Asset Protection Planning for Florida Residents
Under the New Bankruptcy Act

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The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (the “Act”), signed into law by President George W. Bush on April 20, 2005, has narrow but potentially significant impacts on asset protection planning for Florida residents. Under the pre-Act Bankruptcy Code, debtors in bankruptcy were allowed their unlimited state exemptions to keep significant assets out of the bankruptcy estate, and therefore exempt from the claims of creditors. These state exemptions are normally far more generous than the federal exemptions, none more so than Florida’s. Several of the Act’s provisions restrict the ability of a debtor to take advantage of the state exemptions. Asset protection planning counsel for Florida residents need to be well versed in the Act in order to provide complete and competent representation.

This article:

- explains several of the Act’s provisions that impact asset protection;
- reviews in some detail three popular asset protection techniques—homestead, life insurance and annuities, and tenancy by the entirety planning;
- discusses how the Act’s changes impact those planning techniques; and
- offers a brief overview of involuntary individual bankruptcy, a rare procedure that could become more common for creditors seeking to deny debtors the benefit of their state exemptions.

The Act’s Time-Based Restriction on State Exemptions

In bankruptcy, a debtor is permitted to keep assets out of the bankruptcy estate under either the state or federal exemptions, depending on the state of the debtor’s residence. The federal exemptions are modest, and include, for example, the ability to exempt up to $18,450 in a homestead, $9,850 in household goods, $2,950 in a motor vehicle, and $1,225 in jewelry.

A state is permitted to opt out of the federal exemption system and require its residents to use the state exemptions. Florida, like most states, has opted out of the federal exemption system and instead requires its residents to use the Florida exemption system. Florida’s exemptions are quite generous and include unlimited exemptions for a homestead, life insurance cash surrender value and annuities.

The Act makes two significant changes to the Bankruptcy Code for residents of opt out states, such as Florida. The first is an increase in state residency required before the state’s exemptions can be used in bankruptcy, from 180 days to 730 days (approximately two years). If a debtor cannot satisfy this residency requirement, the location where the
debtor resided during the 180 days prior to the 730 day-period shall govern the debtor’s exemptions. If a debtor has no such place, the federal exemptions may be used instead.\textsuperscript{vii} This provision is effective for bankruptcy petitions filed on or after October 17, 2005.\textsuperscript{viii}

The other significant change to the state exemptions is a set of restrictions on the protection of homesteads in bankruptcy. The most important of these requires that the homestead, including previously held homesteads within the same state, be held for 1215 days (approximately three years and four months) prior to the bankruptcy filing, or be limited to $125,000.

\begin{quote}
(p)(1) As 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 –

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(D) real or personal property that the debtor or a dependent of the debtor claims as a homestead.

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(2)(B) For purposes of paragraph (1), any amount of such interest does not include any interest transferred from a debtor’s previous principal residence (which was acquired prior to the beginning of such 1215-day period) into the debtor’s current principal residence, if the debtor’s previous and current residences are located in the same State.
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This provision has some ambiguity because there is no guidance in determining how to measure the “amount of interest that was acquired during the 1215-day period.” For a debtor who paid cash for the homestead more than three years and four months prior to the filing, the entire homestead is clearly protected. What about improvements made during the 1215-day period? If the protection of improvements is limited to $125,000, is that $125,000 measured based on the cost of the improvements or the value at the time of the bankruptcy filing? What about debt repayment? Are mortgage principal payments made within the 1215-day period on a homestead acquired more than 1215 days before the bankruptcy filing fully protected or limited to $125,000?

Another ambiguity, particularly relevant in Florida, where people often keep a second residence, is whether a homestead is protected if acquired prior to the 1215-day window, but only became the debtor’s primary residence, and thus the Florida homestead, within the 1215-day exclusion period.

Finally, the language of subsection (p)(1) indicates that it is effective as a “result of electing under subsection (b)(3)(A) to exempt property under State or local law.” Most states, such as Florida, do not allow an “election,” but instead require its residents to use the state exemptions. At least one bankruptcy court, in Arizona, an opt-out state like
Florida, has held that subsection 522(p)(1) does not apply to an opt-out state’s residents. In Re McNabb, 2005 WL 1525101 (Bankr.D.Ariz.). Whether this provision was intended to exclude from coverage residents from opt-out states, which are the majority of states, is uncertain, given the absence of any meaningful legislative history. ix

The Act also creates an expanded fraudulent conveyance provision specific to homesteads. Any homestead acquired with nonexempt property during the ten-year period before the bankruptcy filing that was made with the intent to hinder, delay, or defraud creditors is not protected by a state homestead exemption. x

The Act also singles out a group of debtors seen as particularly undeserving of homestead protection, by restricting the homestead to a $125,000 cap for debtors who have (i) been convicted of a felony which demonstrates bankruptcy abuse, (ii) incurred a debt arising from a violation of federal or state securities laws, (iii) incurred a debt from a RICO civil remedy, or (iv) incurred a debt resulting from any criminal act, intentional tort, or willful or reckless misconduct that caused serious physical injury or death to another individual during the last five years. xi Curiously, this section of the Act contains a provision allowing more of the homestead to be kept by the debtor if “reasonably necessary for the support of the debtor and any dependent of the debtor.” xii

The homestead provisions of the Act are effective for bankruptcy petitions filed after April 20, 2005. xiii

**Florida Homestead Overview**

Article X, Section 4 of the Florida constitution provides that a homestead, limited to one-half acre within a municipality or 160 acres outside a municipality, is exempt from forced sale, except for property taxes, mortgage default, mechanics liens, and similar claims.

The Florida homestead has withstood many challenges, the latest and most significant in Havoco v. Hill, 790 So.2d 1018 (Fla. 2001). Mr. Hill, a resident of Tennessee, was found liable in a jury trial for a multi-million dollar verdict for breach of contract and several business-related torts. Eleven days after the entry of the judgment, Mr. Hill purchased for cash a large homestead in Florida and changed his residence to Florida. Mr. Hill later filed for bankruptcy and sought to have his new residence in Florida exempt from the bankruptcy estate as protected Florida homestead. In response to a certified request from the United States Court of Appeals for the Eleventh Circuit, the Florida Supreme Court held that the Florida Homestead, given its constitutional genesis, is not subject to curtailment by legislative enactment such as the fraudulent conveyance statutes. The Court summed up its holding as follows.

[A] homestead acquired by a debtor with the specific intent to hinder, delay, or defraud creditors is not excepted from the protection of article X, section 4 [of the Florida Constitution].
The Act’s Restriction on Florida Homestead

For new or existing Florida residents, by far the most significant part of the Act is a new holding period required before a Florida Homestead can be protected in bankruptcy. Any interest acquired in, or value added to, a homestead within the 1215 day period before the filing of a bankruptcy petition cannot be protected by Florida’s homestead exemption in an amount over $125,000. No intent to defeat creditors is required – all homesteads acquired within the window will be limited. Longstanding Florida residents with existing homesteads, however, will not be affected by this change.

The Act also takes aim at the ability of debtors to acquire homesteads for the purpose of defeating creditors, for those homesteads acquired outside the 1215 day window. The Code’s new Section 522(o) operates as a 10-year federal fraudulent conveyance statute to remove the exemption from homesteads acquired to defeat creditors if acquired up to 10 years prior to the bankruptcy filing. Havoco offers no protection in bankruptcy now.

Life Insurance and Annuities Overview

The cash surrender value of an insurance policy insuring the life of a Florida resident is not subject to creditor claims.xiv Also note that the death benefit from life insurance is protected from claims so long as the death benefit passes to a beneficiary and not the decedent’s estate.

The proceeds of an annuity contract issued to a resident of Florida are not subject to the claims of creditors. The operation of this exemption is best illustrated by Goldenberg v. Sawczak, 791 So.2d 1978 (Fla. 2001). Dr. Goldenberg placed several million dollars into an annuity, commenced practicing medicine without insurance, then committed a serious act of malpractice a few years later, and finally declared bankruptcy during the malpractice trial. The Eleventh Circuit certified the question of whether the surrender value of the annuity is exempt, rather than just the “proceeds” as is written in the text of the statute, Section 222.14, Florida Statutes. The Florida Supreme Court, in a unanimous decision, held that the surrender value of an annuity contract is exempt if subject to a contractual surrender penalty, thereby shielding from the malpractice victim Dr. Goldenberg’s largest asset.

Florida has adopted the Florida Asset Conversion Statute, which provides that any conversion of an asset from a nonexempt form to an exempt form, if done to delay, hinder, or defraud the creditor, may be set aside. Section 722.30, Florida Statutes. “However, where the creditor is not in existence at the time of the conveyance, there must be evidence establishing actual fraudulent intent by one who seeks to have the transaction set aside.” Eurovest, LTD. v. Segall, 528 So.2d 482, 483-84 (Fla. 3d DCA 1988). Therefore, absent a prior intent to commit a tort or engage in some other behavior leading to a future judgment, putting assets into life insurance or an annuity prior to the action leading to the judgment should protect those assets from
characterization as a fraudulent conveyance. A debtor should not count on being able to shield assets through the insurance or annuity exemption once a claim against the debtor is known, however.

The Act’s Impact on Life Insurance and Annuities

The Act places no new specific restrictions on the ability of a debtor to protect the cash surrender value of a life insurance contract or an annuity. The only restriction is the new 730-day residency requirement before the state’s exemptions can be claimed. Therefore, if a debtor has been a Florida resident for more than 730 days at the time of the bankruptcy filing, the annuity and life insurance exemption continues to be a viable asset protection device, assuming that no fraudulent conversion can be established.

Tenancy by the Entireties Overview

Tenancy by the entireties has been an excellent form of asset protection for many years. Florida broadly recognizes the ability of spouses to hold title to real property and financial accounts as tenants by the entireties. Property held as a tenancy by the entireties must possess six characteristics: (1) unity of possession (joint ownership and control); (2) unity of interest (the interests must be identical); (3) unity of title (the interests must have originated in the same instrument); (4) unity of time (the interests must have commenced simultaneously); (5) survivorship; and (6) unity of marriage (the parties must be married at the time the property became titled in their joint names). Beal Bank, SSB v. Almand and Associates, Etc., 780 So2d. 45 (Fla. 2001).

Under settled Florida law, when property is held as a tenancy by the entireties, only the creditors of both the husband and wife, jointly, may attach the tenancy by the entireties property; the property is not divisible on behalf of one spouse alone, and therefore it cannot be reached to satisfy the obligation of only one spouse. Beal Bank.

As a means of asset protection, tenancy by the entireties has three concerns. First, the person must be married and desire to hold the assets with the person’s spouse. Second, even if the person is willing to hold title with the spouse, the tenancy can be defeated if (i) the debt is in both parties’ names, (ii) the parties divorce, or (iii) one of the parties dies. Third, tenancy by the entireties offers no protection if created as a result of a fraudulent conveyance. See, e.g., Hurlbert v. Shackleton (Fla 1DCA 1990) 560 So.2d 1276.

The United States Court of Appeals for the Eleventh Circuit, in In Re Sinnreich, 391 F.3d 1295 (11th Cir. 2004), recently affirmed that tenancy by the entireties property is protected in bankruptcy against all creditors except the Internal Revenue Service.

The Act’s Treatment of Tenancy by the Entireties

The Act makes no change to the treatment of tenancy by the entireties property in bankruptcy. Section 522(b)(2)(B) of the Bankruptcy Code exempts from the bankruptcy
estate any interest in property in which the debtor had, immediately before the
commencement of the case, an interest as a tenant by the entirety to the extent such
interest is exempt from process under applicable non-bankruptcy law. The Act’s 730-day
residency period for taking advantage of a state’s exemptions does not apply to tenancy
by the entireties property.

For recent Florida residents who are married, tenancy by the entireties property has
become a much more important asset protection tool.

**Combining Homestead and Tenancy By the Entireties**

For married persons, holding title to a homestead as tenants by the entireties completely
sidesteps the restrictions created by the Bankruptcy Act, because tenancy by the entireties
property is exempt without being subject to the new Bankruptcy Act’s residency and
acquisition waiting periods.

If a new Florida resident or an existing Florida resident acquires a new Florida primary
residence as tenancy by the entireties, the property is exempt from creditors, in and out of
bankruptcy, from the date of acquisition, assuming that no fraudulent conveyance can be
established. For the debtor, the hope is that the property can be held long enough so that
by the time the tenancy by the entireties expires, due to death of one spouse or divorce,
the 1215-day waiting period to protect a newly acquired homestead will have run its
course, allowing a successful bankruptcy filing or otherwise allowing the homestead to
be protected.

**Involuntary Bankruptcy: An Old Tool With New Life**

Given the pro-creditor changes made to the Bankruptcy Code by the Act, many debtors
will find that the state law exemptions outside of bankruptcy are preferable, especially
those debtors with significant exempt assets that could be lost in bankruptcy under the
changes made by the Act. Once the applicable waiting periods have passed (730 days of
residence for state exemptions and 1215 days for new or improved homesteads), a
voluntary bankruptcy may only then be desirable.

Involuntary bankruptcy has historically been a seldom used tool against individual
debtors, given the state exemptions that such debtors would likely claim.

An involuntary bankruptcy petition under Section 303(b) of the Code can be filed:

(i) three or more creditors holding liquidated, undisputed claims which
aggregate at least $12,300 more than the value of any collateral
securing the claims;
(ii) one or more creditors holding liquidated, undisputed claims
equaling at least $12,300 if fewer than 12 non-employee and non-
insider creditors exist;
(iii) any general partners in a partnership; or
(iv) a foreign representative of the estate in a foreign proceeding regarding the debtor.

The effect of the Act is to create a window during which a creditor could force a debtor into involuntary bankruptcy and cause the debtor to lose the state exemptions. A bankruptcy petition filed prior to the end of the 730-day period within which the person became a Florida resident would eliminate the debtor’s ability to use Florida’s generous exemptions. A bankruptcy petition filed prior to the end of the 1215-day period from when the person acquired the homestead would eliminate the protection of the homestead in excess of $125,000. Tenancy by the entireties assets would be protected in an involuntary bankruptcy regardless of waiting periods, assuming that no fraudulent conveyance could be proven.

An involuntary bankruptcy can also allow a creditor to pull a homestead into the bankruptcy estate if acquired through a fraudulent conversion, given that the Havoco case will no longer be applicable in bankruptcy.

Even without filing an involuntary bankruptcy petition, creditors will now have new negotiating leverage with debtors who are subject to losing their exemptions. By threatening bankruptcy, creditors should be able to extract additional sums from debtors holding assets that would be lost in an involuntary bankruptcy filing.

Summary

For existing Florida residents, the primary effect of the Act will be to restrict the Homestead exemption to $125,000 unless acquired at least 1215 days prior to the bankruptcy filing. The 730-day residency waiting period to claim the other Florida exemptions is only a restriction for recent Florida residents. Both of these time-based restrictions can be overcome by holding assets as tenancy by the entireties. If tenancy by the entireties is not a suitable solution, more complex remedies should be explored.

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1 11 U.S.C. § 522(b)(2). All references to the Bankruptcy Code and Title XI of the United States Code are as amended by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, unless otherwise indicated.
iv Section 222.20, Florida Statutes.
v Section 222.14, Florida Statutes; Article X, Section 4, Florida Constitution.
viii Title XV, Section 1501(a) of the Act.
ix For asset protection planning purposes, this article assumes that the 1215-day restriction does (or will, as a result of a potential technical correction bill) apply to the residents of an opt-out state such as Florida.
xii Title XV, Section 1501(b)(2) of the Act.
xiv Section 222.14, Florida Statutes.