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Kansas Bankruptcy News

A monthly publication for the non-bankruptcy attorney prepared by the Law Office of Donald C. Astle, Donald C. Astle, Attorney at Law.

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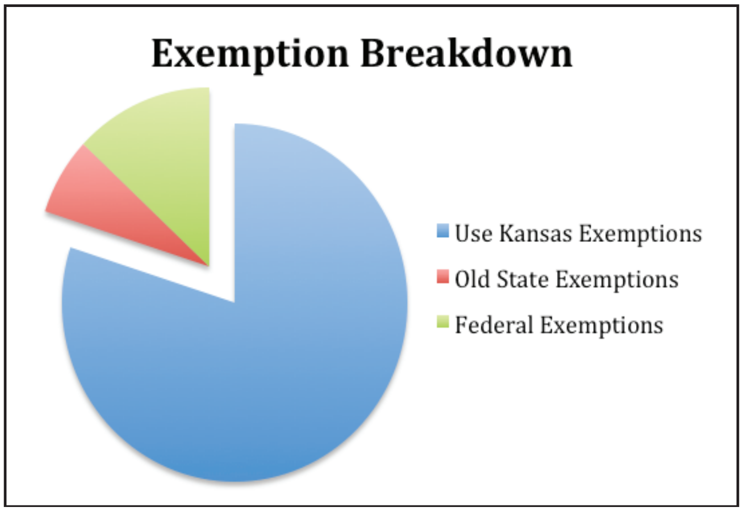
The Out-of-State Exemption Dilemma... The Consternation Continues

If a bankruptcy debtor has not lived in Kansas for the last two years, the debtor will probably not be able to use Kansas bankruptcy exemptions. Remember, one of the fundamentals of the bankruptcy law is that it leaves the debtor with the property needed for a fresh financial start. For example, the debtor would need a house, car, furniture, appliances, tools of the trade and other items for a fresh start. But, you don't need a boat or a lake home for a fresh start. Will, maybe that's not all true. Maybe it is okay to let the debtor keep a boat but not let the debtor keep a home.

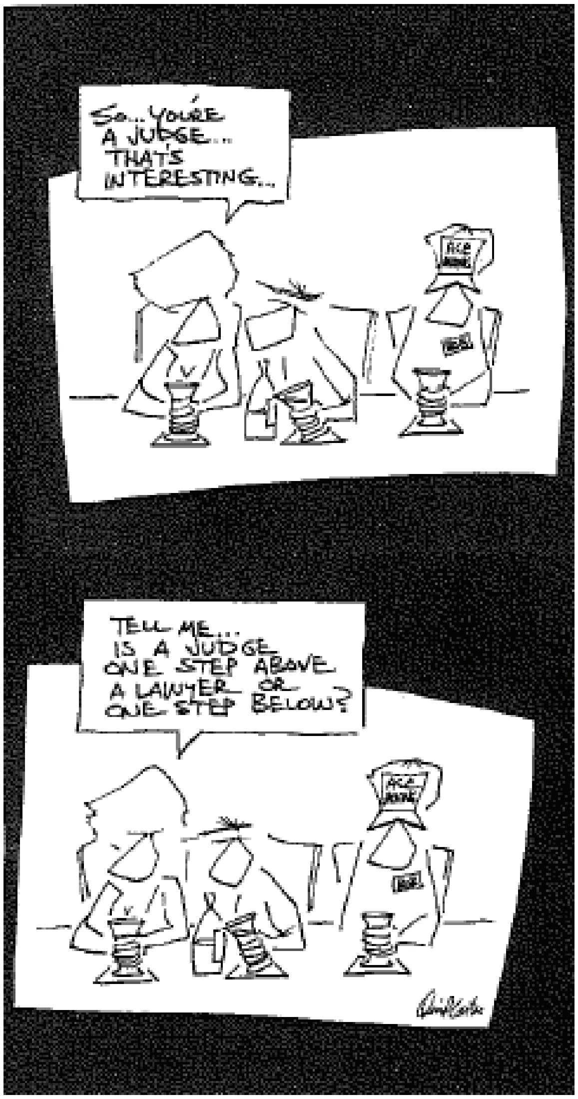
In 2005 the bankruptcy law changed and it required the debtor, in most cases, to live in the state the bankruptcy is filed for at least two years before the debtor could use that state's exemptions. Instead, you would need to use the state's exemptions you used to live in. The purpose of this change in the exemption law was so that debtors could not move to a state with more favorable exemption laws and then immediately file bankruptcy. You could file bankruptcy in your new state but you are stuck with the old state's exemptions. But, congress may not have fully appreciated that the old state's exemptions may not be applicable outside that state. If the old state's exemptions did not apply, and the new state's exemptions were not available, then the default federal exemptions of 11USC522 would apply.

Let's take the case of the homestead exemption. The old state's homestead exemption does not apply outside that state. The Kansas homestead exemption does not apply because the debtor only lived in Kansas for less than two years. So, the default federal exemption applies. But, that exemption is limited to about $20,000. So, if you moved from another state, cashed in your 401k, sold your $20,000 boat, and bought a nice little $50,000 home near mom, who was ailing and needed your help, the house is not exempt. Who needs a house for a fresh start? Now if you had consulted with a bankruptcy attorney you would have been told not to cash in the 401k and not to sell the boat. The 401k is exempt everywhere and the boat is exempt under the federal "wild card" statute. (The "wild card" federal exemption is available if you don't have a homestead exemption.) So you get to keep your 401k and keep your boat when you move to Kansas. Everyone needs a boat for a fresh start!

The purpose of the two year rule was not to defeat the homestead exemption or to allow a debtor to keep a boat. Its purpose was to keep a debtor from moving to a state that has liberal exemptions to defeat creditors from the old state. Not keeping a $50,000 home and



JP...The Legal Cartoon



keeping a $20,000 boat are just unintended consequences of this effort to fix this problem.

Some commentators believe that congress did not consider that most states' exemptions did not have any legal effect once that state's resident left the state. Some commentators believe that congress intended to treat the debtor that had just moved to a new state as a hypothetical resident of the old state. That is, all the old state's exemptions apply regardless of their otherwise ineffectiveness outside that state's borders. The use of "hypothetical" would not be an unprecedented concept in the bankruptcy code. Under 11USC544 a trustee may exercise certain rights and powers other wise not available and is commonly referred to as "hypothetical creditor." If congress had used the term "hypothetical resident" of the old state the exemption scheme would have been simple and probably more in line with the intent of congress. And, in our example, the debtor would be able to keep the new $50,000 house near mom.

Our Take On This:

If the client has just moved from out of state be careful about exemptions. The new home you client just bought may not be exempt!

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