2019 Hon. Steven W. Rhodes Consumer Bankruptcy Conference

State vs. Federal Exemptions

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TENANCY BY ENTIRETIES EXEMPTION IN BANKRUPTCY

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The purpose of this analysis is to evaluate the efficacy of the Tenancy by Entireties exemption in Michigan, when to use it, and when it is ineffective.

The first question to be looked at is whether the Debtor has the choice of taking the State of Michigan exemptions. The length of time the Debtor has been a Michigan resident controls whether they can take the Michigan exemptions, the Federal exemptions or the exemption of the prior state in which the Debtor resided.

The Debtor must use the exemptions allowed by the state in which the Debtor was domiciled for the 730 days preceding the filing of the petition. If the Debtor has not resided in a single state for the last 730 days, then the state law which controls is the state in which the Debtor was domiciled for the 180 days immediately preceding the 730 days or for the longest portion of the 180-day period. 11 USC §522(b)(3)(A).

'Domicile' is established by physical presence in a place with the state of mind that one intends to remain there. Miss. Band of Chactaw Indians v. Holyfield, 490 U.S. 30, 109 S.Ct. 1597 (U.S. 1989)

Assuming that the Debtor has a choice to use the State of Michigan exemptions, pursuant to 11 U.S.C. § 522(b)(1), a Debtor in Michigan has the option of choosing to exempt property listed in the federal exemption scheme outlined in §522(d) or to exempt property pursuant to the state scheme as outlined in 11 U.S.C. §522(b)(3)(A),(B) and (C).

When you examine the state exemption scheme, you will note an infrequently used, yet extremely powerful exemption.

600.5451 Bankruptcy; exemptions from property of estate; exception; exempt property sold, damaged, destroyed, or acquired for public use; amounts adjusted by state treasurer; definitions.

Sec. 5451. (1) A Debtor in bankruptcy under the bankruptcy code, 11 USC §101 to 1532, may exempt from property of the estate property that is exempt under federal law or, under 11 USC §522(b)(2), the following property:

(n) Property described in section 1 of 1927 PA 212, MCL 557.151, or real property, held jointly by a husband and wife as a tenancy by the entirety, except that this exemption does not apply with regard to a claim based on a joint debt of the husband and wife.

Section 557.151
JOINT OWNERSHIP OF PERSONAL PROPERTY IN JOINT TENANCY (EXCERPT)
Act 212 of 1927

557.151 Evidence of indebtedness payable to husband and wife; ownership in joint tenancy.

Sec. 1.

All bonds, certificates of stock, mortgages, promissory notes, debentures, or other evidences of indebtedness hereafter made payable to persons who are husband and wife, or made payable to them as endorsees or assignees, or otherwise, shall be held by such husband and wife in joint tenancy unless otherwise therein expressly provided, in the same manner and subject to the same restrictions, consequences and conditions as are incident to the ownership of real estate held jointly by husband and wife under the laws of this state, with full right of ownership by survivorship in case of the death of either.

OUTDATED LANGUAGE ASIDE, "husband and wife" on June 26, 2015, the U.S. Supreme Court struck down **all state** bans on **same-sex marriage**, **legalized** it in **all** fifty **states**, and required **states** to honor out-of-**state same-sex marriage** licenses. In the case of *Obergefell v. Hodges*, the above stated exemption is extremely powerful.

What Does the Tenancy by Entirety exemption do?

Without restating the obvious, the exemption allows the Debtor or Debtor's to protect assets that would otherwise not be protected using the federal exemptions.

Example:

Samantha and Jamie are married. They own a home worth $300,000.00 with no liens. Unfortunately, Jamie gets into an auto accident, (not alcohol related) and has insufficient insurance coverage to make the victim whole. The victim sues Jamie and gets a judgment against her for $500,000.00. Jamie then comes to see you and wants to file a Chapter 7 bankruptcy. Federal exemptions would not protect the house.

The first question you must ask is: Do Samantha and Jamie own the house as Tenancy by Entireties. To determine this you must examine the deed.

The traditional language you would look for in a deed would be:

Party A quit claims to John Doe and Mary Roe, his wife.

The problem in the case of Samantha and Jamie is that the deed might not be worded as indicated above in a same sex marriage situation. It might say… Jane Doe and Mary Doe her wife or her spouse or John Doe and Mike Doe his husband…etc. Will such a deed qualify as Tenancy by Entireties pursuant to Michigan law?

Today, in spite of the Supreme court decision in Obergefell, I would recommend that you state for same-sex married couples who desire to own property as "Tenants by the Entirety" specific and repetitive language in the Deed that leaves no doubt as to their intention to take title as tenants by the entirety.

Ex:

Jane Roe and Mary Roe, her wife as Tenants by the Entirety, or Jane Roe and Mary Roe, her spouse as Tenants by the Entirety, or Mike Doe and John Doe, his husband as Tenants by the Entirety.

Unfortunately, no matter what language is used, it cannot 100% guarantee a Tenancy by the Entirety because current Michigan law on Entirety Property refers to property owned by "husband and wife" rather than as a " married couple" or "spouses".

Thus, the recommendation is to advise your client of the potential risk if they are in a same sex marriage and realize that the State legislature is likely to fix this issue in some fashion in the future. It is also more than likely that any language which declares two married people to own a property Tenancy by the Entirety will be enforceable as such.

After examination of the Deed, the next step is to examine the debts of the prospective bankruptcy candidate. In this case, upon further investigation you discover that Jamie and Samantha have no joint debt. Jamie further passes the means test and can qualify for a Chapter 7 bankruptcy.

After meeting those qualifying factors, you now turn to the assets of the potential Debtor. Since we as practitioners always seem to jump right to the Federal exemptions by default, your first thought is likely that Jamie has too much equity in the house and cannot protect it in a Chapter 7. Fortunately for you, Jamie is a Michigan resident and meets the qualifying factors to use the Michigan exemptions. Specifically, the Tenancy by Entireties exemption where she can own a property Tenancy by Entireties can protect unlimited equity in the asset. In this case, her house. The house could have unlimited equity and she can still file Chapter 7 so long as she otherwise qualifies.

The Tenancy by the Entirety exemption will protect ALL of her equity in the real property. Not just half, but ALL. This is because the exemption is unlimited. Further, it is not limited to homestead only, the exemption covers any property owned Tenancy by Entirety. This exemption can protect multiple properties against an individual's creditors so long as there is no joint debt.

In the non-bankruptcy world, a judgment creditor will often attempt to put a judgment lien on a parcel of property owned by a Debtor. This lien in effect secures the claim of the creditor and will require payment of the debt upon liquidation of the property. If the property is owned Tenancy by Entirety, the lien will be not be effective when the owners sell the property. The Title company at the closing on the sale will not have to pay the proceeds to the judgment creditor, instead the proceeds will be distributed to the spouses.

Further, the proceeds may now be invested in a stock brokerage account of other protected account as noted in MCL 557.151. The funds will retain their Tenancy By Entirety

status if they are properly invested and will still be protected from creditor attachment or Trustee attachment and liquidation.

Unfortunately, the Tenancy by Entirety protection and exemption is not perfect. There is one creditor that can breach the Tenancy by Entireties exemption, that creditor is the Internal Revenue Service. Pursuant to *United States v. Craft (122.S.CT. 1414 (2002),* the Internal Revenue Service has an effective lien against assets held Tenancy By the Entirety and the subsequent case law indicates that the IRS can liquidate the claim and force the sale of the property to satisfy their lien.

The IRS is not a normal creditor, they actually have the ability to enforce their lien against all property except those which are exempt via IRS rules or 26 USC 6334(a) which states that unless the property is listed in 6334(a) as exempt, the property will not be deemed exempt.

But what if they had joint debt? How would the exemption work? Can the Debtor use it? Does the Trustee get to sell the home and pay off the creditors? All the creditors? Some of the Creditors? What should you do? A fantastic way to look at the answers to these questions is to examine a bankruptcy case involving the use of the Tenancy By Entireties exemption and how it limited a Chapter 7 Trustee in her ability to recover assets on behalf of the bankruptcy estate and how it in effect limits the Trustee's ability to liquidate a recovered asset.

HOLLEY V. CORCORAN AND CORCORAN V. HOLLEY A CONTINUING SAGA IN THE ENTIRETIES WORLD

Holley v. Corcoran, 2016 WL 6211975 (6th Cir. 2016), *opinion on remand*, Case No. 12-33873 (Bankr. E.D. Mi. 2017) – Michigan law protects the *entire* value of couple's property minus deductions for sums due to joint creditors. Debtors properly claimed TBE exemption under Michigan Compiled Laws 600.5451(1) subsection (o). After case was filed, Michigan Legislature changed TBE exemption to subsection (n). Debtors' amended Schedule C to claim property as TBE under then-designated subsection (n). Although exemptions are determined as of date of filing, nothing indicated that Debtors' amendment was intended to change exemption from TBE to "standard" homestead which was subsection (n) when the case was filed but was subsequently re-designated subsection (m). Instead, amendment was intended to continue TBE exemption and to adjust to the current nomenclature of the statute. Trustee not permitted to charge exempt property for payment of administrative expenses. Debtors claimed home exempt as tenants by entireties. Trustee, with Debtors' consent, sold house to third party and used proceeds to pay joint creditors of Husband and Wife. Trustee then sought to recover trustee fee from remaining proceeds. Section 522 prohibits exempt property from being charged for payment of any administrative expense. Entireties exemption applies to all proceeds of sale of property other than proceeds used to pay joint creditors, leaving no non-exempt funds available for administrative expenses.

Holley v. Corcoran, 2016 WL 6211975 (6th Cir. 2016) – Trustee not permitted to charge exempt property for payment of administrative expenses. Debtors claimed home exempt as tenants by entireties. Trustee, with Debtors' consent, sold house to third party and used proceeds to pay joint creditors of Husband and Wife. Trustee then sought to recover trustee fee from remaining proceeds. Section 522 prohibits exempt property from being charged for payment of any administrative expense. Entireties exemption applies to all proceeds of sale of property other than proceeds used to pay joint creditors, leaving no non-exempt funds available for administrative expenses.

Corcoran v. Holley, 2018 WL 5318223 (E.D. Mi. 2018) (appeal after remand) – Trustee cannot offset exemptions to pay administrative expenses. Debtors properly asserted the Tenancy by Entireties exemption as to residence. If trustee liquidates asset, trustee must turnover to Debtors 100% of the proceeds remaining after payment of valid liens. Trustee, with Debtors' consent, sold property and remitted to Debtors all proceeds remaining after payment of liens and costs of sale including trustee administrative fee. Trustee required to turn over all proceeds after payment of liens including amounts paid to broker for commission and amount paid for closing costs of sale plus any commission retained by trustee. Fact that estate is administratively insolvent does not excuse trustee's obligation to turn over all proceeds after payment of liens.

The interesting result in *Corcoran v. Holley* is that the Chapter 7 Trustee effectively cannot liquidate the entireties property without doing so for free. They cannot use a realtor if the property is real estate as they cannot pay the commission. They cannot pay any administrative expenses from the proceeds, they cannot pay counsel for the Trustee from liquidated proceeds, they cannot pay themselves the statutory Trustee fees. Effectively the Trustee cannot touch the entireties property or the proceeds of the entireties property, leaving the Trustee with no way to liquidate collateral and pay joint unsecured creditors who are entitled to be paid from the otherwise exempt assets as the exemption does not apply to the joint creditors.

CAN YOU CHANGE THE STATUS OF PROPERTY TO TENANCY BY ENTIRETIES AND THEN FILE CHAPTER 7? YES AND NO!!!

The question has been raised previously as to whether you can retitle ownership of a property to be held as Tenancy by the Entirety if previously held in some other form. The answer is yes and no. You can always do so if you are not trying to avoid paying creditors and you are not insolvent at the time or the transfer does not render you insolvent. An example of when this happens, and it is not going to cause the situation to be examined in great detail, is when two people own property together as tenants in common and subsequently marry. They then re-deed the property to themselves as husband and wife. This clearly gives them protection against future creditors. If they are doing so in an attempt to avoid creditors, the transaction may be looked at as a fraudulent transfer and may be subject to being set aside, allowing the exemption to be denied and the Trustee to liquidate the asset.

A on point analysis of changing or not changing the title of property to Tenancy by Entireties is seen in the decision *in In Re Robert D. Sassak, Case # 09-56267-R, Adversary Case*

No 09-6121, Eastern District of Michigan, where counsel for the Debtor recommended that corrective action be taken to retitle a brokerage account to meet the original intentions of the parties and the court concluded that the action was not a fraudulent transfer but was actually always held Tenancy by the Entirety.

The court relied upon *DeYoung v. Mesler, 130 N.W. 2d 38 (Mich. 1964)* where the court concluded that spouses hold a debenture as Tenants by the Entirety unless and intent to do otherwise is affirmatively expressed. See also *Comm'r of IRS v. Hart, 76 F.2d 864 (6th Cir. 1935)*

In Michigan, [the] the common – law rule that a conveyance to husband and wife creates a tenancy by the entirety has persisted except in respect to conveyances explicitly indicating that some other kind of tenancy is intended. Even the qualifying phrase "as joint tenants, "which is sufficient to create a joint tenancy in a conveyance to grantees, generally, does not avoid the creation of an estate by the entirety when the grantees stand in the marital relation to each other. Id. At 865.

Additionally the holding in the *Sassak* case referred to *Zavradinos v. JTRB, Inc., 753 N.W. 2d 60 (Mich. 2008)* the court stated, the *Deyoung* Court hypothesized that the only way to overcome the presumption in favor of tenancies by the entirety is to 'use the word "not as tenants by the entirety" when such is the intent of the conveyance'. This is certainly a clear way to overcome the presumption." Id at 63

In *Sassak,* the original application to open the account stated Joint Tenants. In March prior to the case being filed a new account was opened with the same bank where the account was owned as "joint- tenants in entirety". The holding in *Sassek* stated that the court concluded that the presumption in favor of tenants by the entirety has NOT been overcome by evidence that the *Sasseks* intended otherwise.

Thus, the answer to the original question, can you change a property owned NOT as Tenancy by Entirety to a property owned Tenancy by the Entirety? is YES and NO.

WHAT STEPS SHOULD BE TAKEN TO DETERMINE IF JOINT SPOUSAL DEBT EXISTS?

When a client comes in to see you about a bankruptcy, be assured that it is NEVER sufficient to ask the client if they have joint debt and then rely upon the answer given. Due diligence in this case requires a thorough investigation of the resources that you have available. I suggest the following is the minimum.

1. Obtain all the creditor statements available and examine if both parties' names are on same.
2. As to any statements which have both parties names, have your client contact the lender to determine if they are jointly liable or if the second party is only an authorized user.

3. Obtain all three credit reports for each spouse. Cross reference each report to determine if there is any joint debt. Do NOT rely on only one report for each as not all credit reports have the same information.
4. If available to you, do a Lexis or Westlaw search as to the court cases against your client and their spouse to be sure no judgments exist against both of them. Also, you may ask your client to go to the district court and circuit court where they live an have lived for the past 10 years and ask them to investigate if any judgments exist against them.
5. Don't forget to check to see if there is any joint tax debt- Federal, State or Local. Order tax transcripts to be sure.

WHAT IF THE DEBTOR HAS JOINT DEBT? WHAT CAN BE DONE?

In spite of the decision in *Holley v. Corcoran*, sometimes joint debt exists, and you may want to address same before you file a bankruptcy for a Debtor. Especially if only one of the property owners is filing a bankruptcy. In such a case, Debt settlement is a possible solution. Most Debtor's who seek your advice are significantly behind on the debts that they owe at the time they visit you. They are facing pressure from lenders and even from the comakers. Quite often one of the parties really does not need a bankruptcy, in fact, quite often, if the joint $10,000-dollar debt to visa did not exist the second party would have no debt. When faced with such a dilemma, determine if settling the joint debt or paying off the joint debt and waiting 91 days to file the bankruptcy is an option. Most lenders will settle debt for "pennies on the dollar" to avoid total loss in bankruptcy. Obviously, the waiting period would be greater if the debt is owed to an insider, then the waiting period is a year. Even the debt to the insider can be addressed and leave the option to file bankruptcy sooner than one year as an option if you can get the relative to forgive the debt instead, leaving the co-debtor only responsible. Note, this may have a taxable consequence as the debt will be forgiven not due to a bankruptcy but before a bankruptcy. In this case, if the debtor is insolvent, the forgiveness of indebtedness will not be a taxable event. Eliminating the joint debt assures you of the opportunity to utilize the Tenancy by Entirety exemption in Michigan and will allow you to possibly eliminate the need for both parties to file the bankruptcy.

CONCLUSION

Proper analysis and planning when it comes to using Michigan Exemptions is necessary. The exemption can be an incredibly useful tool when looking at the opportunity your client may have to file a bankruptcy. Due diligence is required to determine if joint debt exists and then careful and thoughtful planning is needed to ensure that your client gets the best possible results. Investigate and investigate again as the exemption is not available as to joint debts- or is it….*Holley v. Corcoran* certainly creates an interesting playing field.

Choosing and Using the Homestead Exemption Under Michigan Law

Hon. Steven W. Rhodes ABI Consumer Bankruptcy Conference November 11, 2019

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I. Election of Exemptions

A. Domicile Determines Eligibility for Election

In general, a debtor's election of exemptions is dependent upon the debtor's domicile at the time that their petition is filed, and further dependent upon the state in which they file their petition. In adjudging whether a debtor has a choice of exemptions given the strictures of § 522(b)(2), a debtor must first determine his or her domicile under § 522(b)(3)(A). *In re Capelli*, 518 B.R. 873, 876. Although the Bankruptcy Code provides debtors with a set of Federal exemptions under 11 U.S.C. § 522(d), use of these exemptions may be prohibited in certain states by 11 U.S.C. § 522(b)(2), which states that property specified under subsection (d) is exempt *unless* the State law that is applicable to the debtor under paragraph (3)(A) specifically does not so authorize.

B. Residency Requirement

Congress allowed state legislatures the ability to opt-out of the Federal exemptions, which restricts debtors in such states specifically to the laws of the state. The applicable state law is that of the state in which the debtor was domiciled for the 730 days prior to the filing of the petition, or, if the debtor has not been located in a single state for the 730-day period, the place in which the debtor's domicile was located for 180 days immediately

preceding the 730-day period, or the longer portion of that 180 days than in any other state. 11 U.S.C. § 522 (b)(3)(A).

C. Choice of Exemptions: Michigan is NOT an Opt-Out State

i. Federal Option is Available for Michigan Residents

Michigan is not an opt-out state, therefore both resident and non-resident debtors who would otherwise not qualify to claim exemptions under the Michigan exemption scheme are permitted to utilize the federal exemptions. Pursuant to 11 U.S.C § 522(b)(1), a debtor in Michigan has the option of choosing to exempt property listed in the federal exemption scheme outlined in 11 U.S.C. § 522(d), or to exempt property pursuant to the state scheme as outlined in 11 U.S.C. § 522(b)(3)(A),(B) and (C).

ii. Noteworthy Limitations Regarding Use of the Federal Exemption Scheme

Note that debtors who are domiciled in opt-out states do not have the ability to claim the Federal exemptions under 11 U.S.C. § 522(d)(1). Debtors who relocate to a state that has not opted out may still be required to utilize the state exemptions of their former opt-out state; take for example the debtor who relocates to Michigan from California in connection with a job placement for an undetermined amount of time. Upon relocation the debtor immediately files a bankruptcy in Michigan claiming the Federal exemptions. A

Trustee could object to such exemptions based on the debtor having resided in California for the 730 days immediately preceding the filing, forcing the debtor to have to use California's state law exemptions which may or may not be in the debtor's favor.

iii. The 'Hanging' Residency Paragraph: A Debtor with No State

Finally, debtors may take advantage of the Federal exemption scheme by virtue of the hanging paragraph under 11 U.S.C. § 522(b)(3)(A). This provision ensures that a debtor may apply the federal exemptions if his or her applicable state under § 522(b)(3)(A) is an opt-out state, but the limitations of its exemption law nonetheless prevent the debtor from taking any exemption due to the timing of the petition. *Sheehan v. Ash*, 574 B.R. 585, 589.

D. Use of Other States' Exemptions, and Limitations on the Extraterritorial Application of Michigan Exemptions

i. Michigan Exemptions do Not Extend to Real Estate Outside of Michigan

Domiciled debtors of Michigan are permitted to use state exemptions. The reach of the state's exemptions, however, are not extraterritorial. In *In re Gosnick* a debtor domiciled in Michigan owned real property located in Alabama jointly with his non-filing spouse as tenants by the entireties. The Debtor attempted to claim an entireties exemption in the Alabama

Real Estate under both state exemption schemes pursuant to MCL § 600.6023a and/or MCL § 600.5451(1)(o), to which the Chapter 7 Trustee objected. In denying the claimed exemptions in favor of the Trustee, the Court relied upon a host of cases that have shaped Michigan's anti-extraterritorial law: Michigan courts, for almost one hundred years, have held that its laws do not have extraterritorial application to real property located in another state. Title to real estate can only be acquired or lost agreeably to the law of the place where the same is situated. The tenure, mode of enjoyment, transfer, and descent of real property is regulated by the *lex loci rei sitae. Fuller v. McKim,* 187 Mich. 667, 154 N.W. 55, 58 (Mich. 1915); State laws do not have extraterritorial force. Rights and remedies of property are governed by laws of the state in which it is situate. *Timber-Lee Evangelical Free Church Christian Ctr. v. Baraga County Road Commission*, 1998 U.S. App. LEXIS 8538, 1998 WL 228044 (6th Cir. 1998). *In re Gosnick*, 400 B.R. 582, 583-584. Therefore, individuals domiciled in Michigan with interests in real property located outside of Michigan are cautioned from attempting to use the Michigan exemptions.

E. Michigan's State Exemption Options

i. Choose Your Own Adventure

Michigan law permits debtors in bankruptcy to choose their exemptions from those set forth in 11 U.S.C. § 522(d), from a set of general exemptions available to all Michigan residents irrespective of their bankruptcy status, Mich. Comp. Laws § 600.6023, or from a list of exemptions available solely to debtors in bankruptcy, Mich. Comp. Laws § 600.5451. *Richardson v. Schafer (In re Schafer)*, 689 F.3d 601, 604.

ii. Michigan's General Exemptions Pursuant to Mich. Comp. Laws § 600.6023.

a. The Michigan general exemption scheme is applicable to bankruptcy debtors and judgment debtors.

b. The exemptions are antiquated and severely limited

c. Homestead Exemption Pursuant to Michigan's General Exemption Scheme under MCL § 600.6023(1)(g):

> A homestead of not more than 40 acres of land and the dwelling house and appurtenances on that homestead that is not included in a recorded plat, city, or village, or, at the option of the owner, a quantity of land that consists of not more than 1 lot that is within a recorded town plat, city, or village, and the dwelling house and appurtenances on that land, owned and occupied by any resident of this state, **not exceeding in value $3,500.00.**

iii. Michigan's Bankruptcy-Specific Exemption Scheme Pursuant to MCL §600.5451.

a. Mich. Comp. Laws § 600.5451 permits bankruptcy debtors—and only bankruptcy debtors—to exempt up to $38,225 of the value of a home, or up to $57,350 if the debtor is over the age of 65 or disabled. Mich. Comp. Laws § 600.5451(1)(n).

b. These figures are adjusted for inflation triennially. The homestead exemption contained in § 600.5451 is substantially more generous than either its federal counterpart ($25,150), 11 U.S.C.S. § 522(d)(1), or the Michigan general homestead exemption ($3,500). *In re Schafer*, 689 F.3d 601, 603.

iv. Concurrent use of Michigan's State Exemption Schemes

Bankruptcy debtors who elect to use state law to exempt property *may* concurrently elect exemptions under either Michigan's bankruptcy-exclusive list enumerated under MCL § 600.5451, or the general State of Michigan exemption scheme under MCL § 600.6023 (or other applicable state statute) pursuant to the District Court's ruling in *In re Sassak*: Given the absence of express limiting language in the opening paragraph of MCL § 600.5451 and the conflict which a finding of exclusivity would present with the broader mandate of 11 U.S.C. § 522(b)(3), and further in view of the lack of demonstrable intent in the available legislative history to

radically alter the historically available exemptions that Michigan debtors have long been entitled to claim, and finally, given the directive that this Court should avoid deciding a constitutional issue if resolution can reasonably be reached by statutory interpretation, this Court concludes that Appellee, who claims exemption pursuant to 11 U.S.C. § 522(b)(3), is also entitled to claim an exemption under MCL 500.2207 for the value of his whole life policy. *Mark H. Shapiro Tr. v. Sassak (In re Sassak)*, 426 B.R. 680, 695.

II. Using the Michigan Homestead Exemption Under MCL § 600.5451(1)(m):

A. Uniformity of Election Between Joint Debtors in Michigan:

i. Homestead vs. Residence

Debtors in Michigan can rely on a broad interpretation for the meaning of 'homestead.' In *In re Demeter*, 478 B.R. 281, joint debtors sought to claim a residency exemption in property they owned as a second home in Northern Michigan. The Debtors argued that they intended for their Cheboygan property to be their principal residence, allowing them to claim an exemption in that property under 11 U.S.C. §522(d)(1). The Chapter 7 Trustee objected, arguing that a debtor who owns and uses more than one home may only claim a "residence" exemption under § 522(d)(1) for the home that is his or her principal residence. The court in *Demeter* ruled in

favor of the debtors, finding that "residence" as used in § 522(d)(1), unambiguously is not limited to a "principal residence," articulating that a debtor can have more than one "residence." In doing so, the court relied on a line of cases which hold that the terms "residence" under § 522(d)(1) and "homestead" are interchangeable, and which look to state law to define "homestead" to determine whether debtors can claim a "residence" exemption under § 522(d)(1); *In re Rivera*, 470 B.R. 109, 117 (Bankr. D.P.R. 2012) (concluding that under the law of Puerto Rico, where the property claimed as exempt under § 522(d)(1) was located, a homestead must be a debtor's principal residence); *In re Kaplan*, 468 B.R. 246, (Bankr. W.D. Ky. 2012) (concluding that under Kentucky law, "a homestead is established by actual intention to live permanently in a place, coupled with an actual use and occupancy"). *In re Demeter*, 478 B.R. 281, 290.

In re Demeter is a significant ruling for debtors who own multiple homes, notwithstanding its application as to 11 U.S.C. 522(d)(1); In light of this ruling, a debtor's eligibility to claim the homestead exemption may turn on the duration of occupancy, and intent of the debtor as of the petition date.

ii. A debtor's right to claim the homestead exemption, along with the dollar amount to be claimed is fixed as of the petition date. *Baldridge v. Ellmann (In re Baldridge)*, 553 Fed. Appx. 598.

iii. Use of the homestead exemption under MCL § 600.5451(m) severely limits a debtor's ability to exempt other assets, as compared to the exemptions available under 11 U.S.C. § 522(d). Several notable examples include:

Category of Asset	MCL 600.5451	USC §522(d)
Motor Vehicle	$3,825	$4,000
Household Goods	$3,000	$13,400
Wild Card Exemption	None	$1,325 plus up to $12,575 unused (d)(1)

The Michigan homestead exemption therefore provides a significant benefit for debtors who have very little equity in other assets, and more than $25,150 of equity in a homestead.

iv. Joint Debtors can each claim their separate homestead exemption:

Joint debtors who own a homestead together may each claim the Michigan homestead exemption; In *Hagan v. Mickens*, 589 B.R. 594, the U.S. District Court for the Western District of Michigan affirmed the Bankruptcy court's decision that allowed Mr. and Mrs. Mickens, joint debtors, to each claim a $28,325.00 exemption in their home under the Michigan homestead

exemption, which represented amendments from the original exemptions they claimed in their home under the Michigan tenancy by the entireties exemption, pursuant to MCL §600.5451(1)(n). The Trustee objected to the amended homestead exemptions and argued that the amended exemption was barred by operation of § 522(g) of the Bankruptcy Code. The Bankruptcy Court disagreed with the Trustee and the District Court affirmed, permitting the amended homestead exemptions to stand. *Hagan v. Mickens*, 589 B.R. 594, 597.

Exemptions Expanded; Equitable Exceptions Eroded (*but bankrupts beware Brown* and *Baldridge*).

Hon. Steven W. Rhodes Consumer Bankruptcy Conference
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I. The effect of *Law v. Siegel* on Sixth Circuit exemption practice.

a. The former bad-faith exception to the allowance of an exemption. *Lucius v. McLemore*, 741 F.2d 125 (6th Cir. 1984) was the authority in the Sixth Circuit for a "bad-faith" limitation on a debtor's right to claim a bankruptcy exemption, or, more often, the debtor's right to amend Schedule C and claim an exemption of a previously undisclosed asset. Cases from our district include *In re Daniels*, 270 B.R. 417 (Bankr. E.D. Mich. 2001) (laches barred amendment to exemption) and *In re Rice*, 478 B.R. 275 (E.D. Mich. 2012) (bad faith and concealment barred amendment to exemption). An exhaustive discussion is not useful because, as explained below, this line of cases ended abruptly in 2014.

b. The abrupt end to the exception. *Law v. Siegel* 571 U.S. 415, 134 S. Ct. 1188, 188 L. Ed. 2d 146 (2014) swept away the bad-faith objection, and the surcharge used in other jurisdictions to the same effect.

   i. Facts of the case. The California homestead exemption of $75,000 was not big enough for the debtor, Law, so he recorded a fake mortgage to trick the trustee into believing that there was no equity. The trustee expended hundreds of thousands of dollars in time and money to expose the fraud, and sought to "surcharge" (deny) the debtor's homestead exemption to fund some of the expense. Supreme Court holding: Exempt property is not

liable for administrative expenses, except as specifically provided in § 522(k), so the surcharge was not permitted to stand.

ii. The second holding is that there is no basis for a judicially created bad-faith objection to a claim of a *federal* bankruptcy exemption. "[F]ederal law provides no authority for bankruptcy courts to deny an exemption on a ground not specified in the Code." *Law v. Siegel*, 571 U.S. 415, 425, 134 S. Ct. 1188, 1196–97, 188 L. Ed. 2d 146 (2014). The Supreme Court preserved the possibility of an objection to a state exemption based upon *state* law, and cited three century-old cases as examples. The exemption at issue was a state homestead exemption, but the trustee apparently did not make a state-law argument for the surcharge.

c. Is a penalty for bad-faith prohibited by *Law v. Siegel*? The short answer is yes. The long answer is also yes because the one case that said no, *In re Woolner*, 2014 WL 7184042 (Bankr. E.D. Mich. 2014), has not developed a following. In *Woolner,* Judge Shapero declined to follow *Law v. Siegel*'s dictum and found a legal basis for the denial of the debtor's exemption in a Corvette automobile and tax refunds that were alleged to have been intentionally undervalued. Judge Shapero reasoned that F.R.B.P. 4003(b)(2), which provides that "The trustee may file an objection to a claim of exemption at any time prior to one year after the closing of the case if the debtor fraudulently asserted the claim of exemption" is a basis for concluding that the Supreme Court would not necessarily follow its own dicta. The case stands alone, deserted even by the trustee who prevailed. Once the Sixth Circuit decided *In re Baker*, the trustee gave up the fight (the trial on the issue of the debtor's bad faith

had not yet been held), stipulated to having his objection to the exemption overruled, and closed the case. No reported decision has followed *Woolner.*

d. Is a bad-faith exception supported by state law? Is it possible to raise laches or bad faith as an objection to a Michigan-law exemption?

    i. Laches can bar a claim of exemption that is not adequately asserted until others have relied upon its non-assertion. *Church v. First Nat. Bank*, 255 Mich. 595 (1931) (Boat would have been exempt as "tool of the trade", but laches barred claim of exemption in proceeds of sale of boat where debtor did not promptly take legal action to challenge execution sale); *Mitan v. Reznick*, 2007 WL 287190 (Mich. App.)(Exemption in automobile not claimed until almost 3 years after execution sale; moreover, validity of exemption as "tool of the trade" was not supported by evidence). No reported bankruptcy case cites either of these cases, but laches might be used to prevent a debtor from amending a claim of exemptions from federal to state exemptions, or amending state exemptions. In *In re Rechis*, 339 B.R. 643 (Bankr. E.D. Mich. 2006) the debtor did not seek to claim a tenancy-by-the-entirety exemption in real property until after the trustee had sued to avoid the late-recorded mortgage as preferential and had filed a motion for summary judgment. The timing of the motion and amendment indicated that the motion for summary judgment prompted the amendment. Judge Rhodes disallowed the amendment on the basis of laches, citing federal cases. This was before *Law v. Siegel* limited the laches/bad-faith/surcharge remedy to whatever might exist under applicable state law. The post-*Law v. Siegel* case of *In re Holly*, 2015 WL

9245284 (Bankr. E.D. Mich.), 681 Fed. Appx. 391 (6th Cir. 2016)(affirming in part, vacating in part and remanding), 594 B.R. 872 (E.D. Mich. 2018) (after remand) is discussed in Brian Small's materials on the tenancy-by-the-entirety exemption.

ii. The expansion of laches to a Michigan homestead exemption might be questioned because of the historical roots of the exemption -- traditionally, land was not subject to execution – and because of the Michigan Supreme Court's past treatment of the homestead exemption. Specifically, *Kleinert v. Lefkowitz*, 271 Mich. 79 (1935) describes the homestead exemption in such Olympian terms that harsh treatment seems unthinkable. Further, a non-filing spouse's rights might be implicated. An ALR annotation, 82 A.L.R. 648, discusses waiver or estoppel by laches or delay of a *non-homestead* exemption. Therefore, *Church*, in which the stakes were a few hundred dollars, not a family's home, is distinguishable, at least to those who believe in the homestead exemption's sanctity.

iii. Michigan cases disfavor the creation or enhancement of a tenancy-by-the-entirety to the prejudice of creditors. *See, e.g., McCaslin v. Schouten,* 294 Mich. 180 (1940). A debtor's claim of exemption in property will not defeat a trustee's right to seek to set aside a fraudulent transfer involving the property, and if the trustee "recovers" the property following a voluntary transfer by the debtor, a claim of exemption in it might not be allowed under § 522(g). *But see In re Mickens*, 575 B.R. 797 (Bankr. W.D. Mich. 2017)(property transferred by debtors as joint tenants to themselves as tenants by the entirety was not "recovered" by the trustee despite

avoidance of the fraudulent transfer; debtors could still claim a homestead exemption.)

iv. Alabama, for example, has a statute that provides for a surcharge of exempt property for the value of non-exempt property not accounted for by a judgment debtor. Ala. Code 1975 § 6-10-35. Michigan has no such statute.

e. Does a different standard apply in a re-opened case? Apparently not. *In re Baker*, 791 F.3d 677 (6th Cir. 2015) followed *Law v. Siegel*'s second holding. The trustee had argued that because the exemption at issue was claimed in an amendment filed in a re-opened case, the amendment was subject to disallowance for bad faith. Rule 1009(a) provides for an amendment by the debtor of a "voluntary petition, list, schedule or statement "as a matter of course at any time before the case is closed." (Emphasis added). Therefore, if the case has been closed, the amendment is not allowed "as a matter of course." The court of appeals did not reach the issue because, it reasoned, the trustee had not timely raised it with sufficient specificity. However, the court of appeals did say that "Siegel also applies in cases that have been reopened, like this one" and the reopening of the case is an "artificial delineation." Thus, it seems fairly clear from *Baker* that in the Sixth Circuit Rule 1009(a) now means that the debtor can amend at any time for any reason. Several bankruptcy courts outside the Sixth Circuit have held that Rule 1009(a) use of the phrase "at any time before the case is closed" to be meaningful, and have imposed restrictions on an amendment following the closing of the case. *See*, *e.g.*, *In re Benjamin*, 580 B.R. 115 (Bankr. D. N.J. 2018). Others follow *Baker*, either by citation or by result. *See*, *e.g.*, *In re Muscato*, 582 B.R. 599 (Bankr. W.D. N.Y. 2018) (Does not cite *Baker* and employs a variation on the logic).

f. Cut a wider path through the thicket with two machetes. Can a debtor switch between state and federal exemptions, potentially clearing a wider path for the retention of assets? With no restriction on amendments to exemptions, a debtor can react to the trustee's administration of assets, and to future developments (such as appreciation or depreciation of asset values) by amending exemptions. This can interfere with a trustee' administration of assets. For example, assume that the debtor claims state exemptions, leaving as unexempt an asset worth $12,000. Just as the trustee is preparing to sell the asset, the debtor switches to the federal exemptions, claiming a "wildcard" (d)(5) exemption in the asset. Can the debtor wait until the moment before the trustee closes the sale? Apparently so.

g. Articles on *Law v. Siegel:*

"Does Law v. Siegal Really Stand for That?" NCBJ, Sept. 27-30, 2015, accessed at ncbjmeeting.org/archive/2015.

Exemption Strategies after Law v. Siegel, ABI Northeast Consumer Forum, 2015.

Law v. Siegel, ABI Detroit Consumer Bankruptcy Conference, 2015.

Law v. Siegel and the Ever-Changing Face of Exemptions, ABI Hon. Eugene R. Wedoff Seventh Cir. Consumer Bankr. Conf., 2016.

The Effect of Law v. Siegel on Claims of Exemptions, ABI 4/30/2015

II. Timing and tactics can make a difference in a homestead exemption. The cases of *Burke, Baldridge and Brown.*

a. *In re Burke*, 863 F.3d 521 (6th Cir. 2017).

i. Abandonment as an exemption enhancement. *Burke* upheld the bankruptcy court's order that the trustee abandon the debtors' residence. The basic amounts involved were: Value, as determined by the bankruptcy court and not shown on appeal to have been clearly erroneous, $108,000. Mortgage balance, $91,581. Exemption (under Tennessee law), $7,500. That left about $9,000 in

non-exempt equity, and the debtors, by successfully arguing a motion for abandonment (and defending the ruling on appeal to the district court and court of appeals), were allowed to keep that non-exempt equity.

ii. (Don't) show me the money. The case is notable for additional reasons. The trustee had tendered a check for $7,500 to the debtors, and argued that this entitled him to evict the debtors and sell the house. (The trustee believed the house to be worth significantly more than the figure accepted by the bankruptcy court.) The court of appeals declined the trustee's "invitation to automatically permit the debtors to be evicted upon the tender of the homestead exemption by the trustee." Id. at 527. The opinion does not explicitly hold that the exemption itself is more than the right to receive payment of a certain sum of money. It seems to say that it is not. But the right of the debtors to seek abandonment under § 554, coupled with "net value [that was] inconsequential *from the viewpoint of the unsecured creditors", Id.* at 524 (emphasis added), effectively not only protected their right of possession, but also added to that exemption the $9,000 value found to be inconsequential. The trustee also argued that his tender of a check deprived the debtors of standing to seek abandonment. The court of appeals rejected this argument.

iii. Get to market! The trustee had not previously marketed the house for sale. *Id*. at 525. Had he done so and had he received an offer higher than $108,000, he presumably would have been able to show greater value to the estate. He (belatedly) argued that because the debtors had offered to pay $50,000 to keep the house, abandonment should not have been ordered. In retrospect, the

trustee should have accepted the offer, but he apparently believed the equity to be worth more than $50,000.

b. The carve-out battleground: *In re Baldridge*, 553 Fed.Appx. 598 (6th Cir. 2014), *cert. den.* 135 S.Ct. 113 (2014) and *In re Brown*, 851 F.3d 619 (6th Cir. 2017) *cert. den.* 138 S.Ct. 328 (2017).

   i. The carve-out upheld. *Baldridge* and *Brown* upheld a trustee's sale of the debtor's home where there was no equity. In those cases, the court of appeals upheld the denial of an exemption in proceeds of the sale of a homestead where the funds represented a "carve out" agreed to by the mortgagee whose claim exceeded the sale price. "Section 522 will not support an exemption on the basis of state-law redemption rights in a piece of property if the proceeds from the sale of that property are 'insufficient to satisfy the prior obligations owed to the secured creditors.'" *Brown* at 625 (quoting *Baldridge*).

   ii. The abandonment issue was raised before the court of appeals in *Brown*, but was not considered because it had not been raised in the bankruptcy court. Given the subsequent holding in *Burke*, an abandonment motion in the bankruptcy court might have prevented the bankruptcy sale, giving the debtor a few more months in the home as afforded by the six-month redemption period following a foreclosure sale. The trustee's ability to negotiate, in both *Baldridge* and *Brown*, for a carve-out that not only satisfied the administrative expenses but allowed for a small distribution to unsecured creditors, despite the mortgage balance exceeding the value of the property, makes it difficult to reconcile those cases with *Burke* on a pure legal basis. The distinction must be practical: Had the *Burke* trustee marketed the house and, if necessary to

provide a distribution to unsecured creditors, negotiated a carve-out with the lienholders, he would have been able to complete a sale.

c. *Caution:* The carve-out works until it doesn't! Any trustee intending to "manufacture equity through" stipulations and carve-outs and who is outside of the Sixth Circuit or concerned about the debtor's ability to distinguish *Baldridge* and *Brown* should consider *In re Bird*, 577 B.R. 365 (10th Cir. BAP 2017). In *Bird,* the bankruptcy appellate panel affirmed the Utah bankruptcy court's complete denial of compensation to the trustee and his counsel who had attempted the *Baldridge - Brown* approach, and sought several times more in compensation than the $10,000 that would have been distributed to the unsecured creditors in each case. The bankruptcy court and BAP rejected the Sixth Circuit's approach and took a firm stand against the trustee's sale of property in which there was no equity. The findings against the trustee included: That the sale would not have been permitted under § 363(f); that it was against the "fresh start" policy of the Bankruptcy Code; that the debtors could claim an exemption in the carve-out; that the debtors were permitted to convert their cases to chapter 13 to avoid the sales taking place; that the sale would violate the UST's Trustee Handbook's guidelines which discourage the sale of encumbered assets; and that the tax liens were subordinated under § 724 did not justify a sale which did not primarily benefit unsecured creditors. The National Consumer Bankruptcy Rights Center and National Association of Consumer Bankruptcy Attorneys were *amici curiae* in the BAP appeal, as they had been in *Brown*. The case is a warning to trustees seeking to extend the geographical reach of *Baldridge* and *Brown* beyond the Sixth Circuit, and a catalog of arguments contrary to those cases.