division in the pending divorce proceeding.

This Court granted a motion by Howard to lift the automatic stay in order to allow the divorce action to proceed in state court.¹ On June 24, 2014, the divorce court entered an order requiring Howard to withdraw \$30,000 from his IRA for the purpose of paying his attorney's fees in connection with the divorce action.² The divorce court also ordered Howard to withdraw \$5,000 from his IRA for the purpose of paying the attorney's fees of Kathy's bankruptcy counsel. In addition, the divorce court ordered the following:

Based on the belief that the parties' respective 401(k)/IRA accounts with Spectrum Financial are approximately equal as of June 17, 2014, said 401(k)/IRA accounts are set aside for the use and benefit of each respective party. IT IS ORDERED that each of Howard and Kathy may withdraw any remaining funds in their respective 401(k)/IRA accounts and may use said funds for any reasonable and necessary living expenses and for the payment of attorneys' fees. Further, the parties have no obligation to account to the Court for their usage of the remainder of these 401(k)/IRA accounts, but same will be subject to equalization or unequal division in the Final Decree of Divorce or at final trial.

The present turnover action arises from two withdrawals Howard made from his IRA in the total amount of \$80,395.44. Howard received \$55,395.44 from his IRA on July 2, 2014 and deposited the funds in his bank account. He spent \$35,000 of this amount paying attorney's fees in compliance with the divorce court's order, and he spent all of the remainder on living expenses within 60 days of receiving the funds. He received an

¹ The order lifting the automatic stay, which the Court amended on May 2, 2014, allowed the divorce court to decide matters unrelated to the division of property of the bankruptcy estate. The bankruptcy estate would have no interest in exempt assets, as discussed more fully below, and this Court's amended order allowed the divorce court to issue orders relating to exempt assets. In particular, the amended order provided the automatic stay would remain in effect only "as to the determination of the bankruptcy estate's right in property"

² Under Texas law, a divorce court may consider reasonable attorney's fees, along with the parties' circumstances and needs, in effecting a just and right division of the marital estate. *Murff v. Murff*, 615 S.W.2d 696, 698–99 (Tex. 1981); *Wilson v. Wilson*, 44 S.W.3d 597, 599–600 (Tex. Civ. App. -- Fort Worth 2001, no pet.); *Austin v. Austin*, 619 S.W.2d 290, 292 (Tex. Civ. App. -- Austin 1981, no writ) (although attorney's fees not recoverable in divorce suit under any specific statute or as costs, fees may be awarded as part of court's equitable power to make just and right division of community property).

additional \$25,000 on or about August 26, 2014, deposited the funds in his bank account, and, within 60 days, used all of the funds for living expenses.

Although Howard had claimed the IRA as exempt, the deadline for the trustee or creditors to object had not yet run when he made the two withdrawals. The deadline to object to a claimed exemption runs from the conclusion of the meeting of creditors required by 11 U.S.C. § 341, *see* FED. R. BANKR. P. 4001(b)(1). In Howard's case, the chapter 7 trustee conducted an initial meeting of creditors on May 28, 2014 as required by § 341 of the Bankruptcy Code.³ The chapter 7 trustee filed several notices of continued meeting dates with this Court, finally, formally concluding the meeting on August 26, 2014. Thus, the deadline to object to Howard's claimed exemption of his interest in the IRA was September 26, 2014.⁴

On September 16, 2014 (before the deadline to object to Howard's claimed exemptions had passed), Howard filed a motion to compel the trustee to abandon any interest in the IRA. The trustee objected to the motion on October 3, 2014 (after the deadline for objecting to Howard's claimed exemptions had passed). Howard and the trustee entered into an agreed order resolving the trustee's objection on October 31, 2014. The agreed order provided, among other things, that the trustee abandoned any interest of

³ Howard appeared at the meeting and met with the chapter 7 trustee. No creditor or other-party-in interest appeared.

⁴ Howard filed an amended "Schedule C – Property Claimed As Exempt" after this deadline, which changed various claimed exemptions. He did not change his claimed exemption of his interest in the IRA. Bankruptcy Rule 4003(b)(1) provides an additional 30 days from the date of an amendment to object to the exemptions first claimed by the amendment. Thus, in this case, the deadline to object to Howard's claimed exemption of the IRA was not altered by his amendment of Schedule C.

the estate in Howard's IRA except to the extent Howard had withdrawn funds from the IRA after filing for bankruptcy but before the entry of the agreed order.⁵

On October 31, 2014, Howard filed a motion for this Court's approval of the final decree of divorce. The final decree provided Howard with all rights to retirement plans in his name, including the funds remaining in the IRA at issue in this contested matter. The trustee did not object to Howard's motion, and this Court entered an order approving the final decree.⁶

On November 24, 2014, the chapter 7 trustee filed a motion seeking to compel Howard to turn over the gross amount of funds he had received from his IRA prior to October 31, 2014. Howard opposed the motion. At the conclusion of the hearing on the chapter 7 trustee's motion, the Court took the matter under advisement in order to provide the parties with a detailed written ruling.

ANALYSIS

The question of whether the chapter 7 bankruptcy estate includes payments or withdrawals from an IRA claimed by the debtor as exempt – but not yet withdrawn from the estate – is theoretical in most cases. Exemptions are usually determined shortly after a bankruptcy filing, once and for all, based on the facts and the law as they existed on the date of filing the bankruptcy petition. *Zibman v. Tow (In re Zibman)*, 268 F.3d 298, 302 (5th Cir.

⁵ When a holder of an IRA chooses to withdraw funds before retirement, the balance of the IRA remains protected as exempt. *See Rousey v. Jacoway*, 544 U.S. 320, 330-31 (2005). The holder must pay a large penalty for the early withdrawal, and the amounts withdrawn are taxable as income. *Id.*

⁶ In his turnover motion, the trustee asserts that the divorce court violated the automatic stay when it entered an order requiring Howard to pay attorneys' fees from the IRA. The trustee's assertion of a stay violation by the divorce court has no merit in light of the trustee's failure to object to Howard's claimed exemption of his interest in the IRA or this Court's order approving the final decree of divorce, which finalized the equitable division of the marital estate by the divorce court.

2001). Courts have used the metaphor of a “snapshot” taken on the date of filing, which “determin[es] the extent of the bankruptcy estate and the scope of the exemptions.” *Id.*

Here, the chapter 7 trustee did not swiftly conclude the meeting of creditors but, instead, continued the meeting for many months. These continuances extended the deadline to object to Howard’s claimed exemptions until after the divorce court awarded the IRA to Howard. The chapter 7 trustee ultimately did not file a timely objection to Howard’s claimed exemption of the IRA. Accordingly, Howard’s interest in the assets held in his IRA, and his right to receive payments from the IRA, were withdrawn from the bankruptcy estate effective as of the petition date. *See White v. Stump*, 266 U.S. 310, 313 (1924).

Nonetheless, the chapter 7 trustee seeks a turnover order requiring Howard to pay him a sum of money equal to the two post-petition withdrawals he made from his IRA. The trustee’s motion is based on § 542 of the Bankruptcy Code. As a threshold matter, § 542(a) requires the party seeking turnover to establish the estate has an interest in property. *See, e.g., In re Tri-River Trading, LLC*, 329 B.R. 252, 263 (B.A.P. 8th Cir. 2006) (trustee bears initial burden of showing the estate has an ownership interest in the property, then burden shifts to party claiming that the property was removed from the ambit of the estate); *see also In re Heritage Org., LLC*, 350 B.R. 733, 738 (Bankr. N.D. Tex. 2006) (in an action to compel turnover of property of the estate, the trustee bears the initial burden of proving that the property is property of the estate).

In this case, the chapter 7 trustee seeks to meet his initial burden by arguing, as a matter of law, the bankruptcy estate had a dormant interest in Howard’s exempt IRA on the petition date. The trustee further argues that the estate’s interest in the IRA “sprang” into

life when Howard received funds from the IRA. The trustee reasons the Texas exemption for IRAs, on the petition date, only exempted the assets held in the IRA or a post-petition rollover between the IRA and another exempt account. Thus, when Howard withdrew funds from his IRA after filing for bankruptcy, and when he failed to re-invest those funds into another retirement account, the trustee argues that he lost the exemption in the distributed funds retroactive to the petition date.

Even if the Court were to accept the chapter 7 trustee's argument that the estate held a "springing" interest in the IRA on the petition date, the trustee failed to file a timely objection to Howard's claimed exemption. The chapter 7 trustee has waived the objection he now seeks to raise. Furthermore, as discussed below, the chapter 7 trustee's arguments misread the applicable exemption statute.

Howard claimed his IRA as exempt under § 42.0021(a) of the Texas Property Code. The Texas Legislature added this provision in 1987 in response to several decisions which held that retirement benefits were not exempt in Texas. *See Jones v. American Airlines, Inc.*, 131 S.W.3d 261, 266 (Tex. App. -- Fort Worth 2004, no pet.) (citing *In re Goff*, 706 F.2d 574 (5th Cir. 1983) and *In re Brooks*, 60 B.R. 155 (Bankr. N.D. Tex. 1986)). Section 42.0021 establishes an unlimited exemption with respect to retirement benefits by providing that

a person's right to the assets held in or to receive payments, whether vested or not, under any stock bonus, pension, profit-sharing, or similar plan, including a retirement plan for self-employed individuals, and under any annuity or similar contract purchased with assets distributed from that type of plan, and under any retirement annuity or account described by Section 403(b) or 408A of the Internal Revenue Code of 1986, and under any individual retirement account or any individual retirement annuity, including a simplified employee pension plan.

TEX. PROP. CODE § 42.0021(a) (emphasis added).

In interpreting the new § 42.0021(a), some courts held that once retirement benefits were received by the retiree or other beneficiary, they were no longer exempt. *Cain v. Cain*, 746 S.W.2d 861, 865 (Tex. Civ. App. — El Paso 1988, writ denied). The court in *Cain*, for example, ordered turnover of military retirement pay and teacher retirement pay to a creditor. In 1989, the Texas Legislature addressed these decisions by amending the Texas turnover statute, which is found in § 31.002 of the Texas Civil Practices and Remedies Code. The Texas Legislature enacted a new section (f), providing that “[a] court may not enter or enforce an order under this section that requires the turnover of the proceeds of, or the disbursement of, property exempt under any statute, including Section 42.0021, Property Code.” TEX. CIV. PRAC. & REM. CODE § 31.002(f). *See also Burns v. Miller, Hiersche, Martens & Hayward, P.C.*, 948 S.W.2d 317, 322 (Tex. Civ. App. — Dallas, 1997) (explaining that the Texas Legislature added section (f) “partially in response to a line of cases that allowed the turnover of property that had lost its exempt status because a debtor had received it.”). In *Caulley v. Caulley*, 806 S.W.2d 795, 798 (Tex. 1991), the Texas Supreme Court reasoned that this provision “was intended to specifically exempt [from the turnover statute] paychecks, retirement checks, individual retirement accounts and other such property. *See also, e. g., Bergman v. Bergman*, 888 S.W.2d 580 (Tex. Civ. App. — El Paso 1994) (holding that the trial court abused its discretion in attaching retirement income in a turnover order); *Leibman v. Grand*, 981 S.W.2d 426. (Tex. Civ. App. — El Paso 1998) (holding judgment debtor's loan from his 401K retirement plan was exempt from turnover).

The chapter 7 trustee relies upon the Fifth Circuit’s analysis in *Viegelahn v. Frost (In re Frost)*, 744 F.3d 385 (5th Cir. 2014) to support his argument for turnover in this case. In *Frost*, no one objected to a chapter 13 debtor’s claimed exemption of his homestead under Texas law. The debtor sold his homestead after filing for bankruptcy. Under Texas law, property owners who sell their homesteads must reinvest the proceeds in another homestead within six months in order to maintain their exemption in the sales proceeds. TEX. PROP. CODE § 41.001(c) (“The homestead claimant's proceeds of a sale of a homestead are not subject to seizure for a creditor's claim for six months after the date of sale.”). This provision of the Texas Property Code is commonly referred to as the “Proceeds Rule.”

The debtor in *Frost* did not use \$18,000 of the sale proceeds to purchase a new, exempt homestead, and the bankruptcy trustee held those proceeds in trust while the parties litigated their proper disposition. The issue addressed by the Fifth Circuit was whether the \$18,000 automatically became property of the bankruptcy estate when Mr. Frost failed to use the money to purchase a new home within six months and their temporary protection lapsed under Texas law. The Fifth Circuit held that once the “conditional exemption” of the sales proceeds expired, Mr. Frost “lost his right to withhold the sales proceeds from the estate.” *Id.* at 389. *See also, e.g., In re Smith*, 514 B.R. 838 (Bankr. S.D. Tex. 2014) (holding that, where debtors did not reinvest proceeds from a post-petition, post-discharge sale of an exempt homestead into a new homestead, proceeds must be paid to pre-petition creditors).⁷

⁷ The debtors in *Smith* filed a chapter 7 petition in 2012 and received a discharge of their pre-petition debts in 2013. The bankruptcy court issued its opinion in an adversary proceeding in August 2014. The case was still open because the chapter 7 trustee had not yet liquidated and administered all of the assets of their bankruptcy estate. *See* 11 U.S.C. § 350; FED. R. BANKR. P. 5003. While many chapter 7 cases are “no asset” cases and are quickly closed, other chapter 7 cases, like *Smith*, may stay open for years.

Here, the chapter 7 trustee argues that § 42.0021(c) is a general proceeds rule analogous to the Texas Proceeds Rule discussed in *Frost*. The Texas Legislature amended § 42.0021 to add subsection (c) in 1989. Section 42.0021(c) provides:

Amounts distributed from a plan, annuity, account, or contract entitled to an exemption under Subsection (a) are not subject to seizure for a creditor's claim for 60 days after the date of distribution if the amounts qualify as a nontaxable rollover contribution under Subsection (b).

TEX. PROP. CODE § 42.0021(c).⁸ Since Howard did not deposit the funds he withdrew from his IRA into a tax exempt retirement account within 60 days, the chapter 7 trustee argues the exemption lapsed, and the funds became property of the estate as of the petition date.

Section 42.0021(c) protects non-taxable, rollover contributions between qualifying retirement accounts. It provides that during the period between one qualifying retirement account and the contribution as a rollover to another qualifying retirement account, for up to 60 days, the funds will retain their exempt status. See Karen K. Suhre, *Clarification of Retirement Benefits as Exempt Property*, 52 Tex. B. J. 38-39 (Jan. 1989). However, the present case does not involve a rollover, or attempted rollover, between retirement accounts. The present case involves an account holder's withdrawal of funds from an IRA to pay attorneys' fees and living expenses.

Howard claimed his IRA as exempt under Texas Property Code § 42.0021(a). This statute is fundamentally different than the Texas Proceeds Rule.⁹ The Texas Proceeds Rule

⁸ Subsection (b) refers to amounts qualifying as nontaxable rollover contributions under various provisions of the Internal Revenue Code. The Internal Revenue Code, in turn, defines a "rollover contribution" as "any amount paid or distributed out of an individual retirement account ... to the individual for whose benefit the account ... is maintained ... [that] is paid into an ... individual retirement annuity [within sixty days]." 26 U.S.C. § 408(d)(3).

⁹ This Court is not persuaded by the analysis of the bankruptcy court *In re Hawk*, 524 B.R. 706, 714 (Bankr. S.D. Tex. 2015) (treating § 42.0021(c) as a general proceeds rule "virtually identical" to the proceeds rule relating to the sale of homesteads).

provides a conditional exemption of the proceeds from the sale of a homestead that expires after six months. The IRA exemption statute, in contrast, provides an unlimited exemption of a person's right to the assets held in or to receive payments from an IRA. Section 42.0021(a) is not a conditional exemption statute that operates only for a limited period of time.

The present turnover action is also distinguishable from *Frost* because it arises in a chapter 7 case. When an individual files a chapter 7 petition, property of the estate consists solely of property in existence as of the date of the filing of the chapter 7 petition. *See* 11 U.S.C. § 541(a)(5). In contrast, when an individual files a chapter 13 petition, as in *Frost*, property of the estate also includes income and assets acquired post-petition. *See* 11 U.S.C. § 1306(a)(1) and (2).

The various other cases cited by the chapter 7 trustee are likewise distinguishable. This case does not involve the question of whether a pre-petition distribution from an IRA can be claimed as exempt. *Contrast In re Stokesberry*, 2013 WL 48066426 (Bankr. S.D. Tex. Sept. 5, 2013) (tracing pre-petition withdrawals from an exempt 401k to debtor's bank account and concluding the funds were non-exempt under Texas law). This case is also distinguishable from *In re Morgan*, 481 Fed. Appx. 183 (5th Cir. 2012), and *In re Evans*, 135 B.R. 261 (Bankr. S.D. Tex. 1991). Each of these cases involved the Texas Proceeds Rule -- not the exemption statute at issue here. In *Morgan*, the debtor did not attempt to exempt his homestead from the chapter 7 bankruptcy estate until more than six months after he had sold it. In *Evans*, the debtors sold their home prior to filing for bankruptcy, bought a new, less expensive home, and attempted to claim the excess sales proceeds as exempt.

Howard certainly took a risk in spending the money he received from his IRA before his claimed exemption became effective. If the chapter 7 trustee had objected to his claimed exemption, and if the Court sustained that objection, then the IRA would have been part of Howard's bankruptcy estate as of the petition date, and the IRA and its proceeds would have been used to pay Howard's prepetition creditors. Fortunately for Howard, that is not what happened. The chapter 7 trustee did not file a timely objection to Howard's claimed exemption of the IRA, or any document that could be construed as an objection, before the deadline expired.¹⁰ The chapter 7 trustee has waived any objection to the withdrawal of Howard's interest in the IRA from the bankruptcy estate. *Taylor v. Freeland & Kronz*, 503 U.S. 638, 644 (1992).

CONCLUSION

For all these reasons, the Court concludes the chapter 7 trustee has failed to meet his burden to establish grounds for turnover under § 542(a) of the Bankruptcy Code. A bankrupt debtor's decision to withdraw money from an exempt IRA may have consequences in the bankruptcy context by, for example, increasing the debtor's disposable income in a chapter 13 case. However, this Court does not understand *Frost* to have narrowed the exemptions available to individual debtors under § 522 to such an extent that the chapter 7 estate now includes a chapter 7 debtor's post-petition income derived from his exempt IRA despite the express limitation of § 541(a)(5). The Court concludes that the Texas exemption

¹⁰ The trustee apparently sought to preserve the issue of whether the money Howard spent from his IRA was property of the bankruptcy estate by objecting to Howard's motion to compel the trustee to abandon any interest of the estate in assets Howard had claimed as exempt. The trustee did not file his objection to Howard's motion until after the period for objecting to exemptions had expired. Furthermore, as discussed above, Howard's amendment of his Schedule C did not alter his claimed exemption of the IRA or start a new objection period as to the IRA under Bankruptcy Rule 4003.

statutes for IRAs do not provide the chapter 7 bankruptcy estate with a “springing” interest in an exempt IRA on the petition date that may or may not be triggered at some point during a case as a result of the chapter 7 debtor’s decision to withdraw funds from an exempt IRA and use the funds to pay living expenses.

Signed on 9/30/2015

Brenda T. Rhoades MD
HONORABLE BRENDA T. RHOADES,
UNITED STATES BANKRUPTCY JUDGE