S5406, Washington's New Homestead Law[1]

On April 19, 2021 the Washington Legislature passed S5406 dealing with the Homestead law in the State of Washington. This article will deal with four (4) aspects of the law that practitioners need to know when the law becomes effective. The effective date is not yet known but the legislation contains an emergency clause that makes it effective upon signing by Governor Inslee.

1. The amount of the homestead is dramatically increased and is different in each county.

The Homestead amount is the greater of $125,000 or the previous year's median value of a single-family residence. The amount is tied to the "Annual Median Price by County" records kept and published by the University of Washington Center for Real Estate Research - https://wcrer.be.uw.edu/archived-reports/which is found on the last tab.

The Bankruptcy Court Clerk's Office will provide a link to that number or on its court website. The actual relevant document can be found here: https://wcrer.be.uw.edu/wp-content/uploads/sites/41/2021/02/2020Q4WSHMR.pdf Page 23

Claiming the exemption on Schedule C presents a dilemma. In *Taylor v. Freeland & Kronz,* 503 U.S. 638 (1992), the Supreme Court held that listing the property with no value or unknown value put the trustee on notice and the property exited the estate if the trustee did not object to exemptions. In *Schwab v. Reilly (In re Reilly),* ––– U.S. ––––, 130 S.Ct. 2652, 177 L.Ed.2d 234 (2010), the debtor scheduled some kitchen equipment at $ and claimed the equipment exempt with a value of $10,718. Justice Thomas, writing for the majority said that was not sufficient. The Court ruled that the debtor must claim "100% of Fair Market Value."

Subsequent cases have opined that the debtor must allocate the exemption so that the trustee can determine how much is being claimed exempt. *In re Salazar*, 449 B.R. 890, 901 (2011); *In re Massey*, 465 B.R. 720, 730 (2012); *In re Luckham*, 464 B.R. 67 76-77 (2012). Most software publishers do not allow this allocation and the attorney needs to think carefully before just allowing the software to choose a number.

The authors agree that the intent of the legislature was to make the entire property exempt. However, *In re Mwangi*, 764 F.3d 1168, 1175 (9th Cir. 2014), the court held:

> We applied *Schwab 's* holding in *In re Gebhart*. There, we considered two statutes that allow a debtor to exempt an interest in real property, the value of which may not exceed a certain dollar amount. *In re Gebhart*, 621 F.3d at 1210. Relying on *Schwab*, we held that "the fact that the value of the claimed exemption [was] ... equal to the market value of the residence at the time of filing the petition did not remove the entire asset from the estate." Id.

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> "Instead, what [was] removed from the estate [was] an interest in the property equal to the value of the exemption." Id. (internal quotation marks omitted). As a result, the asset would remain estate property until it was administered in bankruptcy, the trustee abandoned the asset, or the bankruptcy case closed. *Id*. at 1210, 1212, 621 F.3d 1206; *see also Schwab*, 560 U.S. at 792, 130 S.Ct. 2652 ("Where a debtor intends to exempt nothing more than an interest ... [and] an interested party does not object to the claimed interest ..., title to the asset will remain with the estate pursuant to § 541, and the debtor will be guaranteed a payment in the dollar amount of the exemption.").

Mwangi is a case for the wary. It might be that just claiming the exemption is sufficient. However, it might not be. The proper practice of law requires an attorney to know what is being filed and how exemptions are being claimed. Properly planning and claiming exemptions is one of the most important roles of the bankruptcy attorney. It is best not left to a computer programmer. The goal in specifying the exemption is not to be the test case where this gets decided.

2. <u>Post-petition appreciation is now exempt under state law.</u>

In addition to providing a homestead exemption of the median price of a single-family house in the county, the legislature also specifically rejected the Ninth Circuit Ruling in *Wilson v. Rigby*, 909 F.3d 306, 309 (9th Cir. 2018). State law now provides that the exemption is determined on the date of filing and that appreciation after that date belongs to the debtor.

There are issues of what that means and whether there is a federal supremacy issue. We believe that Congress left the issues of exemption to the states and this provision is not subject to attack. The Homestead Exemption Bill (ESSB 5408) brings Washington State's exemption statute more in line with the legislature's intentions than the Ninth Circuit's interpretation of the statute in *Wilson v. Rigby*. While it is true that in *Wilson v. Rigby*, 909 F.3d 306, 309 (9th Cir. 2018), the court relied on 11 USC § 541(a) and 11 USC § 541(a)(1) to review RCW 6.13.070, the amendments to the homestead bill are intended to align with those specific statutes. Remember, however, that choosing a number instead of an asset may create unforeseen problems.

When it comes to exemptions, the bankruptcy code specifically allows states to opt out of the federal exemption scheme to implement their own exemptions under 11 USC 552(b). The US Supreme Court has also opined that the exemption delegation to states is broad, not limited in scope, and even allows a state not to enact any exemption scheme at all. *Owen v. Owen*, 500 U.S. 305, 308 (1991). Additionally, once a bankruptcy petition is filed, the transfer of rights to the estate is limited by the exemptions claimed. *Wilson*, 909 F.3d at 309. And it is widely accepted that property deemed exempt from a debtor's bankruptcy estate revests in the debtor. *In re Smith*, 235 F.3d 472, 478 (9th Cir. 2000); *see also* 11 U.S.C. § 522(l). Simply put, and as the Ninth Circuit has explained, "Congress has not occupied the field of bankruptcy regulation to the point of preempting state exemption statutes." *Sticka v. Applebaum (In re Applebaum)*, 422 B.R. 684, 689 (B.A.P. 9th Cir. 2009).

3. A sale in Title 11 is a "forced sale" under the homestead statute.

The statute codifies Judge Barreca's ruling in *In re Good*, 588 B.R. 573 (Bankr. W,D. Wash. 2018). Any sale in bankruptcy is now classified as a forced sale. This means that the one-year reinvestment provision does not apply. RCW 6.13.070.

The law now is that the homestead may be voluntarily sold, and the proceeds are exempt for one year to allow the homesteader to purchase a new property. When the new property is purchased, that property becomes the homestead.

Other courts have held that the homestead proceeds resulting from the trustee's sale of property are only exempt for one year and must be reinvested. This was not the result in *Good, supra,* and the legislature has not codified that result. The proceeds of a sale under Title 11 remain exempt with no time limits.

4. Moving or getting a new homestead can be problematical.

Section 522(o) and (p) place limits on the homestead, currently $170,360. But note §522(p)(2)(B) provides a safe harbor if moving within the state:

> (B) For purposes of paragraph (1), any amount of such interest does not include any interest transferred from a debtor's previous principal residence (which was acquired prior to the beginning of such 1215-day period) into the debtor's current principal residence, if the debtor's previous and current residences are located in the same State.

Additionally, the limitation does not apply to an exemption claimed on a principal residence by a family farmer.

There is an ambiguity in the phrase "interest that was acquired by the debtor" under section 522(p). The issue is what leads to "acquiring" an interest in a principal residence. Some courts argue that the homestead should not apply to an interest attributable simply to an increase in the market value of the debtor's homestead during the 1215-day period, because that is not an interest "acquired" by the debtor, but rather an increase in the value of the debtor's existing interest. *See, In re Greene*, 583 F.3d 614, 623 (9th Cir. 2009).

In the same vein, paying down the mortgage, or home improvements, do not increase the property interest that the debtor holds. *See. In re Elia*, 198 B.R. 588, 596 (Bankr. D. Ariz. 1996). However, care must be taken. If not done properly, defense of a dischargeability issue may ensue.

> Generally, a Debtor's conversion of non-exempt property into exempt property on the eve of bankruptcy is not fraudulent per se. *In re Daniel*, 771 F.2d 1352 (9th Cir.1985); In re Love, 341 F.2d 680 (9th Cir.1965); *In re Summers*, 85 B.R. 121, 126 (Bankr.Or.1988). Extrinsic evidence of fraud must be present to invalidate the exemption.

In re Luthje, 107 B.R. 292, 295 (Bankr. D. Mont. 1989).