Excerpts from NCLC's Consumer Bankruptcy Law and Practice (12th Edition)

Schwab v. Reilly

If there is any conceivable doubt regarding whether the entire value of an asset is exemptible, debtors should make clear that they are claiming their entire interest in that asset as exempt. If the debtor fails to do so, and the asset is worth more than the amount listed as exempt, a trustee may argue that the debtor has only exempted the asset up to the amount listed, and that the excess value over that amount may be liquidated for creditors. The Supreme Court in Schwab v. Reilly accepted this argument, but also provided suggested language the debtor may use to make clear the debtor's intent to exempt the entire asset. The debtor may list "100% of FMV" to assert this intention.[309] Schedule C provides a box in the third column that the debtor may check stating that the debtor is exempting "100% of fair market value up to any applicable statutory limit." In order to make crystal clear that the debtor is asserting that the debtor's entire interest is worth less than the statutory limit, the debtor should, in the description of the property, in a note, or in the space provided in the fourth column on Schedule C, state that "debtor asserts that 100% of the fair market value is less than the statutory exemption limit" and insert a dollar amount for the value of the debtor's exempt interest in the property. The Fifth Circuit Court of Appeals affirmed a decision adopting this approach to claiming the debtor's entire interest in an asset as exempt.[310] That decision held that a debtor must do two things to accomplish that. "First, she must check the box in the third column of Schedule C that corresponds with the text '100% of fair market value, up to any applicable statutory limit.' Second, she must assign a dollar value to her interest."[311] Such an claim of exemption should trigger an obligation on the part of the trustee or a creditor to object if they believe the property is worth more than the statutory limit.[312]

- **309** Schwab v. Reilly, 560 U.S. 770, 130 S. Ct. 2652, 2668, 177 L. Ed. 2d 234 (2010). See also § 10.3.3, infra. Several decisions after Schwab have come to the same result on similar facts, though with sometimes troubling dicta about factual situations not before the court. In re Orton, 687 F.3d 612 (3d Cir. 2012); In re Messina, 687 F.3d 74 (3d Cir. 2012). See also § 10.3.3, infra.
- **310** Peake v. Ayobami (In re Ayobami), 879 F.3d 152 (5th Cir. 2018).
- **311** In re Ayobami, 2016 WL 3854052, at *23 (Bankr. S.D. Tex. June 9, 2016). See also In re Gregory, 487 B.R. 444 (Bankr. E.D.N.C. 2013).
- **312** In re Farmer, 2017 WL 3207679 (Bankr. E.D. Tex. July 27, 2017) (if debtor claims 100% of fair market value as exempt, trustee must prove value is above exemption limit); In re Ayobami, 2016 WL 3854052 (Bankr. S.D. Tex. June 9, 2016) (approving debtor's use of Schwab's "100% of FMV" language to remove the debtor's entire interest in an asset from the estate, including any postpetition appreciation of the asset).

10.2.3.4.4 Cap on homestead property acquired during 1215-day period before filing

Under new section 522(p)(1), the debtor may not exempt "any amount of interest that was acquired by the debtor" in homestead property by the debtor during the 1215-day period before the filing of the petition that exceeds the amount of $170,350.[263] The determination of whether there is such an excess is based on the value on the date of the petition.[264] The monetary cap imposed by section 522(p)(1) does not apply to any interest transferred from a debtor's previous principal residence to the debtor's current principal residence, if the debtor's previous residence was acquired before the 1215-day period and both the previous and current residences are located in the same state.[265] In addition, the limitation does not apply to an exemption claimed on a principal residence by a family farmer.[266]

A significant question faced by the courts is how to interpret the phrase "interest that was acquired by the debtor." Given that the apparent legislative intent for enacting section 522(p) was to discourage prebankruptcy exemption planning in which some debtors have taken advantage of unlimited or substantial homestead exemption laws, it would seem that the phrase should be construed as applying to the actual purchase or acquisition of an ownership interest in homestead property, an interest that the debtor gains though their own affirmative actions or efforts.[267] Under this view, section 522(p) should not apply to an interest attributable simply to an increase in the market value of the debtor's homestead during the 1215-day period, because that is not an interest "acquired" by the debtor, but rather an increase in the value of the debtor's existing interest.[268] Similarly, this provision should not prevent the debtor from claiming as exempt an interest in a homestead resulting from the application of mortgage payments, or from home improvements, because neither changes the property interest that the debtor holds.[269] Nor should designation of property as a homestead be considered acquiring an interest.[270] Similarly, a transfer of property from a self-settled revocable trust by a debtor who was the trustee or by an entity owned by the debtor should not be considered to increase the debtor's interest in the property.[271]

Footnotes

- 263 This exemption amount is updated every three years. The dollar amount for the period between April 1, 2016, and April 1, 2019, was $160,375.
- 264 In re Colliau, 552 B.R. 158 (Bankr. W.D. Tex. 2016).
- 265 11 U.S.C. § 522(p)(2)(B). See In re Meguerditchian, 566 B.R. 102 (Bankr. D. Mass. 2017) (equity created through use of proceeds from prior homestead exemptible even though prior homestead was sold after current homestead was acquired and current homestead was originally acquired by nominee trust); In re Wayrynen, 332 B.R. 479 (Bankr. S.D. Fla. 2005) ("safe harbor" in section 522(p)(2)(B) found to be applicable because phrase "previous principal residence" includes an interest transferred from a previous residence acquired before the 1215-day period, even if that residence is not most immediate prior residence).
- 266 11 U.S.C. § 522(p)(2)(A).

- **267** See In re Bruess, 539 B.R. 560 (B.A.P. 8th Cir. 2015) (under state law, debtor acquired interest in property by quitclaim deed from her father at time when deed was recorded during the 1215-day period, not several years earlier when deed was executed, based on testimony that father did not intend to transfer interest until recording date); In re Dickey, 517 B.R. 5 (Bankr. D. Mass. 2014) (debtor actively acquired title interest to property by deeding it as part of a fraudulent transfer that resulted in a re-transfer of it back to the debtor); In re Aroesty, 385 B.R. 1 (B.A.P. 1st Cir. 2008) (change in debtor's interest in property during 1215-day period from beneficial interest to owner of legal title was acquisition of interest); In re Presto, 376 B.R. 554 (Bankr. S.D. Tex. 2007) (actively acquiring former spouse's interest in property was acquisition of interest); In re Rasmussen, 349 B.R. 747 (Bankr. M.D. Fla. 2006) (equity resulting from rollover of equity from sale of prior homestead was not an interest "acquired by the debtor" during the 1215-day period).
- **268** In re Sainlar, 344 B.R. 669 (Bankr. M.D. Fla. 2006) (increase in value due to appreciation is not interest acquired within meaning of section 522(p)); In re Chouinard, 358 B.R. 814 (Bankr. M.D. Fla. 2006) (passive market appreciation is not interest acquired); In re Blair, 334 B.R. 374, 376 (Bankr. N.D. Tex. 2005) (one does not "acquire" equity in a home; one acquires title).
- **269** In re Burns, 395 B.R. 756 (Bankr. M.D. Fla. 2008). But see Parks v. Anderson, 406 B.R. 79, 95 (D. Kan. 2009) (equity resulting from $240,000 lump-sum pay-down of mortgage shortly before bankruptcy was interest acquired subject to limitation under section 522(p)).
- **270** In re Greene, 583 F.3d 614 (9th Cir. 2009) (perfection of a homestead exemption by recording homestead or moving onto property does not constitute acquisition of property interest for purposes of section 522(p)(1)); In re Rogers, 513 F.3d 212 (5th Cir. 2008) ("interest" as used in section 522(p)(1) refers to property interests having some economic value; although homestead acquired after debtor occupied inherited property during 1215-day period is a legal interest under Texas state law, it is not an economic interest of the kind contemplated by section 522(p)(1)); In re Noonan, 2014 WL 184776 (Bankr. D. Mass. Jan. 15, 2014) (slip copy) (also holding that lien that existed prior to homestead declaration could be avoided because Bankruptcy Code overrode state law). Cf. Wiggains v. Reed (In re Wiggains), 848 F.3d 655 (5th Cir. 2017) (nondebtor spouse had no separate ownership interest entitled to compensation under section 363(j) when community property homestead sold); Odes Ho Kim v. Dome Entm't Ctr., Inc. (In re Odes Ho Kim), 748 F.3d 647 (5th Cir. 2014) (because homestead rights are not a property interest, nondebtor spouse who co-owned property acquired within 1215-day period had no right to compensation above the capped homestead amount when house sold in bankruptcy).
- **271** Caldwell v. Nelson (In re Caldwell), 545 B.R. 605 (B.A.P. 9th Cir. 2016) (transfer from LLC owned by debtor and his spouse to trust controlled by debtor and spouse was not acquisition of property); In re Peake, 480 B.R. 367 (Bankr. D. Kan. 2012). See also In re Welch, 486 B.R. 1 (Bankr. D. Mass. 2013) (merger of equitable and legal title in debtor by operation of state law when debtor became both the sole trustee and beneficiary of a trust is a passive event and not an acquisition for section 522(p)).

10.2.3.4.5.2 Felony conviction

The debtor may not exempt an interest in homestead property that exceeds $170,350[273] if the debtor has been convicted of certain criminal conduct. Under section 522(q)(1)(A), the cap applies if the court determines, after notice and a hearing on an objection to the exemption, that the debtor has been convicted of a felony (as defined by 18 U.S.C. § 3156),[274] "which under the circumstances, demonstrates that the filing of the case was an abuse" of the bankruptcy provisions. Based on the language of the provision, the felony conviction probably must occur prior to the filing of the petition, and any criminal activity of the debtor that takes place postpetition, such as during the three to five year pendency of a chapter 13 case, cannot provide the basis for an objection to a homestead exemption under section 522(q)(1)(A).

Although the statutory language is not clear, it would seem that the objecting party would need to prove a connection between the felony conviction and the bankruptcy filing such that the filing would be deemed an abuse. This connection might be shown with proof that the debtor is attempting discharge civil liability owing to victims of the crime, or that the bankruptcy filing may affect the debtor's obligation to pay restitution related to the felony.

Footnotes

- **273** This exemption amount is updated every three years. The dollar amount for the period between April 1, 2016, and April 1, 2019, was $160,375.
- **274** The term "felony" is defined as an "offense punishable by a maximum term of imprisonment of more than one year." 18 U.S.C. § 3156.

10.2.3.4.5.3 Debts arising from certain wrongful conduct

A $170,350 cap on the debtor's homestead interest that may be claimed as exempt[275] may also be invoked under new section 522(q)(1)(B) if the debtor owes a debt arising from certain wrongful conduct. The debt must arise from one of the following four specified categories:

- • Any violation of state or federal securities laws (as defined in section 3(a)(47) of the Securities Exchange Act)[276] or any regulation or order issued under state or federal securities laws;[277]
- • Fraud, deceit, or manipulation in a fiduciary capacity or in connection with the purchase or sale of any security registered under sections 12 or 15(d) of the Securities Exchange Act of 1934 or under section 6 of the Securities Act of 1933;[278]
- • Any civil remedy under the Racketeer Influenced and Corrupt Organizations (RICO) Act;[279] or
- • Any criminal act, intentional tort, or willful or reckless misconduct that caused serious physical injury or death to another individual in the preceding five years.[280]

Footnotes

- **275** This exemption amount is updated every three years. The dollar amount for the period between April 1, 2016, and April 1, 2019, was $160,375.

- 276 The term "securities laws" means the Securities Act of 1933 (15 U.S.C. §§ 77a–77aa), Securities Exchange Act of 1934 (15 U.S.C. §§ 78a–78nn), Sarbanes-Oxley Act of 2002, Public Utility Holding Company Act of 1935 (15 U.S.C. §§ 79a–79z-6 (repealed 2005), Trust Indenture Act of 1939 (15 U.S.C. §§ 77aaa–77bbbb), Investment Company Act of 1940 (15 U.S.C. §§ 80a-1–80a-64), Investment Advisers Act of 1940 (15 U.S.C. §§ 80b-1–80b-21), and the Securities Investor Protection Act of 1970 (15 U.S.C. §§ 78aaa–78lll). See 15 U.S.C. § 78c(a)(47).
- 277 In re Bounds, 491 B.R. 440 (Bankr. W.D. Tex. 2013) (imposing homestead limitation under section 522(q)(1)(B)(i) based on state court judgment against debtor for state law securities violation).
- 278 In re Presto, 376 B.R. 554 (Bankr. S.D. Tex. 2007) (debtor violated fiduciary duty to former spouse by concealing and failing to turn over her share of tax refund).
- 279 See 18 U.S.C. § 1964.
- 280 Unlike section 522(q)(1)(A) which requires a criminal conviction, this provision refers to a "criminal act" and may not require a conviction if it can be shown that the act giving rise to the debt is a crime. See In re Larson, 513 F.3d 325 (1st Cir. 2008) (although charge against debtor was continued without conviction, homestead limitation applied to debt arising from negligent operation of motor vehicle because debtor's admission of guilt in criminal proceeding was equivalent of guilty plea under state law).

10.2.3.4.5.5 No cap if homestead reasonably necessary for support

Section 522(q)(2) provides that the dollar limitation contained in section 522(q)(1) shall not apply to the extent that the amount of any interest in homestead property is reasonably necessary for the support of the debtor and any dependent of the debtor.[285] This provision would permit the court to decline to apply the $170,350 cap on the debtor's homestead interest that may be claimed as exempt[286] based on a reasonably necessary test like that found in other subsections of section 522,[287] and other sections of the Code, which generally consider whether the questioned item is a "luxury."[288] For no apparent reason, this exemption from the homestead cap may be asserted by the debtor only in response to an objection to a claim of exemption based on section 522(q) and not an objection based on section 522(p). Congress was apparently more sympathetic to a debtor who commits securities fraud or criminal acts causing serious personal injury than to a debtor who may have innocently acquired homestead property within 1215 days before filing the petition.

A determination as to whether the homestead interest in question is reasonably necessary, based on court interpretations of identical language found in other provisions of section 522 (such as section 522(d)(10)), would therefore require the court to consider the debtor's (and dependents) age, health, earning capacity, present and future financial needs and ability, other assets, future financial obligations such as alimony and child support, and any special needs of the debtor and dependents.[289] In the context of the debtor's potential loss of homestead property if the monetary cap were to be applied, the debtor may wish to present additional evidence on matters such as any potential difficulty the debtor may have in finding suitable and affordable replacement housing, the length of time the debtor has lived in the community, the costs of relocation, the safety of the debtor's current neighborhood as

compared to any potential replacement housing's surroundings, and the impact relocation may have on the debtor's future income and the education of the debtor's children.

Footnotes

- **285** Section 522(a)(1) defines "dependent" as including the debtor's spouse, whether or not actually dependent. This definition is ordinarily not relevant to the application of state exemption laws. However it should apply in any consideration of whether section 522(q)(2) prevents the application of the $170,350 cap on a state homestead exemption. Note that this exemption amount is updated every three years. The dollar amount for the period between April 1, 2016, and April 1, 2019, was $160,375.
- **286** This exemption amount is updated every three years. The dollar amount for the period between April 1, 2016, and April 1, 2019, was $160,375.
- **287** See, e.g., 11 U.S.C. § 522(d)(10), (11).
- **288** See, e.g., 11 U.S.C. § 1325(b)(2)(A).
- **289** See, e.g., In re Cramer, 281 B.R. 193 (Bankr. E.D. Pa. 2002); In re Mann, 201 B.R. 910 (Bankr. E.D. Mich. 1996). See also § 12.3.3, infra.

10.2.3.4.5.6 Delay of discharge

The 2005 Act added new subsections 727(a)(12), 1141(d)(5)(C), 1228(f), and 1328(h), which provide that the entry of the debtor's discharge in a chapter 7, 11, 12, or 13 case may be delayed pending the outcome of any criminal and civil proceedings against the debtor referred to in section 522(q)(1). If a motion to delay or postpone discharge is filed under section 727(a)(12),[290] and after notice and hearing held ten days before the date discharge would otherwise enter, the court shall not grant the discharge if it finds that there is reasonable cause to believe that (1) section 522(q)(1) may be applicable, and (2) there is a pending proceeding in which the debtor may be found guilty of a felony described in section 522(q)(1)(A) or liable for a debt described in section 522(q)(1)(B). These provisions are not intended to provide grounds for the denial of a discharge, but simply provide a procedural mechanism for delaying the entry of discharge until the events that could trigger a potential exemption objection under section 522(q) are resolved.[291]

Given that the first condition is that section 522(q)(1) must be applicable, a debtor's discharge may not be delayed if the debtor is not claiming homestead property as exempt, has not claimed a homestead interest in excess of $170,350 as exempt,[292] or if the debtor is claiming homestead property as exempt under section 522(b)(2) or (b)(3)(B).[293] In addition, there should be no delay of discharge if the potential felony conviction did not cause the debtor's bankruptcy filing to be abusive, the debt alleged to be owed is not of the type described in section 522(q)(1), or the homestead property is reasonably necessary for the support of the debtor and any dependent of the debtor.[294]

The second condition requires that the court, if a motion to delay is filed, have reasonable cause to believe that one of the identified types of proceedings is pending against the debtor and that the debtor may be found guilty or liable in such proceeding. The debtor should therefore have the right to be heard on any claims or defenses asserted in the proceeding that would establish that the debtor may not be guilty or liable. However, to avoid the possibility of the debtor making self-incriminating statements, this would not likely occur if a criminal proceeding is pending. Moreover, even as to a pending civil matter, the bankruptcy court may prefer to abstain and permit the court in which the proceeding is pending to determine the underlying debt. In such cases, the entry of the debtor's discharge will be delayed until resolution of the criminal or civil proceeding.

A problem with the drafting of these new delay in discharge provisions is that they conflict with the language used in section 522(q) in regard to a criminal conviction. Section 522(q)(1)(A) provides that the homestead cap may apply if "the debtor has been convicted of a felony." Because exemptions are determined on the date the petition is filed,[295] this language should mean that no objection may be brought under section 522(q) if the debtor has not been convicted of a felony prior to the filing of the petition. However, the delay in discharge provisions, as in section 727(a)(12) for example, provide that the discharge may be delayed if there is a pending proceeding in which "the debtor may be found guilty of a felony," suggesting that the conviction could occur postpetition. Given the conflict between these provisions, and because section 522(q) is the more specific provision which controls a debtor's substantive rights under the Code relating to exemptions rather than procedural matters relating to the timing of the entry of discharge, section 522(q) probably should control. One could read section 727(a)(12) to deal only with post-conviction cases that are on appeal or somehow not yet final on the date of the petition. Thus, the discharge should

not be delayed if the debtor had not been convicted of a felony prior to the filing of the petition.

The new potential barrier to the granting of a discharge under these provisions could mean that some debtors will have to wait months or even years before their bankruptcy cases are concluded and they obtain a discharge. This result is particularly troublesome in chapter 7 cases in which debtors ordinarily are granted a discharge approximately three to four months after the filing of the petition. It could place some debtors in an extended period of uncertainty about their financial situation, during which time they will be effectively locked out of the financial marketplace and denied a fresh start. While courts are generally not inclined to grant a motion for voluntary dismissal of a chapter 7 case in response to an exemption objection, courts may be more willing to do so under these circumstances.

Footnotes

- **290** See Fed. R. Bankr. P. 4004(c)(1)(I).

  If a debtor in a chapter 11, 12 or 13 has claimed a homestead exemption under section 522(b)(3)(A) in excess of the amount set out in section 522(q)(1), Fed. R. Bankr. P. 1007(b)(8) provides that the debtor must file a statement concerning whether any civil and criminal proceedings described in section 522(q)(1) are pending. A sample statement is provided in Appx. G.12, infra.
- **291** These provisions are found in section 330 of Pub. L. No. 109-8, which is entitled: "Delay of Discharge During Pendency of Certain Proceedings." Presumably Congress sought to include these provisions because of the implications under section 522(c) of the entry of a discharge before a section 522(q) exemption objection is resolved.
- **292** This exemption amount is updated every three years. The dollar amount for the period between April 1, 2016, and April 1, 2019, was $160,375.
- **293** In re Buonopane, 359 B.R. 346 (Bankr. M.D. Fla. 2007) (entireties exemption claimed under section 522(b)(3)(B)); In re Jacobs, 342 B.R. 114 (Bankr. D.D.C. 2006) (federal exemptions claimed under section 522(b)(2)). See § 10.2.3.4.2, supra.
- **294** See §§ 10.2.3.4.5.2, 10.2.3.4.5.3, 10.2.3.4.5.5, supra.
- **295** See, e.g., Lowe v. Sandoval (In re Sandoval), 103 F.3d 20 (5th Cir. 1997).

10.2.3.4.5.7 Application of homestead caps in joint cases

If the homestead cap under section 522(p) (for property acquired within the 1215-day period before filing) or section 522(q) (for certain criminal or wrongful conduct) is imposed, it is applicable to interests that exceed "in the aggregate" $170,350 in value in homestead property.[296] The use of the word "aggregate" in referring to the debtor's interest, consistent with its application in other subsections such as section 522(d)(6),[297] suggests Congress intended the dollar limit to be applied to the combined interests of the debtor in the various forms of property listed in section 522(p)(1)(A) through (D). It is not intended to impose an overall $170,350 cap on the amount both debtors in a joint case may exempt in a homestead under a state exemption law.[298] This construction is supported by the fact that the 2005 Act did not amend section 522(m), which states that section 522 applies separately with respect to each debtor in a joint case.

Thus, the dollar limit of sections 522(p) or (q), if applicable, should apply separately to each debtor's homestead interest and exemption claim.[299] Sections 522(p) or (q), if applicable, will not prevent each debtor in a joint case from claiming as exempt a homestead interest up to the amount of $170,350.[300] For example, if the cap under section 522(q) were imposed in a joint case as to each debtor's homestead interest, the debtors could claim as exempt their total interest in homestead property up to the amount of $340,700[301] or, if lower, the amount state law provides that the joint debtors may exempt in homestead property.

In addition, in a joint case the dollar limit of sections 522(p) or (q) would not apply to both debtors' homestead interests if only one of the debtors has been convicted of a felony or is liable on a debt specified in section 522(q)(1)(B).

Footnotes

- 296 This exemption amount is updated every three years. The dollar amount for the period between April 1, 2016, and April 1, 2019, was $160,375.
- 297 Section 522(d)(6) provides that a debtor who elects federal exemptions may exempt "[t]he debtor's aggregate interest, not to exceed $2525 in value, in any implements, professional books, or tools, of the trade of the debtor or the trade of a dependent of the debtor." 11 U.S.C. § 522(d)(6). This exemption amount is updated every three years. The dollar amount for the period between April 1, 2016, and April 1, 2019, was $2375.
- 298 This exemption amount is updated every three years. The dollar amount for the period between April 1, 2016, and April 1, 2019, was $160,375.
- 299 See Dykstra Exterior, Inc. v. Nestlen (In re Nestlen), 441 B.R. 135 (B.A.P. 10th Cir. 2010); In re Gentile, 483 B.R. 50 (Bankr. D. Mass. 2012); In re Limperis, 370 B.R. 859 (Bankr. S.D. Fla. 2007); In re Rasmussen, 349 B.R. 747 (Bankr. M.D. Fla. 2006).
- 300 This exemption amount is updated every three years. The dollar amount for the period between April 1, 2016, and April 1, 2019, was $160,375.
- 301 This dollar amount represents twice the homestead exemption. The dollar amount for the period between April 1, 2016, and April 1, 2019, would be $320,750.