

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE SOUTHERN DISTRICT OF ILLINOIS

IN RE:)	In Proceedings
)	Under Chapter 7
EVA H. ROYSE,)	
)	No. BK 84-30179
Debtor(s).)	
JOHN L. PETERSON,)	
Trustee,)	
)	
Plaintiff(s),)	
)	
v.)	ADVERSARY NO.
)	88-0033
UNITED STATES OF AMERICA))	
acting through the Internal)	
Revenue Service, et al.,)	
)	
Defendant(s).)	

MEMORANDUM AND ORDER

In March 1984 debtor, Eva Royse, filed a bankruptcy petition under Chapter 11 of the Bankruptcy Code, and the case was later converted to a Chapter 7 liquidation proceeding. On Schedule B-4 of her petition, debtor claimed an exemption in the amount of \$7,500 in certain real property used as debtor's residence. No objections were filed as to this exemption. Having sold debtor's residence, the trustee has filed a motion to marshal liens in order to distribute the sale proceeds from this and other real estate owned by debtor.

In his motion, the trustee proposes to pay sale proceeds remaining after payment of administrative expenses, first, to debtor in the amount of \$7,500 for her homestead exemption and, second, to the United States in the amount of \$198,148.38 for unpaid tax obligations of debtor. These tax liabilities include

\$239,763.78 of so-called "trust fund" taxes imposed pursuant to 26 U.S.C. §6672 and \$938,571.00 of income tax deficiencies for the years 1980 through 1982. The United States objects to the trustee's proposed distribution to debtor under the homestead exemption, asserting that the tax debts in issue take priority over the claimed homestead exemption.

In response, debtor asserts that since no objection was filed to her homestead exemption, the exemption is allowed and cannot be attacked at this time by the United States' objection to the motion to marshall liens. Debtor observes that under the local rules in effect on the date debtor's petition was filed, objections to a debtor's claim of exemption were to be filed within 15 days after the §341(a) creditor's meeting. See also Bankr. Rule 4003(b): objections to claimed exemptions to be filed within 30 days of creditors meeting. In the absence of such an objection by the United States or any party, debtor contends that she is entitled to payment of her homestead exemption as proposed in the trustee's motion.

The right to a homestead exemption is provided by 11 U.S.C. §522(d)(1). Section 522(c), however, provides certain exceptions to a debtor's exemption rights:

(c) ...[P]roperty exempted under this section is not liable during or after the case for any debt of the debtor that arose...before the commencement of the case, except --

(1) a debt of a kind specified in section 523(a)(5) of this title[.]

11 U.S.C. §522(c)(1) (emphasis added). The tax debts asserted by the

United States in the instant case constitute §523(a)(1) debts, as §523(a)(1) includes taxes "required to be collected or withheld" under §507(a)(7)(C) and income taxes for which a return was due within three years of the date the bankruptcy petition was filed (see 11 U.S.C. §507(a)(7)(A)(i)). These debts thus come within the category of debts accorded special treatment under §522(c) with regard to exempt property.

Although Illinois state law specifies which assets may be exempt and to what extent, federal law prescribes the manner in which exemptions may be allowed and declares in §522(c) which claims are not affected by the exemptions. In re Kaufman, 68 B.R. 391 (Bankr. S.D. N.Y. 1986). Under Rule 4003, which prescribes the procedure for claiming exemptions and for filing objections to claimed exemptions, exemptions not objected to within the required time period are allowed. See In re Hahn, 60 B.R. 69 (Bankr. D. Minn. 1985). Section 522(c), however, declares that exempted property continues to remain liable for nondischargeable taxes under §523(a)(1), as well as nondischargeable alimony and support obligations and debts secured by unavowed liens and perfected tax liens (11 U.S.C. §522(c)(2)). Thus, the protection afforded exempt property is removed as to these types of debts, even after the exemptions have been properly claimed and allowed. In re Kaufman; see In re Ewiak, 75 B.R. 211 (Bankr. W.D. Pa. 1987); In re Clate, 69 B.R. 506 (Bankr. W.D. Pa. 1987).

In the instant case, the homestead exemption claimed by debtor was allowed when no objections were filed during the objection period following the creditors meeting. By reason of §522(c)(1), the allowed

exemption remained subject to the payment of taxes asserted by the United States. The United States was not required to object to debtor's claim of exemption in order to preserve the priority afforded by §522(c)(1) and did not forfeit its right to payment of the tax debts in issue. Cf. Matter of Driscoll, 57 B.R. 322 (Bankr. W.D. Wis. 1986): failure of IRS to object to debtor's claimed exemptions was of no consequence because exempt property remained subject to tax lien under Code and no section of Bankruptcy Code required objection under these circumstances. The court finds therefore, that the tax debts in issue are prior to debtor's homestead exemption despite the United States' lack of objection to debtor's exemption claim, and the Court sustains the United States' objection to the trustee's motion to marshal liens insofar as the motion purports to pay debtor's homestead exemption prior to the tax debts.

A further objection to the trustee's motion has been filed by Costello Leasing & Rental Co., formerly All-Car Leasing and Rental Co. (Costello). Costello asserts that it has a judgment lien that was perfected against debtor's real estate by recording of a memorandum of judgment on December 9, 1983, and that this lien is superior to the lien of the United States that arose by virtue of a tax assessment against debtor on November 3, 1987. Costello's lien in the amount of \$78,000 was partially satisfied in September 1986 by payment of \$35,000, and Costello gave a partial release of lien at that time for the homestead property occupied by debtor. Costello's motion states that there remains due and owing a total amount of \$71,012.50, which includes principal of \$43,000 and statutory interest of \$28,012.50.

The United States acknowledges that its tax lien, acquired post-petition upon assessment against debtor, was never perfected by filing and concedes that Costello's judgment lien, if perfected, would take priority over its tax lien. The United States asserts, however, that the homestead exemption claimed by debtor is effective against Costello under state statute (see Ill.Rev.Stat., ch. 110, par. 12-901) and by reason of Costello's partial release of lien for the homestead exemption. The United States contends, therefore, that the amount recovered pursuant to Costello's judgment lien is limited by the \$7,500 homestead exemption claimed by debtor.

The Court finds that Costello's judgment lien was duly perfected against debtor's real estate by the recording of a memorandum of judgment in the county in which the real estate is located. See Ill.Rev.Stat., ch. 110, par. 12-101. Costello's lien in the amount of \$71,012.50 thus comes before the United States' unperfected tax lien, and Costello's objection to the trustee's motion to marshall liens is sustained in this respect. Costello's judgment lien, however, remains subject to debtor's homestead exemption, while the United States has priority over the homestead exemption by reason of the priority afforded its tax debts under §522(c). The United States, therefore, is entitled to payment in the amount of \$7,500 before payment of Costello's judgment lien.

In accordance with the Court's findings, the proceeds from the sale of debtor's real estate should be distributed by the trustee as follows:

Gross proceeds of sale:	\$222,500.00
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Expenses of sale previously paid as ordered:	5,457.78
Interim trustee's fees:	6,771.99
Interim attorney's fees:	4,621.85
Internal Revenue Service priority tax debt:	7,500.00
Costello's perfected judgment lien	71,012.50
Internal Revenue Service priority tax debt:	121,135.88

IT IS SO ORDERED.

/s/ Kenneth J. Meyers
U.S. BANKRUPTCY JUDGE

ENTERED: January 27, 1989