In the United States Bankruptcy Court

for the Northern District of Iowa

DAVID R. ZULAICA
HEIDI ANN ZULAICA
Debtor(s).

Bankruptcy No. 95-22000KD

Chapter 7

RULING ON TRUSTEE'S OBJECTION TO EXEMPTION

On January 31, 1996, the above-captioned matter came on for hearing pursuant to assignment on the Chapter 7 Trustee's Objection to Exemption. Attorney Tom McCuskey, the Chapter 7 Trustee, appeared in person. Debtors appeared in person with their attorney, Tom McKay. Evidence was presented after which the Court took the matter under advisement.

FINDINGS OF FACT

Debtor David Zulaica is 25 years old. He is a truck driver employed by the Iowa Department of Transportation. In addition, he is a combat engineer in the Iowa Army National Guard having first enlisted on June 18, 1989.

On October 22, 1995, Mr. Zulaica reenlisted for three years. His military specialty entitled him to a reenlistment bonus which totaled $2500. It is payable in three installments. The bonus is subject to federal and state income tax and FICA withholding. He received his first payment on January 26, 1996 in the gross amount of $1,000 and the net amount of $600. The bonus will supposedly be paid in full prior to October 1997.

Debtors filed their Chapter 7 Petition on October 17, 1995, five days before Mr. Zulaica reenlisted. They claimed the Iowa Army National Guard reenlistment bonus as exempt property under Iowa Code sec. 627.6(8)(e), and erroneously listed its value as $3,500. Mr. Zulaica testified that because of National Guard regulations, he could not reenlist prior to October 22, 1995.

The Chapter 7 Trustee filed an objection to this exemption and Debtors filed a resistance. Debtors assert that they need not have listed the reenlistment bonus as an asset nor claimed it as exempt under Iowa Code sec. 627.6(8)(e) as they now maintain reenlistment bonus is not property of the estate under § 541 of the Bankruptcy Code.

CONCLUSIONS OF LAW

Section 541(a)(1) provides that property of the estate comprises "all legal or equitable interests of the debtor in property as of the commencement of the case." 11 U.S.C. § 541(a)(1) (1994). Section 541(a)(5) includes within this definition:

> Any interest in property that would have been property of the estate if such interest had been an interest of the debtor on the date of the filing of the petition, and that the debtor acquires or becomes entitled to acquire within 180 days after such date -
>
> (a) by bequest, devise, or inheritance;
>
> (b) as a result of a property settlement agreement with the debtor's spouse, or of an interlocutory or final divorce decree; or

> (c) as a beneficiary of a life insurance policy or of a death benefit plan.

11 U.S.C. § 541(a)(5) (1994).

Debtors cite the following analysis of property of the estate from In re Griseuk, 165 B.R. 956, 958 n.3 (Bankr. M.D. Fla. 1994). This paragraph succinctly sets out an appropriate method of examining property issues:

> When an individual debtor files a Chapter 7 case, all nonexempt property of the Chapter 7 estate is to be liquidated for the benefit of creditors. Because Congress has established a fresh-start policy for the debtor, a new post-petition estate belonging to the individual debtor is created simultaneously with the filing. Into this individual post-petition estate, the debtor may transfer any property he can exempt out of the Chapter 7 estate, as well as post-petition earnings from services he has performed. Other property which the debtor receives, after filing and which is not governed by the exceptions in section 541 (a)(5), would also be part of the debtor's fresh-start estate. Therefore, property acquired after the commencement of the Chapter 7 case is not property of the estate.

Brief for Debtor at 3, In re Zulaica, No. 95-22000KD (Bankr. N.D. Iowa filed Oct. 17, 1995) (quoting Griseuk, 165 B.R. at 958 n.3).

Property acquired post-petition is considered to be property of the estate under certain limited conditions as defined in § 541(a)(5). It is uncontested that a reenlistment bonus does not fit within the exceptions of § 541(a)(5) in that it was not acquired by bequest, devise, inheritance, from a property or divorce settlement, or from a life insurance or death benefit policy. As such, the reenlistment bonus does not qualify as property of the bankruptcy estate based on any of the narrow exceptions contained in § 541(a)(5).

To determine if this reenlistment bonus constitutes estate property, the Court must examine the nature of the reenlistment bonus. The authority for payment of reenlistment bonuses to an enlisted member of the National Guard is found in 37 U.S.C. § 308(b)(1994). This provision provides that:

> an enlisted member of a reserve component who has completed less than ten years of total military service and reenlists or voluntarily extends his enlistment for a period of three years . . . may be paid a bonus . . . [with] an initial payment . . . not to exceed $1250 . . .

Id.

The issues raised in this case have not been previously decided in the Northern District of Iowa. While military reenlistment bonuses have been the subject of dispute in several Chapter 7 bankruptcy cases across the country, the issues examined and the facts of each case are not identical to those raised here. In re Kelly, 88 B.R. 477, 478 (Bankr. M.D. Ga. 1988); In re Burson, 107 B.R. 285, 286 (Bankr. S.D. Cal. 1989).

In Kelly, Mr. Kelly reenlisted in the Air Force for four years and received a reenlistment bonus. He subsequently filed a Chapter 7 petition in anticipation of being involuntarily discharged before he could complete his term of reenlistment. Although not explicitly stated, it appears the debtor received the bonus in full before filing his petition. Upon Mr. Kelly's involuntary discharge, the Air Force withheld $1411.97 from his final paycheck as recoupment of a portion of his unearned reenlistment bonus. Kelly, 88 B.R. at 478.

The issue presented was whether the Air Force held a postpetition claim and whether it violated the automatic stay by withholding the unearned portion of the debtor's reenlistment bonus from the debtor's final paycheck. The court found that the debt was postpetition and the Air Force did not violate the automatic stay. Kelly, 88 B.R. at 479. The Court based its ruling on the initial conclusion that "[t]he funds withheld by [the Air Force] apparently represent earnings from services performed by Mr. Kelly after the commencement of the case, and are therefore not property of the Chapter 7 bankruptcy estate." Id. at 478.

On similar facts, the court in In re Burson, 107 B.R. 285, 286 (Bankr. S.D. Cal. 1989), addressed the issue of "whether a reenlistment bonus disbursed to a serviceman is a pre-petition claim held by the government." The debtor in Burson

reenlisted in the Marine Corps, received a reenlistment bonus, and subsequently filed a Chapter 7 petition in anticipation of receiving an early, involuntarily discharge. The facts of Burson differ from Kelly in that Mr. Burson received a postpetition payment of his reenlistment bonus.

The Burson court found that the Marine Corps held a prepetition claim that was discharged upon entry of the Order of Discharge. 107 B.R. at 288. The court reached this conclusion by determining that the Court in Kelly failed to recognize that a reenlistment bonus is contingent on the recipient completing his or her term of reenlistment. Id. Since the debtor in Burson was still completing his term of enlistment at the time of filing, he was earning his bonus and fulfilling the contingency. Therefore, even though the debtor in Burson reenlisted prepetition, the Marine Corps' contingent claim never matured prepetition, and was dischargeable. This excepted the debtor's postpetition bonus payment from inclusion in property of the bankruptcy estate.

The facts here differ from those in both Kelly and Burson in that Mr. Zulaica reenlisted postpetition and received his bonus postpetition. The analysis from Burson and to a lesser extent from Kelly, however, is useful. Upon reenlistment by a member of the military and receipt of a reenlistment bonus, the military holds a contingent claim. This claim is dischargeable upon the Order of Discharge as the member completes the reenlistment postpetition. Burson, 107 B.R. at 288. As reenlistment bonuses are in the form of increased compensation for current and future services, and the "earnings exclusion" of § 541(a)(6) excepts an individual's postpetition earnings from property of the bankruptcy estate, any bonus payments the military member receives postpetition are property of the debtor, not property of the bankruptcy estate.

It is the conclusion of this Court that the reenlistment bonus acquired postpetition is most properly treated as earnings for services which Mr. Kelly will perform throughout the course of his enlistment. As the reenlistment bonus constitutes postpetition earnings, the reenlistment bonus is most properly categorized as property acquired postpetition and excluded from the bankruptcy estate under § 541(a)(6).

When a debtor receives a large sum of money shortly after filing, a Trustee or creditor may rightly have sufficient suspicion to make further inquiry. Congress sought to prevent fraud by including § 541(a)(5) in the Bankruptcy Code. In re Woodson, 839 F.2d 610, 619 (9th Cir. 1988). Section 541(a)(5) is intended to prevent debtors from fraudulently manipulating the filing date of their bankruptcy petition when they anticipate receiving large amounts of specific assets in the near future. By filing before they receive these assets, debtors could effectively deprive their creditors of these assets.

There is no showing here that Debtors violated the intent of § 541(a)(5) by filing a bankruptcy petition five days before Mr. Zulaica reenlisted. While debtors may have manipulated the date of the bankruptcy filing to predate the reenlistment, it was not fraudulent.

It is not fraudulent or inappropriate to properly use the Bankruptcy Code for estate planning. For example, a debtor may take advantage of the exemptions to which he or she is entitled under state law without committing a fraud against the Bankruptcy Code. Hanson v. First Nat. Bank, 848 F.2d 866, 868 (8th Cir. 1988); see also Norwest Bank Neb., N.A. v. Tveten, 848 F.2d 871, 873-74 (8th Cir. 1988).

In this case, there is little concern about inappropriate manipulation of estate assets. Mr. Zulaica earned this bonus postpetition. Debtors did not commit fraud by filing their bankruptcy petition five days before Mr. Zulaica reenlisted in the National Guard. In fact, under this Court's ruling, the date of reenlistment is not critical to the analysis; it is the date of receipt of the bonus which is important.

In summary, military reenlistment bonuses received postpetition are not property of the bankruptcy estate. Although this Court has never addressed this specific issue before, cases from other jurisdictions support excluding a postpetition bonus from the bankruptcy estate. The "earnings exclusion" of § 541(a)(6) excepts from property of the bankruptcy estate earnings received by an individual debtor for services performed postpetition. Although Debtors may have chosen their filing date to occur before their reenlistment, this was not fraudulent or violative of Congress' intent of § 541(a)(5).

WHEREFORE, for all the reasons set forth herein, it is the determination of this Court that the reenlistment bonus of Debtor David R. Zulaica is not property of the bankruptcy estate as defined in § 541 of the Bankruptcy Code.

FURTHER, as the reenlistment bonus is not property of the estate, Trustee's objection to exemption as to this property is overruled as moot.

SO ORDERED this 6th day of March, 1996

Paul J. Kilburg
U.S. Bankruptcy Judge