

SO HE HUFFED AND HE PUFFED . . . BUT WILL  
THE HOME(STEAD) FALL DOWN?:<sup>1</sup> THE  
APPLICABILITY OF SECTION 522(P)(1) OF THE  
UNITED STATES BANKRUPTCY CODE TO  
VARYING INTEREST ACCUMULATIONS OF  
THE DEBTOR IN HOMESTEAD PROPERTY

*Gloria J. Liddell\**

*Pearson Liddell, Jr.\*\**

TABLE OF CONTENTS

I. Introduction .....	730
II. BAPCPA and the New Code Provision—Section 522(p)(1) .....	735
A. How Does It Work? .....	735
B. Does Section 522(p)(1) Apply in Every State?: Election Versus Opting Out.....	736

---

\* Assistant Professor of Business Law, Mississippi State University College of Business. B.S., District of Columbia Teachers College, 1973; J.D., Howard University School of Law, 1976; M.A.T., Antioch University, 1985. The authors express appreciation to Joshua Nelson Liddell for his assistance in reviewing this paper. We know that he thoroughly enjoyed "correcting us" as much as we enjoyed "correcting him" over the years to assist in making him the talented scholar he is today.

\*\* Assistant Professor of Business Law, Mississippi State University College of Business. B.S., Central State University, 1972; J.D., Howard University School of Law, 1976.

1. Any resemblance this awkward reference to the perennial English fairy tale *The Three Little Pigs* suggests to actual parties in a bankruptcy proceeding is unintended and purely fictional. It should be noted, however, that the debtor–hog analogy is often referenced in regards 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 Robin Hood-type character in its role of protecting the unsecured creditor by redistributing the riches of what may be deemed the “hoggish” debtor.

III. Characterization and Classification of Varying Interest	
Accumulations.....	737
A. Passive Versus Active Interests: A Necessary Dichotomy .....	738
B. Passive/Appreciable Interests .....	738
1. Appreciation Due to Natural Market Conditions.....	738
2. Appreciation Due to Other Factors.....	743
3. Accumulation of Interest Resulting from the Original	
Structuring of the Indebtedness .....	744
a. Regular Mortgage Payments.. .....	745
b. Lease with Purchase Option Exercised .....	746
4. Accumulation of Interests Through Devolution and	
Similar Involuntary Circumstances .....	746
a. Inheritance.. .....	746
b. Rights of Survivorship.. .....	747
c. Rollover of Appreciated Real Estate .....	749
5. Status Accumulation.....	749
C. Active/Transactional Interests .....	750
1. Paying Down a Mortgage with Prepayments.....	751
2. Remodeling.....	753
3. Concurrent Estates .....	754
IV. Conclusion .....	756
V. Appendix.....	758

## I. INTRODUCTION

The homestead exemption is one in a package of many exemptions allowed under both state law and 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.<sup>2</sup> Under the Code, states have the right to opt out of the federal exemption structure, thus requiring citizens to utilize the exemptions of that state. If the state chooses not to opt out, its residents may take the exemptions allowed under federal bankruptcy law.<sup>3</sup> However, residents cannot take both state and federal

2. See generally Alison D. Morantz, *There's No Place Like Home: Homestead Exemption and Judicial Constructions of Family in Nineteenth-Century America*, 24 LAW & HIST. REV. 245 (2006) (providing a brief history of the origins of the homestead exemption).

3. See 11 U.S.C. § 522(b) (2006) (enumerating the exemptions allowed under federal bankruptcy law).

exemptions.<sup>4</sup>

The homestead exemption is perceptibly the most beneficial exemption. The homestead exemption allowable under federal bankruptcy law is currently limited to \$20,200.<sup>5</sup> Some states, on the other hand, have homestead exemptions that are more generous than allowed by federal law.<sup>6</sup> Furthermore, the homestead exemption allowed by some jurisdictions is more generous than that of other jurisdictions.<sup>7</sup> Most notable are the District of Columbia,<sup>8</sup> Florida,<sup>9</sup> Iowa,<sup>10</sup> Kansas,<sup>11</sup> Oklahoma,<sup>12</sup> South Dakota,<sup>13</sup> and Texas,<sup>14</sup> which all have an unlimited homestead exemption in various respects.

In response to these discrepancies, wealthy people anticipating bankruptcy have moved their residences to one of these more favorable states—most infamously Florida—and liquidated a vast portion of their nonexempt assets and invested that money into their “homestead” for the precise purpose of utilizing the homestead exemption. The following is an excerpt from the *Congressional Record* of a statement made during discussions on this topic just prior to the passage of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA):

A review of a few examples in recent years show 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

---

4. *See id.* § 522(b)(1).

5. *Id.* § 522(d)(1); Revision of Certain Dollar Amounts in the Bankruptcy Code Prescribed Under Section 104(b) of the Code, 72 Fed. Reg. 7082 (Feb. 14, 2007). This dollar amount is adjusted by the Judicial Conference of the United States and is set out in § 104 of the Code. 11 U.S.C. § 104(b).

6. *See generally infra* Appendix.

7. *Id.*

8. D.C. CODE § 15-501(a)(14) (2001).

9. FLA. CONST. art. 10, § 4(a)(1); FLA. STAT. ANN. § 222.01 (West 1998 & Supp. 2009).

10. IOWA CODE ANN. § 561.16 (West 1992 & Supp. 2008).

11. KAN. STAT. ANN. § 60-2301 (2005 & Supp. 2007).

12. OKLA. STAT. ANN. tit. 31, § 1(A)(1) (West 1991 & Supp. 2009).

13. S.D. CODIFIED LAWS § 43-45-3 (2004 & Supp. 2008).

14. TEX. CONST. art. 16, §§ 50–51.

in 1998, a home featured on the cover of the November 2004 issue of *Luxury Homes* [sic] magazine, and now worth nearly \$17 million. The IRS says he owes more than \$25 million for back taxes, and he is the defendant in several multi-million dollar securities fraud lawsuits resulting from the failure of WorldCom. 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 its 10 bedrooms, two libraries, double gourmet kitchen, racquetball court, indoor basketball court, movie theater, 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 \$8 million in debt through bankruptcy, but still held onto his \$2.5 million Florida estate.<sup>15</sup>

The homestead exemption, when exploited in this manner, came to be known as the “mansion loophole.”<sup>16</sup> Eventually, as a result of negative publicity and the extensive lobbying efforts on behalf of financial institutions—particularly credit card issuers<sup>17</sup>—Congress took action by

---

15. 151 CONG. REC. S2342 (daily ed. Mar. 9, 2005) (statement of Sen. Kohl).

16. See H.R. REP. NO. 109-31, pt. 1, at 15–16 (2005) (“Under current bankruptcy law, debtors living in certain states can shield from their creditors virtually all of the equity in their homes. In light of this, some debtors actually relocate to these states just to take advantage of their ‘mansion loophole’ laws.”).

17. See, e.g., 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.”); Ronald J. Mann, *Bankruptcy Reform and the “Sweat Box” of Credit Card Debt*, 2007 U. ILL. L. REV. 375, 376 n.1 (citing 144 CONG. REC. H10225 (1998) (remarks of Rep. Nadler) (arguing that the bill was written “by and for” credit card companies)).

passing the newly revised bankruptcy laws known as BAPCPA.<sup>18</sup>

Nevertheless, a minority of debtors filing bankruptcy who were financially situated to benefit from this loophole continued to use it. Out of approximately 1.5 million people who filed bankruptcy within the past ten years, a U.S. General Accounting Office study found that over 400 debtors took advantage of the unlimited homestead exemption in Florida and Texas.<sup>19</sup>

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.<sup>20</sup> The portions of the BAPCPA to which this Article pertains reveal a preference for creditors by making it more difficult for debtors to protect their homestead and other assets than it was before the passage of BAPCPA. Without any doubt, this was the blow which Congress and the law’s advocates sought to strike.

BAPCPA, however, has been recognized by bankruptcy practitioners and scholars as an example of artless craftsmanship in many compelling respects—not the least of which is that portion which forms the substance of this Article.<sup>21</sup> As will be discussed below, the federal courts have already begun efforts to interpret ambiguous legislative promulgations,

---

18. Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, 119 Stat. 23 (2005).

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

20. Henry J. Sommer, *Trying to Make Sense Out of Nonsense: Representing Consumers Under the “Bankruptcy Abuse Prevention and Consumer Protection Act of 2005”*, 79 AM. BANKR. L.J. 191, 191 (2005) (“From its Orwellian title, an example of deceptive advertising if ever there was one, to the last of its 512 pages, the bankruptcy bill recently passed by Congress presents numerous challenges to attorneys who represent consumer debtors.”).

21. See, e.g., Jean Braucher, *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 (“The 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.”) (citations omitted); see also Sommer, *supra* note 20, at 191 (“One of the chief problems that will be confronted is atrocious drafting, especially in many of the consumer provisions of the bill.”).

sometimes with conflicting results. This Article illustrates how BAPCPA fails by leaving judges with the task of plugging the gaps to fulfill, or at least make sense of, the law.

The relevant portion of BAPCPA limits the ability of the debtor to exempt any portion of his or her homestead above \$136,875 that was “acquired” within 1,215 days (or more than three years and four months) prior to filing bankruptcy.<sup>22</sup> What the law does not anticipate are situations in which the debtor has garnered an additional interest in the applicable real property, but such interest was not “acquired” by the debtor under a strict interpretation of the statute. Such additional interest may result from equity appreciation or other resulting accumulation discussed in this Article. Indeed, as discussed in Part III, courts have already faced this issue in a few cases that have attempted to interpret 11 U.S.C. § 522(p)(1). Thus, this Article analyzes various scenarios in 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 BAPCPA, and which we believe must be handled distinctly.

In a case discussed in this Article involving this issue, the court recognized a distinction between passive acquisition of an interest and active acquisition of an interest.<sup>23</sup> The court noted in dicta how certain factual situations might be decided in future cases.<sup>24</sup> By adopting the premise that acquisition can be passive or active and characterizing these scenarios in a similar manner, but distinguishing between “acquisitions” and “accumulations,” an effective mechanism for judicial interpretation is provided. We believe that most matters, as conceived and outlined herein, can fit suitably into one of these two broad categories. If a particular situation is deemed an active or transactional acquisition, then it will be subject to the limitation of § 522(p)(1). Otherwise, if a situation is deemed a passive or appreciable accumulation, then it will be outside of the proscriptions of that section of the Code.

---

22. 11 U.S.C. § 522(p)(1) (Supp. 2007). The exemptible dollar amount is adjusted every three years according to the cost of living pursuant to 11 U.S.C. § 104(b)(1). Prior to April 1, 2007, the amount was \$125,000. 11 U.S.C. § 522(p)(1) (2006).

23. *In re Rasmussen*, 349 B.R. 747, 757 (Bankr. M.D. Fla. 2006).

24. *Id.*

## II. BAPCPA AND THE NEW CODE PROVISION—SECTION 522(P)(1)

### A. *How Does It Work?*

Under BAPCPA, Congress enacted a new code provision which is designed to close the “mansion loophole.” Section 522(p)(1) of the U.S. Bankruptcy Code reads as follows:

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 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.<sup>25</sup>

The operative language of this provision is: “interest that was acquired by the debtor.”<sup>26</sup> In the targeted “mansion loophole” scenario, a debtor, within the 1,215 day window,<sup>27</sup> sells a home in State A, which has a limited or less favorable homestead exemption, and purchases a home in

---

25. 11 U.S.C. § 522(p)(1).

26. *Id.*

27. *Id.* Why did Congress choose precisely 1,215 days? Did it result from research suggesting that the type of prebankruptcy planning the statute needed to thwart occurs no more than three years ahead of time? Does this approach best discern when a pig becomes a hog? Such a length of time will no doubt deter many legitimate prebankruptcy planning efforts. Most people will likely not anticipate a need to seek the protections of federal bankruptcy law in the future. Yet, some individuals may recognize long-term financial warning signs—perhaps a subset of the wealthy few who would have been capable of taking advantage of this “mansion loophole”—resulting in a planned effort to accomplish that which Congress seeks to hinder. However, why Congress chose 1,215 days is beyond the scope of this particular Article.

State B, which has an unlimited homestead exemption. To fund the purchase of the home in State B, the debtor liquefies most of his or her nonexempt assets and combines the cash with the proceeds from the sale of the home in State A. 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 because these assets are now excluded from the bankruptcy estate. 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 that are perfectly suited to the regulatory formula designed to address them. Were it so, court dockets would doubtlessly be less burdened. Thus, while the statute perhaps deservedly targets scenarios such as the one described, doing so draws within its grasp other unintended situations.

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

Bankruptcy law is federal law. 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 exclusively.<sup>28</sup> The state exemption structures exist for debtors who may have to resort to their protections in cases in which a creditor has obtained a judgment against the debtor and seeks to execute it by claiming property of the debtor. In the bankruptcy context, the state exemption structure would be used for those debtors who filed for bankruptcy to allow those assets to be excluded from the debtor's estate as exempt.

In states that have not opted out of the federal exemption structure, a debtor may elect to utilize either their own state exemption structure or the federal exemptions contained in the Code.<sup>29</sup> Thus, a distinction exists 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.<sup>30</sup> Because of this distinction, the bankruptcy

---

28. *Id.* § 522(b)(2).

29. *Id.*

30. It should be noted that BAPCPA revised the ability of a person to claim a



court in the case of *In re McNabb* interpreted the \$125,000 limitation in § 522(p)(1) to be inapplicable to debtors in the states which have opted out.<sup>31</sup> The *McNabb* court interpreted this limitation to mean that this provision of the Code was not applicable to states that have opted out of the federal exemption structure because in those cases a debtor cannot elect the federal exemptions, as the language of this provision states.<sup>32</sup> The court held this way despite admitting 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.”<sup>33</sup>

In a later case, *In re Kaplan*—now considered the seminal case on this issue—the court refused to apply the holding of the *McNabb* court, and instead determined that Congress did not intend such an exception to exist.<sup>34</sup> Thus, the court in *Kaplan* and its progeny<sup>35</sup> have deemed § 522(p)(1) inapplicable to all states, regardless of whether they have opted out of the federal exemption structure.<sup>36</sup>

### III. CHARACTERIZATION AND CLASSIFICATION OF VARYING INTEREST ACCUMULATIONS

Court decisions rendered since the passage of BAPCPA have

---

homestead exemption in a particular state if that debtor has not resided in that state for at least 730 days. *See id.* § 522(b)(3)(A).

31. *In re McNabb*, 326 B.R. 785, 790 (Bankr. D. Ariz. 2005).

32. *Id.* at 790–91.

33. *Id.* at 791.

34. *In re Kaplan*, 331 B.R. 483, 487–88 (Bankr. S.D. Fla. 2005) (explaining that the legislative history of BAPCPA “overwhelmingly and convincingly show[s] legislative intent in clear conflict with the result reached in *McNabb*”).

35. *See, e.g., In re Summers*, 344 B.R. 108, 110–11 (Bankr. D. Ariz. 2006); *In re Landahl*, 338 B.R. 920, 921–22 (Bankr. M.D. Fla. 2006); *In re Kane*, 336 B.R. 477, 481 (Bankr. D. Nev. 2006); *In re Virissimo*, 332 B.R. 201, 205 (Bankr. D. Nev. 2005).

36. *In re Summers*, 344 B.R. at 111; *In re Landahl*, 338 B.R. at 923; *In re Kane*, 336 B.R. at 488–89; *In re Virissimo*, 332 B.R. at 206–07.

grappled with the meaning and application of § 522(p)(1).<sup>37</sup> Specifically, the question posed has been whether the “interest that was acquired” language in the Code is applicable to the facts presented in each particular case.<sup>38</sup>

*A. Passive Versus 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: “active/transactional” and “passive/appreciable.” When a person who later becomes a debtor accumulates an interest in property that is claimed as a homestead in a bankruptcy proceeding, this interest may have been accumulated actively through a transaction, or passively as a result of some accrual for the benefit of that person.<sup>39</sup> When such an interest results from “active/transactional” accumulation, 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, when an interest results from “passive/appreciable” gain, § 522(p)(1) should not prohibit the debtor from excluding such interest from the reach of creditors through the bankruptcy exemption process. Indeed, semantically, the “active/transactional” gain can more classically be thought of as an “acquisition,” whereas the “passive/appreciable” gain may be more appropriately termed an “accumulation,” despite both forms of gain benefitting the debtor.<sup>40</sup>

*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 because the property has appreciated in value due to natural market conditions? The courts and commentators

---

37. See generally 4 COLLIER ON BANKRUPTCY ¶ 522.13[2], at 522-102.5 to 102.6 (Alan N. Resnick & Henry J. Sommer eds., 15th ed. 2008) [hereinafter COLLIER]. “The statutory language leaves some uncertainty as to the exact meaning of the phrase ‘interest that was acquired.’” *Id.* ¶ 522.13[2], at 522-102.5.

38. See *supra* Part I.

39. COLLIER, *supra* note 37, ¶ 522.13[2], at 522-102.5 to -102.6.

40. See *id.* (arguing 11 U.S.C. § 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,” but rather should only apply to the price of acquisition).

alike are unanimous—and it is the position taken by this Article—that this type of increase in value is not an “interest acquired by the debtor” within the meaning of § 522(p)(1), although the reasons for reaching this conclusion differ to some degree.<sup>41</sup>

In the case of *In re Blair*, which was decided by a Texas bankruptcy court seven months after the enactment of BAPCPA, an unsecured creditor filed an objection to the debtors’ claim of exemption in the homestead.<sup>42</sup> The debtors had purchased the homestead property 1,773 days prior to the date of filing the bankruptcy petition.<sup>43</sup> The creditor objected to the debtor claiming as exempt any increase in equity in the property within 1,215 days prior to the date of the petition which exceeded \$125,000.<sup>44</sup> The amount of equity in the homestead was valued at \$688,606.<sup>45</sup> In denying the creditor’s objection to the debtors’ claim of exemption, the court distinguished between “acquiring equity” and “acquiring title.”<sup>46</sup> The court reasoned that one acquires title, but does not acquire equity.<sup>47</sup>

In addition, the *Blair* court conducted an analysis of other parts of § 522 of the Code as added support for its interpretation that § 522(p)(1) did not apply in this case to limit the homestead exemption.<sup>48</sup> The court paid special attention to § 522(p)(2)(B), known as the “safe harbor” provision, which contains an exception to the homestead cap for intrastate transactions.<sup>49</sup> Under this exception, a debtor may take any equity earned in a previous principal residence that was acquired prior to the 1,215-day period and roll it over into a second residence 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 1,215-day period.<sup>50</sup> The court reasoned that it would be statutorily inconsistent for Congress to allow the debtor to take the equity from a first

---

41.      *See, e.g., id.*

42.      *In re Blair*, 334 B.R. 374 (Bankr. N.D. Tex. 2005).

43.      *Id.* at 375.

44.      *Id.*

45.      *Id.*

46.      *Id.* at 376.

47.      *Id.*

48.      *Id.* at 377 (explaining that both § 522(d)(1)–(6) and § 522(p)(2)(B) provide support for the conclusion that the homestead in the current case is exempt).

49.      *Id.*

50.      11 U.S.C. § 522(p)(2)(B) (2006).

residence and put it into a second residence as allowed by § 522(p)(2)(B) if Congress considered “equity” to be something that is “acquired” within the meaning of § 522(p)(1).<sup>51</sup> In other words, the court stated, “the non-selling debtors should enjoy the same protections [as the selling debtor].”<sup>52</sup>

*In re Sainlar* dealt with the same type of issue.<sup>53</sup> In this case, the bankruptcy court in Florida also found that the \$125,000 cap in § 522(p)(1) “has no applicability to property 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.”<sup>54</sup> Just as in *Blair*, the debtors had purchased the homestead property prior to the 1,215 day period.<sup>55</sup> The debtors had accumulated at least \$919,906 of equity in the property, all of which was being claimed as exempt.<sup>56</sup> The debtors’ largest unsecured creditor claimed that the debtors should be “limited to an exemption of no more than \$125,000 in the Property and the creditors [were] entitled to the appreciation in value in excess of \$125,000” pursuant to § 522(p)(1).<sup>57</sup> In ruling against the unsecured creditor, the court applied reasoning similar to the *Blair* court, stating that “[t]itle to real property is acquired, equity is not.”<sup>58</sup> The court went on to describe the difference between equity and title and concluded that “[equity] is not a constant, but fluctuates based upon market conditions and when mortgage principal is paid.”<sup>59</sup>

*In re Rasmussen* is a case in which the court also held that the increase in the value of the homestead resulting from appreciation “does not constitute an interest acquired by the Debtors within the meaning of section 522(p).”<sup>60</sup> Yet, the *Rasmussen* court’s analysis is distinguishable

---

51. *In re Blair*, 334 B.R. at 376–77.

52. *Id.* at 377.

53. *In re Sainlar*, 344 B.R. 669 (Bankr. M.D. Fla. 2006).

54. *Id.* at 674.

55. *Id.* at 670.

56. *Id.* at 671.

57. *Id.* This creditor, Bank One, filed a \$559,495.50 unsecured claim against the debtors. *Id.*

58. *Id.* at 673; see also COLLIER, *supra* note 37, ¶ 522.13[2], at 522-102.6 (“[S]ection 522(p) is applicable only if the debtor has acquired an ownership interest in the property that is quantifiable.”).

59. *In re Sainlar*, 344 B.R. at 673.

60. *In re Rasmussen*, 349 B.R. 747, 758 (Bankr. M.D. Fla. 2006); see also *In re Chouinard*, 358 B.R. 814, 815 (Bankr. M.D. Fla. 2006) (“The balance of the increased equity [of the debtors’ homestead] was from market appreciation and therefore not

from both *Blair* and *Sainlar*.<sup>61</sup> The *Rasmussen* court makes the argument that partially forms the basis of this Article's thesis. The court in *Rasmussen* disagreed with the reasoning in the equity-versus-title dichotomy posited by the *Blair* and *Sainlar* courts, and determined that a more valid 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.<sup>62</sup> What can be derived from this aspect of the *Rasmussen* decision 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 a commonsense interpretation to the applicable statutory provisions.<sup>63</sup> The court concluded that a debtor acquiring an interest is synonymous with acquiring equity because the term "interest" is used in conjunction with the term "amount" within the statute.<sup>64</sup> The court noted that "amount" is a quantitative term; therefore, the word "amount" in § 522(p)(1) was referencing "equity" rather than a "fee simple ownership."<sup>65</sup> 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.<sup>66</sup> Indeed, limiting the ability of a debtor to convert nonexempt assets to exempt assets by using those nonexempt assets toward the purchase of a fee interest in homestead property was one of the primary efforts of this legislation.<sup>67</sup> Thus, a commonsense

---

within the purview of Section 522(p).").

61. *In re Rasmussen*, 349 B.R. at 756 ("[T]he Court does not agree that the 'interest' that is acquired by a debtor is ownership interest in the homestead. . . . [T]he Court concludes that the term 'interest' means equity in the homestead acquired by a debtor during the 1,215-day period.").

62. *Id.* at 756–57.

63. *Id.* at 756 (citation omitted).

64. *Id.*

65. *Id.*

66. *See id.*

67. *See* COLLIER, *supra* note 37, ¶ 522.13[2], at 522-102.5.

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 bankruptcy, the phrase ["interest

interpretation of the statute would have the language “interest that was acquired” apply to both “equity” and “fee simple ownership.”<sup>68</sup> A fee simple ownership interest 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.”<sup>69</sup> The court reasoned that a correct interpretation would restrict the application of this language to affirmative acts “by the debtor,” stating that “it implies an active acquisition of equity such as by an affirmative act of a down payment or mortgage pay down.”<sup>70</sup> Thus, in dicta, the *Rasmussen* court has gleaned two scenarios in which the equity position of the debtor increases and the limitations imposed by § 522(p)(1) are activated: (1) when a debtor makes a down payment on the mortgage, thus increasing the debtor’s equity position in the property; and (2) when the debtor pays down or buys down the mortgage, also resulting in an increase in the debtor’s equity in the property.<sup>71</sup> These and other such “active/transactional” factual situations are discussed later in this Article.<sup>72</sup>

The increased value which the debtor realizes in the homestead property due to appreciation resulting from natural market conditions fits neatly into the category of interest accumulation characterized by this Article, and by the *Rasmussen* court, as “passive/appreciable accumulation.”<sup>73</sup> This Article also differs from the *Rasmussen* court by terming the interest accumulation an “acquisition” ab initio. By not terming this type of gain as an “acquisition,” the transaction escapes the reach of § 522(p)(1) because the interest is not “acquired by the debtor” within the language of that provision.<sup>74</sup>

---

that was acquired”] should be construed as applying to the actual purchase or acquisition of an ownership or fee interest in the homestead property.

*Id.*

68. Yet, in citing *Chouinard*, *Sainlar*, and *Blair*, Collier did not consider the accumulation of “equity” to be within the purview of the statute, only fee simple ownership interests. See *id.* ¶ 522.13[2], at 522-102.5 (“[S]ection 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.”).

69. *In re Rasmussen*, 349 B.R. at 757.

70. *Id.*

71. *Id.*

72. See *infra* Part III.C.

73. See, e.g., *In re Rasmussen*, 349 B.R. at 757.

74. See COLLIER, *supra* note 37 (distinguishing between acquisition and

## 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—such as municipal government rezoning—which also do not involve active participation by the debtor.<sup>75</sup> Rezoning of residential property can have a positive effect on the value of residential property because zoning can protect residential property from certain uncontrollable factors within the zoned area.<sup>76</sup>

A petition for a zoning change 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.<sup>77</sup> For purposes of this analysis, an initial distinction should be made between requests initiated by a homeowner/debtor and those initiated by persons other than the homeowner/debtor, including the municipality. Consider the following questions: What if the process is initiated and authored (or at minimum coauthored as a result of homeowner's association membership) by the homeowner/debtor within the 1,215-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 do not think so.

Certainly the debtor is actively engaged in the process as the initiator of the petition to successfully put into place events designed to result in the property increasing in value. For example, assume the property increases in value within the 1,215-day time frame.<sup>78</sup> Nevertheless, no "interest" has

---

accumulation).

75. See generally William K. Jaeger, *The Effects of Land-Use Regulations on Property Values*, 36 ENVTL. L. 105 (2006) (suggesting zoning, variances, and requests for conditional use and other regulated changes in the way land is allowed to be used fit into this category).

76. See *id.* at 106.

77. 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 recommending body.

78. Such increase in value may typically occur when the property was previously zoned commercially, and the petition for rezoning resulted in the property

been acquired. Rather, there has been a change in the characterization of the property. Just as with those cases discussed in Part III.B.5, in which the debtor changes the property from non-homestead property to homestead property within the 1,215-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.<sup>79</sup> 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 that closing the “mansion loophole” was designed to prevent. The debtor has the same asset prior to the event as after—there has been no conversion of otherwise nonexempt assets to exempt assets that would defeat the rights of the unsecured creditors.

Another category of event that would result in an increase in the value of the debtor’s homestead is an eminent domain proceeding, or an action by a private party from which 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. In this case, the debtor is completely “passive” and the appreciation the debtor may realize should not be subject to the limitations of § 522(p). Even if the debtor is the owner of the adjacent property, and the development of that property has caused the debtor’s homestead to increase in value, this too—for the same reasons that apply to the zoning change—is not the type of event that should provoke the statute’s proscriptions. No “interest” has been acquired—the debtor has the same “interest” as before, and there has been no conversion of assets from nonexempt to exempt. The benefit to the homestead property has accrued passively.

Congress, in passing BAPCPA, did not intend to cause debtors to lose their homesteads as a result of passive, external events over which debtors have no control or are merely incidental to the debtor’s ownership of the homestead property. Such events do not involve the debtor acquiring an additional interest.

### 3. *Accumulation of Interest Resulting from the Original Structuring of the*

---

being zoned for single family residential use only.

79. See *Wallace v. Rogers (In re Rogers)*, 354 B.R. 792, 796 (Bankr. N.D. Tex. 2006) (“[T]he plain meaning of the statute indicates that ‘interest’ refers to some legal or equitable interest that can be quantified by a monetary figure.”).



*Indebtedness*

a. *Regular mortgage payments.* Similar to the situation in which the debtor accumulates an interest in the property due to passive appreciation is the scenario in which the debtor gains an additional interest in the property by merely paying off the principal balance of his or her classically amortized fixed-rate mortgage.<sup>80</sup> 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, the debtor earns little equity in this manner in the early years. However, in the latter years of the loan process, the debtor's interest increases at a greater rate. Depending on how close the debtor is to the end of the loan repayment period or the amount of the loan, such amounts may or may not be significant during the 1,215-day period prior to filing bankruptcy.

For example, if the debtor is close to the end of a thirty-year mortgage, the amount of equity the debtor may have gained in the property during the 1,215-day period could be considerable. However, this type of interest fits well into the category of a passive/appreciable interest because the debtor is doing no more than he or she was contractually obligated to do when the loan transaction was entered into thirty years earlier. 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 is designed to prevent.<sup>81</sup>

In *Rasmussen*, the court suggested that the principal amortization of a regular mortgage payment should be considered an "acquisition" for the purposes § 522(p).<sup>82</sup> However, the *Rasmussen* opinion does not recognize that, in this type of situation, there has been no change in the status quo

---

80. 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. One example would be an interest-only loan, which would cause the debtor's interest to "balloon" when the debtor's payments are attributable to principal only.

81. This type of payment is to be contrasted with making extra payments upon the principal within the 1,215-day period. *See infra* Part III.C.1.

82. *In re Rasmussen*, 349 B.R. 747, 757 n.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.").

during the 1,215-day period. As stated above, the debtor has done nothing more during this period than the debtor was already obligated to do; thus, this activity clearly falls outside of the regulatory intent of Congress.

b. *Lease with purchase option exercised.* In this case, assume a debtor is leasing property which is being used as a primary residence. By the terms of the lease—which the debtor entered into well beyond the 1,215-day period prior to filing bankruptcy—the debtor has the option of purchasing the property with specific portions of the lease payments being credited toward 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, assume the debtor exercises the option within the 1,215-day period prior to filing bankruptcy. The question then becomes: Should the lease payments which have changed characterization to become credits toward the purchase of the property within the relevant time frame be subject to the limitations of § 522(p)(1)?

Because the debtor had the right to purchase the property pursuant to contract terms entered into well before the 1,215-day period, these payments should not be subject to the statutory limitations of this Code provision.<sup>83</sup> Similar to the scenarios previously discussed, the debtor has done nothing more during this period than the debtor was already contractually obligated to do. Therefore, this activity also appears to fall outside of the intent of Congress in enacting this limitation.

#### 4. *Accumulation of Interests Through Devolution and Similar Involuntary Circumstances*

a. *Inheritance.* One should also consider the debtor who

---

83. The lease payments by the debtor/lessee are not likely to aggregate to an amount greater than \$136,875 in equity, except for high-value properties. For example, assume the debtor/lessee rents a homestead worth \$450,000 at \$2,300 per month, with an option to purchase within sixty months. All of the rent payments will accumulate as equity in the event that the option is exercised. The debtor/lessee exercises the option fifty-five months after entering into this lease/purchase agreement and declares this property as a homestead. Two years later, within the 1,215-day period, the debtor files bankruptcy. The amount of equity accumulated is \$143,000 (\$2,300/month x 55 months), which is \$6,125 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.

accumulates an interest in property through circumstances relating to devolution and similar involuntary circumstances. In the case of an inheritance, no voluntary acts on the part of the debtor have caused the debtor to gain an interest in the inherited property.

Consider the following scenario: A debtor, a young man of forty, is residing with his elderly widowed mother. The mother dies, leaving all of her assets, including the homestead, to the debtor. The debtor inherits his mother's homestead, claims it as his homestead, and files bankruptcy all within the 1,215-day period.

Assuming no bad deeds on his part, the debtor has not taken an active role in the accumulation of this interest. Nor has the debtor engaged in any transaction. Therefore, this accumulated interest clearly falls in the category of a passive/appreciable interest.

b. *Rights of survivorship.* The situation is less clear when the debtor is a joint tenant or tenant by the entirety of real property claimed as a homestead. In this case, the debtor may have engaged in a transaction to establish the joint (or entireties) tenancy, but the transaction occurs well outside of the 1,215-day applicable period. However, the joint tenant of the debtor meets his or her demise within the 1,215 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.<sup>84</sup> The interest of the joint tenant, on the other hand, is considered an equal, fractional, undivided share of the tenancy.<sup>85</sup>

The interplay between real property concurrent ownership issues and § 522(p)(1) must be analyzed. First, with respect to both tenancies by the entirety and joint tenancies, the tenants own an undivided interest in the whole.<sup>86</sup> In addition, the "right of survivorship" feature gives the parties in both of these types of tenancies ownership of the whole in the event of the demise of the cotenant(s).<sup>87</sup> In a joint tenancy, the interest of the cotenants

---

84. See, e.g., 7 RICHARD R. POWELL, POWELL ON REAL PROPERTY §§ 51.01–52.03 (Michael Allan Wolf ed., 2007) (explaining the characteristics of the tenancy by the entirety and joint tenancy).

85. *Id.* § 51.03[2].

86. *Id.* §§ 51.03[2], 52.01[1]–[2].

87. *Id.* §§ 51.03[3], 52.01[1]–[2].

is a divisible, fractional share.<sup>88</sup> In tenancies by the entirety, the spouses have an indivisible interest in the whole as if the property is owned by one person.<sup>89</sup> Yet, in both types of concurrent ownerships, as a matter of law, the surviving tenant owns the property as a sole owner in fee simple.<sup>90</sup>

The distinctive features of property interests for joint tenancy and tenancy by the entirety necessitate a separate analysis to determine whether the limitations of § 522(p)(1) should apply. The question with respect to both types of interest is: Has the debtor “acquired an interest” within the 1,215-day period prior to filing bankruptcy in the event of the demise of the cotenant during that time period?

The tenancy by the entirety is less problematic in that the interest of the tenants is not only undivided, but also indivisible.<sup>91</sup> There is a historic unity in this type of interest in which both spouses are actually considered as one person.<sup>92</sup> With respect to the joint tenancy, the interest is a divisible, fractional share such that prior to the demise of the cotenant, that interest can be quantified.<sup>93</sup> Obviously, upon the demise of the cotenant(s), the surviving debtor/tenant has a greater fractional share—it is now 100% of the whole.<sup>94</sup> Assuming the demise of one of two joint tenants, the interest of the surviving tenant/debtor has increased from 50% to 100%. However, it is also a characteristic feature of a joint tenancy that the tenants own the “whole.”<sup>95</sup>

Because of the nature of these concurrent ownership interests, neither should be deemed an interest acquired by the debtor within 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 1,215-day period. This situation would be no different from a debtor who acted to acquire a sole interest in the homestead outside of the 1,215-day period. The difference in this case, of course, is that the

---

88. *Id.* § 51.03[2].

89. *Id.* § 52.01[2]. *But see id.* § 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.”).

90. *See id.* §§ 51.01[1], 52.05[2].

91. *Id.* § 52.01[1]–[2].

92. *Id.* § 52.01[2].

93. *Id.* § 51.01[1].

94. *Id.* § 51.03[2].

95. *Id.* § 51.03[1].

debtor accumulates an interest within the 1,215-day period. However, this is not due to a voluntary act by the debtor. Although in both types of ownership situations the debtor accumulates an interest within the statutory period, this interest is one in which the debtor had a legal interest prior to that period. Even though the interest subject to survivorship had not “vested” in the debtor until the joint tenant’s demise, the right of survivorship was created when the tenancy was established, which was well before the 1,215-day period.

c. *Rollover of appreciated real estate.* BAPCPA allows a debtor to roll an interest in real estate over from one property into another property that will be claimed as the debtor’s homestead as long as both properties are located in the same state.<sup>96</sup> But what if the property which is rolled over appreciates in value during the 1,215-day period? Should that appreciated value be subject to the \$136,875 limitation of the statute? We do not think so. 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 in which creditors argued the change of the debtor’s property to homestead status within the 1,215-day period amounted to an interest “acquired by the debtor” within the meaning of § 522(p)(1).<sup>97</sup> The basic argument of the creditors and the trustee in each of these cases was that when the debtor changed the status of the property to a “homestead” within the 1,215-day period by electing that status in the offices of the municipality, the limitations of the statute applied. The courts did not agree.<sup>98</sup>

*In re Rogers* was a case on appeal from the United States Bankruptcy Court for the Northern District of Texas in which a creditor argued “that the classification of real property as a homestead is an ‘interest’ in property

---

96. 11 U.S.C. § 522(p)(2)(B) (2006).

97. See, e.g., *Venn v. Reinhard* (*In re Reinhard*), 377 B.R. 315, 317 (Bankr. N.D. Fla. 2007); *In re Lyons*, 355 B.R. 387, 389–90 (Bankr. D. Mass. 2006); *In re Greene*, 346 B.R. 835, 841 (Bankr. D. Nev. 2006).

98. See *supra* note 97.

and thus governed by the 1,215-day statutory period.”<sup>99</sup> In concluding that “the term ‘interest’ does not encompass the classification of real property as a homestead,”<sup>100</sup> 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.”<sup>101</sup> The court in *Rogers* 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 on the debtor under this statute.<sup>102</sup> Although this line of cases is distinct because it involves a change in the status of the homestead as opposed to an actual increase in value of the homestead, it nevertheless demonstrates the desire of the courts to apply commonsense construction and reasoning to comprehend the intent of Congress in enacting the BAPCPA. 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 extend the reach of § 522(p)(1) to include limits on the homestead exemption beyond those intended by Congress.

### C. Active/Transactional Interests

The following examples illustrate scenarios that may not have been anticipated by Congress when enacting this legislation and in which the debtor plays an “active” role in the interest the debtor accumulates during the restricted 1,215-day period. Generally, the debtor will have been an active participant in a transaction during that period when the debtor gains an interest he or she did not have prior to the 1,215-day period. Moreover, the assets utilized by the debtor in this transaction might be those that would have been nonexempt. The debtor would, in effect, be converting these assets from nonexempt to exempt status by attempting to invest the assets in homestead property, which would be exempt under the laws of the state where the debtor would be filing bankruptcy. This is the outcome that BAPCPA most fervently prohibits.

---

99. Wallace v. Rogers (*In re Rogers*), 354 B.R. 792, 796 (Bankr. N.D. Tex. 2006).

100. *Id.* at 798.

101. *Id.* at 796.

102. *Id.*

1.    *Paying Down a Mortgage with Prepayments*

A debtor may at some point within the 1,215-day period—either innocently or with the intent to divert assets from the reach of creditors—make extra payments beyond what is 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* concerned a debtor who made substantial payments to pay down a mortgage on the homestead within the 1,215-day period.<sup>103</sup> 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); thus, such amount was excludable from the debtor's exemption.<sup>104</sup> 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.<sup>105</sup>

The *Anderson* court reviewed decisions made by several courts interpreting the term "interest" in § 522(p)(1).<sup>106</sup> The court examined the dicta in the *Rasmussen* and *In re Chouinard* decisions, which suggested that voluntarily paying down a mortgage may be deemed in violation of this statute.<sup>107</sup> The *Anderson* court found the decisions in *Rasmussen* and *Chouinard* to be unpersuasive, and refused to apply their analyses to the case at bar—particularly because neither case involved the paying down of a mortgage, but instead involved passive appreciation that increased the debtor's equity position.<sup>108</sup> Alternatively, the court applied § 522(o).<sup>109</sup>

---

103.    *In re Anderson*, 374 B.R. 848 (Bankr. D. Kan. 2007).

104.    *Id.* at 853.

105.    *Id.* at 849.

106.    *Id.* at 853–56.

107.    *Id.* at 853–54, 856 (discussing *In re Rasmussen*, 349 B.R. 747, 753 (Bankr. M.D. Fla. 2006) and *In re Chouinard*, 358 B.R. 814, 815 (Bankr. M.D. Fla. 2006)).

108.    *Id.* at 856–57.

109.    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

This section of the Code relates to fraud—any effort to improperly convert otherwise-exempt assets to homestead equity is prohibited, so long as the requisite intent can be established.<sup>110</sup>

In rejecting the dicta referenced in *Rasmussen* and *Chouinard*, the *Anderson* court more pointedly reasoned that the term “interest” in the statute “is unambiguous and should be given its plain meaning.”<sup>111</sup> The court stated: “If Congress had intended to capture the accumulation of equity during the 1,215 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).”<sup>112</sup> 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.<sup>113</sup> The *Anderson* court’s reasoning thus coincides with the reasoning in the *Sainlar* and *Blair* cases in that a distinction is made between the

---

debtor uses as a residence;

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

(4) real or personal property that the debtor or a dependent of the debtor claims as a homestead,

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.

See also COLLIER, *supra* note 37, ¶ 522.13[2], at 522-102.6 (“[I]f 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(p)(1).”).

110. In fact, this same court later held an evidentiary hearing in the case of *In re Anderson* to determine whether by paying down the mortgage with the proceeds of nonexempt property the debtor intended to hinder, delay, or defraud creditors within ten years of the petition date as proscribed by § 522(o) of the Code. *In re Anderson*, 386 B.R. 315 (Bankr. D. Kan. 2008). However, the court concluded that “the debtor here did nothing more than take advantage of an exemption to which he is entitled.” *Id.* at 331. The court could not find “the intent to hinder, delay or defraud.” *Id.*

111. *In re Anderson*, 374 B.R. at 858.

112. *Id.*

113. *Id.*



acquisition of “equity” versus the acquisition of “title.”<sup>114</sup>

As previously discussed, the *Rasmussen* court correctly characterizes “equity” to be within the meaning of the term “interest” as that term is used in the statute.<sup>115</sup> 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 “[t]here can be no question that § 522(p) is at best a haphazard effort to accomplish the purpose of closing the ‘mansion loophole.’”<sup>116</sup>

Furthermore, proving the indicia of fraud required by § 522(o) necessarily presents a difficult task, as was established in the later evidentiary hearing held in *Anderson* on that issue.<sup>117</sup> 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 1,215 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 “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).

---

114. *See supra* Part III.B.1.

115. *Id.*

116. *See In re Anderson*, 374 B.R. at 858.

117. *In re Anderson*, 386 B.R. 315, 329–31 (Bankr. D. Kan. 2008) (listing factors needed to establish fraudulent intent, and stating the objecting party bears the burden of providing direct or circumstantial evidence to prove some or all of these factors); *see also supra* note 109 and accompanying text.

### 3. *Concurrent Estates*

There may be cases in which a debtor, within 1,215 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 the non-debtor spouse's tenancy by the entirety interest in homestead property to the debtor spouse. The divorce is also consummated within the 1,215 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 voluntarily. 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 involves certain aspects of real property law that are beyond the scope of this Article.

The peculiar question presented by this factual situation is that because the debtor spouse owned the whole property prior to the divorce or property settlement agreement and the debtor subsequently owns the whole property by the agreement between 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 property with the non-debtor spouse prior to the divorce 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 in the affirmative, 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—then there has been no "acquisition" and § 522(p)(1) and its proscriptions certainly would not apply.

The case of *In re Leung* presents an interesting twist to a scenario similar to the hypothetical presented herein.<sup>118</sup> In this case, the debtor and his non-debtor spouse bought a house in 1988.<sup>119</sup> Later, in 2001—outside of the 1,215-day period—they transferred the house to the possession of the non-debtor spouse alone.<sup>120</sup> Six months prior to filing bankruptcy, the non-debtor spouse transferred the house to both the debtor and non-debtor as tenants by the entirety.<sup>121</sup> They remained married during this

---

118. *In re Leung*, 356 B.R. 317 (Bankr. D. Mass. 2006).

119. *Id.* at 319.

120. *Id.*

121. *Id.*

entire period.<sup>122</sup>

*Leung* is distinct from the previous example. In the example, the debtors are married initially and own the property as tenants by the entirety. Then the parties divorce and agree to transfer the property to the debtor spouse within the 1,215-day period. Yet, in both cases the debtor spouse argues that the limitations of § 522(p)(1) should not apply because the debtor's interest had not changed, albeit based upon differing legal concepts. In the example posed above, the debtor would argue that she had not received anything more than what she already had prior to the 1,215-day period because, 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 he had contributed to and was in control of the property since it was originally acquired.<sup>123</sup> Therefore, the debtor had an equitable interest in the property even before gaining the legal entirety interest.<sup>124</sup> Thus, the debtor argued that no “interest” was “acquired” by the debtor when the legal ownership was transferred to the debtor within the 1,215-day period.<sup>125</sup> The court did not agree. It found that the debtor did not present a legally viable theory—such as a constructive trust—upon which to base the argument that the debtor held an equitable interest in the property.<sup>126</sup> Without factual evidence that proved the debtor had an equitable interest in the property before the legal ownership transfer occurred, we agree that this case falls within the category of being “active/transactional,” and is therefore subject to the limitations of § 522(p)(1).

Another case with issues similar to *Leung* is *In re Khan*.<sup>127</sup> *Khan* was decided by the United States Bankruptcy Appellate Panel of the First Circuit after an order of the United States Bankruptcy Court for the District of Massachusetts sustained the objection of the Chapter 13 bankruptcy trustee to the debtor's homestead exemption above the \$125,000 limitation of § 522(p)(1).<sup>128</sup> In *Khan*, the debtor deeded property

---

122.      *See id.*

123.      *Id.*

124.      *Id.* at 320.

125.      *See id.*

126.      *Id.* at 321.

127.      *In re Khan*, 375 B.R. 5 (B.A.P. 1st Cir. 2007).

128.      *Id.* at 7–8.

to himself and his brother as trustees of a family trust in 1997.<sup>129</sup> In 2006, the trustees transferred the property to themselves as joint tenants with rights of survivorship.<sup>130</sup> Twenty-eight days later—obviously well within the 1,215 days—the debtor filed bankruptcy.<sup>131</sup> The question presented to the court was:

[W]hether an interest in property transferred to the Debtor by a trust is considered an interest acquired by the Debtor within the [1,215 day] time period set by § 522(p)(1) of the Bankruptcy Code, thereby resulting in a limitation of the [\$125,000] amount of homestead exemption that may be claimed by the Debtor.<sup>132</sup>

The debtor argued that the type of trust that was created was a nominee trust,<sup>133</sup> and under Massachusetts law, “when the trustees and beneficiaries of a nominee trust are identical, the relationship is a trust in form only and the beneficiaries hold legal title.”<sup>134</sup> Thus, the debtor argued that when the interest was transferred from the trust to the debtor, nothing was acquired.<sup>135</sup> The appellate court, however, found that the record in this case was insufficient to support the debtor’s claim because 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.<sup>136</sup> Had there been sufficient evidence that a trust was established, the court may have found that the debtor did not acquire an “interest” in the property, since the debtor may 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, the factual scenario presented by *Khan* would fit into the category of “active/transactional” and thus be subject to the limitations of § 522(p)(1).

#### IV. CONCLUSION

A *Washington Post* article reports that “[p]ersonal bankruptcy filings

---

129. *Id.* at 7.

130. *Id.*

131. *Id.* at 8.

132. *Id.* at 7.

133. In a nominee trust, the legal title of the trustee and the equitable title of the beneficiary merge because the trustee has no power to act other than at the direction of the beneficiaries. *Id.* at 9.

134. *Id.*

135. *See id.* at 9–11.

136. *Id.* at 13.

in the United States jumped 40 percent in 2007 because of rising mortgage payments, job losses and other financial pressures.”<sup>137</sup> With the increasing difficulties this country is currently facing due to the subprime lending crisis, bankruptcy prompted by defaults on mortgage loans makes the issues presented in this Article important.

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

This Article has not addressed every possible factual situation that might expose the shortcomings of BAPCPA. There may be circumstances when a particular factual situation will not align itself neatly into either an “active/transactional” or “passive/appreciable” classification. This Article has attempted to articulate a methodology that, if adopted by the courts, could provide for easier resolution of homestead exemption issues. First, a court must decide if there is an “interest” involved, or if the subject property merely changed characterization—such as a property changing from non-homestead to homestead property. Second, a court must determine whether the debtor’s interest has changed, or if the debtor has the same interest prior to the changed circumstance, as may be the case with a debtor having a beneficial interest merging with a legal interest. Finally, if all of this is present, the court should then determine whether the “interest” that the debtor gained was a “passive/appreciable” interest or an “active/transactional” interest. In the case of the latter, the limitations of § 522(p)(1) would apply.

---

137. Alan Zibel, *Personal Bankruptcy Filings Rise 40%*, WASH. POST, Jan. 4, 2008, at D7.

## APPENDIX: STATES WITH HOMESTEAD EXEMPTIONS GREATER THAN \$136,875\*

Jurisdiction	Homestead Dollar Limit	Citation
Arizona	\$150,000	ARIZ. REV. STAT. ANN. § 33-1101 (2007).
D. C.	Unlimited	D.C. CODE ANN. § 15-501(a)(14) (LexisNexis 2008).
Florida	Unlimited	FLA. CONST. art. 10, § 4; FLA. STAT. ANN. § 222.01 (West 1998 & Supp. 2009).
Iowa	Unlimited	IOWA CODE ANN. § 561.16 (West 1992 & Supp. 2008).
Kansas	Unlimited	KAN. STAT. ANN. § 60-2301 (2005 & Supp. 2007).
Massachusetts	\$500,000	MASS. GEN. LAWS ANN. ch. 188, §§ 1, 1A (West 2003 & Supp. 2008).
Minnesota	\$300,000	MINN. STAT. ANN. § 510.02 (West 2002 & Supp. 2008).
Nevada	\$550,000	NEV. REV. STAT. § 115.010.2 (2007).
Oklahoma	Unlimited	OKLA. STAT. ANN. tit. 31, § 1.A.1 (West 1991 & Supp. 2009).
Rhode Island	\$300,000	R.I. GEN. LAWS § 9-26-4.1(a) (Supp. 2008).
South Dakota	Unlimited	S.D. CODIFIED LAWS § 43-45-3 (2004 & Supp. 2008).
Texas	Unlimited	TEX. CONST. art. 16, §§ 50–51.

\*This Appendix was adapted from *In re Kane*, 336 B.R. 477, 489–90 (Bankr. D. Nev. 2006). The table is limited to states whose homestead exemptions are greater than \$136,875. The table is not a precise representation due to the manner in which some states categorize their homestead exemptions.