So He Huffed and He Puffed........But Will the Home(stead) Fall Down?: The Applicability of Section 522(p)(1) of the U.S. Bankruptcy Code to Varying Interest Accumulation of the Debtor in Homestead Property

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ABSTRACT

The homestead exemption is an allowance by state or federal law to protect the homestead of persons whose property may be liquidated for the benefit of creditors. Wealthy people anticipating bankruptcy would move their residences to more favorable states, such as Florida, and convert their assets into a "homestead". This exemption became known as the "mansion loophole". In response Congress passed the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA"). BAPCPA, however, has been recognized as an example of artless craftsmanship in dealing with this loophole - not least of which is that portion which forms the substance of this article.

The relevant portion of this law is § 11 U.S.C. 522(p) (1) of the U.S. Bankruptcy Code. Homestead exemptions are limited to $136,875 if the interest was acquired by the debtor within 1215 days of filing. An open question is when an “interest” has actually been “acquired” by the debtor. Various factual situations are analyzed wherein the debtor may be deemed to have accumulated an interest; however, the issue is whether the proscriptions of the statute were intended to apply to each of these scenarios. The federal courts have been in conflict. A formulaic resolution is proposed. These interests would be characterized as either active (transactional) or passive (appreciable) interests. Categorizing the interest would provide a more uniform manner for resolution of these disputes.

In view of the credit crisis our country is experiencing, particularly with respect to the housing market, frequent disputes will arise as to this provision. A uniform framework is needed.
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I. Introduction

The homestead exemption is one exemption in the package of exemptions allowed under
both state law and by virtue of the U.S. Bankruptcy Code (“the Code”) to persons who
are subject to having their assets converted for the benefit of their creditors as a result of
debt obligations. Under the Code each state has the right to “opt out” of the federal
exemption structure thus requiring its citizens to utilize the exemptions of that state, or
allow its residents to take the exemptions allowable under federal bankruptcy law. They
cannot take both.

The homestead exemption is perceptibly the most beneficial exemption. The homestead
exemption allowable under federal bankruptcy law is limited to $20,200. Some states, on
the other hand, have more generous homestead exemptions than that allowed by federal
law. What is more, the homestead exemption allowed by some jurisdictions is more

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1 Any resemblance this awkward reference to the perennial English fairy tale “The Three Little Pigs” suggests to specific parties in a bankruptcy proceeding is unintended and purely fictional. It should be noted, however, that the debtor/pig-hog analogy is oft referenced in regard to these types of matters as a portrayal of certain debtors. Hence, it seems that casting the trustee in the role of the wolf might also serve well to stage a more adversarial setting highlighting the conflict between the debtor and trustee in these matters. But, of course, it can be argued that the trustee may more likely resemble a kind of Robin Hood character in its role of protecting the unsecured creditor by redistributing the riches of the hoggish debtor.


4 Id.

5 11 U.S.C. § 522 (d) (1).

6 See generally, Appendix A.
generous than that of others. Most notably are the District of Columbia, and the states of Florida, Iowa, Kansas, Oklahoma, South Dakota and Texas, which in various respects each have an unlimited homestead exemption. As a result, in a few cases, mostly wealthy people who were anticipating bankruptcy would move their residences to these more favorable states, most infamously Florida, and liquidate a vast portion of their assets that would otherwise not be exempt investing these monies into their “homestead” which would be acquired, constructed or remodeled for this precise purpose. The following is an excerpt from the Congressional Record of a statement made during discussions on this topic just prior to the passage of BAPCPA:

A review of a few examples in recent years shows how willing disreputable debtors are to engage in such planning to hide their assets. Let me give you just a few of the many examples:

John Porter, WorldCom’s cofounder and former Chairman, bought a 10,000 square-foot ocean front estate in Palm Beach, Florida in 1998, a home featured on the cover of Luxury Homes magazine, and now worth nearly $17 million. The IRS says he now owes more than $25 million for back taxes, and he is the defendant in several multi-million dollar securities fraud lawsuits resulting from

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7 Id.
9 FLA. CONST. art. 10, § 4(a)(1) & FLA. STAT. ANN. 222.01,
10 IOWA CODE ANN. § 561.16 (2008).
11 KAN. STAT. ANN. § 60-2301 (2005),
12 OKLA. STAT. tit, 31 § 1.A.1 XXXX.
14 TEX. CONST. art. 16, §§ 50-51 XXXX.
the failure of World Com. Porter filed for bankruptcy in May 2004. Florida’s homestead exemption allows Porter to keep most of the value of the house.

The former Executive Vice President of Conseco has sought to avoid repaying $65 million in loans from Conseco by selling 90% of her and her husband’s assets and buying a $10 million home on Sunset Island in Miami Beach, FL.

In 2001, Phil Bilzerian – a convicted felon – tried to wipe out $140 million in debts and all the while holding on to his 37,000 square foot Florida mansion worth over $5 million – with up to 10 bedrooms, two libraries, double gourmet kitchen, racquetball court, indoor basketball court, movie theatre, full weight and exercise rooms, and swimming pool.

The owner of a failed Ohio Savings and Loan who was convicted of securities fraud, wrote off most of $300 million in debts, but still held on to the multi-million dollar ranch he bought in Florida.

Movie star Burt Reynolds wrote off over $4 million in debt through bankruptcy, but still held onto his $2.5 million Florida estate.
This exemption, when exploited in this manner, came to be known as the “mansion loophole”.\(^\text{15}\) Eventually, as a result of the negative publicity and extensive lobbying efforts on behalf of financial institutions, particularly credit card issuers,\(^\text{16}\) Congress took action by passing the newly revised bankruptcy laws known as the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA").\(^\text{17}\)

Nevertheless, these legalized manipulations were acted upon by a minority of debtors filing bankruptcy who were financially situated to be beneficiaries of this “loophole”. Of approximately 1.5 million people who filed bankruptcy a U.S. General Accounting Office study only found that 400 debtors took advantage of the unlimited homestead exemption in Florida and Texas.\(^\text{18}\)

BAPCPA decidedly favors the interests of creditors in spite of the fact that the words “Consumer Protection Act” are appended, perhaps more symbolically than representatively, to the end of its name.\(^\text{19}\) Certainly that portion of the amendments to

\(^{15}\) Jacob E. Mitrani, *A Year Older, A Year Wiser*, 26 AM. BANKR. INST. J., 58, (March 2007) (quoting Representative James Sensenbrenner, a leading sponsor of BAPCPA, one of the goals of the new law was to restrict the so-called "mansion loophole" as stated in H.R. REP. NO. 109-31, SENATE BILL § 256 (2005)).

\(^{16}\) See, e.g., Ronald J. Mann, et al., “*Bankruptcy Reform and The ‘Sweat Box’ of Credit Card Debt*”, University of Texas at Austin, School of Law, 2006 Illinois Law Review, Forthcoming, Law and Economics Research Paper No. 75, September 2006, citing generally 144 CONG. REC. H10225 (1998) (remarks of Rep. Nadler arguing that the bill was written “by and for” credit card companies); 144 CONG. REC. H9146 (1998) (remarks of Sen. Kennedy) (“All year long Congress has been teaming [sic] with credit card lobbyists pushing for legislation making it harder for consumers, for working Americans, to get relief from crushing debt woes.”)


\(^{18}\) See, Herb Kohl, *Kohl Letter Urges Colleagues to Keep Homestead Cap*, 21 AM. BANKR. INST. J. 25, (May 2002) (Although cited as indicative of substantial abuse, this number represents a very small percentage of people filing bankruptcy within the past 10 years.)

which this paper pertains reveals that preference in its efforts to make it far more difficult than prior to the passage of BAPCPA for debtors to protect their homestead and other assets. Certainly, this was the blow which Congress and the law’s advocates sought to strike.

BAPCPA, however, has been recognized by bankruptcy practitioners and scholars alike as an example of artless craftsmanship in many compelling respects – not least of which is that portion which forms the substance of this article. As a result, as will be discussed below, the federal courts have already begun efforts to make apt interpretation of ambiguous legislative promulgations, sometimes with conflicting resolution. This article provides illuminated illustration of how this law fails by leaving to the judicial interpreters the task of plugging the gaps to fulfill (or at least make sense out of) the law.

The relevant portion of this law is that which limits the ability of the debtor to exempt any portion of their homestead above $136,875 that was “acquired” within 1215 days or more than a 3 year period prior to filing bankruptcy. What the law does not appear to anticipate is the fact that there may be situations where the debtor has garnered additional

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20See, Jean Braucher, Symposium: Consumer Bankruptcy and Credit in the Wake of the 2005 Act: The Challenge to the Bench and Bar Presented by the 2005 Bankruptcy Act: Resistance Need not be Futile, 2007 U. ILL. L. REV. 93, 97 (2007) (Braucher states, “[t]he problems with the 2005 Act are breathtaking. There are typos, sloppy choices of words, hanging paragraphs, and inconsistencies. Worse, there are largely pointless but burdensome new requirements, overlapping layers of screening, mounds of new paperwork, and structural incoherence.”). See also, Sommer, note 19, supra, wherein it states: “One of the chief problems that will be confronted is atrocious drafting, especially in many of the consumer provisions of the bill.”

2111 U.S.C. § 104(b)(1), 11 U.S.C. § 522(b)(1). This amount is adjusted every three years according to the cost of living. Prior to April 1, 2007, the amount was $125,000.

interest in the applicable real property, but such interest was not actually “acquired”
within the meaning of a strict interpretation of the statute. Rather, such additional interest
may result from equity appreciation or other resulting accumulation discussed in this
paper. Indeed, as discussed in Part III infra, courts have already faced this issue in a few
cases that have attempted to interpret this code provision. Thus, what is analyzed herein
are various scenarios upon which a debtor may be deemed to have either actively gained
an interest in such property or passively gained an interest — scenarios which were either
not anticipated or ignored when constructing this new law and which these authors
believe must be handled distinctly.

In a case discussed in this paper involving this issue, the court recognized a distinction
between passive acquisition of an interest and active acquisition of an interest; noting in
its dicta how certain other factual situations might be decided in future cases. By
adopting this premise and characterizing these scenarios in a similar manner, but
distinguishing between “acquisitions” and “accumulations”, an efficacious mechanism
for judicial interpretation is provided. We believe that most matters, as are conceived of
and outlined herein, can fit suitably into one of these two broad categories and be thusly
interpreted as either being subject to the limitation of §522(p) (1) (if deemed an
active/transactional acquisition), or not (if deemed a passive/appreciable accumulation).

II. BAPCPA and the New Code Provision – Section 522(p) (1)

A. How Does it Work?
Under BAPCPA Congress enacted a new code provision, §522(p) (1) which is designed to close the so-called “mansion loophole”. Section 522(p) (1) of Title 11 of the U. S. Bankruptcy Code reads as follows:

(p)(1) Except as provided in paragraph (2) of this subsection and sections 544 and 548, as a result of electing under subsection (b)(3)(A) to exempt property under State or local law, a debtor may not exempt any amount of interest that was acquired by the debtor during the 1215-day period preceding the date of the filing of the petition that exceeds in the aggregate $125,000 [§125,000 (added by BAPCPA 10-17-05) effective 4-1-04. Adjusted every 3 years by section 104.] in value in—

(A) real or personal property that the debtor or a dependent of the debtor uses as a residence;

(B) a cooperative that owns property that the debtor or a dependent of the debtor uses as a residence;

(C) a burial plot for the debtor or a dependent of the debtor; or

(D) real or personal property that the debtor or dependent of the debtor claims as a homestead.
The operative language of this provision is “interest that was acquired by the debtor”. In the targeted “mansion loophole” scenario a debtor, within the 1215 day window,\(^{23}\) sells a home in state A which has a limited or less favorable homestead exemption and purchases a home in state B which has an unlimited homestead exemption. To fund the purchase of the home in state B the debtor liquefies most of the assets owned by the debtor that would be nonexempt along with the proceeds from the sale of the home in state A to purchase a home in state B. Those assets of the debtor that otherwise would have been nonexempt have been transferred to state B where the total value of these assets can now be exempted so long as they are invested in the homestead. As a result the creditors of the debtor cannot levy upon, attach or effect an execution for sale of the assets of the debtor for any debts owed by the debtor to that creditor and these assets are now excluded from the bankruptcy estate of the debtor. There is no doubt that this transaction was anticipated by and falls within the proscriptions of this statutory provision.

However, financial matters, particularly those pertaining to persons who find themselves in distress, rarely come in neat packages, perfectly suited to the regulatory formula designed to address them. Few situations do. Were it so, court dockets would doubtless

\(^{23}\) Why did Congress choose precisely 1215 days or 3.3 years? Did it result from some studied research that suggests that the type of pre-bankruptcy planning the system needed to thwart happens no more than three years or so out? Does this approach best discern when a pig becomes a hog? Such a length of time will no doubt deter many heretofore legitimate pre-bankruptcy planning efforts. Most people will likely not engage in the type of long range financial prognostics that would anticipate the need for seeking the protections of the federal bankruptcy laws years in the future. Yet, there may be those for whom long range danger signals cause a planned effort beyond this time frame who would yet accomplish that which Congress seeks to hinder – perhaps a subset of the wealthy few who would have been capable of taking advantage of this “mansion loophole”. But that may be a subject for a paper of another sort.
be less overburdened. Thus, while perhaps deservedly targeting scenarios such as the
before described, it draws within its grasp other perhaps unintended situations.

B. Does Section 522(p) (1) Apply in Every State?: Election vs. Opting-Out

Bankruptcy law is a federal law. Obviously, therefore, its provisions apply to every
state in the United States. What the law itself allows, however, is for a state to “opt-out”
of the exemption structure of the federal law and require its citizens who become debtors
to avail themselves of the state exemption structure only. The state exemption
structures are there for those debtors who may have to resort to its protections in cases
where a creditor has obtained a judgment against the debtor and seeks to execute it by
claiming property of the debtor. It would be used in the bankruptcy context for those
debtors who filed for bankruptcy to allow those assets to be excluded from the debtor’s
estate as exempt.

In those states that have not opted-out of the federal exemption structure a debtor can
“elect” to utilize either their own state exemption structure or the federal exemptions
contained in the Code. Thus, there is a distinction between states that have opted out
of the federal exemption structure, requiring their citizens to utilize the state exemptions,
and those states which have not opted-out and therefore allow their citizens to “elect” to

\[24\text{See, Title 11 of the U. S. Code.}\]
\[25\text{11 U.S.C. § 522 (b)(2).}\]
\[26\text{11 U.S.C. § 522 (b)(1).}\]
take either the federal or state exemptions. Because of this distinction the bankruptcy court in the case of *In Re McNabb* interpreted the $125000 limitation in § 522(p)(1) to be inapplicable to debtors in the states which have opted-out. The *McNabb* court interpreted this new code provision to mean that this provision of the code was not applicable to states that have opted-out of the federal exemption structure since in those cases a debtor cannot “elect” the federal exemptions as the language of this code provision states. The court did so even though it admitted that it did not make sense for the limitation not to apply to all states, declaring: “Frankly, this Court believes it should, because it makes little sense to limit the cap to the few remaining non-opt out states, nor to permit debtors to shield assets by obtaining a homestead in some other state merely because that state precludes the alternative of claiming far less generous federal exemptions. Until Congress does fix it, however, the Court must apply the unambiguous statute as written. The cap applies only ‘as a result of electing’.” In a later case, *In re Kaplan*, which is now considered the seminal case on this issue, the court refused to apply the holding of the *McNabb* court, and determined that Congress did not intend such an exception to exist. Thus, the court in *Kaplan* and its progeny have deemed §522(p)(1) to be applicable to all states, whether or not they have “opted out” of the federal exemption structure.

27 It should be noted that BAPCPA revised the ability of a person to claim a homestead exemption in a particular state if that debtor has not resided in that state at least 730 days. [See 11 U.S.C. 522 (b)(3)(A)]
29 Id. at 790-1.
31 Id. at 484.
33 Virissimo, at 206, Kane at 489, Landahl at 922, and Summers at 111, Note 32, supra
III. Characterization and Classification of Varying Interest Accumulations

Court decisions rendered since the passage of BAPCPA have grappled with the meaning and application of 11 U.S.C. 522(p) (1). Specifically, as referenced in Part I. supra, the question posed has been whether the language in the Code “interest that was acquired” is applicable to the facts presented in each particular case.

A. Passive vs. Active Interests: A Necessary Dichotomy

It is the premise of this article that most applicable factual situations can be grouped into one of two categories. When a person who later becomes a debtor accumulates an interest in property that is claimed as a homestead in a bankruptcy proceeding, that interest may have been accumulated either actively through a type of transaction, or passively as a result of some accrual for the benefit of that person. It is hypothesized that where such an interest results from “active/transactional” accumulation then the limitations of §522(p) (1) should apply to prevent the debtor from exempting from the reach of creditors any interest in a homestead that exceeds the $136,875 limit. However, where an interest results from “passive/appreciable” gain it appears that §522(p) (1) should not prohibit the debtor from excluding such interest from the reach of creditors vis a vis the bankruptcy exemption process. Indeed, semantically the “active/transactional” gain can more classically be thought of as an “acquisition”, whereas the

34 See generally, 4 COLLIER ON BANKRUPTCY §102.5 (Alan N. Resnick & Henry J. Sommer, eds., 15th ed. 2008) (“The statutory language leaves some uncertainty as to the exact meaning of the phrase ‘interest that was acquired’.”)
“passive/appreciable” gain may be more appropriately termed an “accumulation”, albeit both forms of gain represent accumulations for the benefit of the debtor.

B. Passive/Appreciable Interests

1. Appreciation Due to Natural Market Conditions

What if a debtor accumulates additional interest in property that is claimed as a homestead merely by virtue of the fact that the property has appreciated in value due to natural market conditions? The courts and commentators alike appear unanimous, and this is the position taken herein, that this type of increase in value is not an “interest acquired by the debtor” within the meaning of §522(p) (1) although the reasonings for reaching this conclusion differ to some degree.35 In the case of In re Blair,36 decided by a bankruptcy court in Texas seven months after the enactment of this statute, an unsecured creditor filed an objection to the debtors’ claim of exemption in the homestead. In this case the debtors had purchased the homestead property 1773 days prior to the date of filing the bankruptcy petition. The creditor objected to the debtor claiming as exempt any increase in equity in the property within 1215 days prior to the date of the petition which exceeds $125,000. The amount of equity in the homestead was valued at $688,606. In denying the creditor’s objection to the debtors’ claim of exemption the

35 Id. at 522-¶102.6 (“…section 522 (p1) should not apply to the accumulation of equity in the debtor’s homestead resulting from an appreciation in value of the property during the 1,215-day period.”) 36 In re Blair, 334 B.R. 374 (Bankr. N.D. Tx., 2005).
court distinguished between “acquiring equity” and “acquiring title”. The court reasoned that one does not “acquire” equity, but does “acquire” title.

In addition, the court in Blair conducted an analysis of other parts of §522 as added support for its interpretation that §522(p)(1) did not apply in this case to limit the homestead exemption. The court paid special attention to Code §522(p)(2)(B), known as the “safe harbor” provision, which contains an exception to the homestead cap for intrastate transactions. By this exception a debtor is able to take any equity earned in a previous principal residence which was acquired prior to the 1215 day period and roll it over into a second residence which is located in the same state and for which the homestead exemption is being claimed, even if the sale of the first residence and purchase of the second residence occurs within the 1215 day period.

The In re Sainlar dealt with the same type of issue. In Sainlar the bankruptcy court in Florida also found that the $125,000 cap in §522(p)(1) “has no applicability to property

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in which a debtor obtained an ownership interest more than 1,215 days before the petition date, even if the property’s equity increases during the 1,215 pre-petition period. In this case, just as in Blair, the debtors had purchased the homestead property prior to the 1215 day period. The debtors’ had accumulated at least $919,906 of equity in the property, all of which was being claimed as exempt. The largest unsecured creditor of the debtors (owed $559,495.50) claimed that the debtors should be limited to an exemption of no more than $125,000 in the property and that the creditors were entitled to the appreciation in value in excess of that amount pursuant to §522(p)(1). In ruling against the unsecured creditor the court applied reasoning similar to the Blair court stating that “title to property is acquired, equity is not.” The court went on to describe the difference between “equity” and “title” determining that “[equity] is not a constant, but fluctuates based upon market conditions and when mortgage principal is paid.”

*In re Rasmussen* is a case in which the court also held that the increase in the value of the homestead resulting from appreciation “did not constitute an interest that was acquired by the debtor within the meaning of §522(p)(1).” Yet, *Rasmussen* significantly distinguishes itself from both Blair and Sainlar in its analysis. Indeed, the court’s analysis in this case makes the argument that partially forms the basis of the thesis of these authors. The court in *Rasmussen* disagreed with the reasoning in the “equity vs. title” dichotomy posited by the Blair and Sainlar courts, and determined that a more valid

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45 *Id. at 673.

46 *Id. at 673; see also* Collier, 522-102.6 (citing Blair and concurring that “…section 522(p) is applicable only if the debtor has acquired an ownership interest in the property that it quantifiable.”) 


48 *Id. at 758; see also*, In re Chouinard, 358 B.R. 814 (Bankr. M.D. Fla., Tampa Div., 2006).
basis for distinguishing the type of interest that results from an increase in equity due to attendant market conditions is to distinguish between “active” and “passive” conduct of the debtor.\(^{50}\) What can be derived from this aspect of the *Rasmussen* decision, basically, is a much clearer framework for categorizing the varied factual situations that may be the subject of dispute in these types of cases.

The *Rasmussen* court’s reasoning was based upon an analysis of rules of statutory construction to apply “commonsense” interpretation to the applicable statutory provisions.\(^{51}\) Therefore, the court concluded that a debtor acquiring an “interest” is synonymous with acquiring “equity” since the term “interest” is used in conjunction with the term “amount” within the statute.\(^{52}\) The court noted that “amount” is a quantitative term and therefore the word “amount” in §522(p) (1) was referencing “equity” rather than a “fee simple ownership” or other form of “title”.\(^{53}\) Although the *Rasmussen* court correctly deems “equity” as a quantitative term and thus the type of “interest” that can be “acquired” within the meaning of the statute, it would be nonsensical to suggest that “fee simple ownership” is not a quantifiable interest and thus outside of the reach of the statute. For indeed, being able to limit the ability of a debtor to convert nonexempt assets to exempt assets by using those nonexempt assets towards the purchase of a fee interest in homestead property was one of the primary efforts of this legislation.\(^{54}\) Thus, a

\(^{50}\) *Id*. at 757.

\(^{51}\) In citing the case of Andersson v. Sec. Fed. Sav. & Loan of Cleveland (In re Anderson), 209 B.R. 76, 78 (B.A.P. 9th Cir. 1997) the *Rasmussen* Court stated at 756: “In this regard, statutes should be ‘read in a straightforward and commonsense manner.…’”

\(^{52}\) *Supra*, note 49 at 756.

\(^{53}\) *Id*. at 756-7.

\(^{54}\) See, Collier, *supra* note 33, at 522-4 (“In view of the apparent purpose of section 522 (p) (1) to discourage the more egregious examples of prebankruptcy exemption planning in which some debtors have purchased “mansions” in states having unlimited homestead exemption laws in contemplation of filing
commonsense interpretation of the statute would have the language “interest that was acquired” apply to both “equity” and “fee simple ownership”. A fee simple ownership obviously can be reduced to a quantifiable amount in dollars and cents.

The *Rasmussen* court then directed its attention to the term “acquired by the debtor” approaching it as “… a question of grammatical construction.” The court reasoned that a correct interpretation would restrict the application of this language to affirmative acts “by the debtor”, stating “it implies an active acquisition of equity such as by an affirmative act of a down payment or mortgage pay down.” Thus, the *Rasmussen* court in its *dicta* has gleaned two scenarios in which the equity position of the debtor is increased which would activate the limitations imposed by §522(p)(1): (a) where a debtor makes a down payment on the mortgage thus increasing the debtor’s equity position in the property and (b) where the debtor pays down or buys down the mortgage also resulting in an increase in the debtor’s equity in the property. These and other such “active/transactional” factual situations are discussed in Part II. C. infra.

The types of increase in value which the debtor realizes in the homestead property due to appreciation resulting from natural market conditions fits neatly into that category of interest accumulation which is characterized herein, similarly to the *Rasmussen* court, as a “passive/appreciable accumulation”. Where this article also differs with the

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55 Yet, in citing the *Chouinard, Sainlar and Blair* cases, Collier did not consider the accumulation of “equity” to be within the purview of the statute, only fee simple ownership interests. (“…section 522 (p)(1) should not apply to the accumulation of equity in the debtor’s homestead resulting from an appreciation in value of the property during the 1,215-day period.”)

56 *Supra*, note 54 at page 757.

57 *Id*.
Rasmussen court is terming it as an “acquisition” *ab initio*. By not terming this type of gain as an “acquisition” the transaction more safely escapes the reaches of the statutory limitations of §522(p) (1), as the interest then would not be an interest “acquired by the debtor” within the language of that provision.

2. Appreciation Due to Other Factors

The value of the homestead may also increase due to appreciation resulting from occurrences other than “natural” market conditions which also do not involve active participation by the debtor. One such occurrence may involve municipal governmental rezoning.\(^{58}\) Rezoning of residential property can have a positive effect upon the value of residential property since zoning can have the affect of protecting residential property from certain uncontrollable factors within the zoned area, among other positive benefits.\(^{59}\)

A petition for a zoning change, or rezoning, may be initiated by individual homeowners, businesses, homeowner’s groups or by a municipality itself as a result of its planning authority for the general welfare of the community.\(^{60}\) For purposes of this analysis an initial distinction should be made between such requests initiated by a homeowner/debtor

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\(^{58}\) Variances and requests for conditional use and other regulated changes in the way land is allowed to be used may also fit into this category.


\(^{60}\) A rezoning of property normally requires approval by a municipal authority after a public hearing and recommendations by a local zoning board, commission or other such recommending body.
and those initiated by persons other than the homeowner/debtor, including the
municipality itself. Consider this: What if the process is initiated and authored (or at
minimum co-authored such as by being a member of a homeowner’s association) by the
homeowner/debtor within the 1215 day statutory “window” resulting in an increase in the
valuation of the debtor’s homestead? Does this action cause the debtor to be considered
an active participant in gaining an increase in the value of his property such that the
proscriptions of the statute should take hold? Has the debtor then “acquired an interest”
within the meaning of §522(p) (1)? Should this type of event be considered
“active/transactional” rather than “passive/appreciable”? We think not.

Certainly the debtor is actively engaged in the process as the author/initiator of the
petition to successfully put into place events designed to result in the property increasing
in value. And assume, arguendo, the property does in fact increase in value\(^{61}\) within the
1215 day time frame. Nevertheless, no “interest” has been acquired. Rather, there has
been a change in the characterization of the property. Just as with those cases discussed
in subsection b.5, infra, where the debtor changed the property from non-homestead
property to homestead property within the 1215 day period, this transformation does not
result in the debtor acquiring an interest in a strict monetary sense. Indeed, it would not
constitute the kind of additional “interest” Congress intended to proscribe. Thus, if a
resultant increase does occur, it should be viewed as a “passive/appreciable” event, albeit
provoked by the actions of the debtor in seeking the zoning change. The debtor has done
none of those things which closing the “mansion loophole” was designed to prevent. The

\(^{61}\) Such increase in value may typically occur where the property previously was zoned commercially and
the petition for rezoning resulted in the property being zoned for single family residential use only.
debtor has the same asset prior to the event as after – there has been no conversion of otherwise non-exempt assets to exempt assets to cause a defeat of the rights of the unsecured creditors.

Another category of event which could occur resulting in an increase in the value of the debtor’s homestead is an eminent domain proceeding or action by a private party wherein the debtor’s homestead incidentally benefits. In an applicable scenario a governmental entity or private party could develop property adjacent to the debtor’s homestead resulting in an attendant increase in the value of the debtor’s property. Obviously in this case the debtor is completely “passive” and the appreciation the debtor may realize also should not be subject to the limitations of this statute. Even in the case where the debtor may be the owner of the adjacent property whose development has caused the debtor’s homestead to increase in value, this too, for the same reasons as apply to the zoning change, is not the type of event which should provoke the statute’s proscriptions. That is, no “interest” has been acquired – the debtor has the same “interest” – there has been no conversion of assets from non-exempt to exempt. What has happened is that the same property has gained a benefit, but this benefit was gained passively.

Just as with appreciation due to natural increases in market value that generally occur over time, these events may also cause the value of the debtor’s homestead to increase. Certainly Congress did not intend to counter any of these types of passive events in passing this law by causing debtors to suffer the possible loss of their homestead as result of these external events over which a debtor has no control, or which are incidental to the
debtor’s ownership of the property but do not involve the debtor acquiring an additional interest.

3. Accumulation of Interest Resulting from the Original Structuring of the Indebtedness

a. Regular Mortgage Payments

Similar to the situation where the debtor accumulates an interest in the property due to appreciation is the scenario where the debtor gains additional interest in the property merely by virtue of the natural paying off of the principal of the loan for a classically amortized fixed rate mortgage. As the debtor makes regular monthly mortgage payments the debtor’s equity position in the subject property naturally increases on an amortized basis. Of course, for a standard mortgage loan in the early years the debtor earns little equity in this manner. However, in the latter years of the loan process the debtor’s interest increases at a greater rate. Such amounts, however, may or may not be significant during a 1215 day period prior to filing bankruptcy depending upon how close the debtor is to the end term of the loan repayment period or upon the loan the amount of the loan.

The debtor may have various types of mortgage loans which may cause the debtor’s interest in the property to accumulate in a variety of ways and at varying rates. An example would be an interest only loan which would cause the debtor’s interest to “balloon” at the point that the debtor’s payments are attributable to principal only.
If the debtor is close to the end of, for example, a 30 year mortgage, the amount of equity the debtor may have gained in the property during the 1215 day period could be considerable. However, this type of interest fits well into the category of a passive/appreciable interest in that the debtor is doing no more than the debtor was previously contractually obligated to do at the time the debtor entered into the loan transaction 30 years prior. The “acquisition” took place at the time the loan was made. The debtor is merely carrying out the terms of the loan agreement. This type of activity on the part of the debtor does not fall within the kinds of proscriptions the statute appears designed to prevent.63

In the Rasmussen case the court suggests in a footnote that the principal amortization of a regular mortgage payment should be considered an “acquisition” according to the interpretation by that court of the statute in question.64 However, what this opinion does not recognize is that in this type of situation there has been no change in the status quo during the 1215 day period. As stated above, the debtor has done nothing more during this period than the debtor was already obligated to do, and this activity clearly falls outside of the regulatory intent of congress.

b. Lease with Purchase Option Exercised

63 This type of payment is to be contrasted with the type of activity of the debtor in making extra payments upon the principal within the 1215 day period as is discussed in part C.1., infra.
64 In re Rasmussen, 349 B.R. 747, 757 fn. 5 (Bankr. M.D. Fla. 2006): “This interpretation of the applicability of section 522(p) would also result in monthly principal amortization constituting the acquisition of equity within the 1,215 day period and counting against the permitted $125,000 exemption for an individual debtor.”
In this case assume there is a debtor who is leasing property which the debtor is using as a primary residence. By the terms of the lease, which the debtor entered into well beyond the 1215 day period prior to filing bankruptcy, the debtor has the option of purchasing the property with certain of the lease payments being credited towards the purchase of the property. At the point the option is exercised the debtor has thereby gained an equity position in the property.

In this example the debtor does exercise the option and does so within the 1215 day period prior to filing bankruptcy. The question becomes: Should the lease payments which have changed characterization to become credits towards the purchase of the property within the relevant time frame be subject to the limitations of §522 (p) (1)? Since the debtor had the right to purchase the property pursuant to contract terms entered into well before the 1215 period, these payments should not be subject to the statutory limitations of this bankruptcy code provision. As in the above scenarios, the debtor has done nothing more during this period than the debtor was already contractually obligated to do. This activity also appears to fall outside of the intent of Congress in enacting this limitation.

4. Accumulation of Interests through Devolution and the Like

The lease payments by the debtor/lessee are not likely to aggregate to an amount which would cause the debtor to have more than $136,875 in equity except for properties with a significant value. For example, assume the lessee/debtor rents a homestead worth $450,000 at $2300/month with an option to purchase within 60 months. All of the rent payments will accumulate as equity in the event that the option is exercised. The lessee/debtor exercises the option 55 months after entering into this lease/purchase agreement and also declares this property as a homestead. Two years later (within the 1215 day period) the debtor files bankruptcy. The amount of equity accumulated is $143,000 ($2300/month x 55 months), which is $6125 above the limit imposed by § 522 (p)(1). In a state which allows an exemption for at least the amount of the debtor’s equity, the $6,125 would remain exempt from the bankruptcy estate.
a. Inheritance

We should also consider the debtor who accumulates an interest in property through circumstances relating to devolution and similar involuntary circumstances. In the case of an inheritance it is apparent that no voluntary acts on the part of the debtor have taken place to cause the debtor to gain an interest in the inherited property.

Consider this scenario. A debtor, a young man of about the age of 40, is residing with his elderly widowed mother who dies leaving all of her assets, including the homestead, to her son. This son inherits the mother’s homestead, claims it as his homestead and files bankruptcy, all within the 1215 day period.

The debtor has not taken an active role (assuming no bad deeds on his part) in the accumulation of this interest. Nor has the debtor engaged in any transaction to allow for this to occur. Therefore, this accumulated interest clearly falls in the category of a passive/appreciable interest.

b. Rights of Survivorship

Less clear is the situation where the debtor is a joint tenant or tenant by the entirety of real property claimed as a homestead. In this case we may have a debtor who engaged in a transaction to establish the joint (or entireties) tenancy but the transaction occurs well
outside of the 1215 day applicable period. However, the joint tenant(s) of the debtor meets their demise within the 1215 day period (again assuming no bad acts on the debtor’s part).

Joint tenants are distinguishable from tenants by the entirety in that although they both enjoy complete unity of possession the tenancy by the entirety has the added feature of each spouse having ownership of the whole as one person. The interest of the joint tenant, on the other hand, is considered an equal fractional undivided share of the tenancy.

As concerns the interplay between the real property concurrent ownership issues and §522 (p) (1), analyses must be made. First, with respect to both entireties property and joint tenancies the tenants own an undivided interest in the whole. In addition, the “right of survivorship” feature gives all parties in both these types of tenancies ownership in the whole in the event of the demise of the co-tenant(s). In a joint tenancy the interest of the co-tenants is a divisible fractional share. In regard to entireties property the spouses have an indivisible interest in the whole as if they are owned by one person. Yet, in both types of concurrent ownerships, as a matter of law, the surviving tenant/debtor owns the subject property as a sole owner in fee simple.

See 7 RICHARD R. POWELL, POWELL ON REAL PROPERTY, § 51.01 et. seq. § 52.03 (Michael Allen Wolf ed., 1999) (explaining the characteristics of the tenancy by the entirety and joint tenancy).

Id.

Id. at §51.01[2]; but see, supra, note 66, at 52.03[3]: (“A few states permit creditors of either spouse to satisfy debts out of the entirety, thus severing it and destroying the right of survivorship.”)
The distinctive features of the joint tenancy versus the tenancy by the entireties property interests necessitate a separate analysis to determine whether the limitations of §522 (p) (1) should apply. The questions with respect to both types of interest is: Has the debtor “acquired an interest” within the 1215 day period prior to filing bankruptcy in the event of the demise of the co-tenant during that timeframe?

The tenancy by the entirety is less problematic in that the interest of the tenants is not only undivided but indivisible. There is a historic unity in this type of interest whereby both spouses are actually considered as one person. With respect to the joint tenancy the interest is a divisible fractional share such that prior to the demise of the co-tenant that interest can be quantified. Obviously, upon the demise of the co-tenant(s) the surviving debtor/tenant has a greater fractional share – it is now 100% of the whole. Assuming a single joint tenant the interest of the surviving debtor/tenant has increased from 50% to 100%. However, as stated, it is also a characteristic feature of a joint tenant that the tenants own the “whole”.

Because of the nature of both types of these concurrent ownership interest, neither should be deemed an interest acquired by the debtor with the meaning of §522 (p) (1). Both types fall within the category of a passive/appreciable interest. Although the debtor actively transacted the establishment of the joint tenancy, the debtor did not act to acquire an interest within the 1215 day period. This situation would be no different from a debtor who acted to acquire a sole interest in the homestead outside of the 1215 day period. The difference in this case of course is that the debtor does accumulate an interest within the
1215 day period. However this is not due to a voluntary act on the part of the debtor. And although in both types of ownership situations the debtor does accumulate an interest within that period, this interest is one which the debtor had a legal interest in prior to that period. Although the interest subject to survivorship had not “vested” in the debtor, so to speak, until the joint tenant’s demise, the right of survivorship had actually been created at the point the tenancy was established which was well before that period.

c. Rollover of Appreciated Real Estate

BAPCPA allows a debtor to roll over an interest in real estate from one property into another property that will be claimed as the debtor’s homestead so long as both properties are located in the same state. But what if the rolled over property appreciates in value during the 1215 day period. Should that appreciated value be subject to the $136,875 limitation of the statute? We think not. This situation is nearly identical to that involving the subject property itself appreciating in value during that period, and also represents a passive/appreciable interest. The debtor has not made an “active acquisition” of equity.

5. Status Accumulation

There is also a line of cases wherein efforts were made to have the court deem the change in characterization of property of the debtor to a homestead status within the 1215 day

69 11 U.S. C. § 522(p)(2)(B): For purposes of paragraph (1), any amount of such interest does not include any interest transferred from a debtor’s previous principal residence (which was acquired prior to the beginning of such 1215-day period) into the debtor’s current principal residence, if the debtor’s previous and current residences are located in the same State.
period as an interest “acquired by the debtor” within the meaning of §522(p) (1). The basic argument of the creditors/trustee in each of these cases was that where the debtor changed the status of their property to a “homestead” such as by electing that status in the offices of the municipality and thus making the property eligible for exemption as a homestead, that this action invoked the limitations of the statute where done within the 1215 day period. The courts did not agree. In Re Rogers\textsuperscript{70} was a case on appeal from a U.S. Bankruptcy Court where a creditor argued “that the classification of real property as a homestead is an ‘interest’ in property and thus governed by the 1215 day statutory period.”\textsuperscript{71} In concluding that “the term ‘interest’ does not encompass the classification of real property as a homestead”,\textsuperscript{72} the court first determined that the language of the statute was unambiguous and that therefore “the plain meaning of the statute indicates that ‘interest’ refers to some legal or equitable interest that can be quantified by a monetary figure.”\textsuperscript{73} The Rogers’ court also applied common meaning to the term “amount” in the statutory language of §522(p) (1) in referring to “amount of interest” in connection with the limitations upon the debtor within this statute.\textsuperscript{74} Although this line of cases is distinct, since these cases involve a change in status of the homestead as opposed to an actual increase in value of the homestead, they nevertheless demonstrate the desire of the courts to apply commonsense construction and reasoning to comprehend the intent of Congress in enacting this legislation. In addition, in these cases it is the term “interest” that is being interpreted as opposed to the word “acquired”. Yet, just as in the cases involving passive appreciation of the homestead, these cases reveal judicial reluctance to

\textsuperscript{70}\textit{In re Rogers}, 354 B.R. 792 (N. D. Tx. 2006).

\textsuperscript{71}\textit{Id.} at 796.

\textsuperscript{72}\textit{Id.} at 798.

\textsuperscript{73}\textit{Id.} at 796.

\textsuperscript{74}\textit{Id.}
extend the reach of §522(p) (1) to limit the homestead exemption other than on a basis upon which it appeared Congress intended to reach by this new law.

C. Active/Transactional Interests

In these examples we illustrate scenarios, which may not have been anticipated by Congress when enacting this legislation, where the debtor plays an “active” role in the interest the debtor accumulates during the restricted 1215 day period. Generally, the debtor will have been an active participant in a transaction during that period which results in the debtor gaining an interest that the debtor did not have prior to that period. Moreover, the assets utilized by the debtor in this transaction might be those that would have been non-exempt. The debtor would in effect be converting these assets from a non-exempt to exempt status by attempting to invest the assets in homestead property which under the laws of the state where the debtor would be filing bankruptcy would be exempt. This outcome is that which BAPCPA most fervently prohibits.

1. Paying Down a Mortgage with Prepayments

A debtor may at some point within the 1215 day period, either innocently or with the intent to divert assets from the reach of creditors, make extra payments on the mortgage beyond that called for by the terms of the mortgage loan on the homestead property. The funds used by the debtor may be assets of the debtor that would otherwise have been
nonexempt and thus available for the benefit of unsecured creditors. At least one court has dealt with this issue.

The case of *In Re Anderson*\(^{75}\) concerned a debtor who made substantial payments to pay down a mortgage on the homestead within the 1215 day period. The trustee argued that “the equity accumulated by the debtor during the look-back period constituted an amount of interest acquired by the debtor during the period, within the meaning of §522(p), and thus such amount was excludable from the debtor’s exemption.” This posed an issue that the court had to consider for the first time since the limitations imposed by BAPCPA had been put in place.

The *Anderson* court reviewed decisions made by several courts interpreting the term “interest” in §522(p) (1). The court examined the dicta in the *Rasmussen* and *Chouinard* decisions wherein these courts suggested that voluntary payments to pay-down a mortgage may be deemed in violation of this statute. The *Anderson* court found the decisions in *Rasmussen* and *Chouinard* not to be persuasive and refused to apply their analysis to the case at bar, particularly since neither of these cases involved the paying down of a mortgage, but rather involved the issue of passive appreciation which increased the debtor’s equity position. Instead, the court deemed a different provision of the code, §522(o)\(^{76}\), to be applicable.\(^{77}\) This provision of the Code relates to fraud, to

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\(^{76}\) 11 U.S.C. § 522(o) provides:

For purposes of subsection (b)(3)(A), and notwithstanding subsection (a), the value of an interest in—

(1) real or personal property that the debtor or a dependent of the debtor uses as a residence;

(2) a cooperative that owns property that the debtor or a dependent of the debtor uses as a residence;

\(^{77}\)
deal with any effort to improperly convert assets that would otherwise be exempt to homestead equity so long as the requisite bad intent can be established.\textsuperscript{78}

In rejecting the dicta referenced in the \textit{Rasmussen} and \textit{Chouinard} cases, the \textit{Anderson} court more pointedly reasoned that the term “interest” in the statute “is unambiguous and should be given its plain meaning.”\textsuperscript{79} The court stated: “If Congress had intended to capture the accumulation of equity during the 1215 day period, whether by paying down the debt against the property or by appreciation in value of the property, it could have easily used the term ‘equity’ or specifically defined ‘interest’ to include equity in §522(p) (1).”\textsuperscript{80} The court reasoned that this provision should be interpreted to refer only to the acquisition of an ownership interest based upon the legislative history and a reading of other parts of §522. The \textit{Anderson} court’s reasoning thus coincides with the reasoning in the \textit{Sainlar} and \textit{Blair} cases wherein a distinction is made between the acquisition of “equity” versus the acquisition of “title” discussed in Part B.1., \textit{supra}.

\begin{itemize}
  \item[(3)] a burial plot for the debtor or a dependent of the debtor; or
  \item[(4)] real or personal property that the debtor or a dependent of the debtor claims as a homestead;
  \item[(4)] shall be reduced to the extent that such value is attributable to any portion of any property that the debtor disposed of in the 10-year period ending on the date of the filing of the petition with the intent to hinder, delay, or defraud a creditor and that the debtor could not exempt, or that portion that the debtor could not exempt, under subsection (b), if on such date the debtor had held the property so disposed of.
\end{itemize}

\textit{S}upra, note 33, at 522-\textsuperscript{102.6}. Collier supports this view (“…if the debtor converts nonexempt assets for the purpose of paying down a mortgage, with an intent to hinder, delay or defraud a creditor, such a transfer may give rise to an objection to the debtor’s homestead exemption under section 522 (o), but should not fall within the purview of section 522(9)(1).”)\textsuperscript{78} In fact a later evidentiary hearing was held by this same court in the case of \textit{In Re Anderson}, 386 B.R. 315 (Bankr. KS 2008) to determine whether the paying down of the mortgage by the debtor with the proceeds of nonexempt property was done with intent to hinder, delay, or defraud creditors within 10 years of the petition date as proscribed by §522(o) of the Code. However, the court in this latter hearing concluded that the debtor did nothing more than take advantage of an exemption to which he is entitled.” The court could not find that “they were done with the intent to hinder, delay or defraud.”\textsuperscript{79} \textit{In Re Anderson}, 374 B.R. 848, 858 (Bankr. D.Kan 2007).\textsuperscript{80} \textit{Id.}
As we stated in Part B.1., supra, we believe the Rasmussen court correctly characterizes “equity” to be within the meaning of the term “interest” as that term is used in the statute. The term “interest” in the statute is used quantitatively and therefore does encompass the concept of “equity”. Indeed, the Anderson court concedes that §522(p) (1) “does not unambiguously refer to title or ownership;” and further admits: “There can be no question that §522(p) is at best a haphazard effort to accomplish the purpose of closing the ‘mansion loophole’. On this latter point all of these courts agree.

Furthermore, proving the indicia of fraud as is required by section 522(o) necessarily presents a difficult task, as was established in the later evidentiary hearing held in Anderson on that issue. Section 522(p)(1) provides a mechanism for capturing this type of conduct which is substantially indistinguishable from that of converting nonexempt assets towards the purchase of a fee simple ownership in newly acquired property. In both cases the debtor has taken affirmative steps to actively gain an interest; whether it be in the form of a newly purchased fee simple ownership or an improved equity position in existing property – the debtor has acquired an interest.

2. Remodeling

On a date within 1215 days of filing bankruptcy the debtor utilizes funds of the debtor to engage in a remodeling of the debtor’s existing homestead. As a result of this remodeling the value of the debtor’s homestead property increases significantly, thus the debtor’s

81 Id. at 858.
82 Id.
83 Supra, note 77.
“interest” in the property has increased because the property is now more valuable. This increase in value is not due to natural appreciation, although it can be said that the property has appreciated in value. Rather it is due to active efforts of the debtor to make the property more valuable. This circumstance clearly falls in the category of “active/transactional” and should therefore be subject to the limitations of §522(p) (1).

3. Concurrent Estates

There may be cases where a debtor, within 1215 days of filing bankruptcy, enters into a divorce or property settlement agreement with a spouse wherein it is agreed that the non-debtor spouse will transfer that spouse’s tenancy by the entirety interest in homestead property to the debtor spouse. The divorce is also consummated within the 1215 days so that there is no longer a tenancy by the entirety estate. In this scenario the debtor spouse actively engages in this transaction and enters into the agreement volitionally. Prior to the settlement agreement and subsequent divorce the debtor owned the property equally with the non-debtor spouse with each spouse effectively owning the entire property. This is not an easy factual situation to resolve and indeed involves certain aspects of real property law that are beyond the scope of this article.

The peculiar issue presented by this factual situation is that since the debtor spouse owned the whole prior to the divorce and/or property settlement agreement, and subsequently the debtor owns the whole by agreement of the parties, has the interest of the debtor spouse changed at all? In considering this question what must be realized is
that although the debtor owned the whole with the non-debtor spouse prior to the divorce and/or property settlement agreement, this interest is subject to the non-debtor spouse’s coinciding equitable interest in the whole. If this question is answered “yes”, then there may be an “active/transaction” involved such that the debtor spouse should be subject to the limitations of §522(p) (1). If the question is answered “no”, that the debtor’s interest in the tenancy by the entirety property has not changed, there has been no “acquisition” and certainly this statute and its proscriptions would not apply.

The case of *In Re Leung*\(^4\) presents a similar scenario to the hypothetical presented herein with an interesting twist. In this case the debtor and his non-debtor spouse bought a house in 1998 and later, in 2001 (outside of the 1215 day period), they transferred the house to the non-debtor spouse alone. Six months prior to filing bankruptcy the non-debtor spouse transferred the house to both of them as tenants by the entirety. They remained married during this entire period.

*Leung* is distinct from the previous example in that in the example at one point the debtors are married and own the property as tenants by the entirety, then the parties divorce and the property is agreed to be transferred to the debtor spouse alone, within the 1215 day period. Yet in both cases the debtor spouse argues that the limitations of §522(p) (1) should not apply since the debtor’s interest had not changed, albeit based upon differing legal concepts. In the example posed above the debtor would argue that the debtor had not received within the 1215 day period more than the debtor already had.

prior to the 1215 day period, since prior to the settlement agreement as well as after the divorce was finalized, the debtor had an undivided interest in the whole.

In *Leung* the debtor argued that the debtor had contributed to and was in control of the property since it was originally acquired, therefore the debtor had an equitable interest in the property even before gaining the legal entirety interest.\(^{85}\) Thus, the debtor argued that no “interest” was “acquired” by the debtor when the legal ownership was transferred to the debtor within the 1215 day period. The court did not agree.\(^{86}\) The court found that the debtor did not present a legally viable theory such as a constructive trust theory or other possible theory upon which to base the argument that the debtor held an equitable interest in the property.\(^{87}\) And without that factual evidence that proved the debtor had an equitable interest in the property before the legal ownership transfer occurred, these authors agree that this case falls within the category of being “active/transactional” and therefore subject to the limitations of §522(p) (1).

Another case with similar issues as those presented above is the case of *In re Khan*.\(^{88}\) *Khan* is a case that was decided by the First Circuit Bankruptcy Appellate Panel after an order of the U.S. Bankruptcy Court for the District of Massachusetts sustaining the objection of the Chapter 13 bankruptcy trustee to the debtor’s homestead exemption above the $125,000 limitation of §522 (p)(1) was appealed by the debtor.\(^{89}\) The facts are that in 1997 the debtor deeded property to himself and his brother as trustees of a family

\(^{85}\) *Id.* at 320.
\(^{86}\) *Id.* at 321.
\(^{87}\) *Id.*
\(^{88}\) *In re Khan*, 375 B.R. 5 (B.A.P. 1st Cir. 2007).
\(^{89}\) *Id.* at 7.
trust. In 2006 the trustees transferred the property to themselves as joint tenants with right of survivorship. Twenty-eight days later, obviously well within the 1215 days, the debtor filed bankruptcy. The question presented to the court was “whether an interest in property transferred to the Debtor by a trust is considered an interest acquired by the Debtor”\(^9\) within the 1215 day period, thereby limiting the exemption that the debtor may claim to $125,000.

The debtor argued that that type of trust that was created was a nominee trust\(^9\) and that under the law of the state of Massachusetts “when the trustee and beneficiaries of a nominee trust are identical, the relationship is a trust in form only and the beneficiaries hold legal title.”\(^9\) Thus, the debtor argued, when the interest was transferred from the trust to the debtor, the debtor acquired nothing. The court, however, found that the record in this case on appeal was insufficient to support the debtor’s claim since there was no evidence that the debtor had ever characterized the trust as a nominee trust or that the debtor held any sort of beneficial interest under the terms of a trust.\(^9\) Had there been sufficient evidence that there was a trust established the court may have found that the debtor did not acquire an “interest” in the property, since the debtor may have been deemed to have held the same interest both at the time the property was held in trust and after the trust transferred the property to the debtor. However, as the case stands, peeling away all of the indicia of a merger between equitable and legal ownership, the factual

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\(9\) Id. at 9.

\(9\) In a nominee trust the legal title of the trustee and the equitable title of the beneficiary merge since the trustee of a nominee trust has no power to act other than at the direction of the beneficiaries.

\(9\) Id. at 9.

\(9\) Id. at 13-4.
scenario presented by the Khan case would fit into the category of “active/transactional” and thus subject to the limitations of the law.

IV. Conclusion

A Washington Post article reports that “personal bankruptcy filings in the United States jumped 40 percent in 2007 because of rising mortgage payments, job losses and other financial pressures.” And with the increasing difficulties this country is facing regarding the subprime lending crisis, bankruptcy prompted by issues relating to defaults on mortgage loans makes the issues posed by the varied scenarios presented by this paper of current import.

When Congress passed the new bankruptcy provisions in 2005, particularly with respect to §522(p), it did so without adequately recognizing its complexity and the need for more thoughtful clarification. A law with such potentially devastating impact upon homeowners merited greater craftsmanship than was obviously employed.

These authors have likely not addressed every possible factual situation that might expose the shortcomings of this law. It is possible that we have only touched upon them. And there may be circumstances where a particular factual situation will not align itself neatly into either classification, and following the methodology developed herein simply will not fit. But what is attempted herein is a methodology that, if adopted by the courts, could provide a mechanism for easier and more judicious resolution. First, a court must decide if there is an “interest” involved at all, or has the subject property merely changed

\[94\] Alan Zibel, Personal Bankruptcy Filings Rise 40%, WASH. POST, Jan 4, 2008 at D07.
characterization, such as is the case of a property going from being non-homestead property to homestead property. Secondly, the court must determine whether the debtor’s interest has changed, or does the debtor have the same interest prior to the changed circumstance, as after, as may be the case with a debtor having a beneficial interest merging with a legal interest. Finally, if all this is so, the court should then determine whether the “interest” that the debtor gained was a “passive/appreciable” one or an “active/transactional” one. In the case of the latter, the limitations of §522(p) (1) would pertain.
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<td>Iowa</td>
<td>Unlimited</td>
<td>Iowa Code Ann. § 561.16</td>
</tr>
<tr>
<td>Massachusetts</td>
<td>$500,000</td>
<td>Mass. Ann. Laws ch 188, §§ 1 &amp; 1A</td>
</tr>
<tr>
<td>Minnesota</td>
<td>$200,000</td>
<td>Minn. Stat. §§ 510.02</td>
</tr>
<tr>
<td>Nevada</td>
<td>$350,000</td>
<td>Nev. Rev. Stat. §§ 115.010.2</td>
</tr>
<tr>
<td>Oklahoma</td>
<td>Unlimited</td>
<td>Okla. Stat. Title 31 § 1.A.1</td>
</tr>
<tr>
<td>Rhode Island</td>
<td>$200,000</td>
<td>R.I. Gen. Laws § 9-23-4.1</td>
</tr>
<tr>
<td>South Dakota</td>
<td>Unlimited</td>
<td>S.D. Codified Laws § 43-45-3</td>
</tr>
<tr>
<td>Texas</td>
<td>Unlimited</td>
<td>Tex. Const. art. 16, §§ 50 &amp; 51</td>
</tr>
<tr>
<td>----------------</td>
<td>-----------</td>
<td>---------------------------------</td>
</tr>
</tbody>
</table>

*Appendix adapted from appendix in In Re Kane, 336 B.R. 477 (Bankr., D. Dev, 2006). The table is limited to states whose homestead exemptions are greater than $136,875 per §522(p). Further, the table cannot be a concise representation because of the manner in which some states categorize their homestead exemptions.*