UNITED STATES BANKRUPTCY COURT
FOR THE
WESTERN DISTRICT OF KENTUCKY

In re:

ELAINE M. SIKES CASE NO. **04-30951 (2)**

CHAPTER 7

Debtor

MEMORANDUM-OPINION

THIS CORE PROCEEDING[1] came before the Court on the Chapter 7 Trustee's Objection to Exemption Claim of Debtor Elaine M. Sikes for a $1,997 federal income tax refund.[2] Debtor filed a Response to Motion of Trustee on July 9, 2004; the Trustee filed a supporting Memorandum on July 14, 2004; and the Debtor filed a Memorandum in Response to Motion of Trustee on August 10, 2003. On August 23, 2004, this matter was deemed submitted by the parties and was taken under submission by the Court. Based upon the statements of counsel and the entire record in this case, the Court determines that the income tax refund in question is not properly claimed as an exemption in bankruptcy because Kentucky Revised Statutes ("KRS") 427.010(2)(2004), which provides restrictions on garnishment, is under the existing circumstances inapplicable in the bankruptcy process. The following constitutes the Court's Findings of Facts and Conclusions of Law pursuant to the Federal Rule of Bankruptcy Procedure 7052.

FINDINGS OF FACT AND CONCLUSIONS OF LAW

On February 19, 2004, Debtor filed for Chapter 7 relief. In her original Schedule C she claimed an exemption for her state and federal tax refund in the amount of $300 under KRS 427.160 (2004). On February 25, 2004, she filed an amended Schedule B & C and claimed an exemption

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[1]28 U.S.C. § 157 (b)(2)(B).

[2]*See* 11 U.S.C. § 522 (b); Fed.R.Bankr.P. 4003(b).

for her state and federal tax refund in the amount of $2,574 under KRS 427.010(2)(a), which provides for restrictions on garnishment. On April 29, 2004, Trustee objected to the income tax exemption claimed under KRS 427.010(2).

For the reasons set forth below, the Court finds that the federal tax refund in question is under these circumstances not exempt under KRS 427.010(2). The Trustee, as the objecting party to the Debtor's claimed exemption, has carried the required burden of proof. Fed. R. Bankr.P. 4003(c).

In 1968, Congress passed the Consumer Credit Protection Act ("CCPA"), 15 U.S.C. §§ 1671-77, in order to protect debtors by regulating commerce and fostering uniform bankruptcy law. The statute preempts any less restrictive applicable state law, but states have the right to "opt-out" of the federal exemption scheme and enact their own scheme of exemptions. Kentucky, in fact, chose to opt out of the federal exemption scheme and enacted a statute modeled on the CCPA, including KRS 427.010(2). In relevant part, KRS 427.010(2) states:

> (2) ... the maximum part of the aggregate disposal earnings of an individual for any workweek which is subjected to garnishment may not exceed the lesser of either:
>
> (a) Twenty-five percent (25%) of his disposable earnings for that week, or
>
> (b) The amount by which his disposable earnings for that week exceed thirty (30) times the federal minimum hourly wage...

This statutory language is virtually identical to the garnishment provision in the CCPA, 15 U.S.C. §1673.

Debtor argues that because Kentucky chose to opt-out of the federal exemption statute, the history and application of the CCPA are irrelevant to a discussion of Kentucky's exemption statute and policies. Trustee states that because KRS 427.010(2) was modeled on CCPA, the Court should be guided by the U.S. Supreme Court's decision in *Kokoszka v. Bedford*, 417 U.S. 642, 94 S.Ct. 2431, 41 L.Ed. 374 (1974), which found that a tax refund is not exempt in bankruptcy under the CCPA. While it appears that no Kentucky Court has yet addressed this issue, there is relevant and persuasive case law from other districts in addition to *Kokoszka v. Bedford*. See, for example, *In re Lawrence*, 205 B.R. 115 (Bankr. E.D. Tenn. 1997), *aff'd.* 219 B.R. 786 (D. Tenn. 1998) that provides persuasive guidance on this issue.

In *Lawrence*, 205 B.R. at 116, the Court addressed whether $140,000 in accounts receivable was exempt and not subject to attack by the trustee in bankruptcy. Like Kentucky, Tennessee has opted-out of the federal bankruptcy exemption scheme, and instead enacted an exemption statute which has virtually identical wording to the CCPA. The Court was presented with the question of whether exemption statutes, that do not sequester property from creditors in the usual way, but instead only limited the amount of property a creditor could obtain from a third party, were applicable in the bankruptcy process. *Id.* at 116-117.

In a careful and thorough discussion, Judge John Cook in *Lawrence*, 205 B.R. at 117-118, noted that the applicable Tennessee garnishment statute did not prohibit execution, seizure or attachment of property, but only placed a limit on the amount. The Court went on to find that the existence of a Tennessee statute providing total exemptions to pensions showed that the legislature was capable of drafting a complete exemption statute for wages but chose not to do so. *Id.* at 118. Additionally, it is noted that there is no restriction in Tennessee for seizure from bank accounts, which meant that a creditor could "go after" any wages once they were paid out to the debtor. *Id.* The Court found that if a debtor could not protect wages once they passed into their own hands it was then doubtful that these wages would be "exempt" in bankruptcy. *Id.* at 119.

The *Lawrence* Court went on to note that other states had also examined similar situations and had come to varying conclusions based on their states respective exemption statute. *Id.* The majority of Courts have held, however, that the CCPA does not protect earnings once they leave the control of the employer.[3] *Id.* at 120. Further, the legislative history underlying CCPA gives no indication that it was meant to be applicable to bankruptcy, and it is not included on the list of federally recognized bankruptcy exemptions. *Id.* While the CCPA listed as one of its purposes to

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[3] *Frazer, Ryan, Goldberg, Keyt & Lawless v. Smith*, 907 P.2d 1384 (Ariz. Ct. App. 1995), refusing to allow the Arizona garnishment statute to act as an exemption in bankruptcy by noting the similarity between the Arizona statue and the CCPA; *Caulley v. Caulley*, 777 S.W. 2d 147 (Tex. Ct. App. 1989), *aff'd in part and rev'd in part*, 806 S.W.2d 795 (1991), holding that the Texas garnishment provision in the state constitution does not protect earnings once they pass into the hands of the debtor, and noting that the CCPA similarly does not offer such protection; *Ellis Sarasota Bank & Trust Co. v. Nevins*, 409 So.2d 178 (Fla. Dist. Ct. App. 1982), finding that the Florida garnishment statute does not protect employees wages once they have been deposited in an employee's bank account.

establish uniform garnishment law so as to regulate its effect on the bankruptcy process among the states as to who would be forced into bankruptcy, it did not mean for the garnishment exemption to continue to operate during the bankruptcy process itself. In short, the CCPA "operates at the door of bankruptcy, but not inside." *Id.* at 123.

With this analysis as a foundation, Judge Cook found that the comparable Tennessee statute was not a general wage exemption but, like the identical CCPA provision, only applies to executions of earnings in the hands of third parties. Once a debtor entered bankruptcy, the purpose of the statute, namely preventing bankruptcy, could not be accomplished, and it was therefore inapplicable in the bankruptcy process.

Kentucky examined the source of its own garnishment statute in *Brown v. Commonwealth of Kentucky*, 40 S.W. 3d 873 (Ky. App. 1999), and came to a similar conclusion reached by Judge Cook. The Court there was faced with the question of whether bank accounts that contained only wages were protected by KRS 427.010(2). *Id.* While this case did not specifically deal with bankruptcy, it does provide a helpful discussion of the source and meaning of KRS 427.010(2). The Court notes that the applicable Kentucky statute was "modeled upon" the CCPA and goes on to discuss the interpretation of the federal statute as a means of understanding KRS 427.010(2). *Id.* at 877. In preforming this analysis, the Court relied on the on the Supreme Court's decision in *Kokozka v. Belford*, 417 U.S. 642, 94 S.Ct. 2431, 41 L.Ed. 2d 374 (1974), which addressed whether a debtor's tax return on money earned pre-petition, but paid out post-petition, was exempt under the CCPA. There the debtor attempted to argue that a tax refund can be traced to wages and fell within the definition of "disposable earnings" in the statute, and the trustee's act of taking the wages is a garnishment because it is a legal or equitable procedure by which the earnings of an individual is withheld for payment of a debt. *Id.* at 649.

Chief Justice Burger rejected this argument in *Kokozka v. Bedford,* 417 U.S. at 650, finding that the CCPA was not intended to alter the Bankruptcy Act's purpose of assembling all of debtor's assets for the benefit of the creditors once a petition is filed. The CCPA was meant to *prevent* bankruptcies, not to function within the bankruptcy process. Once bankruptcy did occur, however, the debtor could no longer look to the CCPA to protect him/her from the reach of the trustee in gathering the estate pursuant to 11 U.S.C. §541. *Id.* The Court ultimately found that the bankruptcy trustee could seize the tax refund for the benefit of the estate. *Id.* at 651.

Brown does note that the CCPA provides a floor, and each state is free to provide more protection to debtors. *Id.* at 877. It is possible, therefore, that Kentucky could provide exemptions where the federal statute does not. *Id.* at 878. States where it has been found that the garnishment statute applies are all instances where the legislatures either modified the federal statute and/or clearly indicated their intention to allow the exemption to continue into bankruptcy.[4] *Id. Brown* ultimately found that KRS 427.010(2) provided only limited protection to debtors, similar to that available in the CCPA, and was applicable only to the extent to which an employee's earnings could be garnished from his/her employer. *Id.* at 878-879.

In the instant case, Debtor argues that her federal tax refund received post-petition is entirely exempt under KRS 427.010(2). In forming her argument, Debtor relies on the fact that Kentucky opted out of the federal exemption statutes. Debtor, however, ignores the fact that KRS 427.010(2) is virtually identical to the federal statute and has provided no legislative history or case law that the General Assembly intended a different reading of the statute.

As found in *Brown*, there is no reason to believe that the General Assembly intended the Kentucky statute to be read differently than the CCPA, upon which it was clearly modeled. When Kentucky intends an exemption to exist, it so states. Additionally, the thorough analysis of a similar

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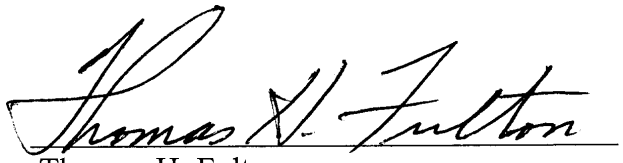
[4] *See MedAmerica Savings Bank v. Miehe*, 438 N.W. 2d 837 (Iowa 1989), finding that exempt earnings retained exempt status in the hands of the debtor based on the Iowa garnishment statute providing that earnings are "exempt from garnishment" as well as policy considerations and the state's long history of providing a complete exemption for earnings; *In re Kobernusz*, 160 B.R. 844 (Bankr. D. Colo. 1993), noting that although an application of the CCPA would lead to a different result, the Colorado exemption statute, per state Supreme Court precedent, protects earnings from the trustee's reach in bankruptcy; *In re Robinson*, 241 B.R. 447 (B.A.P. 9th Cir. 1999), finding that the Oregon statutory scheme, which state that earnings "remain exempt" after passing on to the debtor, demonstrates an intent on the part of the legislature for the garnishment statute to continue into bankruptcy; *In re Urban*, 262 B.R. 865 (Bankr. D. Kan 2001), finding that despite the fact that the Kansas anti-garnishment statute is a verbatim copy of the CCPA, both the state tradition of wage exemption and the legislative history of the statute evince an intent on the part of the drafters to allow the garnishment provision to carry through into the bankruptcy process; *Daugherty v. Central Trust Co. of Northeastern Ohio*, 504 N.E.2d 1100, 1103 (Ohio 1986)(per curiam), holding that the Ohio garnishment statute provided more protection than the CCPA because the Ohio statute was drafted more broadly so as to protect funds "not only from garnishment, but also from attachment and execution"; *In re Irish*, 303 B.R. 380 (Bankr. N.D. Iowa 2003), holding that the Iowa legislature intended to exempt wages not protected under the CCPA by expressly providing for an exemption for tax refunds.

Tennessee law in *Lawrence* persuades this Court that KRS 427.010(2) should be interpreted in the same way as the CCPA. Furthermore, in *Kokoszka* Chief Justice Burger clearly states that the CCPA garnishment statute is not meant to protect a debtor *in* bankruptcy but instead is meant to protect a debtor *from* bankruptcy. As such, a debtor may not utilize the garnishment statute within a bankruptcy case absent a showing of the General Assembly's intent to allow the statute to continue in the bankruptcy process. There is no indication that the Kentucky General Assembly intended a departure from the federal statute. [5]

KRS 427.010(2) is a Kentucky garnishment statute limited to pre-bankruptcy actions by creditors. Once a bankruptcy petition has been filed, a debtor may not look to it for protection from the trustee's reach.[6] As such, the Debtor may not claim an exemption for her 2003 tax refund under KRS 427.010(2). Accordingly, the Chapter 7 Trustee's objection to the Debtor's claimed exemption is granted.

A separate Order consistent with the foregoing has been entered in accordance with the Federal Rule of Bankruptcy Procedure 9021.

Dated: September 8, 2004



Thomas H. Fulton
United States Bankruptcy Judge

[5] This Court has done an independent search for legislative history regarding the enactment of KRS 427.010(2) and was unable to find any indication that the General Assembly intended a for the state statute to be applied differently from the CCPA.

[6]Of course, a Kentucky debtor may claim an exemption pursuant to other applicable exemption statutes if it is appropriate and meaningful to do so. Here it is not.

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ORDER

THIS CORE PROCEEDING came before the Court on the Chapter 7 Trustee's Objection to Exemption Claim of Debtor Elaine M. Sikes for a $1,997 federal income tax refund. Pursuant to the Court's Memorandum-Opinion entered this same date and incorporated herein by reference, and the Court being otherwise sufficiently advised,

IT IS HEREBY ORDERED that the Trustee's Objection be SUSTAINED and that the Debtor may not claim an exemption under KRS § 127.010(2).

Dated: September 8, 2004

Thomas H. Fulton
United States Bankruptcy Judge