

In the United States Bankruptcy Court

for the Northern District of Iowa

Western Division

CARMEN ROCHELLE THOMPSON

Debtor.

Bankruptcy No. 93-51364XS

Chapter 7

ORDER RE: OBJECTION TO EXEMPTIONS

The matter before the court is the trustee's objection to the debtor's claim of exemption in a tax refund. Hearing was held December 7, 1993 in Sioux City, Iowa. The court now issues its findings of fact and conclusions of law as required by Fed.R.Bankr.P. 7052. This is a core proceeding under 28 U.S.C. 157(b)(2)(B).

The debtor, Carmen Rochelle Thompson (THOMPSON), filed her chapter 7 petition August 11, 1993. Thompson maintains two bank deposit accounts. Before the bankruptcy filing, Thompson deposited into a savings account money representing her son's Veterans Administration benefits. She deposited into her checking account her wages and money representing her son's Social Security benefits. Thompson also deposited into the accounts \$1,400.00 representing income tax refunds. This deposit was divided between the savings and the checking accounts. Within 90 days of the bankruptcy filing, the bank accounts were attached by a creditor. The money is being held by the clerk of court in the Iowa District Court for Woodbury County.

The trustee has waived any objection to the claim of exemption based on tracing the bank deposits to the source of funds. The parties agree that the tax refund money is commingled with identifiable exempt funds. The court finds that the only issue in this matter is whether Thompson is entitled to claim an exemption for tax refunds in the prepetition bank deposits. Iowa Code 627.6(9)(c) provides for the tax refund exemption:

In the event of a bankruptcy proceeding, the debtor's interest in accrued wages and in state and federal tax refunds as of the date of filing of the petition in bankruptcy, not to exceed \$1,000.00 in the aggregate. This exemption is in addition to the limitations contained in sections 642.21 and 537.5105.

Iowa Code 627.6(9)(c).

The trustee argues that once Thompson deposited the funds into her bank accounts, they were no longer "tax refunds." Thompson argues that bank deposits traceable to a tax refund retain their exempt character.

The exemption for tax refunds, originally numbered 627.6(10)(e), was added as part of a major revision of the exemption statute in 1981. Acts 1981 (69 G.A.) Chapter 182 3. The court has been unable to find any case law discussing whether an exempt tax refund retains its exempt character once it is deposited in a bank account. The court will construe the statute keeping in mind that exemption statutes are to be liberally construed in favor of the debtor in light of the purpose of the exemption. Wallerstedt v. Sosne (In re Wallerstedt), 930 F.2d 630, 631 (8th Cir. 1991).

Under Iowa law, the change of exempt property from one form to another may cause the property to lose its exempt character. The general rule is that "proceeds from the voluntary sale of exempt property are not exempt in the absence of a statute providing therefor." Millsap v. Faulkes, 236 Iowa 848, 20 N.W.2d 40, 41 (Iowa 1945). Sale of exempt property waives the exemption. In re Brogan's Estate, 177 Iowa 423, 157 N.W. 952, 954 (1916). Moreover, the purchase of property with exempt funds does not make the acquired property exempt. Iowa Methodist Hospital v. Long, 234 Iowa 843, 12 N.W.2d 171 (1943) (savings bonds purchased with exempt wages are not themselves exempt).

Thompson has not sold her tax refund or purchased other property with it. She has deposited the money in bank accounts so that she may use it. The right to receive a tax refund is useless to the debtor unless she is able to negotiate the check and use the funds.

In MidAmerica Savings Bank v. Mische, 438 N.W.2d 837 (Iowa 1989), the court held that personal earnings do not lose their exempt character upon being deposited in a bank account.

In order to permit a wage earner to enjoy any benefit from the protection afforded by section 642.21, it is necessary to accord that person a reasonable opportunity to negotiate the paycheck and spend the funds. The commercial realities of modern-day living will frequently require that the funds be first deposited in a bank account in order to achieve that end. If wages intended by law to be exempt from creditors' claims are only accorded that status in the hands of the debtor's employer, the protection can be rendered meaningless by creditors levying on the funds in the hands of the debtor or on the debtor's bank account.

Mische, 438 N.W.2d at 839. The same rationale is applicable to a debtor's tax refund. Deposit of a tax refund check is not an abandonment of the exemption. The purpose of the exemption would be defeated unless the tax refund could be converted to cash. See Matter of Woods, 59 B.R. 221, 225 (Bankr. W.D. Wis. 1986) (proceeds of exempt property should also be exempt unless legislative intent can be effectuated by exemption limited to the specific item itself).

The court does not construe 627.6(9)(c) to mean that only refunds not yet received from the taxing authority are exempt. If a debtor were holding his or her refund check on date of filing bankruptcy, the asset in debtor's possession would be a "tax refund." The question presented in this case is whether the refund can be possessed by the debtor in a form other than the check from the taxing entity.

The court concludes that tax refunds traceable to savings or checking accounts in a financial institution retain their exempt character. The funds are exempt to the amount of \$1,000.00.

ORDER

IT IS ORDERED that the trustee's objection to exemptions in bank deposits representing tax refunds is overruled.

SO ORDERED THIS 9th DAY OF DECEMBER, 1993.

William L. Edmonds
Chief Bankruptcy Judge

I certify that on _____ I mailed a copy of this order and a judgment by U. S. mail to: Tim Shuminsky, Wil Forker and U. S. Trustee.