
CHAPTER TWO

EXEMPTIONS

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I. § 2.1 INTRODUCTION

A wide variety of both state and federal laws establish categories of property that can be exempt from claims of creditors or bankruptcy trustees. These materials discuss the exemptions provided to individual debtors, the procedures for challenging claimed exemptions, and the dangers of overly-aggressive exemption planning.

II. § 2.2 EXEMPTIONS

(a) A. Overview

Both Minnesota and federal law create categories of real and personal property that are exempt from the reach of creditors of an individual debtor. Minn. Stat. § 550.37; chap. 510; 11 U.S.C. § 522(d). A chart comparing the exemptions available under federal bankruptcy law and Minnesota state law follows in Section F. The specific exemptions will be discussed in detail below.

(b) B. Claiming Exemptions Outside of Bankruptcy

When the sheriff executes on a debtor's personal property, the debtor, the debtor's agent, or the debtor's legal representative can identify the debtor's property that is claimed as exempt. Minn. Stat. § 550.37, subd. 17. If the sheriff is of the opinion that the judgment debtor has more property of the classes specified in Minn. Stat. § 550.37 than is exempt, the sheriff may levy on the whole of any such class, make an inventory, and obtain an appraisal. If the appraisal exceeds the dollar exemption limitation, the debtor may select particular property within the class in an amount not exceeding the amount of exemption, and the balance will be executed upon. If the debtor does not make the selection, the sheriff may. If one or more indivisible items in the class of property is appraised at a greater value than the exempt amount, the sheriff may sell the item or items and, after paying the debtor the amount of the exemption, apply the balance of the funds to the judgment debt. Minn. Stat. § 550.41.

(c) C. Applicable Exemptions – Nonbankruptcy

Outside the bankruptcy context, a debtor's exemptions are controlled by the law of the state of his or her domicile, and any generally applicable federal law other than 11 U.S.C. § 522(d) ("nonbankruptcy federal law"). If a creditor is collecting a debt from an individual debtor residing in Minnesota and that debtor does not file bankruptcy, the following exemptions may apply.

PRACTICE TIP:

There are some claims that statutorily are not affected by state law exemptions, such as the States' claim for medical care in a state hospital. *See In re Estate of Mathews*, 558 N.W.2d 263 (Minn. Ct. App. 1997); Minn. Stat. §§ 524.2-402(c), 570.061.

(i) 1. Minnesota State Law

a. Homestead - Minn. Stat. § 510.01

A debtor may exempt up to \$200,000 of value of real property owned and occupied by the debtor, whether the exemption is claimed individually or jointly. The exemption is limited to one-half acre for parcels within the laid out or platted portion of a city. The area limit increases to 160 acres if outside the laid out or platted portion of the city. The amount of the exemption increases to \$500,000 for land used primarily for agricultural purposes.

A manufactured home that is actually inhabited as a home by the debtor is also exempt. Minn. Stat. § 550.37, subd. 12.

In addition, the proceeds of a homestead are exempt for up to one year. Minn. Stat. § 510.07.

- *Kelly v. Dill*, 23 Minn. 435 (1877). The debtor must own and occupy the property in order to claim the homestead exemption under Minnesota law.

- *In re Smoinikar*, 200 B.R. 640 (Bankr. D. Minn. 1996). The debtor must reside in, or have resided in and intend to return to, the property claimed exempt to assert the exemption. Intent to reside without any actual residence will not suffice.
- *Bowers v. Norton*, 218 N.W. 108, 109 (Minn. 1928). The homestead exemption will be lost if the debtor "abandons" the property. Minn. Stat. § 510.07. Abandonment occurs "when the owners remove therefrom and cease to occupy the same, with the intention of never returning, but with no intention of returning thereto to reside."
- *First Nat'l Bank of Mankato v. Wilson*, 47 N.W.2d 764 (Minn. 1951). A debtor is presumed to have abandoned his or her homestead if he or she is absent for longer than six consecutive months. If the debtor is absent for longer than six consecutive months, and fails to file a declaration of homestead within that six-month period, the debtor is deemed to have lost the homestead exemption. Minn. Stat. § 510.07; *see also In re Kasden*, 84 F.3d 1104 (8th Cir. 1996) (debtor forced to move from his home when it was rendered inhabitable by fire loses exemption unless declaration filed); *In re McGowan*, 97-30606 (Bankr. D. Minn. April 2, 1998).
- *In re Mueller*, 210 B.R. 460 (Bankr. D. Minn. 1997). A debtor's right to payment from her former spouse, secured by a lien on real property, is not exempt under the homestead exemption because (1) the debtor's lien is not an interest in property; and (2) the right to payment awarded in a marriage dissolution is not "proceeds" of the homestead.
- *In re Johnson*, 207 B.R. 878 (Bankr. D. Minn. 1997). A homestead owned by two spouses in joint tenancy remains exempt from the claims of creditors of both spouses so long as one of the spouses can claim the property as his or her homestead. This is true even if the other spouse has not physically resided in the home for a long period of time. It also is true even if the spouses are separated and have commenced dissolution proceedings.
- *In re Becker*, 212 B.R. 322 (Bankr. D. Minn. 1997). Unplatted land within city limits is not limited to the one-half acre exemption.
- Minn. Const. art. 1, § 12, creates an exception to the homestead exemption for mechanics' liens. *See Builders and Remodelers, Inc. v. Hanson*, 20 B.R. 440, 441 (Bankr. D. Minn. 1986).
- *Baumann v. Chaska Bldg. Ctr., Inc.*, 621 N.W.2d 795 (Minn. Ct. App. 2001) (Holtan, J.). The exemption covers \$200,000 of the debtor's equity in the property, not just \$200,000 in market value of the property.
- *Kipp v Sweno*, 629 N.W.2d 468 (Minn. Ct. App. 2001). \$109,900 in value of property worth \$309,900, held in joint tenancy by a debtor and a nondebtor spouse, is subject to attachment by the debtor spouse's creditor. The debtor and non debtor spouse are entitled to only one \$200,000 exemption.
- *In re Stenzel*, 301 F. 3d 945 (8th Cir. 2002) (Loken, C.J.). Reversing the Bankruptcy Appellate Panel decision which denied the homestead exemption, the Eighth Circuit remanded for a factual determination regarding whether the debtor actually occupies land adjacent to his homestead in which he holds a reversionary interest. The court noted that Minnesota has adopted a "pragmatic" standard in determining whether contiguous farmland qualifies for the homestead exemption, and directed the lower court to look at whether the debtor and his neighbor had a legally valid contractual relationship,

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whether the debtor used the two parcels as one piece of land, and whether the debtor intended to occupy the two as a single farm.

- *In re Johnson*, 288 B.R. 130 (BAP 8th Cir. 2003). The debtor may exempt his lien interest in the real property where his ex-wife and dependent child reside under the bankruptcy exemptions in 11 U.S.C. § 522(d)(1). Over the trustee's argument that the debtor's lien was personal property in which no one could "reside," the BAP applied the Bankruptcy Code definition of a lien to find that the debtor did have an interest in the real property.
- *In re Estad*, 295 B.R. 905 (Bankr. D. Minn. 2003). Under Minnesota law a judgment lien obtained before the debtors occupied the property on which they were building their home validly attached to the real estate while it was not their homestead. Therefore, the property was not exempt to the extent of the judgment lien and the debtors could not avoid the judgment lien, since it did not impair an exemption to which they would have otherwise been entitled.
- *In re Holman*, 286 B.R. 882 (Bankr. D. Minn. 2002). A debtor who separated from her husband and moved out of the homestead 19 months before seeking bankruptcy relief could no longer claim the homestead exemption because the real estate was no longer her homestead as a matter of fact, and because she did not take steps to retain her exemption by filing the required homestead declaration under Minn. Stat. § 510.07.
- *In re Estate of Riggle*, 654 N.W.2d 710 (Minn. App. 2002). In a probate dispute regarding the decedent's intention to maintain his homestead, despite having moved out in the course of divorce proceedings, the court determined that the decedent's actions were not clear and convincing evidence of an abandonment. The court noted the probate policy favoring a surviving spouse and dependents, holding that abandonment requires both cessation of occupancy and lack of an intent to return.
- *Drenttel v. Jensen-Carter (In re Drentell)*, 403 F.3d 611 (8th Cir. 2005). The debtors, who had moved from Minnesota to Arizona less than 90 days prior to commencement of their Chapter 7 case, were entitled to claim their new Arizona residence as exempt under the homestead laws of Minnesota. The Bankruptcy Code's domicile requirements prevented the debtors from using the Arizona homestead exemption. The Eighth Circuit held that the Bankruptcy Code's reference to state exemption laws makes those laws a part of the federal bankruptcy scheme. Limiting application of a state's laws to the state's borders would be inconsistent with the national effect of the bankruptcy laws. A contrary holding would leave the debtors without a homestead exemption. Moreover, the creditors were presumed to have been aware of the debtors' entitlement to the state's homestead exemption because the debts had been incurred while living in Minnesota.

- *Ladd v. Ries (In re Ladd)*, 319 B.R. 599 (BAP 8th Cir. 2005). The bankruptcy court ruled that its final order sustaining the trustee's objection to the debtor's federal homestead exemption claim precludes the debtor from amending the schedules to claim the state homestead exemption. When an objection is raised, the debtor must raise all theories for exemption. Once judgment is entered, debtors may not raise new claims or theories.
- *In re Estate of Bonde*, 694 N.W.2d 74 (Minn. Ct. App. 2005). The residence in which the decedent's daughter resided was not homestead property. Classification of the property under debtor-creditor law promoted the purpose of intestate succession to protect the residence of the surviving spouse, and property not occupied by the decedent was not homestead property under debtor-creditor law.
- *Kipp v. Sweno*, 638 N.W.2d 259 (Minn. 2004). The judgment debtor's homestead property, held in joint tenancy with his non-debtor spouse, could not be unilaterally severed through an execution sale to satisfy judgment against the debtor. Unilateral severance and sale of property would dispose of or eliminate spouse's possessory or occupancy interests, right of survivorship, and remainder interest in the homestead property.

(ii) b. Family Bible, Library, and Musical Instruments - Minn. Stat. § 550.37, subd. 2

The state statute sets out an exemption for a family bible, a library, and musical instruments. However, the exemption for musical instruments was held unconstitutional in *In re Hilary*, 76 B.R. 683 (Bankr. D. Minn. 1987).

(iii) c. Burial Plot - Minn. Stat. § 550.37, subd. 3

A debtor may exempt one lot in any burial plot.

(iv) d. Motor Vehicle - Minn. Stat. § 550.37, subd. 12a

A debtor may exempt \$3,800 in one motor vehicle, or \$38,000 for a vehicle that has been modified at a cost of not less than \$2,850 to accommodate a physical disability. The exemption is measured by the debtor's equity, not the total value of the vehicle.

(v) e. Wearing Apparel, One Watch, Utensils, and Foodstuffs - Minn. Stat. § 550.37, subd. 4(a)

Clothing, utensils, food stuffs and one watch are not subject to a dollar limitation. See *In re Irwin*, 232 B.R. 151 (Bankr. D. Minn. 1999).

(vi) f. Household Furniture, Household Appliances, Phonographs, Radio, and Television - Minn. Stat. § 550.37, subd. 4(b)

A debtor may exempt \$4,500 total value of household furniture, household appliances, radios, and televisions. A lawnmower is a household appliance. A computer is not. *In re Irwin*, 232 B.R. 151 (Bankr. D. Minn. 1999).

(vii) g. Weddings Rings – Minn. Stat. § 550.37, subd. 4(c)

A debtor may exempt the aggregate interest not exceeding \$1,225 in wedding rings or other religious or culturally recognized symbols of marriage exchanged between the debtor and spouse at the time of marriage and in the debtor's possession.

(viii) h. Any property

There is no "catch-all" exemption under Minnesota law.

(ix) i. Implements, Professional Books, Office Furniture, Tools, and Library - Minn. Stat. § 550.37, subd. 6

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A debtor may exempt \$9,500 in implements, books, office furniture, tools and business library (specifically excluding farm equipment).

Determining whether items fall within this exemption requires a two part analysis: (1) whether the items are "tools" or "implements" of the debtor's trade, and (2) whether they are commonly used or employed in the debtor's trade. *Middleton v. Farmers State Bank of Fosston*, 41 B.R. 953 (D. Minn. 1984).

- *In re Smith*, No. 3-86-1121 (Bankr. D. Minn. Dec. 9, 1986). Motor vehicles can, in some circumstances, be tools of the trade. A truck-tractor is a tool of an independent trucker's trade.
- *In re Johnson*, 160 B.R. 613 (Bankr. D. Minn. 1993). A van is not a tool of a plumber's trade.
- The test is whether the vehicle is "necessary" as opposed to "incidental" to the business.
- *In re Wagner*, No. 3-92-3128 (Bankr. D. Minn. 1992). The debtor does not have to be employed full-time in an activity to claim tools of the trade. A debtor who was part-time farmer and full time mechanic could exempt farm implements as tools of the trade. However, the debtor could not utilize the exemption for farm machinery because the debtor was not "employed principally in farming."
- *In re Fossum*, 59 B.R. 820 (Bankr. D. Minn. 1986). To claim farm machinery and equipment as tools of the trade, a debtor must be employed in farming at the time the exemption is claimed or have a present intent to continue farming at some point in the future.

(x) j. Farm Machine and Implements - Minn. Stat. § 550.37, subd. 5

A debtor may exempt \$13,000 in farm machines and implements, including livestock, farm produce, and standing crops provided the debtor is engaged principally in farming. The total value of property selected pursuant to subd. 5 and subd. 6 cannot exceed \$13,000. Minn. Stat. § 550.37, subd. 7.

- *In re Peters*, 60 B.R. 711 (Bankr. D. Minn. 1986). Large grain bin and miscellaneous tools are not machines and implements.
- *In re Zimmel*, 185 B.R. 786 (Bankr. D. Minn. 1995). Whether a debtor qualifies as a debtor engaged principally in farming activities depends on the debtor's historical involvement in farming and present intention. Analysis should take into account intensity of past farming operations and sincerity as to intentions to continue as well as evidence that the debtor is legitimately engaged in trade that currently and regularly uses specific implements or tools exempted.

(xi) k. Funds Received by or Payable to a Surviving Spouse or Child at the Death of a Spouse or Parent - Minn. Stat. § 550.37, subd. 10

A debtor may exempt \$38,000 plus \$9,500 for each dependent.

(xii) l. Loan Valued or Accrued Dividend Under an Unmatured Life Insurance Contract - Minn. Stat. § 550.37, subd. 23

A debtor may exempt up to \$7,600 loan value or accrued dividends in a life insurance contract.

(xiii) m. Earnings - Minn. Stat. §§ 550.37, subd. 13; 571.922

A debtor may exempt the greater of 75% of disposal earnings or 40 times minimum hourly wage per week of pay period established by 29 U.S.C. § 206(a)(1). The minimum hourly wage is currently \$5.15. See Chapter 9.

- (xiv) n. Unemployment Compensation, or Local Public Assistant Benefits - Minn. Stat. §§ 268.17, 550.37, subd. 14

Unemployment compensation and relief based on need are totally exempt. Any assignment, pledge or encumbrance of unemployment benefits is void.

- *In re Tomczyk*, 295 B.R. 894 (Bankr. D. Minn. 2003). “Relief Based On Need,” includes more than examples provided within the text. The word “includes” is not exclusionary, and the list and statute therefore is nonexclusive. A portion of the debtor’s income tax refunds attributable to the federal Earned Income Credit and the Minnesota Working Family Credit was exempt. These credits constitute relief based on financial need.
- *In re Guyot*, 240 B.R. 326 (Bankr. D. Minn. 1999). The exemption for life insurance policies extends to only one contract. The debtor may not use it to exempt his or her interests in multiple contracts, even if the total loan value or accrued dividend is under \$7,200.

- (xv) o. Veterans Benefits - Minn. Stat. § 550.38

Veterans benefits are exempt for a period of one year after receipt.

- (xvi) p. Disability, Illness, or Unemployment Benefits - Minn. Stat. §§ 268.17, 550.39

Payments from accident or disability insurance and unemployment are totally exempt, whether paid to the insured or any beneficiary.

- (xvii) q. Stock Bonus, Pension, Profit-Sharing, or Similar Benefits - Minn. Stat. § 550.37, subd. 24

- *Patterson v. Shumate*, 504 U.S. 753 (1992). The United States Supreme Court held that ERISA-qualified retirement plans are not property of the bankruptcy estate. Therefore, in a bankruptcy case, any ERISA-qualified plan is outside the reach of the trustee, whether or not it would fall within a particular bankruptcy or non-bankruptcy exemption.

For retirement plans that are not ERISA-qualified plans (such as IRAs and nonqualified Keogh plans), the Minnesota statute provides two alternatives:

- a. An exemption for the full amount of any plan or contract qualifying under §§ 401A, 403, 407 or 457 of the Internal Revenue Code (IRC), or
- b. In the alternative, the right to receive present or future payments under a stock bonus, pension, profit-sharing, annuity, individual retirement annuity, simplified employee pension, or similar plan or contract on account of illness, disability, death, age, or length of service, to the extent of \$57,000 plus such additional amounts to the extent reasonably necessary for the support of the debtor and any spouse or dependent of the debtor. Minn. Stat. § 550.37, subd. 24.

There is a split of authority among the Minnesota Bankruptcy Courts on whether the dollar value of a debtor's ERISA-qualified plans counts towards the \$57,000 (or other amounts reasonably necessary) cap. See *In re Hawkinson*, 222 B.R. 334 (Bankr. D. Minn. 1998) (O'Brien) (the ERISA-qualified

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plans do not count in calculating the aggregate interest); *In re Nielsen*, 1997 WL 309148 (Bankr. D. Minn. June 5, 1997) and *In re Nielsen*, No. 4-96-7257 (Bankr. D. Minn. Jan. 5, 1987) (Dreher) (ERISA-qualified plans do count in calculating the balance).

- *Estate of Jones by Blume v. Kasme*, 529 N.W.2d 335 (Minn. 1995). The first clause of Minn. Stat. § 550.37, subd. 24, is unconstitutional to the extent that it applies to non-ERISA qualified plans that fall under IRC §§ 401A, 403, 408, or 457, because the statute does not contain a specific dollar limitation. However, the second clause, governing all retirement plans, is constitutional because it contains a dollar limit and an objective limit expressed by the phrase "to the extent reasonably necessary for the support of the debtor and any spouse or dependents of the debtor."
- *Community Bank of Henderson v. Noble*, 522 N.W.2d 37 (Minn. Ct. App. 1996). ERISA absolutely preempts application of state exemption law to qualified plan, such as an employee stock ownership plan (ESOP). Therefore, the alienation provisions of ERISA, which allow attachment of funds disbursed from an ESOP "trumps" any claim of exemption under Minn. Stat. § 550.37, subd. 24. The funds are no longer considered principal or income of the trust once disbursed.
- *Anderson v. Seaver (In re Anderson)*, 269 B.R. 27 (BAP 8th Cir. 2001). An interest in the debtor's ex-spouse's IRA awarded to the debtor under a divorce decree is not an exempt employee benefit under Minn. Stat. § 550.37, subd. 24(a).
- *In re Jenkins*, No. 03-45729 (Bankr. D. Minn. Oct. 24, 2003) (Kressel, J.). IRAs which are strictly investment accounts to which the debtor has immediate access are not exempt under Minn. Stat. § 550.37, subd. 24, because the right to payment under such account is not solely on account of illness, disability, death, age, or length of service. Even though withdrawal would result in tax and a penalty, the debtor has unfettered access to the accounts and they do not qualify for exemption under the plain language of the Minnesota statute.
- *Clark v. Lindquist*, Civ. No. 03-4542 (D. Minn. Nov. 12, 2003) (Montgomery, J.). The federal district court certified to the Minnesota Supreme Court the question of whether or not a debtor's IRA that is presently accessible, subject to a withdrawal penalty, is exempt under Minn. Stat. § 550.37, subd. 24.
- For a case interpreting the "reasonably necessary standard," see *Halliday v. Halliday*, 1997 LEXIS 778 (Minn. Ct. App. 1997).

(xviii) r. Payment on Account of Wrongful Death - Minn. Stat. § 550.37, subd. 22

These payments would be totally exempt, but this exemption was held unconstitutional by the Minnesota Bankruptcy Courts. See *In re Cook*, 138 B.R. 943 (Bankr. D. Minn. 1992).

(xix) s. Payment on Account of Personal Bodily Injury - Minn. Stat. § 550.37, subd. 22

General damages claims are exempt but special damages are not exempt. *In re Cook*, 138 B.R. 943 (Bankr. D. Minn. 1992); *In re Bixby*, 84 B.R. 608 (Bankr. D. Minn. 1988).

- *In re Carlson*, 40 B.R. 746 (Bankr. D. Minn. 1984). The scope of the state exemption for personal injury claims has been the subject of frequent litigation in the bankruptcy courts in Minnesota. One issue that has been a source of litigation is the question of whether the exemption applies only to

unliquidated claims, and not to payments actually received or to be received under a settlement agreement. The language of the statute refers to "rights of action." In *Carlson*, the bankruptcy court considered whether a "debtor has a right of action" when he has negotiated a settlement of his personal injury claim. In that case, because no releases had been executed and no money paid to the debtor, the court held that the debtor still had a "right of action." The answer may be different in those cases where the debtor has signed a settlement agreement or dismissed an action pending receipt of structural settlement payments.

- *In re Medill v. State*, 477 N.W.2d 703 (Minn. 1991). The constitutionality of Minn. Stat. § 550.37, subd. 22, has been challenged. The Minnesota Supreme Court has ruled that the exemption is constitutional as applied to general damages and future special damages, but declined to resolve a challenge to the constitutionality of the statute as applied to special or punitive damages. A subsequent decision from the bankruptcy court in *In re Cook*, 138 B.R. 943 (Bankr. D. Minn. 1992), held that a claim for special damages accruing before the debtor files a petition for relief is not exempt, nor is a claim for punitive damages.
- *In re Marshall*, 208 B.R. 690 (Bankr. D. Minn. 1997). A court reviewing a debtor's exemption claim under the Minnesota exemption for personal injury claims must be able to locate "injuries to person" within the context of original or underlying injury. To exempt property for claims of injuries to the person, it is not enough that the injury to the debtor spawns physical damage. The original trauma must be to debtor's body. Sexual harassment claims are not "injuries to person" and thus are not exempt under Minn. Stat. § 550.37, subd. 22.

(d) 2. Bi-Annual Adjustments

The maximum dollar amounts are subject to adjustment on a periodical basis. Minn. Stat. § 550.37, subd. 4a. The next adjustment will occur July 1, 2006.

(e) 3. Property Exempt Under Federal Law Other Than 11 U.S.C. § 522(d)

The following is an illustrative and non-exhaustive list of property that may be exempt under federal law other than 11 U.S.C. § 522(d):

- a. Social security payments. 42 U.S.C. § 407.
- b. Veterans' benefits. 38 U.S.C. § 5301.
- c. Railroad Retirement Act annuities and pensions. 45 U.S.C. § 231(M).
- d. Civil service retirement benefits. 5 U.S.C. §§ 8346, 8470.
- e. Wages of fishermen, seamen, and apprentices. 46 U.S.C. § 601; and
- f. Other miscellaneous exemptions. *See* 22 U.S.C. § 4060 (Foreign Service Retirement and Disability); 42 U.S.C. § 1717 (Compensation for Injury, Death, or Debenture of Employees of Contractors with United States Outside the United States); 33 U.S.C. § 916 (Long Shore and Harbor Workers' Compensation); and 38 U.S.C. § 3101 (Veterans' Benefits).

(f) 4. Waiver of Exemption

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Exemption of the property listed in Minn. Stat. § 550.37, subd. 2, 3 and 5-12(a) may not be waived except by a statement in substantially this form:

I understand that some or all of the above property is normally protected by law from the claims of creditors, and I voluntarily give up my right to that protection for the above listed property with respect to claims arising out of this contact.

The statement must be printed in bold face type of a minimum of 12 points, signed and dated by the debtor at the time of the execution of the contract surrendering the exemption, and immediately adjacent to the listing of the property. Minn. Stat. § 550.37, subd. 19.

(g) 5. Tracing Exempt Proceeds

The exemption of funds from creditors' claims provided by subdivisions 9, 10, 11, 15 and 24 of Minn. Stat. § 550.37 is not affected by the subsequent deposit of funds in a bank or other financial institution, whether in a single or joint account, if the funds are traceable through their exempt source. The "first-in first-out" method of accounting is used in tracing funds. The burden of establishing funds as exempt rests upon the debtor. Minn. Stat. § 550.37, subd. 20.

2.2 D. Applicable Exemptions - Bankruptcy Law

In a bankruptcy case, 11 U.S.C. § 522(b) of the Bankruptcy Code permits a debtor to elect either (1) the exemptions provided under state and non-bankruptcy federal law, or (2) the exemptions expressly set forth in § 522(d) of the Code. The Bankruptcy Code expressly permits states to enact laws that prohibit their domiciliaries from electing the exemptions provided by § 522(d) of the Code, 11 U.S.C. § 522(b). Most states have "opted out" and do not permit a debtor to elect the exemptions set forth in § 522(b)(2). Collier 522.02[1] (15th ed. Rev. 2005). However, Minnesota has not opted out and the choice is available for debtors in Minnesota bankruptcy cases. In other words, a debtor in Minnesota can choose either the bankruptcy exemptions listed below, or the state and federal nonbankruptcy exemptions described in Section C above. There are significant differences between the two sets of exemptions. The following is a summary of the federal bankruptcy law exemptions. A chart comparing the state exemptions and the federal bankruptcy exemptions follows in Section F.

(a) 1. Domiciliary Requirement in 11 U.S.C. § 522(b)(3)(A)

To be subject to exemption laws of a state, the debtor must be domiciled in the state for the 730 days immediately preceding the petition date. If the debtor did not live in any state for 730 days, then the debtor must use the exemptions of the state in which the debtor resided during the 180 days, or majority of the 180 days, before the 730 day period.

If the effect of this change is to render a debtor ineligible for any exemption, then the debtor may elect to exempt property under the Bankruptcy Code.

(b) 2. Exemptions in 11 U.S.C. § 522

(i) a. Homestead - § 522(d)(1)

A debtor may exempt his or her aggregate interest not to exceed \$18,450 in value in real or personal property that the debtor or a dependent of the debtor uses as a residence, or in a burial plot for the debtor or a dependent of the debtor.

(ii) b. Burial Plot - § 522(d)(1)

This exemption is included within the homestead exemption.

(iii) c. Motor Vehicle - § 522(d)(2)

A debtor may exempt \$2,950 in one motor vehicle.

(iv) d. Household Furnishings, Household Goods, Wearing Apparel, Appliance, Books, or Musical Instruments - § 522(d)(3)

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A debtor may exempt \$475 per item, up to a limit of \$9,850 total value.

- (v) e. Jewelry - § 522(d)(4)

A debtor may exempt jewelry with a total value of \$1,225.

- (vi) f. Any property - § 522(d)(5)

The Code provides an exemption of \$975 plus the unused portion of the homestead exemption, not to exceed \$9,250. This exemption can be designated by the debtor to apply to any property.

PRACTICE TIP:

The "catch-all" exemption may be used for unmatured rights to payment, such as anticipated income tax refunds and state sales tax rebates. Similarly, these assets are often unscheduled or overlooked, and are not exempt under the state law exemptions. Therefore, these rights to payment may be available nonexempt assets of the estate if the debtor chooses to use the state law exemptions.

- (vii) g. Implements, Professional Books, Office Furniture, Tools and Library - § 522(d)(6)

A debtor may exempt \$1,850 of property in this category.

- (viii) h. Farm Machines and Implements - § 522(d)(6)

This exemption is included in tools of the trade.

- (ix) i. Funds Received by or Payable to a Surviving Spouse or Child at the Death of a Spouse or Parent - § 522(d)(11)(c)

The federal law exempts the amount necessary for support of the debtor and the debtor's dependents.

- (x) j. Loan Valued or Accrued Dividend Under an Unmatured Life Insurance Contract - § 522(d)(8)

A debtor may exempt \$9,850 of property in this category less any property transferred under Minn. Stat. § 542(b).

- (xi) k. Health Aids - § 522(d)(9)

This category of property is totally exempt.

- (xii) l. Earnings

Under 11 U.S.C. § 541, post-petition earnings are not property of the estate, except under Chapter 11, 12, or 13. The debtor, however, may be required to devote a portion of future earnings to creditors based on the outcome of the "means test." See 11 U.S.C. § 707(b).

- (xiii) m. Social Security Benefits, Unemployment Compensation, or Local Public Assistant Benefits - § 522(d)(10)(A)

This category of property is totally exempt.

- (xiv) n. Veterans Benefits - § 522(d)(10)(B)

This category of property is totally exempt.

- (xv) o. Disability, Illness, or Unemployment Benefits - § 522(d)(10)(C)

This category of property is totally exempt.

- (xvi) p. Alimony, Support or Maintenance - § 522(d)(10)(D)

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This category of property is exempt to the extent reasonably necessary for the support of the debtor and the debtor's dependents.

(xvii) q. Stock Bonus, Pension, Profit Sharing or Similar Benefits - § 522(d)(10)(E)

This category of property is exempt to the extent reasonably necessary for the support of the debtor and the debtor's dependents. ERISA-qualified plans that are exempt from seizure of creditors under applicable "nonbankruptcy law" are not property of the bankruptcy estate and, therefore, not subject to the claims of debtor's creditors or the trustee in bankruptcy. *Patterson v. Shumate*, 505 U.S. 1239 (1992).

- *Rouse v. Jacoway*, 544 U.S. 320 (2005). The trustee objected to an exemption claim by the Chapter 7 debtors for their individual retirement accounts under 11 U.S.C. § 522(d)(10)(E). The bankruptcy court entered an order sustaining the objection. The Eighth Circuit Bankruptcy Appellate Panel affirmed as did the Eighth Circuit Court of Appeals. The Supreme Court ruled that debtors may exempt IRAs from the bankruptcy estate, resolving a discrepancy in the circuits on this issue.
- *Andersen v. Ries (In re Andersen)*, 2001 WL 24211 (BAP 8th Cir. 2001). An annuity contract purchased with an inheritance is sufficiently similar to a pension plan to qualify as an exempt asset under 11 U.S.C. § 522(d)(10).

(xviii) r. Retirement Funds - § 522(d)(12)

Retirement funds are exempt to the extent those funds are in a fund or account that is exempt from taxation under IRC §§ 401, 403, 408, 408A, 414, 457, or 501(a).

For assets in individual retirement accounts described in IRC §§ 408 or 408A, other than the simplified employee pension under § 408(k) or a simple retirement account under § 408(p), the aggregate value of such assets are limited to \$1,000,000. That amount may be increased if the interests of justice so require. The aggregate value is without regard to amounts attributable to rollover contributions under IRC §§ 402(c), 402(e)(6), 403(a)(4), 403(a)(5), and 403(b)(8). 11 U.S.C. § 522(n).

(xix) s. Award Under a Crime Victim's Reparation Law - § 522(d)(11)(A)

These awards are totally exempt.

(xx) t. Payment on Account of Wrongful Death - § 522(d)(11)(B)

These awards are exempt to the extent reasonably necessary for the support of the debtor and debtor's dependents.

(xxi) u. Payment on Account of Personal Bodily Injury - § 522(d)(11)(D)

An \$18,450 exemption is provided, but it does not include an award for pain and suffering or for compensation for actual pecuniary loss. The exemption covers payments for personal bodily injury to the debtor or a dependent.

2.3 E. The Maximum Dollar Amounts are Subject to Adjustment on a Periodical Basis in 11 U.S.C. § 104.

The next adjustment will occur April 1, 2007. 11 U.S.C. § 104(b)(1).

2.4 F. Comparing the Nonbankruptcy and Bankruptcy Law Exemptions

As discussed above, the specific bankruptcy and non-bankruptcy exemptions vary in scope and dollar amount. The following table summarizes and compares the two sets of exemptions. The statutory language of the exemptions has been paraphrased in this chart. The actual language must be reviewed when analyzing a debtor's claim to a particular exemption.

Chapter 2 – Exemptions

EXEMPTIONS
(Due for MN adjustment, July 1, 2006)
(Due for Federal adjustment, April 1, 2007, 11 U.S.C. § 104)
Revised October 2005

PROPERTY	BANKRUPTCY CODE	NON-BANKRUPTCY LAW
1. Homestead	The debtor's aggregate interest not to exceed \$18,450 in value in real or personal property that the debtor or a dependent of the debtor uses as a residence. 11 U.S.C. § 522(d)(1).	Up to \$200,000 of value of real property owned and occupied by the debtor, whether the exemption is claimed individually or jointly. Limited to ½ acre within laid out or platted portion of a city, 160 acres if outside. Exemption is \$500,000 for land used primarily for agricultural purposes. Minn. Stat. § 510.01. A manufactured home that is actually inhabited as a home by the debtor is also exempt. Minn. Stat. § 550.37, subd. 12. In addition, the proceeds of a homestead are exempt for up to one year. Minn. Stat. § 510.07. Under some circumstances the Bankruptcy Code limits this exemption to \$125,000.
2. Family Bible, Library, and Musical Instruments	No comparable exemption.	Minn. Stat. § 550.37, subd. 2. THE EXEMPTION FOR MUSICAL INSTRUMENTS WAS HELD UNCONSTITUTIONAL IN <i>IN RE HILARY</i> , 76 B.R. 683 (Bankr. D. Minn. 1987).
3. Burial Plot	Included within part of the homestead exemption. 11 U.S.C. § 522(d)(1).	One lot in any burial plot. Minn. Stat. § 550.37, subd. 3
4. Motor Vehicle	\$2,950 in one motor vehicle.	\$3,800 in one motor vehicle, or \$38,000 for a vehicle that has been modified at a cost of not less than \$2,850 to accommodate a physical disability. Minn. Stat. § 550.37, subd. 12a (measured by the debtor's equity, not the total value).
5. Household Furnishings, Household Goods, Wearing Apparel, Appliance, Books, or Musical Instruments	\$475 per item, limit of \$9,850 total value. 11 U.S.C. § 522(d)(3).	Clothing, utensils, and foodstuffs are not subject to a dollar limitation. Minn. Stat. § 550.37, subd. 4(a). \$4,500 total value of household furniture, household appliances, radios, and television. Minn. Stat. § 550.37, subd. 4(b).
6. Jewelry	\$1,225 total value. 11 U.S.C. § 522(d)(4).	One watch. Minn. Stat. § 550.37, subd. 4(a). \$1,225 in wedding rings. Minn. Stat. § 550.37, subd. 4(c).
7. Any property	The Bankruptcy Code provides an exemption of \$975 plus the unused portion of the homestead exemption, not to exceed \$9,250. This exemption can be designated by the debtor to apply to any property. 11 U.S.C. § 522(d)(5).	No comparable exemption.
8. Implements, Professional Books, Office Furniture, Tools and Library	\$1,850. 11 U.S.C. § 522(d)(6).	\$9,500 (specifically excluding farm equipment) Minn. Stat. § 550.37, subd. 6.
9. Farm Machines and Implements	Included in tools of the trade. 11 U.S.C. § 522(d)(6).	\$13,000 of farm machines and implements including livestock, farm produce, and standing crops used by a debtor engaged principally in farming. Minn. Stat. § 550.37, subd. 5. The total value of property selected pursuant to subd. 5 and subd. 6 may not exceed \$13,000. Minn. Stat. § 550.37, subd. 7.
10. Funds Received by or Payable to a Surviving Spouse or Child at the Death of a Spouse or Parent	Amount necessary for support of debtor and debtor's debtor. 11 U.S.C. § 522(d)(11)(B).	\$38,000 plus \$9,500 for each dependent. Minn. Stat. § 550.37, subd. 10.
11. Loan Valued or Accrued Dividend Under an Unmatured Life Insurance Contract	\$9,850 less any amount used by an insurance company to pay automatic premium or non-forfeiture payment. 11 U.S.C. § 522(d)(8).	Exempt up to \$7,600. Minn. Stat. § 550.37, subd. 23.
12. Health Aids	Totally exempt. 11 U.S.C. § 522(d)(9).	No comparable exemption.
13. Earnings	Under 11 U.S.C. § 541, post-petition earnings are not property of the estate, except under Chapter 11, 12, or 13. A Chapter 7 debtor may be required to devote a portion of his or her earnings to creditors based on the outcome of the means test. See 11 U.S.C.	The greater of 75% of disposal earnings or 40 times minimum hourly wage per week of pay period. Minn. Stat. § 550.37, subd. 13, Minn. Stat. § 571.922, subd. 13.

Debtors' and Creditors' Handbook

PROPERTY	BANKRUPTCY CODE	NON-BANKRUPTCY LAW
	§ 707(b).	
14. Social Security Benefits, Unemployment Compensation, or Local Public Assistant Benefits	Totally exempt. 11 U.S.C. § 522(d)(11)(A).	Social Security benefits are exempt under 42 U.S.C. § 407. Unemployment compensation is exempt under Minn. Stat. § 268.17. Relief based on need is exempt under Minn. Stat. § 550.37, subd. 14.
15. Veterans Benefits	Totally exempt. 11 U.S.C. § 522(d)(10)(B).	Exempt for a period of one year. Minn. Stat. § 550.38.
16. Disability, Illness, or Unemployment Benefits	Totally exempt. 11 U.S.C. § 522(d)(10)(C).	Payments from accident or disability insurance are exempt. Minn. Stat. § 550.39 Unemployment benefits are exempt. Minn. Stat. § 268.17.
17. Alimony, Support, or Maintenance	Exempt to the extent reasonably necessary for the support of the debtor and the debtor's dependents. 11 U.S.C. § 522(d)(10)(D).	No comparable exemption.
18. Stock Bonus, Pension, Profit Sharing or Similar Benefits	Exempt to the extent reasonably necessary for the support of the debtor and the debtor's dependents. 11 U.S.C. § 522(d)(10)(E). ERISA-qualified plans that are exempt from seizure of creditors under applicable "non-bankruptcy law" are not property of the bankruptcy estate and, therefore, not subject to the claims of debtor's creditors or the trustee in bankruptcy. <i>Patterson v. Shumate</i> , 505 U.S. 1239, (1992). Any retirement funds to the extent that those funds are in an amount that is exempt from taxation under IRC §§ 401, 403, 408, 408A, 414, 457, or 501(a) (these are provisions regarding rollovers, etc.). 11 U.S.C. § 522(d)(12). Certain IRAs, however, are subject to a \$1 million cap. 11 U.S.C. § 522(n).	Minn. Stat. § 550.37, subd. 24. Two alternatives: (1) Exemption of full amount in a plan or contract is IRC §§ 401(a), 403, 408, or 457, including amounts which have been or could be rolled over; (2) In the alternative, the right to receive present or future payments received by the debtor under a stock bonus, pension, profit-sharing, annuity, individual retirement annuity, simplified employee pension, or similar plan or contract on account of illness, disability, death, age, or length of service is exempt to the extent of \$57,000 plus additional amounts to the extent reasonably necessary for the support of the debtor and any spouse or dependent of the debtor.
19. Award Under a Crime Victim's Reparation Law	Totally exempt. 11 U.S.C. § 522(d)(11)(A).	No comparable exemption.
20. Payment on Account of Wrongful Death	Exempt to the extent reasonably necessary for the support of the debtor and debtor's dependents. 11 U.S.C. § 522(d)(11)(B).	Totally exempt under Minn. Stat. § 550.37, subd. 22. THIS EXEMPTION WAS HELD UNCONSTITUTIONAL BY LOCAL BANKRUPTCY COURTS.
21. Payment on Account of Personal Bodily Injury	An \$18,450 exemption is provided but it does not include an award for pain and suffering or for compensation for actual pecuniary loss. The exemption covers payments for personal bodily injury to the debtor or a dependent. 11 U.S.C. § 522(d)(11)(D).	General damages claim is exempt, special damages are not exempt. <i>In re Bixby</i> , 84 B.R. 608 (Bankr. D. Minn. 1988) Minn. Stat. § 550.37, subd. 22.
22.. Proceeds of payments received by mechanic lien holder	No comparable exemption.	Totally exempt under Minn. Stat. § 550.37 subd. 25.

2.5 G. Claiming Exemptions in Bankruptcy

(a) 1. File Schedules

When a bankruptcy case is filed, the debtor must file a schedule of property claimed as exempt (Schedule C) with the schedules of assets and liabilities required by Fed. R. Bankr. P. 1007. 11 U.S.C. § 522(l); Fed. R. Bankr. P. 4003(a). If the debtor fails to file a schedule of exempt property, a dependent of the debtor may do so. 11 U.S.C. § 522(1).

The debtor must indicate his or her election under § 522(b) on Schedule C and must provide a description of the property claimed as exempt, the applicable law providing the exemption, the value of the claimed exemption, and the current market value of the property without deducting the value of the exemption. See Debtor - Creditor Formbook at MCLE DC #3080.

- *Soost v. NAH, Inc. (In re Soost)*, 262 B.R. 68 (BAP 8th Cir. 2001). A debtor's claimed exemption of "\$1.00" in a parcel of nonresidential real estate valued at \$26,000 on the debtor's schedules effectively exempts an interest of only one dollar and nothing more.

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- *In re Alexander*, 236 F.3d 431 (8th Cir. 2001). Under 11 U.S.C. § 348(f), exemptions are determined as of the date of the filing of the petition rather than the date of conversion. The court denied the exemption. Congress' enactment of § 348(f) overruled the Eighth Circuit's decision in *In re Lindberg*, 735 F.2d 1087 (8th Cir. 1984).
- *In re Wick*, 276 F.3d 412 (8th Cir. 2002). The bankruptcy estate is entitled to post-petition appreciation in value of an asset which is only partially exempt at the time the debtor claims the exemption. The debtor had a stock option which had not vested when she filed and she listed the value as "unknown." Its value was later determined to exceed the allowable exemption amount. The court split the value between the debtor and the estate based on how much of the stock option vesting period occurred pre-petition.
- *In re Bauer*, 291 B.R. 127 (Bankr. D. Minn. 2003). The debtors grossly undervalued their homestead in the original bankruptcy filing but corrected the filing when the true value came to light. The court disallowed the amended homestead exemption as being in bad faith.
- *In re Cochraine*, 178 B.R. 1011 (Bankr. D. Minn. 1995). The court rejected the debtor's filing of an alternative schedule of exemptions and held that the creditors' time to object would run from time debtor chose one scheme or the other.

(b) 2. Determined as of Date of Petition

The nature and extent of the debtor's right to an exemption is determined as of the date of the petition. 11 U.S.C. § 522(b)(3); *In re Peterson*, 897 F.2d 935 (8th Cir. 1990) (post-petition death of the debtor does not constitute abandonment of the homestead exemption).

(c) 3. Joint Cases

In a joint bankruptcy case, each spouse is entitled to claim his or her own separate exemptions. 11 U.S.C. § 522(m). However, both must elect either the federal bankruptcy exemptions under § 522(b)(2) or the state and federal nonbankruptcy exemptions under § 522(b)(3).

(d) 4. Amend at Anytime

A debtor may amend his or her schedule of exempt property at any time before the bankruptcy case is closed without leave of court. Fed. R. Bankr. P. 1009(a). After the case is closed, the debtor must seek leave from the court to amend his or her exemptions. Any amendment to the schedule of exempt property begins a new 30-day period for parties in interest to object under Fed. R. Bankr. P. 4003(b).

PRACTICE TIP:

An objection and entry of an order may preclude the debtor from subsequently raising alternative theories for exemption. *Ladd v. Ries (In re Ladd)*, 319 B.R. 599 (BAP 8th Cir. 2005) (holding bankruptcy court's final order sustaining the trustee's objection to debtor's federal exemption claim precludes the debtors from amending the schedules to claim the state exemption).

- *In re Kaelin*, 308 F.3d 885 (8th Cir. 2002). A debtor does not act in bad faith or to the prejudice of creditors by amending his exemptions to add an asset, where he was previously unaware of the asset. A legal malpractice claim came to light after the debtor filed his bankruptcy case. The debtor amended schedules to claim the property as exempt with the intention of abandoning the claim. Over the trustee's objection that this exemption was therefore in bad faith, the court held that a debtor may do as he wishes with exempt property and that any intent to abandon it does not constitute bad faith.

(e) 5. Property Reverts to Debtor

Upon expiration of the period to object to the debtor's exemptions without a timely objection having been filed, title to the property claimed exempt reverts from the bankruptcy estate to the debtor. Exempt property is not available to satisfy prepetition claims, or claims that arose post-petition but which are deemed to have arisen prepetition, except for:

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- a. debts that are determined to be nondischargeable under 11 U.S.C. § 523(a)(1) (certain taxes), (a)(5) (child support, alimony, and maintenance – a “domestic support obligation”), and (a)(15) (spouse or child related to a divorce decree or separation agreement);
- b. debts that are determined to be non-dischargeable under 11 U.S.C. § 523(a)(4) (debts incurred by fraud) or (a)(6) (willful and malicious injury), which are owed by an institution or affiliated party (see 11 U.S.C. § 101(33)) of an insured depository institution to a federal depository institution regulatory agency;
- c. liens that are not avoided under the avoiding powers set forth in 11 U.S.C. §§ 506(d), 522(f), 522(g), 544, 545, 547, 548, 549, or 724(a); or
- d. properly filed tax liens.

2.6 H. Objecting to Exemptions in Bankruptcy

(a) 1. Time

A trustee, creditor, or other party in interest may file a written objection to the exemptions claimed by a debtor within 30 days after the 11 U.S.C. § 341 meeting of creditors, or within 30 days of the filing of an amendment to the list of exempt property. 11 U.S.C. § 522(l); Fed. R. Bankr. P. 4003(b); *see also Debtor - Creditor Formbook* at MCLE DC #3050.

If a written objection is timely filed, the bankruptcy court will conduct a hearing to determine the allowance of the exemption. Fed. R. Bankr. P. 4003(c). Rule 4003(b) authorizes the court to extend the 30-day objection period, but only if the court grants the extension “within such period.” Fed. R. Bankr. P. 4003(b).

The court has in rare circumstances exercised the powers under 11 U.S.C. § 105(a) and considered an untimely objection to exemptions where the claimed objections involved fraud or deceit on the court. *See In re McGowan*, No. 97-30606 (Bankr. D. Minn. Apr. 2, 1998).

(b) 2. Effect of Failure to Object

If a party in interest fails to object to the debtor’s claimed exemptions, then the property claimed as exempt is automatically deemed exempt. 11 U.S.C. § 522(l); *Taylor v. Freeland & Kronz*, 503 U.S. 638 (1992). In *Taylor*, a Chapter 7 debtor claimed the proceeds of a pending discrimination suit as exempt under § 522(d). No objection was filed. The court held that although the debtor had no valid statutory basis for the exemption, the trustee could not contest the validity of the claimed exemption after the 30-day period had expired.

However, even if a creditor fails to object to the debtor's claimed exemption in a vehicle as a farm machine within the 30-day period, the creditor is not barred from challenging the exemption for lien avoidance purposes. *In re Carr*, No. 3-92-6647 (Bankr. D. Minn. 1993).

2.7 I. Avoiding Liens on Exempt Assets in Bankruptcy

In bankruptcy, the debtor may have the ability to avoid liens that impair his or her exemptions.

11 U.S.C. § 522(f)(1) gives debtor the power to avoid a lien in property to the extent that such lien impairs an exemption to which the debtor would have been entitled, if such lien is –

1. a judicial lien, other than a judicial lien that secures a debt –
2. a nonpossessory, nonpurchase-money security interest in any –
 - a. household furnishings, household goods, wearing apparel, appliances, books, animals, crops, musical instruments, or jewelry that are held primarily for the personal, family, or household use of the debtor or a dependent of the debtor;
 - b. implements, professional books, or tools, of the trade of the debtor or the trade of a dependent of the debtor; or
 - c. professionally prescribed health aids for the debtor or a dependent of the debtor.

- *Kaler v. Overboe (In re Arzt)*, 252 B.R. 138 (BAP 8th Cir. 2000). Prior to the filing of their bankruptcy petition, Chapter 7 debtors granted two mortgages against their homestead to secure certain preexisting debts. The Chapter 7 trustee avoided the mortgages as preferential transfers and successfully attached the debtors' resulting equity in the homestead for the benefit of the bankruptcy estate under § 551 of the Bankruptcy Code. The debtor was not able to exempt any new equity created by the avoided transfer under § 522(f).
- *Kolich v. Antioch Laurel Veterinary Hosp., Inc.*, 273 B.R. 199 (BAP 8th Cir. 2002). A judgment creditor's lien may be avoided in its entirety under Code § 522(f) as impairing the debtor's homestead exemption, where the sum of all liens on the property (including junior liens that are unsupported by collateral value) plus the amount of the debtor's exemption exceeds the value of the property. The judgment lien may be avoided under the plain language of the Bankruptcy Code, even where it will give value to a subsequent lien that was previously not supported by collateral value.
- *In re Fossum*, 59 B.R. 820 (Bankr. D. Minn. 1986). Debtors will be limited to the dollar amounts of the exemptions existing at the time they entered into the contract with the secured creditor.

III. § 2.3 RISKS OF ESTATE PLANNING

While it is possible for debtors to transfer assets in anticipation of filing for bankruptcy to maximize the available exemptions, there are several ways in which a creditor can challenge such transfers.

The most commonly used method of pre-bankruptcy planning is to maximize the value of exempt assets, that is, assets that are exempt from the reach of creditors under either state or federal law. In the past, many attorneys advised their clients to convert non-exempt assets to exempt assets on the eve of bankruptcy as part of their standard pre-bankruptcy planning. In other words, debtors would sell or liquidate non-exempt assets and use the funds to purchase assets that are exempt under state or federal law. Today, for the reasons discussed below, this type of pre-bankruptcy planning must be approached more cautiously.

3.1 A. As Grounds for Loss of Exemption

(a) 1. Trustee's Avoidance Powers

A trustee is able to object to an exemption and recover otherwise exempt property by using certain avoiding powers set forth in the Bankruptcy Code. The Bankruptcy Code allows the trustee to avoid any transfer made either for less than adequate consideration or made with intent to hinder, defraud, or delay creditors within six years before a bankruptcy filing, at a time when a debtor is insolvent. Assuming that the transfers are all made at arms-length for fair value, the only likely remaining risk is that a trustee will assert that the transfers were made with the intent to hinder, defraud or delay creditors. So far, no trustee in recent years in Minnesota has been successful in establishing, without more, that a debtor put money into his or her homestead with the intent to burden, defraud, or delay, and the courts have issued generally favorable opinions about the broad nature of the homestead exemption. *Hanson v. First Nat'l Bank in Brookings*, 848 F.2d 866 (8th Cir. 1988).

In one pre-bankruptcy planning case in this district, *In re Sholdan*, 218 B.R. 475 (Bankr. D. Minn. 1998), the court denied a homestead exemption finding actual intent to hinder, delay and defraud creditors in the following fact situation. The debtor, a 90-year-old man in 1994, had sold his farm in 1980 and moved into an apartment, living off the proceeds from the sale and the retained mortgage rights. In 1992, Sholdan severely injured Raymond Olson in a car accident, and Olson filed a claim for \$1 million. In 1993, Sholdan moved into an assisted living facility. In 1994, he purchased a new \$140,000 three-bedroom home. Sholdan's nephews (Earl and Roger Jensen) consulted a bankruptcy attorney for help in structuring the transaction. Following the liquidation of all his income in the

purchase, Sholdan's only remaining source of income was his Social Security benefits of \$486 per month, while the property taxes amounted to \$2,000 per year. He filed for bankruptcy two months after buying the home. The transaction was accomplished in a clandestine manner using an attorney and real estate agent who were outside the community and without informing the debtor's doctor or the nursing home. The transfer was followed almost immediately by the filing of the bankruptcy petition. More importantly, other than his farm, the debtor had no experience as a home owner and had always previously lived quite frugally.

(b) 2. Homestead Exemption

Recent amendments to the Bankruptcy Code significantly limit one of the most common pre-bankruptcy planning approaches – to convert non-exempt assets into home equity. Specifically, the value of property that may be exempt under state law is 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 the disposed-of property. 11 U.S.C. § 522(o); see *Kim G. Maronde*, No. 05-42535 (Bankr. D. Minn. Nov. 8, 2005) (reducing debtor's homestead exemption to the extent of a transfer of non-exempt assets into an exempt asset with the requisite intent to hinder, delay and defraud creditors). This limitation applies to all bankruptcy cases filed on or after April 20, 2005.

In addition, any value in property over \$125,000 that was acquired by the debtor during the 1,215 days before the petition may not be exempted. This does not apply if the proceeds used for the acquisition were derived from the debtor's previous principal residence provided the debtor's previous and current residences are located in the same state. Notably, however, this only limits pre-bankruptcy planning with respect to the homestead exemption to \$125,000. 11 U.S.C. § 522(p). This limitation also applies to all bankruptcy cases commenced on or after April 20, 2005.

3.2 B. As Grounds for Denial of Discharge

Using a broader standard of analysis, the courts have found, while upholding the exemption itself (typically the homestead exemption), that the totality of a debtor's conduct justifies denial of his or her discharge. The discharge is the mechanism by which debtors are relieved from further liability for payment of legal obligations incurred prior to the date of a bankruptcy filing. The discharge can be denied if the trustee or any interested creditor establishes that the debtor transferred assets within one year before bankruptcy with the intent to hinder, delay, or defraud.

- *Norwest Bank Nebraska, N.A. v. Tveten*, 848 F.2d 871 (8th Cir. 1988). The debtor sold over \$700,000 in non-exempt assets and invested the proceeds in annuities and life insurance contracts, which were potentially exempt under Minnesota law, all within five months before filing for bankruptcy. The debtor admitted in court that he transferred the property to place it out of the reach of his creditors, several of whom had entered judgments against him during the time he was engaged in the transfers. The court determined that this amounted to "an actual intent to hinder and delay creditors" and that, under bankruptcy law, the debtor was not entitled to a discharge of any of his debts. Moreover, the \$700,000 that the debtor invested in the annuities was declared not exempt and the amount of money was distributed to his creditors. The Bankruptcy Court's decision was upheld by the District Court and by the Eighth Circuit Court of Appeals.

- *In re Johnson*, 124 B.R. 290 (Bankr. D. Minn. 1991). A debtor converted non-exempt assets into an exempt homestead, and also purchased a musical instrument and whole life insurance policy, which were potentially exempt under Minnesota law. The bankruptcy judge denied the objection to the homestead exemption and to the discharge. The Eighth Circuit upheld the debtor's exemption in his homestead, but asked the bankruptcy court to reanalyze the debtor's activity as it related to the purchase of the musical instrument and whole life insurance contract. On remand to the bankruptcy court, the bankruptcy judge found that the debtor's pre-bankruptcy conversion of nonexempt assets to certain exempt assets warranted a denial of his discharge. The debtor did not lose his homestead but lost his discharge. In this case, the bankruptcy judge applied a two-part test to determine whether to deny discharge. The court stated that it must, first, ascertain the debtor's actual intent in invoking the state exemption laws and the debtor's intended use of the assets claimed as exempt and, second, measure this intent and use against the purposes for which the legislature created the exemption. The debtor lost his discharge because it was clear that the assets he had purchased were not purchased for his own family use (the debtor bought a piano and a harpsichord but he admitted that he played neither and left the instruments in storage, and purchased the whole life insurance policy even though he was single, had no dependents, and already had adequate term insurance).

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