

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF NEW YORK

In re:

ROBERT R. CINELLI and
PATTI M. CINELLI,
Debtors.

Chapter 13
Case No. 05-16962

APPEARANCES:

MICHAEL A. CASTLE, ESQ.
Attorney for the Debtors
110 West Albany Street
Herkimer, New York 13350

CHRISTIAN H. DRIBUSCH, ESQ.
Chapter 7 Trustee
The Patroon Building
Five Clinton Square
Albany, New York 12207

Hon. Robert E. Littlefield, Jr., U.S. Bankruptcy Judge

MEMORANDUM-DECISION AND ORDER

Presently before the court is the motion by the Chapter 7 Trustee (the “Trustee”), pursuant to 11 U.S.C. § 522 and Rule 4003(b) of the Federal Rules of Bankruptcy Procedure, objecting to the cash exemption claimed by Robert and Patti Cinelli (the “Debtors”) for their 2005 federal and state tax refunds. The Trustee opposes the exemption, filed as an amendment to schedule C of the Debtors’ petition, as prejudicial to him and asks that it be disallowed.

JURISDICTION

The court has jurisdiction over this core proceeding pursuant to 28 U.S.C. §§ 157(a), (b)(1), (b)(2)(B) and 1334(b).

FACTS

The Debtors filed their chapter 7 petition on September 27, 2005. (No. 1.) The Debtors list on schedule A (Real Property) of their petition an interest in their residence located at 5229 State Highway 29, St. Johnsville, New York with a fair market value of \$140,000 and a mortgage with a balance of \$168,008. The Debtors claim a homestead exemption of \$100,000 on schedule C (Property Claimed as Exempt). Schedule I (Current Income of Individual Debtor(s)) reflects that the debtor-husband has been working for his employer for the past 17 years and that his wife has been employed at the same job for over 10 years.

The Debtors' first meeting of creditors was originally scheduled for November 7, 2005, but due to a scheduling conflict of Debtors' counsel, the meeting was adjourned to December 5, 2005. Prior to the Debtors' meeting of creditors, the Trustee forwarded a document production request to Debtors' counsel. It is undisputed that the Debtors substantially complied with the Trustee's request. One of the items produced for the Trustee was a copy of the Debtors' 2004 tax return. The Debtors' meeting of creditors was held on December 5, 2005, and the Trustee filed a Report of No Distribution the following day.

On December 22, 2005, a reaffirmation agreement between the Debtors and Household Financial Realty Corporation of New York ("Household"), the holder of the Debtors' mortgage, was entered on the docket (the "Reaffirmation Agreement"). (No. 8.) The value of the Debtors' residence was listed as \$164,000 in the Reaffirmation Agreement, \$24,000 higher than the fair market value scheduled on the Debtors' petition. The Debtors were listed as the "basis or source" of the valuation in the Reaffirmation Agreement. The Trustee filed a letter withdrawing his Report of No Distribution on January 11, 2006. (No. 10.) On January 13, 2006, the Trustee

sent a letter to the Debtors requesting copies of their 2005 tax return and informing them that he would be investigating possible non-exempt cash for distribution to creditors. (Trustee's Obj. to Exemptions ¶ 13.)

On January 23, 2006, the Debtors filed amended schedules A, B, and C to their chapter 7 petition. (No. 12.) Although schedule A reflects no observable changes, the Debtors' amended schedule B (Personal Property) lists an anticipated income tax refund for 2005 as an asset with a value of \$5,000.¹ Schedule C was amended to delete their homestead exemption and replace it with a cash exemption of \$5,000 from their anticipated tax refund.

The Trustee filed an objection to the Debtors' amended schedule C on January 30, 2006. (No. 16.) The Trustee's objection is premised on two theories: bad faith and prejudice to the Trustee. In the event the court allows the Debtors' amendment to their exemptions, the Trustee requests attorneys fees and costs of \$500. The Debtors filed an affidavit in response to the Trustee's objection on February 10, 2006. (No. 21.) A hearing was held on February 15, 2006 and, during oral argument, the Trustee withdrew his bad faith objection. The parties were given an opportunity to brief the issue of prejudice to the Trustee and, as of May 5, 2006, the matter was considered fully submitted.

ARGUMENTS

The Trustee recommends the court adopt a standard disallowing amended exemptions once "a trustee commences the administration of a clearly identifiable property which has not been claimed exempt from the bankruptcy estate and which has not been involuntarily

¹ The Debtors' amended Schedule B actually lists "2004 anticipated Income Tax Refund." The court assumes this is a typographical error and that the Debtors meant to list their 2005 tax refund.

transferred by a debtor pre-petition.” (Trustee’s Mem. of Law 6.) The Trustee contends that when the Debtors completed their petition and schedules they had the same information available to them as the Trustee, namely the value of their home, their mortgage balance, and their 2004 tax return. The Trustee argues that allowing debtors to amend their schedules to exempt an asset that the Trustee seeks to administer would encourage debtors to play “hide and seek” with a trustee. (*Id.* at 5.)

In this case, the Trustee asserts that the Debtors’ failure to acknowledge the increased value of their residence reflected in the Reaffirmation Agreement along with their decision not to amend their schedules, “evidences a reckless disregard” for the bankruptcy process. (Trustee’s Objection to Exemptions ¶ 16.) The Debtors respond that the higher value listed on the Reaffirmation Agreement was not intended to mislead the Trustee. The Debtors state that the Reaffirmation Agreement was prepared by Household but, more importantly, the higher value reflected for their residence was still less than the balance outstanding on their mortgage. Therefore, utilizing either the fair market value on schedule A or the increased value noted on the Reaffirmation Agreement, would still result in no equity in the Debtors’ property.

The Debtors argue that pursuant to Rule 1009(a) of the Federal Rules of Bankruptcy Procedure, they may amend their schedules at any time before their case is closed. The Debtors assert their homestead exemption originally listed on schedule C was without effect due to the lack of equity in their property; consequently, they always had the ability to claim a cash exemption. The Debtors contend they did not originally claim a cash exemption because they were uncertain if they were eligible for a refund as their 2005 tax returns had not yet been prepared. The Debtors further argue that the Trustee has not taken extensive steps in

administering their refund which would warrant an award of attorneys' fees.

DISCUSSION

Rule 1009(a) of the Federal Rules of Bankruptcy Procedure permits liberal amendment of exemption schedules by allowing debtors to amend their schedules at anytime before a case is closed.² “The right to amend, however, is not the same as the right to [claim an] exemption. . . . Upon objection by the trustee, allowance of the amended exemption depends on other considerations, namely, whether there is a showing of bad faith by the debtor or prejudice to creditors.” *In re Blaise*, 116 B.R. 398, 399 (Bankr. D.Vt. 1990). As the Trustee withdrew his objection based on bad faith at the February 15, 2006 hearing, the issue that remains is whether the Debtors' amended exemption is prejudicial to creditors.

Pursuant to 11 U.S.C. § 522(b)(1), New York has “opted out” of the federal property exemption provisions under 11 U.S.C. § 522(d) and enacted its own exemption statutes. *See* NY Debtor & Creditor Law §§ 282-284 (McKinney 2001). New York's Debtor and Creditor Law § 283(2)³ provides for a \$2,500 cash exemption for a debtor who has not exercised his or her

² **Rule 1009. Amendments of Voluntary Petitions, Lists, Schedules and Statements (a) General Right to Amend.** A voluntary petition, list, schedule, or statement may be amended by the debtor as a matter of course at any time before the case is closed. The debtor shall give notice of the amendment to the trustee and to any entity affected thereby.

Fed. R. Bankr. P. 1009(a)

³ **§ 283. Aggregate individual bankruptcy exemption for annuities and personal property**

2. Contingent alternative bankruptcy exemption. Notwithstanding section two hundred eighty-two of this article, a debtor, who (a) does not elect, claim, or otherwise avail himself of an exemption described in fifty-two hundred six of the civil practice law and rules; (b) utilizes to the fullest extent permitted by law as applied to said debtor's property, the exemptions referred to in subdivision one this section which are subject to the five thousand dollar aggregate limit; and (c) does not

homestead exemption under NYCPLR § 5206, or who has not claimed the maximum \$5,000 exemption in the aggregate for personal property under NYCPLR § 5205. *In re Hill*, 95 B.R. 293, 298 (Bankr. N.D.N.Y. 1988). It is undisputed that if the Debtors had listed their 2005 income tax refund as exempt on their original schedule C, the exemption would have been allowed, and this case would have been reviewed as a routine no asset case.

The court declines to adopt the Trustee's proposition that the Debtors' right to amend their exemptions to claim their income tax refund exempt ceased when the Trustee commenced administration of the refund. The case law and the facts of this case do not support the Trustee's position. The crux of the Trustee's argument seems to be that he detrimentally relied upon the Debtor's original schedules incurring time and costs associated with administering their income tax refund. Delay in filing an amendment, where a case is not closed, has not been found to be prejudicial to creditors. *In re Fournier*, 169 B.R. 282 (Bankr. D. Conn. 1994); *In re Blaise*, 116 B.R. 398. The Trustee correctly points out that the Debtors could have logically determined whether or not to claim a cash exemption for any anticipated 2005 tax refund by reviewing information available to both parties, such as the Debtors' employment history and their 2004 tax returns. As Judge Lundin indicates, where bad faith is not at issue,

the failure to claim the exemption in the original documents is almost always the result of 'attorney oversight' or 'miscommunication' between the attorney and client not intentional misconduct or gross neglect. . . . The trustee and affected creditors can be protected from prejudice and fraud by requiring reimbursement

reach such aggregate limit, may exempt cash in the amount by which five thousand dollars exceeds the aggregate of his exemptions referred to in subdivision one of this section or in the amount of two thousand five hundred dollars, whichever amount is less. For purposes of this subdivision, cash means . . . the right to receive a refund of federal, state and local income taxes.

New York Debtor and Creditor Law § 283(2).

of costs and expenses reasonably incurred in detrimental reliance on the original exemption schedule on a case by case basis. (Footnote omitted.).

In re Davis, 38 B.R 585, 587 (Bankr. M.D. Tenn. 1984).

The court recognizes that the Trustee expended time, effort, and expense in attempting to administer the Debtors' refund for the benefit of creditors, only to have the Debtors amend their exemptions to protect the refund. While the court finds there was no prejudice to creditors warranting a denial of the Debtors' amended exemption, there was prejudice to the Trustee. Thus, the court finds cause to condition the allowance of the Debtors' amended exemptions upon reimbursement to the Trustee by the Debtors of \$500 to cover the Trustee's reasonable attorney fees, expenses, and costs. *See In re Fournier*, 169 B.R. 282 (debtor's amendment to exemptions allowed, subject to submission by trustee of his application for reasonable compensation and expenses); *In re Blaise*, 116 B.R. 398 (debtor's amendment allowed, but because Trustee was prejudiced, allowance conditioned upon reimbursement of costs and expenses to the Trustee).

CONCLUSION

Based on the foregoing, it is hereby

ORDERED, that the Trustee's objection to the Debtors' amended exemptions is overruled, and the Debtors' amended schedule C filed on January 23, 2006 is hereby allowed conditioned upon the Debtors reimbursement to the Trustee of \$500 for attorney fees, costs, and expenses within thirty days from entry of this memorandum-decision and order.

Dated: December 8, 2006

/s/ Robert E. Littlefield, Jr.
Hon. Robert E. Littlefield, Jr.
U.S. Bankruptcy Judge