

What in the world have they done to the Texas homestead exemption?

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**The authors are a judge, a Chapter 13 trustee, and a bankruptcy lawyer.
Nothing contained in this paper reflects a position they may take or a
ruling they may make in the future.**

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This paper covers the following areas:

- (1) the 6-Month Rule (or Texas Proceeds Rule) regarding the exemption of homestead sales proceeds under Texas state law,
- (2) the provisions of 11 U.S.C. §522(p) and whether a non-filing spouse has a right to compensation when a homestead is liquidated, and
- (3) the extent of *Law v. Siegel*'s protection of the homestead exemption from equitable limitations.

THE 6-MONTH RULE

Texas has a long and proud history of protecting homestead property. When homestead property is sold, Texas law provides a protection for the sales proceeds for six months. The statutory provision is found in TEX. PROP. CODE § 41.001(c) (West 2000) and provides, "The homestead claimant's proceeds of a sale of a homestead are not subject to seizure for a creditor's claim for six months after the date of sale." This provision is commonly referred to as the "6-Month Rule" or the "Texas Proceeds Rule". It is clear that the snapshot rule is alive and well - it just does not mean what most of us thought it meant all these years.¹ Maybe. It does not mean "once exempt, always exempt". Instead, it means that the law that existed as of the date of the filing prevails, both the favorable and unfavorable provisions of that law, along with all of its contingencies, conditions, and limitations. Again, maybe.

Here are the relevant cases, in chronological order—

***In re England*, 975 F.2d 1168 (5th Cir. 1992)** - This case is cited in all of the subsequent Fifth Circuit opinions regarding the 6-Month Rule and sets out the analysis which forms the foundation for those subsequent decisions. The debtor and his non-filing spouse owned an urban homestead which they sold for some cash and a note payable to the debtor and his wife ("Note"). Two weeks after the sale, the debtor and his wife moved to their ranch property. Two days after

¹ The snapshot rule originated in the case of *White v. Stump*, 226 U.S. 310, 45 S. Ct. 103, 69 L.Ed.301 (1924), although the Supreme Court did not call it the "snapshot rule". In *White*, the debtor filed bankruptcy *prior* to properly establishing his homestead as exempt under Idaho law. He claimed the exemption anyway and the trustee objected. In ruling in favor of the trustee, the Supreme Court stated:

The Bankruptcy Law does not directly grant or define any exemption, but directs . . . that the bankrupt be allowed the exemptions 'prescribed by the state laws in force at the time of the filing of the petition'; in other words, it makes the state laws existing when the petition is filed the measure of the right to exemptions. *Id.* at 312, 45 S.Ct. 103.

that, the debtor filed a Chapter 11 proceeding (the case later converted to a Chapter 7). He elected Texas exemptions and attempted to exempt both the ranch as a rural homestead and the Note proceeds. He used the Note proceeds to improve his ranch property and to pay for living expenses. Both the bankruptcy court and district court ruled in favor of the creditor objecting to the exemption of **both** the ranch (where the debtor lived) and the Note (the proceeds from the sale of the prior homestead). The Fifth Circuit affirmed, holding that the Note proceeds were not exempt.

The Fifth Circuit reviewed the history of Texas homestead law, noting that in 1897, the Texas legislature passed the predecessor of the proceeds exemption statute, a provision amended in 1985. The Fifth Circuit stated that when someone sells a homestead, the six-month window instantly activates and the sales proceeds are exempt. But when someone acquires another homestead during that six months, they change the prior homestead (and the proceeds from the sale of that prior homestead) to a former homestead and instantly deactivate the protection of the proceeds.² When the debtor designated his ranch as homestead, he automatically terminated his right to exempt any proceeds from the sale of his urban homestead, like the Note, because those were former homestead proceeds.

The court stated that this result is consistent with the intent of the Texas legislature in enacting the proceeds protection statute. Pre-1897, homestead proceeds were not protected, leading to harsh results, including homelessness - results inconsistent with the purpose of the Texas homestead exemption. The Texas legislature cured this problem by amending the statute to protect the sales proceeds for a period of time. The sole purpose of this amendment was to allow the homestead claimant to reinvest the sale proceeds in another homestead, rather than to protect the proceeds themselves.

Footnote eleven is worth some attention. In response to the debtor's argument that the portion of the Note proceeds which were used to improve the ranch should be construed as an "investment in homestead" and exempt, the Fifth Circuit stated that a review of Texas case law made it clear that terms like "invest" or "reinvest" in a homestead means to "purchase" or "acquire", rather than, presumably, to "improve". Per the case, these improvements were extensive, including building barns, roads and wells.

Finally, it is clear from the holding that the debtor was not entitled to the exemption, but what was the remedy? Neither the Fifth Circuit nor the District Court discuss that aspect of the case and the bankruptcy court record and opinion for the time period are archived.

It is interesting to note that the Fifth Circuit unequivocally concluded the object of the proceeds exemption statute was solely to allow the claimant to invest the proceeds in another homestead, not to protect the proceeds, in and of themselves. In reaching its holding, the Fifth Circuit relied on two state court cases, *Gaddy v. First National Bank*, 283 S.W. 277, 280 (Tex.Civ.App.-Beaumont 1926) and *Taylor v. Mosty Bros. Nursery, Inc.*, 777 S.W.2d 568, 570 (Tex.App.--San Antonio 1989).

It should be noted that the *Gaddy* case was a workers' compensation case and any reference in the opinion to the proceeds exemptions statute would be at best dicta. Workmen's

² The court makes it clear that its use of the terms "abandonment" and "former homestead" do not refer to a homestead abandoned by sale or the proceeds from that sale. Those terms mean abandonment as a result of acquiring another homestead. When someone sells a homestead, those sale proceeds are considered homestead proceeds, as opposed to former homestead proceeds, at least until the proceeds are used for some purpose other than investment in a new homestead.

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12th Annual Consumer Bankruptcy Practice session

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