

Memorandum 96-9

Homestead Exemption: Proceeds Exemption

This memorandum sets out some technical amendments to SB 1368, the homestead exemption recommendation, to implement decisions made at the January meeting. Language approved by the Commission will be amended into the bill before it is heard in its first committee.

Code of Civil Procedure Section 704.720 has been revised to cover the situation where the judgment debtor has received the proceeds from sale of the homestead before the judgment creditor's lien attaches to the home. This may occur in any case where there is no recorded judgment lien and the creditor levies on a bank account containing the proceeds of sale or insurance. The protection of proceeds in such cases is consistent with the general rule under Section 703.080(a) which provides that "a fund that is exempt remains exempt to the extent that it can be traced into deposit accounts or in the form of cash or its equivalent." The general procedures for claiming an exemption under Section 703.510 *et seq.* would apply in this situation — levy occurs, notice of levy is given to the debtor, claim of exemption must be made within 10 days after notice of levy, burden on the debtor to prove the exemption and trace the funds, etc.

The additional feature that is needed for the homestead proceeds exemption is to hold the proceeds for purchase of another qualifying homestead within six months. Accordingly, the court will need to order that the money be deposited into court or held by the garnishee subject to court order, or paid as agreed by the debtor and the creditor. This type of procedure may also apply where the proceeds are still in escrow and the judgment creditor levies on the debtor's interest in the escrow account.

Where the homestead is subject to a recorded judgment lien, the goal has been to make the exemption work with as little procedural complication as possible. From our discussions of these issues with title company representatives, it appears that the draft statute will work. The preliminary title report will show judgment liens of record. The debtor-seller could try to reach an agreement with the judgment creditor so that the lien can be released and the sale proceed. If an

agreement is reached, the title company or other escrow agent simply follows regular procedures and obeys the escrow instructions. If no agreement can be reached, then the escrow will not close until there is a court order or the parties finally do reach some agreement. At that time, after the exemption claim is determined, the proceeds will be deposited in court or as otherwise agreed by the debtor and creditor. This procedure provides more guidance than exists under the current proceeds exemption applicable where there is a recorded homestead declaration.

The cumulative changes that would be made to Section 704.720 to implement these policies, and the other policies of the recommendation on the *Homestead Exemption*, are as follows:

Code Civ. Proc. § 704.720 (amended). Homestead exemption

SEC. 5. Section 704.720 of the Code of Civil Procedure is amended to read:

704.720. (a) A homestead is exempt from enforcement of a money judgment as provided in this article and is exempt from sale under this division to the extent provided in Section 704.800.

(b) The proceeds from a disposition of a homestead are exempt for the purpose of purchasing another qualifying homestead under the following conditions:

(1) If a homestead is sold under this division or is damaged or destroyed or is acquired for public use, the proceeds of sale or of insurance or other indemnification for damage or destruction of the homestead or the proceeds received as compensation for a homestead acquired for public use are exempt in the amount of the homestead exemption provided in Section 704.730. The proceeds are exempt for a period of six months after the time date the proceeds are actually received by or become payable in an amount certain to the judgment debtor, whichever is the earlier date except that, if a homestead exemption is applied to other property of the judgment debtor or the judgment debtor's spouse during that period, the proceeds thereafter are not exempt.

(2) If a homestead is voluntarily sold, or otherwise sold in a manner not described in paragraph (1), the proceeds of sale are exempt in the amount of the homestead exemption provided in Section 704.730 for a period of six months after the date of sale.

(3) If a homestead exemption is applied to other property of the judgment debtor or the judgment debtor's spouse during the six-month period provided in paragraph (1) or (2), the proceeds exemption terminates.

(c) If the judgment debtor and spouse of the judgment debtor reside in separate homesteads, only the homestead of one of the spouses is exempt and only the proceeds of the exempt homestead are exempt.

(d) The exemption of proceeds provided in paragraph (2) of subdivision (b) does not apply to the enforcement of a judgment for child, family, or spousal support, unless the judgment debtor has other obligations for child, family, or spousal support and obtains an order, on noticed motion, that all or part of the proceeds are exempt. In making this determination, the court shall apply the standards provided in subdivision (c) of Section 703.070.

(e) Except as otherwise agreed by the judgment debtor and judgment creditor, if an exemption is claimed for proceeds under this section, the proceeds shall be deposited with the court, or held in a controlled deposit account, subject to the judgment creditor's lien. At any time during the applicable six-month exemption period provided in subdivision (b), the court shall, on noticed motion of the judgment debtor, make an order applying all or part of the proceeds to the purchase of another dwelling that qualifies for a homestead exemption under this article. Unless the judgment debtor purchases another dwelling that qualifies for a homestead exemption under this article during the six-month exemption period, the court, on noticed motion, shall order the proceeds applied to the satisfaction of the judgment.

(f) The proper court for filing motions under this section is the court where an application for an order of sale of the dwelling would be made under Section 704.750.

Comment. Subdivision (a) of Section 704.720 is revised for clarity and for consistency with other exemption provisions. See, e.g., Sections 703.010, 704.010, 704.020.

Subdivision (b) is amended to adopt as a general rule the exemption for proceeds of voluntary sales under former Section 704.960 (homestead declaration). Subdivision (b)(3) is generalized from the last clause of former subdivision (b) of this section. See also Section 703.080 (tracing exempt funds).

Subdivision (d) is a new provision that implements the application of the general rule on equitable division of exemptions in Section 703.070 in a situation where the judgment debtor has multiple support obligees. Unlike the general rule, however, subdivision (d) places the burden on the judgment debtor to file the motion and seek the court order.

Subdivision (e) provides a new procedure for claiming the proceeds exemption and restricting the availability of the funds to the purpose of acquiring a new homestead. Accordingly, during the six-month period during which proceeds are exempt, the money is held in a court account or other controlled account for the purchase of another homestead that qualifies under this article. The judgment creditor's lien priority is preserved on the proceeds during the six-month period. If the proceeds have been levied upon after they were received by the judgment debtor, such as in a case where the debtor has deposited the proceeds in a deposit account, the general exemption procedure following levy of execution is applicable. See Section 703.510 *et seq.* The tracing rules in Section 703.080 apply

to determine the extent to which a fund contains the exempt proceeds from disposition of a homestead.

Subdivision (f) specifies the proper court for proceedings under this section.

Revised Background Comment (1982). Subdivision (a) of Section 704.720 supersedes former Civil Code Section 1240 (providing for a declared homestead) and former Code of Civil Procedure Sections 690.3 and 690.31(a) (providing for a claimed dwelling exemption). Unlike the former provisions, Section 704.720 does not specify the interest that is protected and does not limit the homestead in a leasehold to a long-term lease; any interest sought to be reached by the judgment creditor in the homestead may be entitled to the exemption. The homestead exemption does not apply where a lien on the property other than an enforcement lien is being foreclosed. See Section 703.010.

Subdivision (b)(1) provides an exemption for proceeds of an execution sale of a homestead, for proceeds from insurance or indemnification for the damage or destruction of a homestead, and for an eminent domain award or proceeds of a sale of the homestead for public use. Subdivision (b)(1) supersedes portions of former Civil Code Sections 1256 and 1265 and of former Code of Civil Procedure Sections 690.8 and 690.31(k). The exemption for insurance proceeds was not found in former law. *But see* Houghton v. Lee, 50 Cal. 101, 103 (1875) (insurance proceeds for destruction of declared homestead exempt).

Subdivision (c) is new. The spouses may select which of the homesteads is exempt. If the spouses are unable to agree, the court determines which homestead is exempt. See Section 703.110 (application of exemptions to marital property). Note that a married person may, after a decree of legal separation or an interlocutory judgment of dissolution of marriage, be entitled to a homestead in his or her own right, and this right is not affected by subdivision (c). See Section 704.710(d) (“spouse” defined) & Comment.

We have retained the language in subdivision (b)(2) that runs the six-month period from the “date of sale.” The staff discussed other possibilities with a representative of the California Land Title Association, but no clear improvement presented itself. Using a more precise event, such as the date of the recording of the deed, has the defect of not being directly related to the debtor’s actions. In addition, the “date of sale” language is the same as the existing rule under Section 704.960(a) in the homestead declaration procedure. In practice, we doubt that it will be much of a problem.

Respectfully submitted,

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