How To Figure Out Whether A Lien Impairs an Exemption

Section 522(f) of the Bankruptcy Code provides a method by which a debtor may avoid two types of liens – judicial liens (with certain exceptions) and non-possessory, non-purchase money liens in described personal property. A limitation on this avoidance power is that such a lien can be avoided only to the extent that the lien impairs an exemption claimed by the debtor on Schedule C.

This monograph has three main parts. The first part is a discussion of the need for accuracy in preparing Schedules A, B, C and D, because these documents supply the values to be used in determining whether a lien is avoidable. The second part highlights the basic concepts that one must understand to do accurate calculations. The third part outlines how the calculations are done.

1. Accurate Schedules. A motion to avoid a lien under section 522 of the Bankruptcy Code depends on the accurate preparation of the Schedules.

- **Avoid Orphan Properties.** If a debtor claims on Schedule C an exemption in a particular item or piece of property, that property must be disclosed in Schedule A or Schedule B.

- **Have the Client Value the Property.** If the value of the exempted property shown in Schedule C is "unknown," it is impossible to determine whether a lien would impair the exemption, and hence a motion to avoid a lien on unvalued property will always be denied.

- **Obtain Accurate Values and Amounts.** Be careful to obtain accurate information about both the value of property and the amount of secured debt. It is not uncommon for debtors to schedule less debt than they actually owe to a creditor secured by property to which a judgment lien has attached. Understating the amount of debt as of the petition date may prevent the avoidance of a judgment lien that in fact would be avoided if the correct amount of debt had been stated.

- **Double Check Ownership and Liability.** In a joint case, be careful about who actually owns the residence or other property and who the judgment is against. Spouse 1 has no need to avoid a judgment lien that is against only spouse 2.

- **Read Ga. Code Ann. 44-13-100.** Do not list on Schedule C property not exemptible under this statute and do not claim an exemption amount larger than that permitted by this statute. Real estate (other than a grave site) not used as a residence by the debtor or a dependent of the debtor is NOT exemptible under O.C.G.A. § 44-13-100(a)(1).

2. Basic Concepts.

- **Each Property Must be Separately Analyzed.** This is because consensual liens may not be the same for each item or piece of property. In all likelihood, the car financier does not have a consensual lien on the house and the mortgagee does not have a consensual lien on the car.

- **Key Date is Petition Date.** For purposes of section 522(f), the values of properties and amounts of debts are determined as of the petition date.

- **Value the Debtor's Interest in Property.** The value of the debtor's interest in property is the value of the property multiplied by the debtor's percentage of ownership. If the debtor owns an undivided 50% interest, the value of his interest is one-half the total value.

- **Value Debtor's Share of Consensual Liens.** The debtor's share of the amount of consensual and statutory liens against the property in question is, generally, the aggregate amount of such liens multiplied by the debtor's percentage of ownership. (It is possible, however, for a consensual lien to attach by agreement only to a debtor's fractional interest in the property and not the co-owners's interest, in which case, that debt is chargeable entirely to the debtor.)

- **Determine Who the Judgment Is Against**. If the debtor is a co-owner, pay very careful attention to who owes the debt and on whose interest in property a lien attaches. A judgment lien against a husband only does not attach to the wife's property. If the house is jointly owned, a judgment lien against the husband attaches only to his half interest, making it necessary to determine the value of the husband's interest in the house and his proportionate share of mortgage debt and statutory liens. Sometimes judgments are against a corporate entity that the debtor owns but not against the debtor himself, in which case, the judgment lien would not attach to the debtor's property.

- **Read section 522(f).** The only avoidable consensual liens are nonpossessory, nonpurchase money security interests attaching to the following property: (I) household furnishings, household goods, wearing apparel, appliances, books, animals, crops, musical instruments, or jewelry that are held primarily for the personal, family, or household use of the debtor or a dependent of the debtor; (ii) implements, professional books, or tools, of the trade of the debtor or the trade of a dependent of the debtor; or (iii) professionally prescribed health aids for the debtor or a dependent of the debtor. 11 U.S.C. § 522(f)(1)(B). Consensual liens on vehicles are not avoidable because vehicles are not listed in section 522(f)(1)(B). Tax liens, mechanics liens and other statutory liens are not avoidable, and if a judgment has been obtained on a statutory lien, it is not avoidable because it is still, practically speaking, a statutory lien.

- **If Exemption Amount is Greater Than or Equal to the Value of Debtor's Interest, the Judgment Lien is Always Avoidable.** If the amount of the exemption claimed is greater than or equal to the value of the Debtor's interest in an item of property, an avoidable lien on that property will always impair the exemption. For example, if the value of the household goods stated on Schedule B is $1,000 and the amount of the exemption claimed for household goods is $1,000, any avoidable lien will impair the exemption.

- **All Judgment Liens Must be Considered Together.** Never, ever file separate motions against judgment creditors with respect to the same property. Instead, name all of the judgment creditors as respondents in the same motion.

3. The Arithmetic of Lien Avoidance Under Section 522(f). Section 522(f)(2) supplies a formula for figuring out whether a lien impairs an exemption. It provides:

> (2)(A) For the purposes of this subsection, a lien shall be considered to impair an exemption to the extent that the sum of -
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> (I) the lien;
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> (ii) all other liens on the property; and
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> (iii) the amount of the exemption that the debtor could claim if there were no liens on the property;
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> exceeds the value that the debtor's interest in the property would have in the absence of any liens.
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> (B) In the case of a property subject to more than 1 lien, a lien that has been avoided shall not be considered in making the calculation under subparagraph (A) with respect to other liens.
>
> (C) This paragraph shall not apply with respect to a judgment arising out of a mortgage foreclosure.

Section 522(f) refers to four separate values:

(1) the amount of the lien sought to be avoided;
(2) the aggregate amount of all other liens on the property;
(3) the amount of the exemption claimed on the property; and
(4) the value of the debtor's interest in the property.

The computations are actually easier than the statute suggests.

- **Step 1 -** Determine the value of the debtor’s interest in a particular property. For example, if the property is a residence, the debtor’s interest is the entire value if the debtor is the sole owner and is one-half the value if debtor owns an undivided one half interest in the property.

- **Step 2 -** Determine the debtor’s share of all consensual liens and statutory liens against the debtor’s interest in the property in question. For example, if the property in question is the residence, add up all of the mortgage debt (evidenced by notes and secured by security deeds on the residence), tax debt secured by tax liens against the residence, etc. If all of those liens encumber the entire property and the debtor’s interest is 50%, the debtor’s share of the debt would be one half of the total.

- **Step 3 -** Subtract the total amount of consensual and statutory liens against the debtor’s interest in the property from the value of the debtor’s interest in that property. If the value of the debtor’s interest in the property exceeds the total amount of the debtor’s share of the consensual and statutory liens, we will call the difference, if any, the GROSS EQUITY. If there is no GROSS EQUITY, stop because all judgment liens are avoidable in their entirety.

- **Step 4 -** If the amount of the exemption claimed in the property exceeds the GROSS EQUITY, stop because all judgment liens are avoidable in their entirety. But if the GROSS EQUITY exceeds the exemption claimed, we will call the difference the NET EQUITY.

- **Step 5 -** List the judgment liens (including their respective amounts) in their order of priority (date of entry), oldest one first. Remember that if two judgments are obtained at the same term of court in Georgia, they are co-equal.

- **Step 6 -** Subtract the amount of the judgment having the highest priority from the NET EQUITY. If the amount of that judgment exceeds the NET EQUITY, stop. In that event, the judgment is not avoidable to the extent of the NET EQUITY but is avoidable for the difference between the amount of the judgment and the NET EQUITY. If the NET EQUITY is greater than the amount of the judgment, the judgment is NOT avoidable at all, and we will call the difference between the NET Equity and the amount of such a senior judgment the REMAINING NET EQUITY.

- **Step 7 -** Repeat Step 6 for the next most senior judgment, using REMAINING NET EQUITY in place of NET EQUITY. Whatever is left over at the end of the calculations, if anything, we will call the new REMAINING NET EQUITY.

- **Step 8 -** Repeat Step 6 for other judgments, if any, in the order of seniority, oldest first, using new REMAINING NET EQUITY calculated for the previous judgment analyzed, and repeat for as long as after each computation there is still a new REMAINING NET EQUITY.

Examples:

Debtor is sole owner of a residence: Value = $250,000

1st Mortgage Debt = $175,000
2nd Mtge Debt = 35,000
Tax Lien = 15,000

Total Unavoidable Debt = $225,000

GROSS EQUITY = $25,000

Exemption claimed = $10,000

NET EQUITY = $15,000

Judgment 1 (03/03/02) Amount = $ 2,100

REMAINING NET EQUITY = $12,900
(Judgment 1 is unavoidable)

Judgment 2 (04/13/03) Amount = $17,500

REMAINING NET EQUITY = $0.00 (negative $4,600)

(Judgment 2 is unavoidable to extent of $12,900 and avoidable to extent of $4,600.)

Debtor and spouse each own an undivided one half interest in residence: Value = $250,000

Debtor interest in Residence = $125,000

1st Mortgage Debt = $175,000.00
2nd Mtge Debt = 35,000.00
Tax Lien = 15,000.00

Total Unavoidable Debt = $225,000

Debtor's share of Unavoidable Debt = $112,500

GROSS EQUITY = $ 12,500

Exemption claimed = $10,000

Net Equity = $2,500

Judgment 1 (03/03/02) Amount = $2,100

Remaining Net Equity = $ 400

(Judgment 1 is unavoidable)

Judgment (04/13/03) Amount = $17,500

REMAINING NET EQUITY = $0.00 (negative $17,100)

(Judgment 2 is unavoidable to extent of $400 and avoidable to extent of $17,100.)