

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**

REPLY BRIEF

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

TABLE OF CONTENTS

	Page
ARGUMENT	1
I. The Opinion and Response presuppose language not found in the Bankruptcy Code, and split from current authority on whether a portion of a residence ceases to be property of the estate upon allowance of an exemption in part of its value	2
II. There is a circuit split on whether a trustee may avoid a lien on property subject to a claim of exemption	6
III. The penalty lien the Trustee sought to avoid attached to the residence.....	9
IV. The Opinion will have far-reaching, adverse effects	12
CONCLUSION.....	13

TABLE OF AUTHORITIES

	Page
CASES	
<i>Coslow v. Reisz</i> , 811 F. App'x 980 (6th Cir. 2012).....	8
<i>DeGiacomo v. Traverse (In re Traverse)</i> , 753 F.3d 19 (1st Cir.), cert. denied, 574 U.S. 976 (2014)	7
<i>Goetz v. Weber (In re Goetz)</i> , __ F.4th __, 2024 WL 998765 (8th Cir. Mar. 8, 2024).....	8
<i>Greene v. Savage (In re Greene)</i> , 583 F.3d 614 (9th Cir. 2009).....	3, 4
<i>In re Orton</i> , 687 F.3d 612 (3d Cir. 2012).....	8
<i>Matter of Salzer</i> , 52 F.3d 708 (7th Cir. 1995).....	8
<i>Matter of Voelker</i> , 42 F.3d 1050 (7th Cir. 1994).....	10
<i>Morris v. St. John National Bank (In re Haberman)</i> , 516 F.3d 1207 (10th Cir. 2008)	7
<i>Reeves v. Callaway</i> , 546 F. App'x 235 (4th Cir. 2013)	6
<i>Savage v. Pierson</i> , 123 Nev. 86, 157 P.3d 697 (2007).....	3
<i>Schwab v. Reilly</i> , 560 U.S. 770 (2010)	3
<i>Taylor v. Freeland & Kronz</i> , 503 U.S. 638 (1992).....	3
<i>U.S. v. Rodgers</i> , 461 U.S. 677 (1983).....	4, 10
<i>Zubrod v. Duncan (In re Duncan)</i> , 329 F.3d 1195 (10th Cir. 2003).....	8

TABLE OF AUTHORITIES—Continued

	Page
STATUTES	
11 U.S.C. § 522(b).....	2, 5
11 U.S.C. § 522(c)	2
11 U.S.C. § 522(g).....	2
11 U.S.C. § 522(i)(2)	2
11 U.S.C. § 522(k).....	2
11 U.S.C. § 541	2, 3
11 U.S.C. § 554(d).....	2, 3
11 U.S.C. § 724(a).....	1, 2, 5, 7, 10, 12
11 U.S.C. § 726	5
OTHER AUTHORITIES	
<i>Exemption</i> , Black’s Law Dictionary, https://thelawdictionary.org/exemption/ (last visited Mar. 26, 2024).....	4

ARGUMENT

The Government’s Response confirms the need for this Court’s review. The central point of the Response is that “[t]he trustee lacks the power to avoid a lien that attaches to a debtor’s exempt property, which is not part of the property of the estate.” Resp. at 9. From that, the Government contends the trustee is seeking to augment the estate by bringing exempted property back in. Resp. at 9, 12. The premise of the Government’s position is exactly the issue on which there is now a confusing circuit split. Other circuits have held that exempt property is property of the estate until it is abandoned or sold, and have held that a trustee may avoid a lien on property subject to a claim of exemption. The Opinion below creates a circuit split on these fundamental propositions, and they cannot harmoniously coexist.

The Government’s arguments are also inconsistent with the plain language of the Code. And contrary to the position of the Government and the Opinion, the trustee sought to avoid a penalty lien on the residence itself—not on the exempt interest in a portion of the residence’s value. Bankruptcy Code § 724(a) provides for avoiding this type of lien on property of the estate, regardless of whether it is exempt.

I. The Opinion and Response presuppose language not found in the Bankruptcy Code, and split from current authority on whether a portion of a residence ceases to be property of the estate upon allowance of an exemption in part of its value.

Contrary to the Response at 9-10, the Code does not provide in § 522(b) or any other section that exemptions remove property from the estate. It provides only that exempt assets are “not liable” for payment of most prepetition debts. § 522(c). But exempt assets are still liable for payment of certain administrative expenses, as well as tax lien debts. §§ 522(c), 522(k). How could exempt property be liable for administrative expenses if it ceases to be property of the estate? Likewise, § 522(i)(2) provides that property to which avoiding powers have applied may be exempt under § 522(g) if the avoided transfer was involuntary. But if avoiding powers never applied to exempt property, that could not be the case. And § 724(a) contains no exempt property exception to penalty lien avoidance.

The Government accuses Petitioner of an improper “time-of-commencement focus” when defining property of the estate. Resp. at 10. Property of the estate is determined as of the commencement of the case, then continues until each estate asset is abandoned or sold (with a reversionary interest remaining in the estate even after a sale if homestead-exempt proceeds are not reinvested in another homestead under statutes in Arizona and some other states). Pet. at 12; §§ 541, 554(d) (“Unless the court orders otherwise,

property of the estate that is not abandoned under this section and that is not administered in the case remains property of the estate.”). While *Schwab v. Reilly* stated that exempt interests in property can be withdrawn from the estate, it explained that exempt funds would be transferred to the debtor in the end-of-case distribution, and held that the asset itself remained in the estate to be administered by the trustee during the case. 560 U.S. 770, 791-92 (2010); *Taylor v. Freeland & Kronz*, 503 U.S. 638, 642 (1992) (“all of [a debtor’s] property becomes property of the estate. *See* 11 U.S.C. § 541. The Code, however, allows the debtor to prevent the distribution of certain property by claiming it as exempt.”).

The Opinion acknowledges that asset title remains in the estate during the case. But it conflicts with § 554(d) and *Schwab* by failing to recognize that the entire asset, including all intangible interests, is property of the estate until sold or abandoned out of the estate. An exempt interest in a residence is not a transferrable legal interest like a leasehold. *Greene v. Savage (In re Greene)*, 583 F.3d 614, 621 (9th Cir. 2009) (“the substantive right gained via a homestead declaration in Nevada, although broad, is a ‘legal protection of’ the property interest, not ‘an interest’ in the equity or title of the property . . . [it] ‘only protects the amount of equity the debtor holds in the property’”), quoting in part *Savage v. Pierson*, 123 Nev. 86, 157 P.3d 697, 700-01 (2007). “Exemption” is defined as “[a] privilege allowed by law to a judgment debtor, by which he may hold property to a certain amount, or certain classes

of property, free from all liability to levy and sale on execution or attachment.” *Exemption*, Black’s Law Dictionary, <https://thelawdictionary.org/exemption/> (last visited Mar. 26, 2024); *see U.S. v. Rodgers*, 461 U.S. 677, 700-01 (1983) (refusing to equate a homestead exemption with a vested property right).¹

A homestead exemption provides a property owner a statutory right to realize upon equity in an asset after priority liens are satisfied. *Greene*, 583 F.3d at 621. (“If the debtor has such ownership, then she can choose to protect up to [state statutory cap] of equity in her property from legal process”). As those lien amounts change with the accrual of interest and pay-downs of principal, the exempt homestead amount can change too when the property value is less than the total homestead amount and all priority encumbrances. In Arizona, the homestead exemption statute says nothing about priority encumbrances in the form of federal tax liens. Arizona authority recognizes that tax liens take priority, and that homestead exemptions are ineffective against them. Pet. at 25 (misinterpreted in the Opinion, App. at 22 n.4). A homestead-exempt interest is a right to a portion of unencumbered property value, sometimes shifting in amount as lien

¹ The Government downplays the circuit split by arguing that Petitioner did not cite out-of-circuit precedent in the court of appeals. Resp. at 14-15. Petitioner’s focus there was arguing that the Government’s position was inconsistent with circuit precedent. Its focus here is that the Ninth Circuit has now created a significant split.

amounts change. It is not distinct from the asset itself, which remains in the estate.

The Opinion builds upon its unsupported concept that exempt interests in assets exit the estate when it holds that liens cannot be avoided because exemptions are determined before distributions. Under the Opinion, (i) the portion of the asset claimed to be exempt ceases to be property of the estate and vests in the debtor upon exemption allowance (App. at 15-16 n.2, 18, 28-29), and (ii) “§ 724(a) applies to property that is part of the estate at the time of distribution [after exemption allowance] based on its express reference to § 726(a)(4).” App. at 17.

The Response does not refute Petitioner’s point that § 726 distribution language is not incorporated into § 724(a). Pet. at 8. The Government just opines that the Opinion is correct in stating that the Trustee can avoid a lien attaching to property of the estate at the time of distribution, and assumes that means no avoidance before distribution. Resp. at 9. The Government does not explain why § 724(a) avoidance actions must be determined on the distribution date, which necessarily occurs after full estate administration with avoidance actions, claim disputes and other litigation resolved. The Government simply says that “the trustee lacks the power to avoid a lien that attaches to a debtor’s exempt property, which is not property of the estate.” Resp. at 9. But the Government cites only § 522(b), which says no such thing.

II. There is a circuit split on whether a trustee may avoid a lien on property subject to a claim of exemption.

Cases in other circuits recognize and respect trustee rights to avoid liens on property of the estate despite allowed exemptions of interests in that property during administration of the case. The Fourth Circuit so held in *Reeves v. Callaway*, 546 F. App'x 235 (4th Cir. 2013). The Response does not directly dispute this circuit split, but attempts to distinguish it as a case where the debtor had no equity in the property. Resp. at 16. That was because the court recognized the priority of a federal tax lien on the property over the homestead exemption, just as Petitioner contends it trumped the debtor's homestead exemption in the residence here. *Id.* at 237. *Reeves* held that the court could administer the property over the debtor's objection despite an allowed homestead exemption instead of abandoning it out of the estate to the debtor. *Id.* at 241-42. The Response argues that the Opinion did not preclude the Trustee from similarly administering the residence, because he did sell it. Resp. at 13 n.2, 15. But the residence was sold under the bankruptcy court's construction of the law, before the Opinion was issued. And the Opinion held that despite the residence as an asset remaining in the estate, the Trustee could not administer the residence by avoiding the penalty lien on the residence before it was sold and exited the estate. App. at 14-15, 15-16 n.2. The Opinion prevents a trustee from exercising avoidance powers of any kind against assets subject to an exemption interest.

The Response attempts to avoid the circuit split between the Opinion and *DeGiacomo v. Traverse* (*In re Traverse*), 753 F.3d 19 (1st Cir.), cert. denied, 574 U.S. 976 (2014), and *Morris v. St. John National Bank* (*In re Haberman*), 516 F.3d 1207 (10th Cir. 2008), by noting that those concerned trustee avoidance of liens under statutory provisions other than § 724(a). Resp. at 16-17. But this merely demonstrates, rather than denies, that the Opinion generates a circuit split by holding that avoiding powers never apply to exempt interests that supposedly previously left the estate. It offers no justification for treating lien avoidance under various Bankruptcy Code provisions differently. Both cases hold that a trustee can avoid any lien on exempt property and exercise the rights of the lienholder with respect to that exempt property for the benefit of creditors. *Traverse*, 753 F.3d at 30-31; *Haberman*, 516 F.3d at 1208, 1210.

In *Traverse*, the trustee could not force a sale of the property because the lien he avoided was not in default, could not be foreclosed, and the trustee had no other equity interest he could sell. 753 F.3d at 28-29. Here, the penalty lien could be foreclosed by the Trustee, stepping into the shoes of the IRS. And in *Haberman*, the trustee could not seize payments exceeding the value of the security interest because the secured creditor into whose shoes the trustee stepped could not do so. 516 F.3d at 1211-12. The Trustee here sought only to avoid the IRS's lien. The relevant holdings of these cases directly conflict with the Opinion's holding that a trustee cannot avoid a lien on property subject

to an exemption and cannot exercise the rights of the lienholder, here, the IRS.

The Government distinguishes *Zubrod v. Duncan* (*In re Duncan*), 329 F.3d 1195 (10th Cir. 2003) as not holding that a lien attached to exempt property can be avoided. Resp. at 17. *Duncan* does, indeed, hold that trustees may pursue avoidance actions to recover exempt assets; they are not immune from avoidance. *Id.* at 1204. The Government does not address Petitioner’s cases from other circuits holding that a trustee is entitled to administer estate assets after an exempt interest in the assets has been allowed. *Matter of Salzer*, 52 F.3d 708, 711 (7th Cir. 1995); *In re Orton*, 687 F.3d 612, 618-19 (3d Cir. 2012); *Coslow v. Reisz*, 811 F. App’x 980, 982-84 (6th Cir. 2012). The Eighth Circuit recently joined these circuits in *Goetz v. Weber* (*In re Goetz*), ___ F.4th ___, 2024 WL 998765 (8th Cir. Mar. 8, 2024). It held that an increase in equity in a chapter 13 debtor’s residence resulting from market appreciation was property of her bankruptcy estate, since the residence was not abandoned or sold during the case, and thus subject to trustee administration for creditors upon conversion of the case to chapter 7.

While these cases admittedly arise in different contexts than the Opinion, they conflict with its fundamental analysis. Given the nationwide importance assumed by published opinions about the Bankruptcy Code, allowing further percolation of this issue is unlikely to resolve it, and the split will work immediate confusion. The Opinion hinges on an exempt interest in a residence being distinct from the residence itself,

since that is the only way the exempt interest could exit the estate while the asset “title” remains in the estate, which the Government admits. The holdings of other circuits’ cases rely on exactly the contrary principle: no distinction between the asset itself and the exempt interest in a portion of the asset’s value would allow this asset value to exit the bankruptcy estate and escape lien avoidance while the asset itself remains in the estate.

This circuit split is important, and needs to be resolved by this Court. In the large Ninth Circuit, trustees may not avoid liens on assets subject to an exemption to benefit creditors. In other circuits, trustees can avoid such liens and their creditors recover more. The Bankruptcy Code is being applied unevenly and unfairly across the country.

III. The penalty lien the Trustee sought to avoid attached to the residence.

The Petition argued that the Opinion rests on a fundamental misconception that the penalty lien attached to the exempt interest in the residence, which the Opinion held was no longer property of the estate after lien allowance. Petitioner demonstrated that this was error. Pet. at 20-22. The Response does not discredit any of Petitioner’s authorities. Instead, the Response rests its argument on the erroneous misconception. The Government repeatedly states that what the Trustee sought was to avoid the tax lien “that attached to the debtor’s exempt interest” (Resp. at 4); the

bankruptcy court held the Trustee could avoid the “tax lien on the homestead exemption” (*Id.*); the Trustee sought to “avoid the lien on the exempt property” (*Id.* at 5); both the homestead exemption and the non-exempt interest were subject to the tax lien (*Id.* at 6); the court concluded the Trustee could not avoid a lien “attached to exempt property” (*Id.*); the Trustee’s argument is to avoid a “tax lien attached to the debtor’s exempt homestead interest” (*Id.* at 7); the Trustee lacks ability to avoid a tax lien “that attached to the debtor’s exempt property” (*Id.* at 8); the Trustee “lacks power to avoid a lien that attaches to a debtor’s exempt property” (*Id.* at 9); the Trustee seeks “to avoid a lien that attaches *to the exempt interest* (*Id.* at 15, Response emphasis); the tax lien here is “a lien that attaches to the exempt property” (*Id.* at 17).

The lien the Trustee sought to avoid under § 724(a) was a lien on the debtor’s physical property and all interests therein, superior to the homestead interest. *See U.S. v. Rodgers*, 461 U.S. at 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 concerning 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).

The Government is satisfied with the tax penalty lien continuing to encumber a portion of the residence

value, here sale proceeds, in the possession of the debtor. Resp. at 18. It contends the Opinion is consistent with authority holding that the Government can enforce its tax lien despite a state-law exemption. *Id.* But the Government does not offer any authority to support the notion that the Trustee cannot avoid the penalty lien on the residence itself.

Instead, the Government invents an extra-statutory principle that “the interest in the property is bifurcated, [with] both the interest in the asset that remains in the estate and the amount that is withdrawn pursuant to the exemption [] each still subject to the lien.” Resp. at 11; *see also* Resp. at 13 (“the estate’s portion of the asset had no value”). Its hypotheticals rest on the assumption that an exemption interest in a portion of the residence value is separate from the residence in a manner that the Trustee cannot avoid a lien on the residence, although the Trustee can sell it. As noted above, that concept of an exemption is contrary to statutory and common law authority. The federal penalty lien attached to the residence, and Arizona state exemption law did not and could not override the federal right to seize and foreclose on the residence. The federal Bankruptcy Code empowers the Trustee to step into the shoes of the IRS and exercise its collection rights for the benefit of creditors, instead of leaving that money in the possession of the debtor.

IV. The Opinion will have far-reaching, adverse effects.

The Government does not deny that the Opinion is likely to be extended to other circumstances where trustees have avoided liens on exempt property under § 724(a) for the benefit of creditors. Nor does it deny that the Opinion may also be extended to avoidance of non-penalty liens on property subject to homestead exemptions. Pet. at 27. It does not deny the disruptive effect on trustee administration, or fomenting of litigation across all circuits. Pet. at 28-29. The Government does not deny that reversal of the Opinion would not adversely affect tax collection. Pet. at 30-31.

The Response includes the Opinion concern for a so-called “double penalty” on debtors resulting from distributing penalty funds to creditors when the debtor must still pay her taxes (Resp. at 6-7, 12-13, 18), but this concern does not excuse disregarding and rewriting Code provisions. That debtors’ exempt proceeds will be reduced, and that the Government will continue to have a priority right to collect taxes, is a deliberate balancing of interests by Congress. Pet. at 31-32. Congress can change the law. The Ninth Circuit should have enforced the law as written.

CONCLUSION

The Petition 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