No. _____

In The
Supreme Court of the United States

LAWRENCE J. WARFIELD,

Petitioner,

v.

UNITED STATES OF AMERICA,

Respondent.

On Petition For Writ Of Certiorari To The Ninth Circuit Court Of Appeals

PETITION FOR WRIT OF CERTIORARI

SUSAN M. FREEMAN
Counsel of Record
LAWRENCE A. KASTEN
KATERINA GRAINGER
LEWIS ROCA ROTHGERBER CHRISTIE LLP
201 East Washington Street, Suite 1200
Phoenix, Arizona 85004
(602) 262-5311
sfreeman@lewisroca.com

TERRY A. DAKE
Co-Counsel
TERRY A. DAKE, LTD.
20 East Thomas Road, Suite 2200
Phoenix, Arizona 85012
(602) 252-4712
tdake@cox.net

COCKLE LEGAL BRIEFS (800) 225-6964
WWW.COCKLELEGALBRIEFS.COM

QUESTION PRESENTED

All of a debtor's interests in property become property of the bankruptcy estate when the bankruptcy petition is filed, including the debtor's residence. The debtor may claim an interest in that residence up to a statutory maximum as a homestead exemption by listing it on a schedule. The exemption of the debtor's equity interest in the homestead is allowed if no timely objection is filed or an objection is resolved by court order.

The Bankruptcy Code expressly authorizes bankruptcy trustees to avoid liens against estate property securing penalties, including for debtor tax delinquencies, with no requirement that the property be non-exempt. Congress' stated purpose was that debtors alone, not their creditors, should bear the consequences of debtor misconduct. Tax liens are not limited by homestead exemptions, and the Bankruptcy Code and Rules impose no deadline to file such avoidance actions. The Ninth Circuit ruled, over a strong dissent, that once the debtor's homestead exemption has been allowed, a trustee cannot avoid a penalty lien on the residence underlying the homestead and preserve it for the benefit of creditors. Contrary to other circuits and this Court, the Ninth Circuit held that once the homestead exemption is allowed, it ceases to be property of the estate, and that prevents the trustee from accessing and avoiding the penalty lien that encumbers the residence subject to the homestead.

The question presented is: When a bankruptcy court allows a state homestead exemption, is the

QUESTION PRESENTED—Continued

debtor's exempt interest in the residence instantaneously removed from the bankruptcy estate in a manner that defeats the trustee's federal statutory right to avoid a penalty lien on the residence and all of the debtor's interests in it for the benefit of unsecured creditors?

PARTIES TO THE PROCEEDING

The case caption contains the names of all parties.

RULE 29.6 STATEMENT

Lawrence J. Warfield is an individual, and the chapter 7 bankruptcy trustee of the Sandra J. Tillman ("Debtor") bankruptcy estate.

TABLE OF CONTENTS

TABLE OF CONTENTS—Continued

TABLE OF CONTENTS—Continued

TABLE OF AUTHORITIES

Page

CASES

TABLE OF AUTHORITIES—Continued

TABLE OF AUTHORITIES—Continued

TABLE OF AUTHORITIES—Continued

STATUTES

TABLE OF AUTHORITIES—Continued

TABLE OF AUTHORITIES—Continued

Lawrence J. Warfield (the "Trustee") petitions for a writ of certiorari to review the opinion of the United States Court of Appeals for the Ninth Circuit in this case.

OPINIONS BELOW

The published Ninth Circuit opinion is reported at 53 F.4th 1160 and attached in the Petition Appendix ("App.") at 1-43. The Ninth Circuit order denying reconsideration, No. 21-16034, 2023 U.S. App. LEXIS 25431, is unreported and reprinted at App. 105-06. The opinion of the United States District Court for the District of Arizona, No. CV-20-08204-PCT-DWL, 2021 WL 1530094, is unreported and reprinted at App. 44-77. The order of the United States Bankruptcy Court for the District of Arizona, No. 3:19-BK-01074-DPC, 2020 WL 4574900, is unreported and reprinted at App. 78-104.

JURISDICTION

The Ninth Circuit issued its opinion on November 18, 2022 (App. 1) and denied a timely petition for rehearing or rehearing *en banc* on September 26, 2023. App. 105-06. This Court's jurisdiction is invoked under 28 U.S.C. § 1254(1). The District Court and Bankruptcy Court had jurisdiction under 28 U.S.C. §§ 157, 158 and 1334, and the Ninth Circuit had jurisdiction under 28 U.S.C. § 158(d)(1).

STATUTES AND CONSTITUTIONAL PROVISIONS INVOLVED

This case involves 11 U.S.C. §§ 522(b)(1), 522(c)(1), 522(c)(2), 522(l), 541(a)(1), 541(a)(4), 551, 554(a), 554(b), 554(d), 724(a), 726(a)(4); 26 U.S.C. §§ 6321, 6322, (hereafter cited as "IRC" section number); Federal Rule of Bankruptcy Procedure 4003(a), (b)(1); Arizona Revised Statutes §§ 33-1101(A)(1) (2004), 33-1101(C) (2004), 33-1104(D), 33-1133(B). These provisions are set forth in App. 107-13.

STATEMENT OF THE CASE

The Debtor's bankruptcy schedules listed her residence in Prescott, Arizona ("residence"), which she valued at $511,000.00. She listed a Bank of America deed of trust thereon securing indebtedness of $371,350.85, a homestead exemption of $150,000.00, and a federal tax claim. The Internal Revenue Service ("IRS") filed a proof of claim for $24,686.26 in penalties and interest on penalties that the Debtor incurred by untimely filing of returns and untimely payment of taxes that accrued less than three years before her bankruptcy petition, secured by a recorded tax lien specifically listing the residence. The IRS proof of claim was filed the day before the § 341 meeting of creditors, and was "deemed allowed." 11 U.S.C. § 502(a).

The Trustee objected to the Debtor's homestead exemption before the deadline, arguing the priority of the federal tax lien over the homestead exemption. App. 82. The Trustee asserted an interest in the

residence superior to the Debtor's homestead exemption interest because the lien proceeds could be used to pay estate expenses and claims under 11 U.S.C. § 724(a). The Debtor responded that while the IRS's interest and Trustee's § 724(a) interest might attach to a portion of her equity in the residence, her homestead exemption should be allowed. App. 82-83. She argued the Trustee should not be allowed to sell the residence to pay his Trustee's fees. The Trustee replied that he did not know so early in the case if the residence would need to be sold or the penalty lien avoided, but he was timely objecting to preserve bankruptcy estate rights. The bankruptcy court allowed the homestead exemption, expressly providing that it was subordinate to the bank lien and the penalty lien. App. 95.

Eight months later, the Trustee filed an adversary complaint against the IRS for an order avoiding the penalty lien under § 724(a) and preserving it for the bankruptcy estate under 11 U.S.C. § 551. App. 84. The Debtor intervened. *Id.* The IRS confirmed that the principal amount of the Debtor's assessed taxes had been paid prepetition. However, it also said the tax penalties remained unpaid, were non-dischargeable, and secured by a recorded lien on the residence.

In summary judgment briefing, the IRS contended that § 551 lien preservation is limited to property of the estate and the penalty lien "attached to the homestead exemption [instead of the residence] and the exemption is property of the debtor [instead of property of the estate]," but simultaneously argued that tax liens reach every interest in property a taxpayer might

have. The IRS also conceded that title to the residence passed to the trustee, but argued that title was subject to the Debtor's exemption net of any consensual security interest (*i.e.*, the Bank of America mortgage), without accounting for the tax lien.

The IRS further argued that, under 11 U.S.C. § 552(c)(2)(B), the penalty lien survives against the exemption amount or attaches anew to exempt sale proceeds. The IRS asserted that therefore, the Debtor could exempt the proceeds under § 522(g)[1] and either the entire avoided amount or any proceeds remaining after the Trustee's avoidance could not be made to the Debtor without paying the first monies to the IRS.

The bankruptcy court granted the Trustee's summary judgment motion. App. 80, 103. In doing so, it held that the Debtor's exemption was only the value of her interest in the residence, which never included the value of the bank or IRS liens, *i.e.*, only the Debtor's equity in the residence was exempt, and was subordinate to both the bank lien and penalty lien. App. 91-92, 95, 103.

After entering summary judgment avoiding the penalty lien under § 724(a) and preserving it for the estate under § 551, the bankruptcy court approved a sale of the residence for $475,000 free and clear of all liens. The bank lien was paid in full, $26,771 of the sale proceeds was ordered held by the Trustee as the

---

[1] The Debtor also argued § 522(g) rights, but § 522(g) was not reasserted on appeal and is not an issue in this petition. App. 9 n.1.

avoided penalty lien until further court order, and the balance after closing costs, approximately $30,000, was disbursed to the Debtor for her homestead exemption. The record does not disclose whether the IRS received any portion of the $30,000 from the Debtor. The district court affirmed the bankruptcy court's order. App. 45, 76.

The Ninth Circuit reversed in a published opinion. App. 3, 32. The majority held that the Trustee could not avoid the penalty lien because the lien encumbered exempt property, and upon allowance of the exemption, the exempt interest ceased to be property of the estate, which it held prevented the Trustee from administering the residence subject to that exemption. App. 15-16 n.2, 19, 22, 28. It held that § 724(a) penalty lien avoidance powers can never apply to assets subject to an exemption, despite the Bankruptcy Code having no such limitation. App. 12-13, 31-32. The majority explained its motivation for circumventing the statutory language: not "doubling the burden" of the penalty on the Debtor by distributing the penalty funds to creditors when the Debtor still must pay the IRS. App. 28-31. The dissent noted the plain language of the Bankruptcy Code permits a trustee to avoid federal tax penalty liens and concluded the majority's concerns about a potential "double penalty" should be addressed, if at all, by Congress not courts. App. 34, 43. If reversed by this Court, the Trustee will use the $26,771 for creditors in accordance with Code distribution provisions,

and the IRS may collect its tax penalty lien amount from the Debtor.

REASONS FOR GRANTING THE WRIT

The Opinion disregarded the plain language of the Bankruptcy Code permitting trustees to avoid penalty liens out of concern that debtors' exempt funds would be reduced. It also decided two issues of law in a way that has a profound impact on trustee administration and creditor payments and which conflicts with settled decisions of this Court and other circuits.

First, the court found immaterial the clear statutory language allowing trustees to avoid penalty liens. It held that trustees are automatically precluded from administering property in which a debtor claims an exempt interest once the objection deadline passes, including avoidance of voidable liens for the benefit of creditors. This holding conflicts with the holdings of five circuits and this Court's analysis in *Schwab v. Reilly*, 560 U.S. 770 (2010).

Second, to contend again with the statute's plain language, the Opinion held that tax liens on homesteads only encumber the exempt interest, not the underlying real property itself, and that state exemption laws supersede the priority of tax liens. These holdings conflict with the holdings of three circuits.

The Ninth Circuit reached beyond statutory language and settled principles laid down by this Court

and those of other circuits because it believed Congress would not have intended to reduce the funds a debtor could keep for himself post-bankruptcy. However, the Opinion is not limited to tax penalty liens with potential post-bankruptcy collection rights—it encompasses, for example, antitrust treble damages judgment liens. Moreover and in any event, as noted by the dissent, the court's speculation about Congressional intent does not justify ignoring or adding exceptions to plain statutory provisions, especially where penalty lien avoidance is consistent with longstanding bankruptcy treatment of debtor wrongdoing. The Opinion contravenes decisions from this Court and other courts of appeals, results in unfair disparities in treatment of bankruptcy trustees and creditors around the country, and will promote litigation as bankruptcy and appellate courts in circuits without precedent on point guess which way this Court will ultimately rule.

I. The statutory provisions empower the Trustee to preserve and avoid a lien on the residence.

This case should begin and end with the plain language of the Bankruptcy Code. Section 541(a)(1) defines property of the estate as, subject to inapplicable exceptions, "all legal or equitable interests of the debtor in property as of the commencement of the case." That property may be augmented through a trustee's avoiding powers. Section 541(a)(4) adds to the definition, "[a]ny interest in property preserved for the benefit of . . . the estate under section . . . 551 of this

title." The Opinion does not dispute that property subject to an exemption is property of the estate as of the commencement of the case. Instead, it opines that by the time any penalty lien is avoided under § 724(a), which it says turns on postpetition claim allowance and distributions to creditors, such exempt property is no longer property of the estate.

Section 724(a) provides that "the trustee may avoid a lien that secures a claim of a kind specified in section 726(a)(4) of this title." Section 726(a)(4) defines that type of lien, *i.e.*, "for any fine, penalty . . . arising [prepetition or before the trustee's appointment] to the extent that [it is] not compensation for actual pecuniary loss. . . ." There is no dispute here that the IRS lien at issue is of the type that § 724(a) permits a trustee to avoid.

Section 726 describes how property of the estate is to be distributed, including in payment of § 726(a)(4) allowed claims, secured and unsecured. Contrary to the Opinion, § 726 language is not incorporated into § 724(a), except for the description of the kind of claims the trustee may avoid. Neither § 724(a) nor § 726(a)(4) excepts a lien on property subject to an exemption from avoidance or restricts lien avoidance to the end of the case when the trustee distributes liquidated assets, as the majority ruled.

Section 551 provides that "[a]ny transfer avoided under section . . . 724(a) . . . is preserved for the benefit of the estate but only with respect to property of the estate." The Opinion does not purport to address § 551.

App. 27 n.5. The dissent explains that § 551 applies because the residence subject to the tax lien remains property of the estate even though a specific dollar amount is protected from prepetition debts by the homestead exemption. App. 39-41.

The Trustee would prevail if the Opinion followed the plain language of the Bankruptcy Code.

II. Assets subject to exemptions are property of the estate until abandoned or distributed.

A. This Court has unequivocally held that a residence subject to an exemption remains property of the estate during the case.

Crucial to the Opinion's result was its holding that exempt interests in property exit the estate upon allowance, and that this prevents trustee avoidance of liens or other administration ***of the property itself***. Without that holding, the Code's clear grant of authority to the trustee to avoid penalty liens would apply. § 724(a). The court's holding is inconsistent with settled authority.

All of a debtor's interests in property are property of the bankruptcy estate upon the commencement of the case. § 541(a). A debtor may exempt certain kinds of assets, enabling him to retain them post-bankruptcy. § 522(b)(1). The Code provides that exempt assets are "not liable" for the payment of any prepetition debts, but the Code does not provide that they cease to be

property of the estate during the case. § 522(c); *see also* § 522(k) (§ 522 exempted property is liable for payment of certain administrative expenses); App. 37-38 (dissent), quoting *Law v. Siegel*, 571 U.S. 415, 417-18 (2014) (exempt property is what a debtor may "retain . . . post-bankruptcy") and *Owen v. Owen*, 500 U.S. 305, 308 (1991) (exempt property is "immunized against liability for prebankruptcy debts").

Some exemptions apply to the entirety of specific assets, such as a family Bible. Some courts have held that ownership of that specific property revests in the debtor and it exits the estate when no objections are filed by the deadline for objecting without an abandonment order. *See Mwangi v. Wells Fargo Bank, N.A. (In re Mwangi)*, 764 F.3d 1168, 1176-77 (9th Cir. 2014) (account funds revested in debtors upon expiration of exemption objection period); *but see Garzoni v. Taunt*, 56 F. App'x 214, 216 (6th Cir. 2003) ("no asset report" did not result in abandonment of lawsuit). Like the homestead here, however, most exemptions consist of "an interest withdrawn from the estate (and hence from the creditors) for the benefit of the debtor." *Owen*, 500 U.S. at 308.

Even though the interest is "withdrawn from the estate," ***the asset*** subject to exemptions (here, the real property) does not leave the estate prior to sale, abandonment, or closing of the case. The trustee may still administer the property, with the debtor receiving a distribution of exempt funds along with the creditors at the end of the bankruptcy case when the exemption is only of an interest in an asset, generally as a

statutory dollar amount. "To help the debtor obtain a fresh start, the Bankruptcy Code permits him to *withdraw from the estate* certain *interests in* property, such as his car or home, *up to certain values*." *Schwab*, 560 U.S. at 791 (court's emphasis, quoting *Rousey v. Jacoway*, 544 U.S. 320, 325 (2005)).

> If an interested party does not object to the claimed interest by the time the Rule 4003 period expires, *title to the asset will remain with the estate* pursuant to § 541, and *the debtor will be guaranteed a payment in the dollar amount of the exemption*.

Id. at 792 (emphasis added).

This is critical because an asset claimed as exempt "may have value beyond the dollar amount the debtor claims as exempt, or [the asset's] full value may not be available for exemption because a portion of the interest is, for example, encumbered by an unavoidable lien." *Id.* at 785. The trustee is responsible for administering property of the estate, maximizing its value for the benefit of creditors. *Commodity Futures Trading Comm'n v. Weintraub*, 471 U.S. 343, 352 (1985). This includes liquidating assets subject to exempt interests and avoiding liens when it will benefit unsecured creditors. *See Morgan v. K.C. Mach. & Tool Co. (In re K.C. Mach. & Tool Co.)*, 816 F.2d 238, 247 (6th Cir. 1987) (subordination of tax liens is beneficial to estate, justifying non-abandonment of property despite lack of equity therein).

Moreover, proceeds of selling an Arizona homestead only remain exempt in bankruptcy cases as well as outside of bankruptcy for 18 months after a homestead property is sold, unless the proceeds are reinvested in another homestead within that period. *See Flatt v. Mullen*, 2018 WL 5807078 (D. Ariz. Nov. 6, 2018); *White v. Brown (In re White)*, 389 B.R. 693, 704-06 (B.A.P. 9th Cir. 2008) and bankruptcy cases cited therein, interpreting A.R.S. § 33-1101(C). If property subject to a homestead exemption is sold postpetition or prepetition, the bankruptcy "estate [holds] a contingent, reversionary interest" in the proceeds, which the estate is entitled to recover if the debtor does not invest homestead interest proceeds in another homestead. *McCallister v. Wells (In re Wells)*, 2021 WL 5755086 *2 (9th Cir. Dec. 3, 2021); *see Wolfe v. Jacobson (In re Jacobson)*, 676 F.3d 1193, 1198-1200 (9th Cir. 2012) (interpreting comparable California law).

These cases underscore that exempt homestead interests in residential property remain part of the bankruptcy estate and subject to trustee administration. If a debtor seeks unfettered access to an exempt interest in an asset with no ability of the trustee to administer it before the case-end distribution, he needs to prove to the bankruptcy court that there is no value in that asset for creditors and obtain an abandonment order. § 554; *Gebhart v. Gaughan (In re Gebhart)*, 621 F.3d 1206, 1212 (9th Cir. 2010). The Debtor's residence was never abandoned out of the estate, and the premise underlying the court's holding that the residence

could no longer be administered by the Trustee was incorrect.

B. The Ninth Circuit Opinion conflicts with Third, Fourth, Sixth, and Seventh Circuit cases holding that property with an exempt interest is still subject to trustee administration with other property of the bankruptcy estate.

The Opinion conflicts with holdings of other circuit courts. The rule in the Fourth Circuit is that scheduling a claim of exemption, with no timely trustee objection, does not result in "automatic re-vesting of the entire [asset] in the debtor, but only for an exemption of the debtor's interest up to" a statutory cap. *Wissman v. Pittsburgh Nat. Bank (In re Wissman)*, 942 F.2d 867, 871 (4th Cir. 1991). The estate has an interest in the asset as well as the debtor, and the trustee would have to abandon the estate's interest for the debtor to have the entire asset. *Id.* at 872. The court noted that if the trustee does nothing to administer the scheduled property before the case closes, it will be deemed abandoned by operation of law effective when the bankruptcy case closes. "[T]he debtor can move the bankruptcy court to compel abandonment of the estate's interest in order to proceed alone," exercising control over the asset. *Id.* at 873.

The Seventh Circuit likewise has held that when no objection to personal property exemptions is timely filed, title does not revest in the debtor. The debtor is

not "entitled to possession of the property on the thirty-first day." *Matter of Salzer*, 52 F.3d 708, 711 (7th Cir. 1995). The automatic stay still applies to possession of that property, protecting the trustee's possession and control over such property of the estate. *Id.* at 712. The trustee is "to administer the property until such time as the value [of property subject to an exemption] is determined" so that any value for creditors can be ascertained and liquidated. *Id.* at 712 n.5.

The Opinion also conflicts with cases in the Third and Sixth Circuits holding that because assets remain in the estate despite exemption of an interest in them, the estate is entitled to any appreciation in value beyond the amount exempted on the debtor's schedules. § 541(a)(6); *In re Orton*, 687 F.3d 612, 618-19 (3d Cir. 2012) (debtor's exemption is limited to petition date valuation; trustee may recover appreciation during case); *see Coslow v. Reisz*, 811 F. App'x 980, 982-84 (6th Cir. 2020) (estate entitled to postpetition home equity appreciation caused by third party payments of secured debt; debtor not entitled to abandonment of residence).

The Opinion nominally acknowledged that only an interest in the residence was exempt, and in its view, "removed from the estate." App. 15-16 n.2, citing *In re Mwangi*, 764 F.3d at 1175-76 & n.4 (a post-*Schwab* case holding that debtors gain immediate full access and control of specific exempt assets, distinguishing them from exemptions of interests in assets, including homesteads). However, the Opinion held that because this interest actually exited the estate upon entry of

the exemption allowance order, the Trustee could not administer the residence to avoid the federal penalty lien and use any portion of the residence sale proceeds for unsecured creditors. The Opinion erred because the residence remained in the estate, encumbered by the avoidable penalty lien, subject to the Debtor's right to payment for the exempt interest when distributions are made to creditors at the end of the case. Moreover, the Opinion, even qualified such as it was, is inconsistent with the decisions of other circuits that a residence can still be administered, in addition to *Schwab* itself.[2]

C. The Opinion conflicts with First, Fourth, and Tenth Circuit holdings that a trustee can pursue and avoid liens on property subject to exempt interests and exercise the secured creditor's rights.

The Opinion also conflicts with the Fourth Circuit in *Reeves v. Callaway*, in which the debtors' residence was encumbered by a mortgage lien and a federal tax lien that together exceeded the property value. 546 F. App'x 235, 237 (4th Cir. 2013). There, the debtors'

---

[2] Prior to *Schwab*, some circuit cases suggested that property subject to an exempt interest is no longer property of the bankruptcy estate. *See* cases cited in *In re Luongo*, 259 F.3d 323, 339 (5th Cir. 2001). We have found no reported circuit case post-*Schwab* that property subject to an exempt interest exits the bankruptcy estate except the instant case, which effectively holds that in preventing avoidance of the tax lien on property subject to an exempt interest after exemption allowance.

actual equity interest was $0, but they nonetheless scheduled the maximum dollar interest in the residence they could claim as exempt under state law. *Id.* The bankruptcy court denied the trustee's objection to the exemption, ruling that the debtors were "entitled to assert and reserve their available exemptions in Debtors' Residence." *Id.* at 238, 241. The debtors argued, like the Debtor here, that the grant of their claimed exemption removed the residence from the bankruptcy estate and prevented the trustee from selling it. *Id*. at 239. The Fourth Circuit held that "Debtors' Residence remained property of the estate despite the bankruptcy court allowing Debtors to reserve an exemption of $60,000 as their aggregate interest in Debtors' Residence subordinate to the first mortgage lien and the federal tax lien." *Id.* at 241-42.

The *Reeves* trustee was allowed to sell the residence with liens attaching to the proceeds, and the trustee receiving a portion of the IRS tax lien proceeds under a carve-out agreement with the IRS for the benefit of the estate. *Id.* The Fourth Circuit upheld the sale order, recognizing the priority of the tax lien over the debtors' exemption. *Id.* It ruled that title to the residence remained with the bankruptcy estate and "the carve-out operate[d] to assign equity in Debtors' Residence for the benefit of the bankruptcy estate (*i.e.*, unsecured creditors), thus justifying the Trustee's action in selling Debtors' Residence as opposed to abandoning it." *Id.* at 241. In *Reeves*, the trustee and IRS agreed that the debtors would receive full credit with respect to the IRS lien for any amount paid to

unsecured creditors from the carve-out, as the IRS later pursued collection of the balance of the taxes. *Id.* The instant case is like *Reeves*, with the Trustee stepping into the tax lien through § 724(a) avoidance instead of negotiated carve-out terms. In direct conflict with *Reeves*, the Opinion says the residence sale proceeds are not payable to the IRS tax lien in the hands of the Trustee, thereby refusing to recognize the priority of the tax lien or the residence remaining property of the estate.

The Opinion precluding trustees from avoiding liens on exempt property also conflicts with a First Circuit case addressing different facts implementing the law of lien avoidance in the context of a bankruptcy homestead exemption. *DeGiacomo v. Traverse (In re Traverse)*, 753 F.3d 19 (1st Cir. 2014). *Traverse* held that a trustee can avoid a lien on exempt property and exercise whatever rights the lienholder had with respect to the exempt property for the benefit of unsecured creditors—but only those rights. *Id.* at 30-31.

The debtor in *Traverse* claimed a homestead exemption exceeding the value of the property, but subject to an unperfected mortgage lien that was not in default. *Id.* at 23-24. The court held that the

> Bankruptcy Code empowers a trustee to avoid and preserve the lien for the benefit of the estate . . . benefit[ing] the unsecured creditors by allowing the trustee to eliminate unperfected liens on a debtor's property and subsequently to apply the value represented by

> those liens to the general estate, bypassing any junior lienholders.

Id. at 26. However, the mortgage interest that the trustee acquired through avoidance in *Traverse* carried no right to immediate ownership nor immediate payment of the loan, only a right to foreclose in the event of a default or to receive payment in full when the home is sold. *Id.* at 29. There, the loan was not in default, so the *Traverse* trustee could only sell the preserved mortgage interest, not foreclose and sell the underlying property. *Id.* at 30-31. Here, in contrast, the Trustee stepped into the shoes of the IRS, which could foreclose on the Debtor's tax penalty lien.

The Opinion conflicts with two Tenth Circuit decisions as well. *Morris v. St. John Nat'l Bank (In re Haberman)*, 516 F.3d 1207 (10th Cir. 2008) (Gorsuch, C.J.) (similar to *Traverse*); *Zubrod v. Duncan (In re Duncan)*, 329 F.3d 1195 (10th Cir. 2003) (similar to *Reeves*). The chapter 7 trustee in *Haberman* avoided an unperfected bank lien on a car the debtor claimed as exempt, and preserved it for the estate under § 551. *Id.* at 1208. The debtor was allowed to continue using the car and paid the bank loan balance during the bankruptcy case. *Id.* at 1209 n.1. The court held that "the trustee, on behalf of the entire bankruptcy estate, in some sense step[ped] into the shoes of the former lienholder, with the same rights in the collateralized property that the original lienholder enjoyed." *Id.* at 1210. The trustee acquired the lien rights, but not a separate contractual right to payments in excess of the value of the security interest. *Id.* at 1211-12. The

trustee was held entitled to the value of the avoided lien as of the petition date.[3] *Id.* at 1213-14.

In *Duncan*, the debtor transferred his residence to himself and his wife to create a tenancy by the entirety before bankruptcy to increase his $10,000 homestead exemption. 329 F.3d at 1200. The trustee did not object to the exemption, but avoided the transfer as fraudulent for the benefit of the estate. *Id.* at 1197. The Tenth Circuit held that the property was subject to execution with proceeds payable to the trustee, including the pre-transfer $10,000 exempt portion, because of the debtor's fraudulent act. *Id.* at 1200. The court held that a debtor "is not entitled to claim a homestead exemption in property voluntarily transferred and recovered by the Trustee in an adversary proceeding, notwithstanding the Trustee's failure to object [to the exemption] within the 30-day period of Fed. R. Bankr. P. 4003(b)." *Id.* at 1204. The circuit courts recognized in these cases that a trustee may exercise Bankruptcy Code avoidance rights on exempt property.

The Ninth Circuit previously held that a ***debtor*** cannot avoid tax penalty liens on exempt property, distinguishing the situation in the instant case and

---

[3] The Opinion does not expressly state that the Trustee does not stand in the IRS's shoes, but effectively holds that by preventing the Trustee from avoiding the tax penalty lien and exercising IRS's rights. The Opinion holding is especially likely to apply to trustee avoidance of a bank lien in cases like *Traverse* and *Hutchinson* when the bank is in receivership, so the secured debt is likewise collectible from exempt property post-bankruptcy. § 522(c)(3).

recognizing that a trustee can avoid such liens and preserve them for the benefit of the estate and its creditors. *Hutchinson v. United States (In re Hutchinson)*, 15 F.4th 1229 (9th Cir. 2021) (discussed at App. 34-36, 41-42 (dissent)). The majority Opinion distinguished *Hutchinson* as having relied on a stipulation between the trustee and the IRS that the tax penalty lien on property subject to a homestead exemption was avoided under § 724(a). App. 24-27. That is a stipulation the IRS has executed in numerous cases, evidencing its recognition that trustees may avoid tax penalty liens on exempt property. *See Reeves*, 546 F. App'x at 238, 241; *Gill v. Kirresh (In re Gill)*, 574 B.R. 709, 713 (B.A.P. 9th Cir. 2017) (cited at App. 23-24); *In re Bolden*, 327 B.R. 657, 663 n.5 (Bankr. C.D. Cal. 2005) (also cited at App. 23-24).

III. Tax liens encumber all of a debtor's property and cannot be limited by state exemption laws.

A. Recorded tax penalty liens attach to real property, not just to exempt interests.

The Opinion rests on a fundamental misconception that the tax penalty lien "attached to" the exempt "interest in" the residence that was "no longer part of the estate" after exemption allowance. App. 18-19. This contributed to its erroneous conclusion that the Trustee could not administer the liened property because it left the bankruptcy estate when the deadline for homestead exemptions passed. The Opinion thus conflicts directly with the Internal Revenue Code and opinions

of this Court and circuit courts that federal tax liens encumber "all property and rights to property" of a debtor. 26 U.S.C. § 6321; *U.S. v. National Bank of Commerce*, 472 U.S. 713, 719-20 (1985) (IRC § 6321 and related statutory language "is broad and reveals on its face that Congress meant to reach every interest in property that a taxpayer might have."). The liens attach upon assessment to the debtor's property. IRC § 6322.

A recorded tax lien attaches to real property without impairment by any homestead, not merely attaching to an intangible homestead interest. *See U.S. v. Rodgers*, 461 U.S. 677, 692, 701-02 (1983) (The government is entitled "to reach the entire property in which a delinquent taxpayer has or had any 'right, title, or interest,'" rendering state-created homestead and other exemptions against forced sale ineffective with regard to the entire property); *Matter of Voelker*, 42 F.3d 1050, 1051-52 (7th Cir. 1994) ("the federal tax lien attaches to all of a debtor's property, without exception" including the bankruptcy debtor's exempt property); *Knox v. Great West Life Assur. Co.*, 212 F.2d 784, 785 (6th Cir. 1954) ("Exemptions provided by state laws are ineffective against the statutory liens of the United States for federal taxes."); *see U.S. v. Union Cent. Life Ins. Co.*, 368 U.S. 291, 294-96 (1961) (state limitations on enforceability of recorded federal tax lien are ineffective). As this Court explained in *United States v. Mitchell*,

> [IRC §] 6331(a) authorizes levy 'upon all property and rights to property . . . belonging to

> such person. . . .' What is exempt from levy is specified in § 6334(a).[4] Section 6334(c) provides, 'Notwithstanding any other law of the United States, no property or rights to property shall be exempt from levy other than the property specifically made exempt by subsection (a).' This language is specific and it is clear and there is no room in it for automatic exemption of property that happens to be exempt from state levy under state law . . . state law which exempts a husband's interest in community property from his premarital debts does not defeat collection of his federal income tax liability.

403 U.S. 190, 204-05 (1971).

B. The Opinion's holding that state exemption laws trump federal tax laws conflicts with holdings of this Court and other circuit courts.

The Opinion conflicts with this Court's law, and with First, Fourth and Fifth Circuit decisions by

---

[4] The Internal Revenue Code provides for specific federal exemptions from a tax levy, which supersede state exemptions, and which do not restrict or limit federal tax liens. IRC §§ 6321 (lien), 6331 (levy), 6334 (exemptions from levy); *See Rodgers*, 461 U.S. at 700-01 (taxpayer's exemptions, including IRC § 6334 exemptions cannot defeat enforcement of federal tax lien); *American Trust v. American Community Mut. Ins. Co.*, 142 F.3d 920, 922-24 (6th Cir. 1998) (IRC § 6334 exemption from levy does not apply when IRS enforces § 6321 tax lien); *Voelker*, 42 F.3d at 1051-53 (federal tax levy exemptions do not protect property from federal tax lien).

implicitly holding that state exemption laws are superior to federal tax liens. It does so by concluding that the language of Arizona's homestead law means "[t]he value of the Debtor's homestead exemption is ***not*** subject to a deduction of the IRS tax penalty lien" even though the cited provision says nothing at all about federal tax liens. App. 28 (majority's emphasis); A.R.S. § 33-1104(D); App. 22-23 n.4, 28, 31, 32.

The Opinion's reasoning overlooks longstanding holdings of this Court that, while state law determines that a taxpayer has an interest in property, state law restrictions on creditor collection from such property do not override or affect federal tax law. *U.S. v. Craft*, 535 U.S. 274, 288-89 (2002) (state law exempting entireties property rights from creditor execution does not bind IRS); *U.S. v. National Bank of Commerce*, 472 U.S. at 723-24, 727 ("The federal statute relates to the taxpayer's rights to property and not to his creditors' rights."); *United States v. Bess*, 357 U.S. 51, 56-57 (1958) ("Congress did not intend to recognize [state] exemptions which would prevent attachment of [federal tax] liens;" state law providing that an insured's property right in cash surrender value is not subject to creditors' liens "is inoperative to prevent the attachments created by federal statutes in favor of the United States."); *Perez v. Campbell*, 402 U.S. 637, 651-52 (1971) (explaining the "controlling principle that any state legislation which frustrates the full effectiveness of federal law is rendered invalid by the Supremacy Clause"). The Opinion violates this fundamental principle by holding the federal tax lien attached only

to the taxpayer's homestead interest, not the residence itself.

The Opinion also conflicts with cases from the other circuits, including *Portfolio, LLC v. Weinstein (In re Weinstein)*, 164 F.3d 677, 681 (1st Cir. 1999) (even if the state has defined exempt property to specifically exclude property encumbered by a particular type of lien, such a provision "is inoperative in bankruptcy and must yield to the Code's lien avoidance provision."); *Pasquina v. Cunningham (In re Cunningham)*, 513 F.3d 318, 323 (1st Cir. 2008) ("Property that is properly exempted under § 522 is immunized against liability for prebankruptcy debts, subject only to a few exceptions. Those exceptions include: (1) debt from certain taxes and customs duties, (2) debt related to domestic support obligations, (3) liens that cannot be avoided or voided, including tax liens, and (4) debts for a breach of fiduciary duty to a federal depository institution."); *Shambaugh v. Scofield*, 132 F.2d 345, 346 (5th Cir. 1942) ("Homesteads are not exempted [from federal statutes authorizing the seizure and sale of real estate] . . . [Such IRC provisions,] enacted to effectuate a constitutional power, are the supreme law of the land. If they are in conflict with State law, constitutional or statutory, the latter must yield."); *see also Wachovia Bank & Trust Co., N.A. v. Opperman (In re Opperman)*, 943 F.2d 441, 443 (4th Cir. 1991) (federal provision for avoidance of lien controls over state law limiting homestead exemption to duration of debtor's actual residence in the exempted place); *United States v. Heffron*, 158 F.2d 657, 658-59 (9th Cir. 1947)

("Against [federal tax] liens, exemptions prescribed by State laws are ineffective").

The Opinion's view also ignores Arizona authority that "[e]xemptions created by state laws do not render such exemptions effective against federal tax liens." *Birch v. Dodt*, 2 Ariz.App. 228, 229 (1965) (citing *Heffron*, 158 F.2d at 658-59 ("The Federal taxes assessed as aforesaid constituted liens in favor of appellant upon all property of the bankrupt, including his interest in the homestead property, and, that interest having been sold, constitute liens upon the proceeds thereof" and also holding that "federal statutes regarding bankruptcy specifically give a homestead exemption to a bankrupt . . . but that this exemption does not apply to liens for other taxes, and particularly income taxes"); *see Conrad v. Maricopa County*, 40 Ariz. 390, 393 (1932) ("laws exempting property from taxation are to be construed strictly. The presumption is against the exemption, and every ambiguity in the statute will be construed against it").

According primacy to a state exemption statute over federal tax and bankruptcy law misconstrues Arizona law and more importantly, conflicts with authority from other circuit courts, creating a split this Court should resolve.

IV. The erroneous Ninth Circuit Opinion causes inconsistent treatment of trustees and creditors around the country, impairs bankruptcy trustee estate administration, and removes Code protections for unsecured creditors against debtor wrongdoing.

A. The Opinion causes inconsistent treatment in the administration of bankruptcy cases in different circuits, and its rationale invites confusion.

The Bankruptcy Code should be interpreted uniformly across the country, without variance by circuit. *See New York v. Saper*, 336 U.S. 328, 328 (1949) (granting certiorari to resolve conflict between courts of appeals regarding an "issue of considerable practical importance in the administration of the Bankruptcy Act"). With the advent of the circuit split created here, the Code is not being interpreted uniformly, which creates significant problems in trustee administration. Bankruptcy courts in different circuits must apply the same Code provisions differently. This is not only unfair to trustees and creditors in various circuits, but gives rise to substantial litigation as bankruptcy courts and appellate courts around the country guess which interpretation this Court will adopt, and apply the Ninth Circuit's reasoning to other bankruptcy taxation and exemption issues. Bankruptcy practice is sufficiently specialized that published circuit court opinions on major topics like homestead exemptions are publicized among practitioners and have an impact nationwide. Conflicts between circuits, deep and

shallow, are magnified and particularly troublesome in bankruptcy cases.

The Opinion is likely to be extended to other circumstances where trustees have avoided liens on exempt property for the benefit of creditors. Section 724(a) encompasses secured and unsecured claims for fines, penalties, forfeitures, and punitive damages not compensating for actual pecuniary loss. § 726(a)(4). If a judgment including treble damages is recorded and creates a lien on the debtor's residence, for example, the treble damages portion would be avoidable for the benefit of the estate, but barred under the Opinion if there is a homestead despite no risk of a double penalty.

The Opinion could also be extended to avoidance of non-penalty liens on homesteads. If a father took a lien on his son's house to secure an antecedent debt during the year before bankruptcy, the trustee could no longer avoid that lien as a preference under § 547 and step into the father's shoes if the property was claimed as exempt. For similar circumstances where liens have been avoided on exempt property, *see Duncan*, 329 F.3d at 1200 (trustee avoided debtor's pre-bankruptcy fraudulent transfer of his residence to himself and his wife; debtor was not entitled to sale proceeds as a homestead exemption despite no timely homestead objection); *see also Heintz v. Carey (In re Heintz)*, 198 B.R. 581, 583-88 (B.A.P. 9th Cir. 1993) (trustee avoided judgment lien encumbering exempt property as preferential transfer; sale proceeds payable to trustee despite no timely exemption objection).

The Opinion's reasoning for avoiding the plain language of § 724(a) also upsets settled law on the contents of the bankruptcy estate that trustees may administer, the nature of tax liens and the property to which they attach, and whether state statutes can limit tax liens on exempt property. It is likely to result in courts applying various aspects of the Opinion's reasoning in other tax and bankruptcy contexts that were previously considered settled law.

B. The Opinion impairs trustee administration of bankruptcy estates in the Ninth Circuit, with a risk of courts in other circuits following suit.

If the Opinion is not reversed, a trustee cannot avoid a penalty lien once a homestead exemption has been allowed. Trustees are also prevented from negotiating a carve-out of funds from the IRS or otherwise dealing with a tax penalty lien once a homestead exemption has been allowed. Because the Opinion considers tax liens to be subordinate to homestead exemptions, a trustee likewise cannot disburse residence sale proceeds to the IRS for tax liens if there is a homestead exemption, instead leaving the IRS to collect from the debtor later, if possible. The same is presumably true of state and local tax authorities and other entities assessing penalties against debtors.

If the Opinion stands, trustees would endeavor to pursue lien avoidance litigation at the inception of the case before homestead allowance. Under the Opinion,

it is insufficient to timely object to a homestead exemption on the ground that a penalty lien is avoidable and obtain an order, like the bankruptcy court order below, that the homestead exemption is subordinate to the penalty lien plus the mortgage debt. There is no statute of limitations for § 724(a) avoidance actions (*compare* § 546(a)), but trustees will have to disrupt their caseloads by promptly pursuing lien avoidance. The Bankruptcy Code and Rules do not call for imposing that burden on trustees. *See Duncan*, 329 F.3d at 1203 (trustee avoidance actions are not subject to 30-day limitations period governing objections to allowed exemptions; "otherwise, the two-year limitations period of section 546(a)(1)(A) would effectively become a 30-day limitations period, thereby rendering the provision meaningless").

There are fifteen bankruptcy courts in the Ninth Circuit, processing many thousands of chapter 7 cases. In chapter 7 cases, unsecured creditors' recoveries already are often minimal. Inability to avoid penalty liens whenever the debtor claims an exemption reduces the payout to unsecured creditors even further. It will be reduced further still if the Opinion is interpreted to cover preference and other avoidance actions on assets with exempt interests. Ninth Circuit trustees and unsecured creditors will be treated less favorably than trustees and creditors in other circuits where bankruptcy courts follow other circuit precedents discussed above. This is precisely the type of circuit split inequality that warrants Court acceptance of certiorari.

C. The Opinion's "double penalty" concern does not justify disregarding Code provisions, nor is it inconsistent with Code balancing of debtor, tax and creditor interests.

The Opinion is not necessary to protect the federal tax system. The Bankruptcy Code provides for nondischargeability of tax claims relating to transactions within three years of the petition filing, like those at issue here, including tax penalties. § 523(a)(7); *see Roberts v. United States (In re Roberts)*, 906 F.2d 1440 (10th Cir. 1990) (discussing dischargeability limitations for tax penalties). The Code also protects the IRS by providing that property the Debtor retains as exempt remains liable for tax liens. Congress indicated that a debt secured by a lien avoided under § 724(a) does not remain attached to exempt property (§ 522(c)(2)(A)), but then Congress brought back liability of all exempt property for any properly filed tax lien. Section 522(c)(2)(B) (debtor's exempt property remains "liable during or after the case" for "a tax lien, notice of which is properly filed"); *United States v. Estes*, 450 F.2d 62, 65 (5th Cir. 1971) ("Even though the homestead might be exempt under state law from the claims of private creditors, '[n]o provision of a state law may exempt property or rights to property from levy for the collection of' federal taxes owed.") (quoting Treas. Reg. on Proc. and Admin. 26 C.F.R. § 301.6334-1(c)).

These Code provisions to aid tax collection led the majority Opinion to speculate that Congress could not

have intended to let trustees avoid tax penalties for unsecured creditors while allowing the IRS to recover the same amount, with both reducing the debtor's exempt funds. Such speculation about intent does not justify replacing the plain language of § 724(a). Nor is the "double penalty" unjust, as the majority believed. The purpose of § 724(a) is to protect unsecured creditors from the debtor's wrongdoing. S. Rep. No. 95-989, at 96 (1978), *reprinted in* 1978 U.S.S.C.A.N. 5787, 5882. As this Court explained in a case concerning the predecessor Bankruptcy Act of 1898,

> [t]ax penalties are imposed at least in part as punitive measures against persons who have been guilty of some default or wrong. Enforcement of penalties against the estates of bankrupts, however, would serve not to punish the delinquent taxpayers, but rather their entirely innocent creditors.

Simonson v. Granquist, 369 U.S. 38, 40-41 (1962).

The majority's belief that the Code balance of provisions for payments to creditors, debtor exemptions and payment of taxes is inequitable does not justify the Opinion. *See Bruning v. United States*, 376 U.S. 358, 361 (1964) (Bankruptcy Act provision for post-discharge tax liability "is not a compassionate section for debtors. Rather, it demonstrates congressional judgment that certain problems—*e.g.*, those of financing government—override the value of giving the debtor a wholly fresh start. Congress clearly intended that personal liability for unpaid tax debts survive bankruptcy."). "[I]t is not for courts to alter the balance

struck by the statute." *Law v. Siegel*, 571 U.S. at 427; *U.S. v. Pioneer American Ins. Co.*, 374 U.S. 84, 92 (1963) (federal tax liens may not be denied priority even though it would reduce another's recovery). The Opinion rests on that flawed perspective and should not remain the law in any part of this country.

CONCLUSION

The petition for certiorari should be granted.

Respectfully submitted,

SUSAN M. FREEMAN
Counsel of Record
LAWRENCE A. KASTEN
KATERINA GRAINGER
LEWIS ROCA ROTHGERBER CHRISTIE LLP
201 East Washington Street, Suite 1200
Phoenix, Arizona 85004
(602) 262-5311
sfreeman@lewisroca.com

TERRY A. DAKE
Co-Counsel
TERRY A. DAKE, LTD.
20 East Thomas Road, Suite 2200
Phoenix, Arizona 85012
(602) 252-4712
tdake@cox.net