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## Homestead Protected

**B**arry Nelson, partner in North Miami Beach, Fla.'s Nelson & Levine, P.A., has this report: When the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 passed, many believed that homestead protection would be significantly curtailed based upon the act's \$125,000 cap for homesteads purchased within 1,215 days of declaring bankruptcy, and for homesteaders who'd been convicted of a felony or incurred debt from certain other criminal or civil lawsuits.

But in the first reported bankruptcy case addressing homestead issues after the act's adoption, the U.S. Bankruptcy Court for the District of Arizona in the case of *In re Robin Bruce McNabb*, 2005 Bankr. LEXIS 1231, held that the \$125,000 homestead cap under Section 522(p)—where a residence is acquired by a debtor within 1,215 days prior to filing for bankruptcy—doesn't apply to states that have "opted out" of the federal exemptions. Instead, the homestead cap for the applicable opt-out state applies.

The opinion, written by Judge Randolph J. Haines, distinguishes several sections of the bankruptcy act, and concludes that the fraudulent conveyance provisions under Section 522(o) do apply to reduce the homestead exemption (regardless of whether in an opt-out state) by the amount of fraudulent transfers that contributed to it. The distinction between Sections 522(p) and 522(o) is that Section 522(p) applies only "as a result of electing... to exempt property under State or local law." No such election is required under Section 522(o). Planners must be aware of the *McNabb* decision to properly inform debtors and creditors of their rights under the bankruptcy court's interpretation of the new law.

Robin Bruce McNabb filed for bankruptcy on April 28, about a year after he'd purchased a home in Arizona, having moved from California where he had resided for at least three years. The filing was just eight days after the bankruptcy act was enacted. McNabb's home was reported at a value of \$330,000 and subject to a mortgage of \$202,500. Arizona is an "opt-out state" (that is, its residents are not entitled to claim federal bankruptcy exemptions). Arizona's homestead exemption is \$150,000. Equity in the McNabb's home was \$124,500.

McNabb's creditors objected to his claim seeking to exempt his home. They argued that, under Section 522(b)(3)(A) as amended by the bankruptcy act, McNabb was subject to California law, because he hadn't resided in Arizona for 730 days pre-petition. If California law applied, the maximum homestead exemption would be \$75,000 if married with dependents, or \$50,000 for a single debtor without dependents. The creditors also argued that Section 522(p)(1) as amended by the bankruptcy act imposes a \$125,000 cap, because McNabb's house was acquired less than 1,215 days before his bankruptcy petition. Moreover, the creditors contended that the \$250,000 borrowed by McNabb from one of the creditors may have provided some or all of the funds used to acquire his home. If so, the creditors argued that Section 522(o), as added by the bankruptcy act, requires a reduction of the homestead exemption to the extent of the value obtained through "such fraud" that was invested in the homestead.

What is the effective date of the 730-day domicile requirement under Section 522(b)(3)? If this section applied, McNabb would be subject to the homestead provisions under California law rather than the more favorable provisions under Arizona law because: (1) the debtor would not have resided in Arizona for 730 days prior to filing for





bankruptcy, and (2) he spent a majority of his time in California before moving to Arizona. The court found the effective date of the 730 day domicile requirement was 180 days after enactment or Oct. 17. This allowed the debtor, who'd moved to Arizona more than 180 days pre-petition, to benefit from Arizona's homestead exemption.

The court also indicated that new Section 522(o) applied to the case. The new Section provides that the value of property claimed as homestead must be reduced to the extent that the value is attributable to fraudulent transfers of non-exempt property made by the debtor within 10 years pre-petition. The court noted that Section 522(o) was one of the exceptions to the general effective date rule, because Section 1501(b)(2) states that the amendments provided under Section 308 apply to cases filed on or after the date of enactment. The case was remanded for an evidentiary hearing on valuation of the residence and "possibly, on the source of the funds used to pay for the home."

But does the \$125,000 cap on homesteads acquired within 1,215 days pre-petition apply? The new Section 522(p) is effective as of the date of the bankruptcy act's adoption. According to the holding in *McNabb*, the \$125,000 homestead cap applies only as a result of electing under Section 522(b)(3)(A) of the bankruptcy code to exempt property under state or local law. The *McNabb* opinion states: "If the cap. . . becomes applicable only 'as a result of electing,' then it can apply only in non-opt out states, i.e., those states where such an election is available." The *McNabb* opinion further states: "[I]t makes little sense to limit the cap to the few remaining non-opt out states. . . . Until Congress does fix it, however, the Court must apply the unambiguous statute as written. . . . The cap applies only 'as a result of electing'. Where there is no election, the cap cannot be the result." Although *McNabb* applied Arizona law, the issues should be the same for all opt-out states (that is, those states where the election under Section 522 (b)(3)(A) is unavailable).

The opinion notes that two-thirds of the states have opted out of federal exemptions, and of the states that have not, only two, Texas and Minnesota, have homestead exemptions in excess of \$125,000.

The *McNabb* court also noted that Sections 522(p) and (q) require an election to become effective distinguished from Section 522(o), which makes no reference to an election. Accordingly, it'd appear that based upon *McNabb*, both the Section 522(p) 1215 day rule and the Section 522(q) homestead limitations resulting from felony conviction, securities law fraud or breach of fiduciary duty, do not currently apply to opt-out states.

The 2005 bankruptcy act is likely to generate much uncertainty in the homestead arena. But *McNabb* suggests the act may not be as encompassing as Congress seems to have intended.