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BUSINESS REORGANIZATION ALERT

The Recent Bankruptcy Act's Possible Effect on Florida Homestead

by Grace E. Robson, Esq.

The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005[1] ("BAPCPA" or the "Act") was signed into law on April 20, 2005 following several legislative attempts dating back to the Clinton administration. The Act amends numerous sections of the Bankruptcy Code (the "Bankruptcy Code") effective October 17, 2005 (180 days from enactment). However, one example of a Bankruptcy Code amendment that took effect upon enactment, is BAPCPA's purported limitation of homestead protection, which is the topic of this article.

Florida was a natural center of discussion amongst politicians and others, especially when taking into consideration the numerous famous (or infamous) migrating to take advantage of Florida's unlimited homestead protection, e.g., Burt Reynolds, O.J. Simpson, Scott Sullivan (WorldCom) and Paul Bilzerian, as well as the 2001 decision of the Florida State Supreme Court in *Havoco of America v. Hill.* In *Havoco,* the Florida Supreme Court held that the homestead exemption contained in Florida's Constitution permits an individual to shelter his or her homestead from creditors even when such homestead was acquired with *non-exempt* assets, and with *actual* intent to hinder, delay or even *defraud* creditors. However, decisions from Florida courts after *Havoco* still recognize the ability of a court to impose an equitable lien on a homestead where a creditor proves that the debtor used fraudulently obtained funds in acquiring (or paying down) a homestead, i.e., trace the funds.

Based upon all of the press received, it is reasonable to presume that BAPCPA was intended to close the "millionaire loophole" whereby individuals who lived in (or who moved to) a jurisdiction that provided for unlimited homestead protection could transfer all of their wealth into such homestead, thus shielding it from the reach of creditors.

Generally speaking, the Bankruptcy Code provides that an individual is entitled to exemptions that are either: (i) provided for under the Bankruptcy Code (the "Federal Exemptions"); (ii) provided for under the laws of the State where the individual resides (presuming satisfaction of the residency requirement) where such State has "Opted Out" of the Federal Exemption scheme; or (iii) of his or her choosing if the State of his or her residence allows the individual to elect which set of exemptions to utilize for bankruptcy purposes.

The homestead-related provision of BAPCPA discussed herein provides, in pertinent part:

> [A]s a result of electing under subsection (b)(3)(A) to exempt property under State or local law, a debtor may not exempt any amount of interest that was acquired by the debtor during the 1215-day period preceding the date of the filing of the petition that exceeds in the aggregate $125,000 in value in (A) real or personal property that the debtor or a dependent of the debtor uses as a residence; (B) a cooperative that owns property that the debtor or a dependent of the debtor uses as a residence …or (D) real or personal property that the debtor or dependent of the debtor claims as a homestead.

After BAPCPA's enactment, much speculation ensued as to the likely effect of the referenced legislation on the homestead provisions of the State of Florida, the beneficiary of migration from America's embattled boardrooms. Just over 2 months after enactment, some insight was provided in the case of *In re McNabb,* 326 B.R. 785 (Bankr. D. Ariz. June 23, 2005). In summary, the bankruptcy judge found, based upon a plain reading of the statutes, that the limitation on homestead exemption did not apply to McNabb since Arizona was an "opt-out" State and the statute only applied to debtors who were eligible to "elect" federal versus state or local exemptions (of which there are only two: Texas and Minnesota). The Court found that the statutory language was clear and unambiguous and that there would be no absurdity in the result as applied to McNabb since it would be consistent with the prior 163 years of bankruptcy law.

So what does that mean for Florida residents who satisfy the residency requirement, have over $125,000 in equity in their homestead and are contemplating bankruptcy protection? Since *McNabb,* there have been two bankruptcy court decisions from the Southern District of Florida interpreting the effect of BAPCPA as it pertains to the Florida homestead. In one case, *In re Kaplan,* the bankruptcy court upheld the objection to claimed homestead exemption and in another, *In re Wayrynen,* the Bankruptcy Court overruled it. In both cases, the respective debtors acquired the subject homestead property less than 1215 days before filing for bankruptcy.[2] *In Kaplan,* Chief Bankruptcy Judge Robert A. Mark criticized the *McNabb* decision as narrow and mechanical in its application. Specifically, Judge Mark ruled that it was appropriate to look to the legislative intent (which he found was clear to its intention to apply to all States) since the language of the statute was unclear. Similarly, *in Wayrynen,* Judge Friedman, citing to the legislative history, found that "[t]o exclude Florida residents from the limitations provided in § 522(p)(1) would be contrary to the intention of the Reform Act's drafters." Judge Friedman also reconciled the "as a result of electing" language in the statute with the balance of § 522 by finding that a person who chooses to purchase a home and permanently reside in Florida combined with voluntarily filing for bankruptcy, elects to invoke the exemptions available under Florida law.

While other Bankruptcy Courts in Florida have yet to rule on this issue, BAPCPA does not take away other bases for an unlimited homestead, e.g., where homestead is held by husband and wife as tenants by the entireties. As the Court ruled *in Wayrynen,* under BAPCPA, if a debtor's former and new residence are in the same State, the debtor is allowed to rollover the equity in the former residence into the new home without triggering the restart of the 1,215-day residency period. However, to the extent a debtor moves, for example, from North Carolina (after having lived there for greater than 1215 days), where such debtor's North Carolina homestead protection was limited to $10,000, to Florida, the North Carolina homestead exemption will apply.

In addition to the analysis performed by the Bankruptcy Judges who decided *McNabb, Kaplan* and *Wayrynen,* it is yet to be seen whether a challenge to the homestead cap will be made on federalism[3] grounds.

Despite the referenced Florida opinions, it is unclear whether BAPCPA may have its intended effect of reducing the number of wealthy individuals who move to Florida then file for bankruptcy protection. Since the facts surrounding each individual varies, it will be critical for all individuals contemplating bankruptcy protection to have proper legal advice. ■

[1]Pub. L. No. 109-8, 119 Stat. 23 (codified as amended at 11 U.S.C. § 101 *et seq*).

[2]In *Wayrynen,* the debtor owned real property in Florida more than 1215 days before filing for bankruptcy. However, in *Kaplan*, the court noted only that the debtor acquired the homestead less than 1215 days before filing bankruptcy. We presume that the debtor in *Kaplan* did not continuously own a Florida residence more than 1215 days before filing bankruptcy.

[3]Federalism is defined as the "distribution of power in a federation between the central authority and the constituent units (as states) involving esp. the allocation of significant lawmaking powers to those constituent units." *Merriam-Webster's Dictionary of Law, © 1996 Merriam-Webster, Inc.*

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Grace E. Robson received her law degree from the Benjamin N. Cardozo School of Law in 1997 and her undergraduate degree, *cum laude*, from the University at Albany in 1994.

Ms. Robson is a resident in the firm's Fort Lauderdale office. Her practice includes representation of debtors, trade and institutional trustees as well as creditors' committees. She has been principally involved in the claims reconciliation process in cases with claims ranging from $100 million to $1 billion.

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Ms. Robson is a member of the Bankruptcy Bar Association for the Southern District of Florida, the Young Lawyers Division of the Florida Bar, the International Women's Insolvency and Restructuring Confederation (IWIRC) as well as the American Bar Association.

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