

REQUIREMENTS FOR MASSACHUSETTS HOMESTEAD EXEMPTION: CAN DEBTORS EXEMPT PRINCIPAL RESIDENCE OCCASIONALLY RENTED AS SHORT-TERM LODGING?

Date: 25 June 2018

U.S. Financial Institutions and Services Litigation / Restructuring & Insolvency Alert

By: Sean R. Higgins, David A. Mawhinney

Should a Massachusetts homeowner be allowed to claim a homestead exemption in a principal residence that is also used for business or other commercial purposes? Answering this question several years ago as a matter of first impression, the U.S. Bankruptcy Court for the District of Massachusetts adopted a fact-intensive, case-by-case inquiry into the "predominant use" of the property. [1] The predominant use test was developed to address the point at which an owner forfeits homestead protection in the pursuit of commercial activity. The inquiry recognizes the ubiquity of the home office or boarder in modern residences. Bankruptcy Judge Elizabeth Katz's recent opinion in *In re Shove* takes a fresh look at the Massachusetts Homestead Statute and rejects the predominant use inquiry as unnecessary and, in some cases, unduly burdensome on the homesteader. [2]

A. THE "PREDOMINANT USE" TEST

Bankruptcy Judge Melvin Hoffman's 2015 decision in *In re Catton* concerned a two-story structure that doubled as the owner's principal residence and the office for his insurance agency. [3] After filing for protection under chapter 7 of the Bankruptcy Code, [4] the owner claimed that the property was exempt from his bankruptcy estate because it was recognized as his homestead under chapter 188 of the Massachusetts General Laws (the "Homestead Statute"). The chapter 7 trustee objected to the exemption due to the property's mixed use for residential and commercial activities. [5] Judge Hoffman accepted the trustee's argument that, at some point, a single family dwelling "crosses the line from residential to commercial and thus becomes ineligible for homestead protection." [6] Notably, the Homestead Statute does not identify where the line is crossed. Judge Hoffman employed a fact-intensive inquiry regarding the "predominant use" of the property in order to adjudicate the homestead exemption. [7]

In *Catton*, Judge Hoffman found that the residential use predominated over the commercial use where, among other things, the living area comprised 61.5% of the interior space. [8] The district court affirmed on appeal observing that "[n]othing in the statute's language precludes a mixed-use building from being a single-family dwelling." [9]

B. MASSACHUSETTS HOMESTEAD PROTECTS MIXED-USE PROPERTY

In a recent decision, Judge Katz employed a different analysis of the homestead exemption to a mixed-use property. *In re Shove* concerned the efforts of married, chapter 7 co-debtors to strip a judicial lien from real

property located in Lenox, Massachusetts. [10] In addition to serving as their principal residence, the debtors had historically leased out a second dwelling unit on the property and had recently advertised short-term rentals of that unit through services such as Airbnb. In the past, the debtors had also operated a landscaping business from the property. [11]

Section 522(f)(1) of the Bankruptcy Code allows a debtor to avoid a judicial lien "to the extent that such lien impairs an exemption to which the debtor would have been entitled" under state or federal law. The debtors argued that the judicial lien impaired their exemption under the Homestead Statute. The Homestead Statute permits an owner to acquire an estate of homestead in a property that the owner occupies as a principal residence. [12]

The lienholder did not dispute that the property qualified as a "home" and the "principal residence" of the debtors under the Homestead Statute. Relying on *Catton*, however, he argued that the bankruptcy court must consider the commercial activity at the property before enforcing the homestead claim. Judge Katz disagreed, holding that the predominant use inquiry was unnecessary and unwarranted where the property otherwise qualified as the homestead. [13] The plain and ordinary meaning of the Homestead Statute requires only that the property meet the clear and unambiguous definitions of "home" and "principal residence." [14] Nothing in the statute precludes a debtor from taking a homestead exemption simply because the property may be additionally used for business purposes, Judge Katz noted. [15] Accordingly, because the lienholder had agreed that the property was the debtor's principal residence, and the value of the exemption was not in dispute, the court granted the motion to avoid the judicial lien. [16]

C. CONCLUSION

In affirming *Catton*, the district court approved of the "[c]ommon sense" of Judge Hoffman's interpretation, which allows courts to recognize and enforce a homestead claimed under the Homestead Statute when there is some commercial activity at the property. But has the predominant use test created another factual burden for the debtor to overcome? As the district court noted, commerce creeps into the home in a variety of ways:

Many people perform work from their home, some out of a so-called "study," others at the dining room table, and still others in particular areas designed for receiving clients or patients. It belies common understanding to not consider these houses single-family dwellings, yet [trustee's] construction compels that result. Many children experience their first lesson in entrepreneurship through selling lemonade in their yard during hot summer days—under [trustee's] reading, such a lemonade stand would arguably strip its operators' residence of dwelling status. And if a homeowner in Foxborough were to rent out her driveway to Patriots fans on Gillette Stadium game-days, or her teenage daughter operated a lawn mowing and shoveling service out of the home year-round, it defies intuition to think she no longer lives in a single-family dwelling, yet [trustee's] interpretation would make it so. [17]

Judge Hoffman explained that his predominant use approach was intended to further the policy of construing exemptions liberally in favor of debtors. [18] Arguably, however, a predominant use requirement gives an aggrieved lienholder leverage to oppose lien avoidance, even where the status of the home as the principal residence of the debtor and the economic values of the property and the encumbrances are not in dispute. [19]

In *Shove*, the key to the court's decision was that the lienholder had stipulated that the property was both a home and the principal residence of the debtors within the meaning of the Homestead Statute, leaving no material facts in dispute. This was sufficient for Judge Katz to enforce the homestead, regardless of how much commercial

activity occurred at the property. Judge Katz's decision will likely have a pragmatic appeal to individual debtors in chapter 7 and 13 because it avoids any contest over how much commerce takes place at the home or how much of the interior space of the property the debtor occupies.

While not controlling law, *Shove* represents a departure from *Catton*. It remains to be seen whether other bankruptcy judges in Massachusetts will follow Judge Katz. We will continue to monitor and report on any developments in this area.

[1] See *In re Catton* ("*Catton I*"), No. 14-41468, 2015 WL 1058363, *1 (Bankr. D. Mass. Mar. 5, 2015).

[2] See *In re Shove*, No. 17-31052-EDF, 2018 WL 2459091, *2 (Bankr. D. Mass. May 29, 2018).

[3] See *Catton I*, 2015 WL 1058363, *1.

[4] 11 U.S.C. § 101 *et seq.*

[5] See *id.*

[6] See *id.* *3.

[7] See *id.*

[8] See *id.*

[9] See *In re Catton* ("*Catton II*"), 542 B.R. 33, 37-38 (D. Mass.) ("[T]he Court holds that the mere use of a residence for non-residential purposes, at least when the predominant purpose is residential, does not, by itself, preclude an exemption for the Property.")

[10] *Shove*, 2018 WL 2459091, *2.

[11] See *id.*

[12] See Mass. Gen. Laws ch. 188 § 3.

[13] See *Shove*, 2018 WL 2459091, *4.

[14] See *id.*

[15] See *id.*

[16] See *id.*

[17] See *Catton II*, 542 B.R. at 37.

[18] See *Catton I*, 2015 WL 1058363, *3.

[19] Similarly, as was the case in *Catton*, a chapter 7 trustee may attempt to disqualify a homestead exemption by establishing that the use is predominantly commercial.

KEY CONTACTS



SEAN R. HIGGINS
PARTNER

BOSTON
+1.617.261.3128
SEAN.HIGGINS@KLGATES.COM

This publication/newsletter is for informational purposes and does not contain or convey legal advice. The information herein should not be used or relied upon in regard to any particular facts or circumstances without first consulting a lawyer. Any views expressed herein are those of the author(s) and not necessarily those of the law firm's clients.