

**WHY PROCEEDS OF A SALE OF HOMESTEADED REAL ESTATE ARE
PROTECTED, IF AT ALL, ONLY BY STATE STATUTE AND NOT SECTION
522(c) OF THE BANKRUPTCY CODE**

by

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INTRODUCTION

The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005¹ provides the most substantial amendments to the U.S. Bankruptcy Code² since the 1978 adoption of the Code, which replaced the 1898 Bankruptcy Act. The “Reform” Act addresses perceived abuse by consumer debtors and substantially rewrites Section 707 of the Bankruptcy Code by providing for dismissal upon motion of certain Chapter 7 filings brought on or after October 17, 2005, where the debtor’s means exceed median family income for the debtor’s home state. In opposing such a motion, the debtor may assent to conversion of the Chapter 7 case to a Chapter 13 case, thereby providing at least some dividend for unsecured creditors as the cost of the debtor obtaining a discharge.

Bankruptcy is an area in which federal law operates coexistent with state common law and statutes. Sometimes bankruptcy law preempts portions of state law, but in many instances, like those here examined, bankruptcy law specifically allows state law to control a portion of the outcome under the bankruptcy law system. Because the bankruptcy court is a court of record and bankruptcy judges try many cases within weeks

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¹ 11 U.S.C. § 101 et seq., as comprehensively amended by Pub. L. No. 109-8 (2005).

² 11 U.S.C. § 101 et seq. (2000).

of the issues being joined, the bankruptcy court often provides a number of variations on state law themes before the state's appellate court fully addresses an issue. Such is the case in the matter of *In re Maurice F. Cunningham*.³

A major goal of bankruptcy has been to provide the honest debtor a fresh start.⁴ In a Chapter 7 liquidation case, the trustee, appointed by the Justice Department, acquires ownership of all assets of the debtor subject only in an individual case to the debtor's claim of exemptions. The trustee then liquidates the assets to provide a dividend to principally unsecured creditors, where secured creditors may look to their security for adequate protection or payment. In a reorganization case, Chapter 11, the debtor (unless dishonest or a poor record keeper) assumes the duties of the trustee under the debtor's role as debtor in possession (DIP). Chapter 13 cases resemble Chapter 11 cases for individuals with regular income and are either composition cases (creditors receive a percentage of their allowed claims) or extension cases (creditors receive their entire claim, but over a period of time, usually 3-5 years, in accordance with an approved plan).

States operating under their general police power in the mid-nineteenth century provided "homestead" protection by statute⁵ for families after having codified protections for individual spouses extant at common law, such as dower and curtesy.⁶ The twentieth

³ *In re Maurice F. Cunningham*, 2005 Bankr. LEXIS 2419 (Bankr. D. Mass. Dec. 7, 2005). In *Cunningham*, the debtor was a lawyer who breached his fiduciary duty to his disabled employer by converting cases and referral fees from the employer's practice. Although this debt was declared non-dischargeable both under 11 U.S.C. § 523(a)(4) and § 523 (a)(6), such a "garden variety" non-dischargeable debt could not be satisfied from debtor's homesteaded real estate. Debtor then voluntarily sold his Massachusetts residence, after having moved into a Florida condominium titled in his wife's name. When the former employer/creditor sought to reach those proceeds in state court, the Massachusetts Bankruptcy Court, Rosenthal, J relied on dicta from *In re Hyde*, 334 B.R. 506 (Bankr. D. Mass. 2005) and a Texas case, *In re Reed*, to determine that debtor's net cash proceeds of the sale were also exempt [*See In re Reed*, 184 B.R. 733 (Bankr. W.D. Tex. 1995)]. That determination is presently on appeal.

⁴ Bankruptcy also seeks to treat like classes of creditors in an even handed fashion and by utilizing the automatic stay [11 U.S.C. § 362 (2000)] cut down the rush of creditors to the courthouse when otherwise the rule of "first in time, first in right" might prevail.

⁵ MASS. GEN. LAWS ch. 188. In 1970 "a homestead estate (in the amount of \$4,000) was exempt from the laws of conveyance, descent and devise, and from attachment, levy on execution and sale for the payment of debts and legacies, with certain limitations". Some 25 statutory amendments later, the sum of \$500,000 is exempt via a so-called regular homestead (MASS. GEN. LAWS ch.188 § 1 (2004)) and a homestead for the elderly or disabled is available in a similar amount for owners at least 62 years of age (MASS. GEN. LAWS ch. 188 § 1A (2004)). Stacking of the two statutory homesteads with one claimed by either spouse, in accordance with the bankruptcy court, is permissible [Walter Oney, *Homestead in Massachusetts - Termination with Extreme Prejudice*, Mass. Law. Wkly., Dec. 20, 2004].

⁶ MASS. GEN. LAWS ch. 189 § 1 (1978). At common law, husband had a right of curtesy to a 1/3 life estate in real estate owned by his spouse upon her death. Similarly, wife had a dower right, being a life estate in 1/3 of the property owned in her husband's name alone. These rights were of little value, because less than available under the statutory forced share rights (MASS. GEN. LAWS ch. 191 § 15 (1992)). With the approval of the Supreme Judicial Court, the legislature in 1965 abolished inchoate dower and curtesy [*See Opinion of the Justices* 337 Mass. 786, 151 N.E.2d 475 (1958)], and thereafter in 1978 abolished statutory curtesy, making statutory dower applicable to a surviving spouse of either sex. When Massachusetts abolished inchoate dower and curtesy, the U.S. Supreme Court had long since settled that there was no constitutional prohibition on such an abolition [*See Randall v. Dreiger* 23 Wall. 137, 148, 23 L.Ed. 124 (1874)], and the Massachusetts Court noted that more than half of the states had abolished these common

century brought numerous updates to these schemes and also updated common law tenancy by the entirety⁷.

Homestead

An estate of homestead “is a provision by the humanity of the law for a residence for the owner and his family,” free from attachment or levy on execution by creditors up to the amount allowed by law.⁸

The English common law of property had addressed the balance between creditors and property owners in an agrarian economy by dower and curtesy.⁹ Homestead statutes provided new statutory protection for a spouse and family members (homestead) both during life and upon the death of the landowner, distinct from dower and curtesy.¹⁰

I. INDIVIDUAL BANKRUPTCY IN MASSACHUSETTS – CHOICE OF FEDERAL OR STATE EXEMPTIONS

Massachusetts is one of fifteen states, along with the District of Columbia, where a debtor may choose either federal or state exemptions.¹¹ An individual debtor can elect between two exemption schemes provided by the Bankruptcy Code:

- The federal exemptions;¹² or
- The exemptions permitted by state law and federal law other than the Bankruptcy Code.¹³

Federal Exemptions:

The federal exemptions provided by Section 522(d) of the Bankruptcy Code, while pervasive, provide only a modest protection for the debtor or a dependent’s residence owned by debtor, some \$18,450. Exemptions include differing amounts for motor vehicles, household items (with a per item and aggregate), jewelry, miscellaneous aggregate, life insurance, health aids, public benefits, alimony, support or separate maintenances, (in reasonably necessary amounts), stock bonus, pensions, annuities, injury and death benefits, and retirement funds.¹⁴

law creations [See POWELL, REAL PROPERTY, 217-218, Opinion of the Justices 337 Mass. at 793].

⁷ MASS. GEN. LAWS ch. 209 § 1A (1989). See *infra* footnote 20.

⁸ Ladd v. Swanson, 24 Mass App. Ct. 644, 646 (1907). Internal cites omitted.

⁹ See *supra* note 6.

¹⁰ See *supra* note 5.

¹¹ The others are Arkansas, Connecticut, Hawaii, Michigan, Minnesota, New Hampshire, New Jersey, New Mexico, Pennsylvania, Rhode Island, Texas, Vermont, Washington and Wisconsin. See STEPHEN ELIAS, HOW TO FILE FOR CHAPTER 7 BANKRUPTCY (12th ed. 2005).

¹² 11 U.S.C. § 522(d) (2000).

¹³ 11 U.S.C. § 522(b) (2000).

¹⁴ The Federal exemptions include, among others: *Residence* - Up to \$18,450 of the equity in debtor’s residence or the equity in a dependent’s residence owned by debtor [11 U.S.C. § 522(d)(1)]; *Motor Vehicle* - Up to \$2,950 of the equity in one motor vehicle [11 U.S.C. § 522(d)(2)]; *Household Items* - Up to \$475 per item, totaling not more than \$9,850 in the aggregate, in household furnishings and goods, apparel, appliances, books, animals, crops, or musical instruments held for personal or family use [11 U.S.C. §

State Exemptions:

Massachusetts State Exemptions:

Conversely, the state exemptions scheme available in Massachusetts is far more generous with respect to the debtor's homestead, affording \$500,000 of protection subject to the newly imposed limitations of the Reform Act.¹⁵ These exemptions include civil service pensions, workers' compensation benefits, credit union benefits, group life benefits, disability and accident insurance benefits, certain life insurance benefits, group annuity contracts, individual retirement accounts, and qualified retirement plans.

522(d)(3)]; *Jewelry* - Up to \$1,225 of jewelry [11 U.S.C. § 522(d)(4)]; *Miscellaneous/Aggregate* - A debtor is entitled to exempt his or her aggregate interest in any property, not to exceed \$975, plus up to \$9,250 of an unused amount of the residence exemption [11 U.S.C. § 522(d)(5)]; *Tools* - Up to \$1,850 in implements, books, or tools of the trade of the debtor or a dependent [11 U.S.C. § 522(d)(6)]; *Life Insurance* - Any unmaturing life insurance contract debtor owns, other than a credit life insurance contract [11 U.S.C. § 522(d)(7)]; *Insurance Dividend or Loan Value* - The debtor's interest, up to \$9,850, in any accrued dividend or interest under, or loan value of, any unmaturing life insurance contract under which the insured is the debtor or a person of whom the debtor is a dependent [11 U.S.C. § 522(d)(8)]; *Health Aids* - Professionally prescribed health aids for the debtor or a dependent [11 U.S.C. § 522(d)(9)]; *Public Benefits* - Debtor's right to receive Social Security benefits, unemployment compensation, local public assistance benefits, veterans' or disability, or illness or unemployment benefits [11 U.S.C. § 522(d)(10)(A)-(C)]; *Alimony, Support, or Separate Maintenance* - The debtor's right to receive alimony, support, or separate maintenance... to the extent reasonably necessary for the support of the debtor and any dependent [11 U.S.C. § 522(d)(10)(D)]; *Stock Bonus, Pensions, and Other Annuities and Similar Plans* - Debtor's interest in an ERISA-qualified stock bonus, pension, profit-sharing, annuity, or similar plan or contract on account of illness, disability, death, age, or length of service, provided that the plan was not established by an insider [11 U.S.C. § 101(31) (2000)] and the payment is not on account of age or length of service, provided the debtor may exempt the value of such a plan only to the extent reasonably necessary for the support of the debtor or any dependent. [11 U.S.C. § 522(d)(10)(E)]; *Injury and Death Benefits* - Certain injury and death benefits, including the following [11 U.S.C. § 522(d)(11)(A-E)]: Awards under the crime victim reparation law, payments on account of wrongful death or life insurance payments where reasonably necessary for the debtor's, a payment of up to \$16,150 on account of personally bodily injury (not including pain and suffering or compensation for actual pecuniary loss), and a payment in compensation of loss of future earnings where reasonably necessary for the debtor's support; *Retirement Funds* - Retirement funds that are in a fund or account that is exempt from taxation under any one of several sections of the Internal Revenue Code (including individual retirement accounts) are exempt under 11 U.S.C. § 522(d)(12). There is a limit of \$1 million on the amount that may be exempted [11 U.S.C. § 522(n)]. See 3 LAWRENCE P. KING, COLLIER ON BANKRUPTCY § 522.09, at 522-24 (15th ed. rev. 2005); See also MARK G. DEGIACOMO – REPRESENTING THE DEBTOR IN A CHAPTER 7 CONSUMER BANKRUPTCY 11-17 (MCLE, 4th ed. 2005).

¹⁵ The most commonly used state-law exemptions available under the Section 522(c) exemption scheme are insurance and work related benefits, which include: Civil service pensions [MASS. GEN. LAWS ch. 171, § 84 (1990)]; Group life policies [MASS. GEN. LAWS ch. 175, §§ 36, 135]; Disability and accident insurance benefits [MASS. GEN. LAWS ch. 175, §§ 36B, 110A]; Certain life insurance benefits [MASS. GEN. LAWS ch. 175, §§ 125, 126 (1928)]; Group annuity contracts MASS. GEN. LAWS ch. 175, § 132C (1981)]; Minor exemptions involving assets with low values [MASS. GEN. LAWS ch. 235, § h. 32, § 19 (1998)]; Workers' compensation benefits [MASS. GEN. LAWS ch. 152, § 47 (2001)]; Credit union benefits [34]; Individual retirement accounts and qualified retirement plans [MASS. GEN. LAWS ch. 235 § 34A (1998)]. See DEGIACOMO, *supra* note 14 at 11-17.

Nonbankruptcy Federal Exemptions:

There are several major nonbankruptcy federal exemptions available with a claim of state exemptions.¹⁶ These include civil service retirement benefits, federal service retirement and disability payments, Longshoremen's and Harbor Workers' Compensation Act death and disability benefits, Veterans' benefits, special pensions paid to winners of the Congressional Medal of Honor, Social Security payments, Railroad Retirement Act annuities and pensions, and wages of people who fish, serve at sea, or are apprentices.

Massachusetts Homestead (Post Reform Act):

Under M.G.L. c. 188, §§1, 1A, and 2, if prior to the bankruptcy filing a proper homestead declaration has been recorded at the appropriate registry of deeds, debtor may protect up to \$500,000 of the equity in his or her home, provided that the home was acquired more than three years and four months prior to the filing of the bankruptcy petition or, if acquired within this time period, was acquired with the proceeds from the sale of another home located in the same state. If the home does not qualify for exemption under Section 522 because of recent acquisition or if debtor has been convicted of a felony or owes certain debts such as those for securities fraud or arising out of a criminal or intentional act causing serious injury or death within the last five years, the homestead exemption will be limited to \$125,000, unless the property is found to be "reasonably necessary for the support of the debtor and any dependent of the debtor."¹⁷ The amount of the homestead exemption will be reduced by the amount of the homestead's value attributed to any nonexempt property disposed of within the ten-year period prior to the filing of the bankruptcy petition with the intent to hinder, delay, or defraud a creditor.¹⁸

Joint Tenancies and Tenancies by the Entirety Exempt from Process:

When the state exemption scheme is chosen, the debtor may also exempt any interest in property held as a joint tenant or a tenant by the entirety... provided that the tenancy "is exempt from process under applicable nonbankruptcy law."¹⁹ Massachusetts provides no special exemption from process for the interest of a joint tenant. The husband's interest is subject to seizure but the purchaser acquires a right to possession and rents, but the record ownership in the fee is subject to the wife's survivorship rights. Massachusetts law (amended to apply to tenancies created February 11, 1980, or thereafter, or those common law tenancies that filed a written election to become

¹⁶ Civil service retirement benefits [5 U.S.C. §§ 729, 2265 (2000)]; Federal service retirement and disability payments [22 U.S.C. § 1104 (2000)]; Longshoremen's and Harbor Workers' Compensation Act death and disability benefits [33 U.S.C. § 916 (2000)]; Veterans' benefits [38 U.S.C. § 916 (2000)]; Special pensions paid to winners of the Congressional Medal of Honor [38 U.S.C. § 3101 (2000)]; Social Security payments [42 U.S.C. § 407 (2000)]; Railroad Retirement Act annuities and pensions [45 U.S.C. § 228(L) (2000)]; Wages of people who fish, serve at sea, or are apprentices [46 U.S.C. § 601]. See DEGIACOMO, *supra* footnote 14.

¹⁷ 11 U.S.C. § 522(p), (q) (2000).

¹⁸ 11 U.S.C. § 522(o) (2000); see DEGIACOMO, *supra* note 14.

¹⁹ 11 U.S.C. § 522(b)(3)(B) (2000).

statutory tenancies) provides that an interest in a statutory tenancy by the entirety may be attached but is not subject to levy on execution,²⁰ unless it is a joint debt of both spouses for necessities.

Common Law vs. Statutory Tenancy by the Entirety:

A common law tenancy by the entirety in Massachusetts vests all rights to rents and possession in husband, while wife merely has an expectancy if she survives husband. Massachusetts law provides that an interest in property as a tenant by the entirety is “exempt from process” if the interest is a wife’s interest in a common law tenancy by the entirety (a tenancy by the entirety created before February 11, 1980).²¹ The entire equity in a statutory tenancy by the entirety property gets the benefit of a Massachusetts homestead in a lien avoidance case under Section 522(f) of the Bankruptcy Code.²²

II. FEDERAL LAW PERMITS STATES TO CHOOSE WHAT PROPERTY TO PROTECT BUT PREEMPTS A STATE DETERMINATION THAT CERTAIN CLAIMS ARE NOT SUBJECT TO HOMESTEAD PROTECTION

Congress has plenary power to enact uniform federal bankruptcy laws.²³ Consequently states may not pass or enforce laws to interfere with or complement the Bankruptcy Act or to provide auxiliary regulations.²⁴ “Federal law determines whether property is exempted and immunized against seizure and sale for pre-bankruptcy debts.”²⁵ The Court of Appeals for the First Circuit considered whether certain causes of action (such as debt incurred prior to when the homestead was filed) exempted under Massachusetts law²⁶ from the homestead shield were preempted by Section 522(c) of the Bankruptcy Code:

...Congress afforded significant deference to state law by allowing bankruptcy debtors to choose state exemptions and...allowing states to opt out of the federal exemption scheme entirely. *See In re Boucher*, 203 B.R. 10 (Bankr. D. Mass. 1996) (citing 11 U.S.C. Section 522(b)). Yet, such deference does not warrant the conclusion that the “property exempted” in Section 522(c) must be defined by first applying all the built-in exceptions to the state exemption statute. As the Supreme Court recognized in discussing the interplay between Section 522(f) and state exemption exceptions in *Owen v. Owen*, 500 U.S. 291, 111 S. Ct. 1825, 114 L. Ed. 2d 337 (1991), the state’s ability to define its exemptions is not absolute and must yield to conflicting policies in the bankruptcy Code. *See Owen*, 500

²⁰ MASS. GEN. LAWS ch. 209, § 1A (1989); *Peebles v. Minnis*, 402 Mass. 282 (1988).

²¹ *In re Paul*, 67 B.R. 342 (Bankr. D. Mass. 1986) (Queenan, J.); *In re Coombs*, 86 B.R. 314 (Bankr. D. Mass. 1988) (Queenan, J.).

²² *In re Snyder*, 249 B.R. 40 (Bankr. D. Mass. 2000).

²³ U.S. CONST. art. 1 § 8, cl. 4; *International Shoe Co. v. Pinkus*, 278 U.S. 261, 265, 49 S. Ct. 1081 110 (1929).

²⁴ *International Shoe Co.*, 278 U.S. at 265

²⁵ *Bruin Portfolio, LLC v. Leicht (In re Leicht)*, 222 B.R. 670, 678 n.9 (B.A.P. 1st Cir. 1998).

²⁶ MASS. GEN. LAWS ch. 188 § 1(2).

U.S. at 313, 111 S. Ct. at 1838...[T]he analysis applies equally where the debtor chooses the state exemption scheme.²⁷

Like the bankruptcy court and the district court below, Judge Feeney's analysis of the conflict is persuasive.²⁸ As Judge Feeney recognized, the Massachusetts exceptions overlap and conflict with Section 522(c).²⁹ Judge Feeney's conclusion is persuasive that because the exceptions to the Massachusetts homestead statute are preempted to the extent that it permits exempt property to be liable for debts other than those expressly enumerated in Section 522(c) (1)-(3), particularly because the language employed by Congress in Section 522(c) is devoid of ambiguity.³⁰

On this basis, the First Circuit in *Patriot Portfolio* concluded that Section 1(2) of the Massachusetts Homestead Statute is preempted by Section 522(c) of the Bankruptcy Code.³¹

The Cash Proceeds of the Voluntary Sale of Homestead Property are not Exempt Property (Unless a State Statute Exempts Same):

Cash proceeds are not protected from the reach of post-petition creditors or those pre-petition creditors with garden variety, non-dischargeable debts. This is so because the Massachusetts Homestead Exemption Statute,³² (“the Act”), does not provide for an exemption of the proceeds that derive from the sale of a homestead property. That statute reads as follows: “An estate of homestead... *in the land and buildings* may be acquired pursuant to this chapter...”. There is no reference in the statutory scheme, nor is there any case law in Massachusetts, stating that the cash proceeds from the voluntary sale of a homestead estate are similarly protected. There is, however, legislative history behind the Act that demonstrates that the legislature did not intend to exempt proceeds of a homestead sale from attachment and execution. Further, a glimpse at the laws in other states further bolsters the fact that the legislature was well aware of how to exempt the proceeds of a homestead, but chose not to do so.

The Legislative History of the Massachusetts Homestead Act:

The legislative history of the Act demonstrates that, while at one time proceeds from an involuntary sale of the homestead were exempt, further amendments to the Act removed that provision, thus indicating intent by the Massachusetts legislature to leave proceeds unprotected. In the earliest version of the Homestead Act, entitled “An Act to exempt from Levy on Execution the Homestead of a Householder having a Family,”³³ (“the 1851 statute”), the legislature allowed limited protection to proceeds acquired from

²⁷ *Patriot Portfolio, LLC v. Weinstein* (In re Weinstein), 164 F3d 677 (1st Cir. 1999).

²⁸ In re Whalen-Griffin, 206 B.R. 277 (Bankr. D. Mass. 1997).

²⁹ *Id.* at 290.

³⁰ *Id.* at 291-92.

³¹ *Patriot Portfolio*, 206 B.R. at 292.

³² Codified and defined at MASS. GEN. LAWS ch. 188, §1 (2005) (emphasis added).

³³ See Mass. Acts St. 1851, c. 340, § 1 *et seq.*

an involuntary sale. The 1851 statute provided that “the judgment creditor may require the premises to be sold by such sheriff or his deputy, at public sale... and out of the proceeds of said sale to pay to debtor the sum of five hundred dollars, to be exempted from liability from his debts for one year thereafter, and to apply the balance to such execution...”.³⁴ Four years later, however, the legislature amended the homestead statute and, in the amended version, removed the provision exempting proceeds from attachment.³⁵ To this day, despite over twenty-five subsequent amendments to the homestead statute, the legislature has never provided an exemption for the proceeds of a homestead sale, whether that sale was voluntary or involuntary.

Consequently, it is entirely clear that the legislature was well aware of how to exempt the proceeds of a homestead sale from attachment, even to the point of differentiating between voluntary and involuntary sales. Further, after four years with such an exemption, they apparently decided to remove the exemption. The current version of the Act, first enacted in 1939, has never contained any such exemption for proceeds. It is beyond the power of a court to impose its own opinion on what the law should be when it is clear that the state legislature considered the matter, and chose not to allow an exemption for proceeds resulting from the voluntary sale of property protected by the Act.

Review of How Other States Exempt Proceeds:

Should the Massachusetts legislature want to exempt proceeds for the sale of homestead property, not only could it look at its own past Act, it could look to other jurisdictions, most of which do not exempt proceeds of the sale of a homestead. A survey of other states’ statutes and case law reflects that there are thirty-three states that do not provide a statutory exemption for proceeds of the sale of a homestead,³⁶ there are fifteen states that provide a statutory exemption for proceeds³⁷ and two states that do not offer

³⁴ See Mass. Acts St. 1851, c. 340, § 7.

³⁵ See Mass. Acts St. 1855, c. 238, § 1 *et seq.*

³⁶ Alabama (ALA. CODE § 6-10-2 (1980)); Arkansas (ARK. CODE ANN. § 16-66-210 (1981)); Delaware (DEL. CODE ANN. § 10-4902 (1974)); Florida (FLA. CONST. art. X, § 4); Georgia (GA. CODE ANN. § 44-13-1 (1976)); Hawaii (HAW. REV. STAT. § 651-92 (1978)); Idaho (IDAHO CODE ANN. § 11-601 (2004)); Illinois (735 ILL. COMP. STAT. 5/12-901 (2006)); Indiana (IND. CODE ANN. § 34-55-10-2 (2005)); Iowa (IOWA CODE § 561.16 (2005)); Kansas (KAN. STAT. ANN. § 60-2301 (1991)); Kentucky (KY. REV. STAT. ANN. § 427.060 (1980)); Louisiana (LA. CONST. art. VII, § 20); Maryland (MD. CODE ANN. § 11-504 (2002)); Massachusetts (MASS. GEN. LAWS ch. 188, § 1A (2004)); Michigan (MICH. COMP. LAWS § 600.6023 (1998)); Mississippi (MISS. CODE ANN. § 85-3-21 (1999)); Missouri (MO. REV. STAT. § 513.475 (1982)); Nevada (NEV. REV. STAT. § 21.090 (1997)); New Jersey (N.J. STAT. ANN. § 2A:17-17 (1991)); New Mexico (N.M. STAT. ANN. § 42-10-9 (1993)); North Carolina (N.C. GEN. STAT. (§ 1C-1601 (2005)); North Dakota (N.D. CENT. CODE § 28-22-01 (1985)); Ohio (OHIO REV. CODE ANN. 2329E.66 (2003)); Oklahoma (OKLA. STAT. tit. 31 § 1 (1999)); South Carolina (S.C. CODE ANN. § 15-41-30 (1962)); South Dakota (S.D. CODIFIED LAWS § 43-45-3 (2005)); Tennessee (TENN. CODE ANN. § 26-2-301 (2004)); Vermont (VT. STAT. ANN. 27 § 101 (2004)); Virginia (VA. CODE ANN. § 34-4 (1995)); West Virginia (W. VA. CODE R. § 38-9-3 (1996)); Wyoming (WYO. STAT. ANN. § 1-20-101 (1983)).

³⁷ Alaska (ALASKA STAT. § 09.38.010 (2004)) (proceeds must be reinvested in new homestead); Arizona (ARIZ. REV. STAT. § 33-1101 (1980)) (proceeds protected for 18 months); California (CAL. Civ. Proc. CODE § 704.730 (1986)) (proceeds protected for 6 months); Colorado (COLO. REV. STAT. 38-41-207 (2005)) (proceeds protected for 1 year); Connecticut (CONN. GEN. STAT. § 52-352b (2003)) (proceeds

homestead protection at all.³⁸ Further, of the states that do not have statutory exemptions for proceeds, most of those jurisdictions' highest courts have refused to read an exemption into the homestead statute as it would be tantamount to improper judicial legislation.³⁹

Proposed Massachusetts Legislation Senate 917 (S. 917) Includes Specific Limited Proceeds Exemption Provisions:

In 2001, the Boston Bar Association's Legislative Committee proposed a replacement to the Homestead Act. The proposed Act included a provision specifically protecting the cash proceeds of a homestead sale until the debtor had established a new homestead.⁴⁰ Even under this provision a debtor would not be protected if debtor and debtor's spouse had already established a new homestead. The 2001 proposed act was side-tracked by the passage of an increase in value of real estate protected from \$300,000 to \$500,000. The present S. 917, sponsored by Senator Michael Creedon (who sponsored the recent increase) and the Boston Bar Association and the Real Estate Bar Association contains a similar provision. This is further persuasive authority that proceeds are not protected because S. 917 the proposed replacement act, includes a specific provision protecting proceeds from a homestead sale in a specially labeled "homestead account" with the inference being that the current act should not be interpreted as offering similar protection.

Cash Proceeds Do Not Go Back Into the Estate of the Debtor, but Are Available To Creditors with Non-Dischargeable Debts as a Matter of State Law:

In the case of *In re Cunningham*, the Bankruptcy Court relied heavily on both *In re Reed* and *In re Hyde* to support the conclusion that proceeds from the sale of exempt property are also exempt.⁴¹ However, footnote 7 of the *Reed* decision explicitly states that the case does not make that assertion; it states:

protected for 1 year); Maine (14 ME. CODE R. § 4422 (2001)) (proceeds protected for 6 months); Minnesota (MINN. STAT. § 510.02 (1993)) (proceeds protected for 1 year); Montana (MONT. CODE ANN. 70-32-201 (1979)) (proceeds protected for 18 months); Nebraska (NEB. REV. STAT. § 25-1552 (1993)) (proceeds protected for 6 months); New York (N.Y. C.L.S.C.P.L.R. § 5206 (2005)) (proceeds protected for 1 year); Oregon (OR. REV. STAT. § 18.395 (1999)) (proceeds protected for 1 year provided that there is intent to purchase new homestead); Texas (TEX. PROP. CODE ANN. § 41.001 (2001)) (proceeds protected for 6 months); Utah (UTAH CODE ANN. § 78-23-3 (2004)) (proceeds protected for 1 year); Washington (WASH. REV. CODE § 6.13.070 (2006)) (proceeds exempt for 1 year); Wisconsin (WIS. STAT. § 815.20 (1995)) (proceeds exempt for 2 years, provided that there is an intent to purchase new homestead).

³⁸ Pennsylvania and Rhode Island.

³⁹ *In re Schalebaum*, 273 B.R. 1 (Bankr. D. N.H. 2001); *Matter of England*, 975 F.2d 1168 (5th Cir. 1992); *Drennan v. Wheatley*, 195 S.W.2d 43 (Ark. 1946); *Millsap v. Faulkes*, 20 N.W.2d 40 (Iowa 1945); *Smith v. Hart*, 49 N.W. 657 (S.D. 1926); *Mack v. Boots*, 239 P. 794 (Ariz. 1925) (legislature has since amended statute to protect proceeds); *Fred v. Bramen*, 107 N.W. 159 (Minn. 1906) (legislature has since amended statute to protect proceeds); *Wright v. Westheimer*, 28 P. 430 (Idaho 1891)].

⁴⁰ William Hovey, *Automatic, Paperless Homesteads Would Eliminate Much Confusion*, Mass. Law. Wkly., Dec. 24, 2001.

⁴¹ *In re Cunningham* (B.R. 2006); *See also In re Reed*, 184 B.R. 733 (W.D. Tex. 1995), The Bankruptcy Court, at page 3 "adopts the reasoning and holding of *Lowe v. Yochem* that the sale of exempt property

It is important to note that the court is *not* holding that the proceeds of the disposition of exempt property are therefore also “exempt.” When a debtor claims exemptions under state law, only state law controls whether a given property is “exempt.” Our holding is only that under bankruptcy law, if a given property owned by the debtor is removed from the estate, it is no longer property of the estate. The conversion of that property into some other form which under applicable law, would not be exempt will not restore the property to the estate, but that is not the same as saying the property as transmogrified is still exempt.⁴²

The first sentence of the footnote makes it clear that the *Reed* court is not saying that the proceeds are exempt. The *Reed* decision is simply holding that when exempt property is converted into non-exempt property, such as the cash proceeds from a voluntary sale, this non-exempt property does not return to the debtor’s estate. The Bankruptcy Court, in *Hyde*, observed this important distinction.⁴³ The fact that the property will not return to the debtor’s estate does not prevent a creditor with a garden variety, non-dischargeable debt from attaching the proceeds because his debt is non-dischargeable.

Federal Bankruptcy Law Does Not Enlarge State Homestead Statutes to “Transmorgify” Non-Exempt Proceeds Into Protected Property:

Had Congress intended such a broad reading of Section 522(c) they could have easily provided for it as they have in other sections of the Bankruptcy Code, i.e. “property exempted under this section and the proceeds thereof.”⁴⁴ Nothing changes this, although the bankruptcy court stated:

With respect to the debtor, whatever share of the Homestead Proceeds belong to him under state law are exempt from the claims of his pre-petition creditors, including the Creditor. *See Patriot Portfolio v Weinstein (In re Weinstein)*, 164 F.3d 677, 683 (1st Cir. 1999), quoting *In re Whalen-*

(here real estate) does not make the sales proceeds property of the estate. “The majority of courts, however, hold that a post-petition change in the character of property claimed as exempt will not change the status of that property, relying on the principle that once property is exempt, it is exempt forever and nothing occurring post-petition can change that fact.” (Rosenthal, J. decision dated December 7, 2005)

⁴² *In re Reed*, 184 B.R. at 738. (Emphasis in original).

⁴³ *In re Phillip W. Hyde*, 334 B.R. 506 (Bankr. D. Mass. 2005), *In Hyde*, debtor had endorsed pension checks payable to his deceased mother from the Chicago Teachers Retirement Board for some eighteen years following her death. Debtor’s homesteaded real estate was exempt from creditors, including the Retirement Board, whose garden variety, non-dischargeability judgment (for fraud) was not one for taxes or child support or alimony that § 522 (c)(1) provides can trump exempted property. When debtor voluntarily sold his homestead, the Massachusetts Bankruptcy Court, Feeney, J., deferred acting on the Board’s request to reach the proceeds, because it felt the same result would be achieved by the criminal court, which was garnishing the funds under a post-petition restitution order. Although the court recognized that the issue of whether proceeds from a sale was an issue of state law 334 B.R. at 515, it nonetheless hinted in dicta it might have ruled the proceeds exempt.

⁴⁴ *Patriot Portfolio*, 164 F.3d. 677 (1st Cir. 1999).

Griffin, 206 B.R. 277, 290 (Bankr. D. Mass. 1997) (‘Because the exceptions to the Massachusetts homestead have the same effect on the homestead as the exceptions set forth in § 522(c), ... the Massachusetts homestead statute is preempted to the extent that it permits exempt property to be liable for debts other than those expressly enumerated in § 522(c)(1)-(3), particularly because the language employed by Congress in § 522(c) is devoid of ambiguity.’)⁴⁵

The Proceeds of the Sale of Homestead Property Are Not Protected From the Reach of Creditors; This is Consistent with Results When a Debtor Converts Exempt Property to Non-Exempt Property:

Notwithstanding the fact that a debtor’s homestead exemption in *Cunningham* expired when debtor abandoned the property, the cash proceeds following the sale of homestead property are not exempt from the reach of creditors under the Act. The plain language of the statute is clear: “An estate of homestead... *in the land and buildings* may be acquired pursuant to this chapter...” (Emphasis added). There is no reference in the statute, nor is there any case law in Massachusetts, stating that the liquid proceeds from the sale of a homestead estate are similarly protected. Nevertheless, there certainly are cases that involve the transformation of exempt assets other than the estate of homestead, and the courts in those cases held that, once the transformation occurs, the exemption is lost.⁴⁶

In the case of *In re Toone* the debtor, former president of the First National Bank of Marlborough, had \$220,000 in that bank’s qualified plan and claimed the same as exempt under both Massachusetts law⁴⁷ and ERISA,⁴⁸ after he had his attorney in fact son Attorney David Toone withdraw the same for purposes of rolling them over into an IRA account so-called, in accordance with I.R.C. grace provisions. The FDIC, a pre-petition creditor, had a \$48,000,000 judgment. The bankruptcy court (Hillman, J) found once the ERISA plan administrator wrote checks to Debtor’s attorney in fact, as a matter of state law the funds were no longer exempt property and the pre-petition creditor recovered. *Cunningham*’s conduct in the within proceeding, converting exempt real estate to non-exempt cash is exactly parallel.⁴⁹

In the case of *In re Wiesner*, where homestead Massachusetts real estate was properly claimed as exempt, the court found the fire insurance proceeds payable after a fire were not exempt under the Homestead Act.⁵⁰ In *Hoult v. Hoult*, the defendant entered into a post-judgment stipulation to address a non-dischargeable judgment. The court

⁴⁵ The cited language applies to real estate only, not the proceeds of the sale. See *In re Cunningham*, 2005 Bankr. LEXIS 2419, at *3 n.1 (Bankr. D. Mass. Dec. 7, 2005).

⁴⁶ *Hoult v. Hoult*, 373 F.3d 47 (1st Cir. 2004); *In re Wiesner*, 267 B.R. 32 (Bankr. D. Mass. 2001); *In re Toone*, 140 B.R. 605 (Bankr. D. Mass. 1992).

⁴⁷ MASS. GEN. LAWS ch. 235 § 34A.

⁴⁸ 29 U.S.C. 1056(d) (2000).

⁴⁹ *In re Toone*, 140 B.R. 605 (Bankr. D. Mass. 1992).

⁵⁰ *In re Wiesner*, 267 B.R. 32 (Bankr. D. Mass. 2001).

found the anti-alienation provision of ERISA applies to benefits only where held by the plan administrator and not after they reach the hands of the beneficiary, although a different result would pertain under the Social Security Statute, but the First Circuit in *Hoult v. Hoult* did not need to reach that issue.⁵¹

*A Debtor's Spouse is not Protected by a Homestead
Once the Tenancy by the Entirety Is Severed by Sale:*

The Act explicitly states that only “one owner may acquire an estate of homestead...”. However, when the property that is subject to the homestead is a tenancy by entirety, the homestead held by one owner is effectively held by the other owner as well. This is because in a tenancy by entirety “husband and wife are seized of the estate so granted as one person, and not as ordinary joint tenants or as tenants in common.”⁵² Thus, a tenancy by entirety is a legal creation in which the “interests of both the husband and wife extend to the whole of the property, not merely to some fractional interest that the other does not also hold.” *Id.*⁵³ Further, any creditors of one party may not encumber the property as it is also held by the other, non-debtor party. Rather, the creditor must wait until after the end of the tenancy by entirety to encumber the debtor.

Section 522(c)⁵⁴ only preempts state law from determining what kinds of debts exempt property can be subject to. This is different from creating a new broad federal category of exempt property, i.e. cash proceeds from the voluntary sale of exempt property. The Bankruptcy Code does not preempt the state from determining what kinds of property to exempt, and each state determines, as a matter of state law, the degree of protection given to the proceeds resulting from a voluntary sale of homestead property.

In *Bruin Portfolio*, the Bankruptcy Appellate Panel for the First Circuit provides: “states can determine the nature and amount of property that can be exempted, but not the nature of debts to which the exemption applies.”⁵⁵ This underscores the proposition that state law controls the exemptability of homestead proceeds because it is a question of what nature of property the state is choosing to exempt. Massachusetts exempts certain qualifying real estate, but does not exempt proceeds of a voluntary sale of exempt real estate from post-petition creditors or garden variety pre-petition creditors whose debts have been declared non-dischargeable by the Bankruptcy Court. However, once a debtor abandons the homestead, and clearly once he sells the exempt property, Section 522(c) of Federal bankruptcy law no longer protects non-exempt proceeds from the sale of real property. The drafters of Section 522(c) knew of the different states schemes set forth above. They did not choose to preempt or broaden protection for exempt property or cash proceeds resulting from such a sale thereby making proceeds exempt property protected in perpetuity. Hence, the disposition of cash proceeds to debtor from the sale

⁵¹ *Hoult v. Hoult*, 373 F.3d 47 (1st Cir. 2004).

⁵² *In re Snyder*, 249 B.R. 40, 44 (Bankr. D. Mass. 2000).

⁵³ *In re Snyder*, 249 B.R. 40, 44 (Bankr. D. Mass. 2000).

⁵⁴ 11 U.S.C. §522(c) (2000).

⁵⁵ *Bruin Portfolio, LLC v. Leicht (In re Leicht)*, 222 B.R. 670 at 678, citing *In re Whalen-Griffen* 206 B.R. 281 at 282 and *In re Scott* 199 B.R. 586, 593 (Bankr. E.D.Va 1996).

of homestead property is not preempted and remains a question that the Massachusetts Bankruptcy Court has already decided.

The Bankruptcy Court's Reliance in Cunningham upon In re Reed is Misplaced:

In the case of *In re Reed*, which was heavily relied upon by the bankruptcy court, the Western Texas Bankruptcy Court states: "When a debtor claims exemptions under state law, only state law controls whether a given property is exempt?"⁵⁶ The Massachusetts Bankruptcy Court in *Cunningham* does not take this language into account.

In the case of *In re Reed*, the Chapter 7 Bankruptcy trustee sought to include proceeds from the voluntary sale of exempt Texas homestead real estate in the bankrupt estate for the benefit of all pre-petition creditors.⁵⁷ Jerry Lee Reed filed for Chapter 11 protection in the Western District of Texas on February, 1991 and timely and properly claimed the "Reed Ranch" in Bandera County as exempt homestead property. The objection period had expired when on August 20, 1992 the debtor and his wife sold the ranch for cash and a \$375,000 "Bartley (purchase) note". On February 16, 1993 (within the relevant 6 month period allowed by Texas statute) the Reeds purchased a new home using the Bartley note as collateral for a \$583,637.67 note they gave to the McDades (sellers of 2nd house). On May 19, 1993 the case was converted to Chapter 7 and the trustee claimed that the Bartley note was property of the estate under Section 541(a) of the Bankruptcy Code. Debtor and his wife ultimately received, on July 27, 1993, a net of \$106,574.28 from the then payment of the Bartley note after payment of other sale expenses and an additional \$167, 352.12 of proceeds was applied on account to the McDade note.

The *Reed* case turned on the analysis of Section 541(a) of the Bankruptcy Code during an ongoing Chapter 11 case. Had Reed's sale and purchase transactions been entirely for cash, because within the six (6) month protected period under Texas statute, no case would have been brought, as the cash proceeds were exempt under the Texas Homestead Law. The \$375,000 Bartley note from the sale in *Reed* did not become property of the Chapter 11 estate when six (6) months from the sale of the homestead expired on February 20, 1992 because none of the relevant provisions of Section 541(a) of the Bankruptcy Code include such a note obtained from a sale of exempt property as property of the estate. That should end the *Reed* analysis and inquiry (parenthetically, a post-petition creditor of Reed could have reached the Bartley note).

The *Reed* court cites several cases immediately after a quoted passage that states:

"The majority of courts, however, hold that a post-petition change in the character of property properly claimed as exempt will *not* change the status of that property, relying on the principle that once property is

⁵⁶ *In re Reed*, 184 B.R. 733 at 738, n.7.

⁵⁷ *In re Reed*, 184 B.R. 733.

exempt, it is exempt forever and nothing occurring post-petition can change that fact.”⁵⁸

The first such cited case does not involve a change in the character of property post-petition at all, but merely the Chapter 7 debtor’s death eight months after the Bankruptcy filing⁵⁹ and proper claiming of a state (North Dakota) homestead. Reciting familiar principals, the Eighth Circuit held that the exempt homestead status is determined as of date of Chapter 7 filing and: “[o]ne of the main goals of the Bankruptcy Code is to provide *honest* debtors with a fresh start.”⁶⁰

The *Payne* case involved which fire insurance proceeds for an Illinois Chapter 7 debtor’s December, 1981 fire became property of the estate.⁶¹ The estate’s property was limited by insurance proceeds designated for certain personalty, properly and timely claimed as exempt. The *Wickstrom* case does not appear to revolve around any post-petition death by debtor (but rather alleged fraudulent transferees – debtor’s parents) and does not stand for the proposition cited, or support either the *Reed* dicta or the Cunningham holding appealed from.⁶² In the case of *In re Harlan*,⁶³ the Chapter 7 debtors filed a voluntary petition on October 14, 1982, having sold their homestead pre-petition on October 1, 1982 for \$15,015.54 and a \$48,000 note. Texas statute Article 3834 made said proceeds exempt for six (6) months, and a garden variety pre-petition creditor had no claim on such proceeds.

CONCLUSION

The intersection of bankruptcy and state law is a fascinating area to observe preemption at work. The recent heralded “Reform” Act, i.e., The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005,⁶⁴ addressed perceived abuses including those perceived in the exemption system. While initial feedback from consumer advocates suggests Congress shot a flea with an elephant gun, the area of bankruptcy and homestead will doubtless generate more litigation, appeals and legislative tinkering.⁶⁵

⁵⁸ *In re Reed*, 184 B.R. 733 at 738.

⁵⁹ *Armstrong v. Peterson*, 897 F.2d 935, 937 (8th Cir. 1990).

⁶⁰ *In re Lindberg*, 735 F.2d 1087, 1090 (8th Cir. 1986) (emphasis supplied).

⁶¹ *Payne v. Wood*, 775 F.2d 202 (7th Cir. 1985).

⁶² *Estate of A. N. Wickstrom v. Wickstrom* (Matter of Wickstrom), 113 Bankr. 339, 343-44 (Bankr. W.D.Mich. 1990); *See also* *In re Reed*, 184 B.R. 733.

⁶³ *In re Harlan*, 32 B.R. 91, Bankr. W.D.Tex 1983.

⁶⁴ *Supra* note 1.

⁶⁵ *See* National Association of Consumer Bankruptcy Attorneys (NACBA), *Bankruptcy Reform’s Impact: Where are all the “Deadbeats”?*, February 22, 2006.