

By CRAIG HERSCH

Florida physicians should be aware how the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA, or Bankruptcy Act) affects Florida homestead protections. At issue is whether the federal bankruptcy laws limiting homestead equity to \$125,000, while subjecting all additional homestead equity to the claims of creditors, apply to Florida homeowners.

With soaring malpractice premiums coupled with physicians inability to purchase adequate coverage, asset protection planning while the “skies are clear” becomes ever more important.

Many physicians have been counseled by legal and financial advisors to pay down mortgages on their Florida homestead due to the beneficial Florida homestead protections. However, recent cases under the new Bankruptcy Act calls this strategy into question. The news was good for physicians, at first, under an Arizona case, *In re: McNabb*, where an Arizona bankruptcy court ruled that the \$125,000 federal limitation against homestead protection does not apply to “opt-out” states.

For a brief period of time after the Arizona *McNabb* ruling, it appeared that Florida homestead equity may not be subject to the reach of judgment creditors. Regrettably, and suddenly, the tide has since changed.

Opt-outs out of luck

Arizona is an “opt-out” state under the federal bankruptcy laws. States are given the choice under the federal bankruptcy statutes as to whether the federal menu

of exempt assets from bankruptcy should apply, or whether the state law menu of exempt assets should apply.

Florida is an “opt-out” state too, so the issue as it relates to homestead protection is whether the beneficial Florida protections would apply in a federal bankruptcy court or the recently enacted federal law limiting homestead protection to \$125,000 applies.

In *re: Kaplan*, a Florida case decided in October 2005, squelched any hope that the Arizona case would save Florida homestead protections from the harsh realities of BAPCPA. The Florida Bankruptcy Courts held in direct contrast to *McNabb* that the \$125,000 cap on equity in homestead did apply, even in Florida, an opt-out state.

The *Kaplan* facts are noteworthy. In April of 2003, following a divorce, Elona Kaplan moved from New Jersey to a condo in Miami. She accumulated approximately \$36,000 in credit card debt before filing for bankruptcy in May 2005.

Kaplan claimed her homestead was exempt and valued the property at \$280,000 with a first mortgage of \$181,000. Since she owned the property less than 1,215 days (as provided under the statute), the bankruptcy trustee arranged an appraisal which valued the unit at \$335,000. Subtracting the mortgage from the appraised amount, the bankruptcy trustee determined there was asset value in the homestead sufficient to pay creditors above the \$125,000 exemption amount provided under the federal law.

This homestead equity was, apparently, the only asset available to the cred-

itors. Kaplan’s lawyer cited *Mc-Nabb*, arguing that the homestead was an exempt asset under Florida, an “opt-out” state. On Oct. 6, 2005, Bankruptcy Court Judge Robert Mark found that the homestead cap of \$125,000 applied to Kaplan, as she acquired her home within the 1,215 days prior to filing bankruptcy.

In other words, Judge Mark held in direct contrast to the Arizona court’s ruling, deciding that the intent of Congress was to subject homestead equity to the reach of creditors, even in opt-out states.

Kaplan’s lawyer argued that even if the \$125,000 equity cap applied, the appreciation on the residence during the 1,215-day period should not count in determining the equity available to the reach of creditors. Elona Kaplan

Beware Bankruptcy

Under the old bankruptcy rules, it was not uncommon for a physician to avail himself of a bankruptcy ruling to discharge malpractice awards that exceeded his insurance coverage. The draconian rules under BAPCPA take this option off the table in most circumstances.

A physician may be in danger of being forced into bankruptcy involuntarily. A judgment creditor who decides that a physician may use asset protection tools to “wait out the creditor” could decide to take matters into his own hands and attempt to force the physician involuntarily into bankruptcy court, and therefore subject to these rules.

Involuntary bankruptcy filings are fraught with their own particulars and difficulties, and are beyond the scope of this article. Physicians should be aware, however, that the protected moat around the homestead castle has become more vulnerable under the Bankruptcy Law.

Florida homestead subject to attack by creditors

settled the case before the Court decided this issue.

Since *McNabb*, another Florida case (*In re: Wayrynen*), two Nevada cases (*In re: Virissimo* and *In re: Heisel*) and a Texas case (*In re: Blair*) have all agreed with the *Kaplan* court that the \$125,000 cap on equity applies in bankruptcy settings. Except in Arizona, *McNabb* appears dead.

'Acquired' interest

There are several important issues under the new Bankruptcy Act that *Kaplan* left unaddressed. Under the law, "any equity acquired" in a homestead asset during the 1,215 days prior to filing is subject to the reach of creditors. For those of you without calculators nearby, 1,215 days equates to slightly more than 3 years. Why the law provides for this amount of time is anyone's guess. Suffice it to say, however, that even proactive asset protection planning might be called into question if homestead equity is acquired during this time period.

Moreover, *Kaplan* left open the question whether or not passive appreciation in value, and whether ongoing mortgage payments made during the 1,215 days constitutes "any equity acquired" subject to bankruptcy creditors. Passive appreciation can be best explained by example:

Assume Physician A owns a home valued at \$1.5 million (with no debt) on the date that is 1,215 days before a bankruptcy filing. If the property is valued at \$2.5 million on the date of filing, is \$875,000 of equity in the home available to satisfy creditors (\$1 million of appreciation during the 1,215 days less \$125,000 exempted)?

Ongoing mortgage payments could also increase equity during the statutory 1,215 day period. Assume Physician A has a mortgage on his property and during that 3+ year period before filing he pays down \$275,000 in mortgage debt on his home. Does this mean that \$150,000 of that pay down is subject to the claims of creditors?

Quick pay-down

A Texas court recently weighed in, deciding that for purposes of the new Bankruptcy Act, the Congressional intent was for the cap to apply to people who acquire homes, not to those who have mere accretions in value to existing homes. In the *Blair* case, the issue was whether the increase in value accruing from ongoing mortgage payments within the 1,215 days is subject to the reach of creditors. Texas, like Florida, offers homestead protections from creditors.

Here, 1,773 days before filing for bankruptcy, Kevin and Susan Blair purchased homestead property in University Park, Texas. On May 27, 2005, they filed for bankruptcy protection, claiming \$688,606 from their home as exempt. An unsecured creditor bank objected to the homestead exemption, stating that during the 1,215 days prior to filing, the Blairs paid down their mortgage in excess of \$125,000. The bank argued that any increase in the equity in the home during the 1,215 day period prior to filing should not be exempt.

While passive appreciation was not directly ruled upon, Judge Harlin Hale disagreed with the creditor bank's assertions, ruling "one does not actually 'acquire' equity in a home. One acquires title to a home." Here, the *Blair* Court held that the regular pay down of the homestead mortgage balance within the 1,215 days was not subject to the reach of creditors.

I would suggest that *Blair* does not hold for the proposition that irregular payments of mortgages, such as a lump sum payment to reduce mortgage debt within the 1,215 days prior to bankruptcy court filing, is outside of the reach of creditors. The *Blair* Court simply reviewed regular, ongoing mortgage payments. Lump sum payments would most likely be ruled upon differently, and could also be challenged under the Uniform Fraudulent Conveyance statutes.

Prior residence rollover

Another issue with regard to Florida homestead protection is whether "rolled over" equity from a prior Florida homestead is subject to the reach of creditors under the new Bankruptcy Act. *In re: Wayrynen*, the debtor originally owned a home he purchased in 1989 for \$99,500. But 983 days before filing for bankruptcy he sold that home for \$250,000 and within 30 days purchased another home for \$174,800. Only 46 days before filing he sold that property for \$271,500 and 2 days later (44 days before filing) purchased another home for \$146,000. He claimed the entire residence as exempt.

The bankruptcy trustee objected to the exemption. The debtor argued first that *McNabb* applied, but even if it didn't that the equity in the home was not limited to \$125,000, but included the equity he "rolled over" from his previous home that was purchased well in advance of the 1,215 days before filing.

While the court disregarded the *McNabb* argument (citing *Kaplan*), the court disagreed with the bankruptcy trustee's limited reading of "previous principal residence" exclusion under the new Bankruptcy Act. The *Wayrynen* judge found that equity rolled over to the present home from prior residences owned within Florida includes not only the home most recently owned but also the home owned before that which was acquired more than 1,215 days prior to filing.

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