



Dean, Mead, Egerton, Bloodworth, Capouano & Bozarth, P.A.  
800 North Magnolia Avenue, Suite 1500  
P.O. Box 2346 (ZIP 32802-2346)  
Orlando, FL 32803

Orlando  
Fort Pierce  
Viera

407-841-1200  
407-423-1831 Fax  
www.deanmead.com

**June 2005**

## **DE-CODING THE NEW BANKRUPTCY LAW**

The amendments to the Bankruptcy Code just signed into law by President Bush dramatically reduce the exemptions available in bankruptcy and limit the ability to wipe out debts by filing bankruptcy. The following is a brief summary of the most significant changes affecting Florida residents. For a complete explanation and analysis of the law as it applies to specific situations, we recommend you contact one of our Wealth Preservation and Estate Planning attorneys.

### **HOMESTEAD PROTECTION**

The most significant changes for Florida residents are the new limitations on the ability to use Florida's homestead exemption. Under Florida law, a person's homestead is entitled to complete exemption from claims (other than mortgages and liens placed on the homestead itself), regardless of the home's value or how long you have lived there. Under the new bankruptcy law, the homestead exemption will be limited to \$125,000, unless you have lived in the home for at least 40 months. If you sell one home and invest the proceeds in another, then you are allowed to count the time in the old home against the 40-month requirement. The residency requirement is extended to 10 years if the purchase of the home is considered a fraudulent conveyance, meaning that the home was purchased with the intent to hinder, delay or defraud creditors. Moreover, if the debtor has committed securities fraud, a felony or other serious acts, the homestead exemption is completely eliminated regardless of the period of ownership. If there is a significant paydown or payoff of a mortgage with non-exempt funds within the 40-month (or 10-year) period, this will likely be deemed a "purchase" of a portion of the homestead and thus subject to the \$125,000 limitation.

### **RETIREMENT PLANS**

Under the new bankruptcy law, all retirement plans are exempt from creditors, with the exception of individual retirement accounts (IRAs), for which the exemption is capped at \$1 million. However, the \$1 million limit does not apply to SEP IRAs, SIMPLE IRAs or any portion of an IRA that is rolled over from another type of retirement plan, such as a 401(k) plan. Florida law (which still applies outside bankruptcy) exempts all plans (including IRAs) from claims of creditors, but it will be superseded if the debtor goes into bankruptcy.

## **SELF-SETTLED TRUSTS**

Many foreign countries and several states, including Alaska, Delaware and Nevada, permit “self-settled trusts” (also known as asset protection trusts). The assets in these trusts generally are protected from creditors’ claims, even though the settlor may be a beneficiary of the trust. The new bankruptcy law exempts such trusts only if they have been existence for at least 10 years prior to filing bankruptcy. This rule does not apply to irrevocable trusts created for children and other family members, so long as the settlor is not a beneficiary of the trust.

## **LIMITATION ON FILING CHAPTER 7 BANKRUPTCY**

Under old bankruptcy rules, most individuals filed under Chapter 7, which allowed the person’s debts to be erased immediately by applying non-exempt assets to pay down claims, usually on a cents-on-the-dollar basis, with the debtor retaining all their exempt assets. Under the new rules, if an individual’s income exceeds the state median income, that person must go through a 5-year repayment plan during which most of their income would have to be applied to repay creditors.

## **TENANTS BY THE ENTIRETIES**

One bit of good news in the new law is that it makes no changes to state law exemptions for tenants-by-the-entireties (TBE) property. In Florida, TBE property is protected from creditors’ claims where only one spouse is the creditor. Although there have been attacks on the TBE exemption in some states and on the federal level, the Florida Supreme Court affirmed its continuing effectiveness in Florida in 2003. Unless there is a major change in Florida law, TBE protection should continue in Florida. Because this is one area where the bankruptcy courts defer to state law, TBE property should remain exempt for Florida residents even in bankruptcy.

## **INVOLUNTARY BANKRUPTCY**

Because of the limited exemptions and other restrictions of the new law, many debtors may worry whether they can be forced into bankruptcy involuntarily. The involuntary bankruptcy rules provide that if a debtor has fewer than 12 unsecured creditors, then a single creditor owed at least \$10,000 may be able to force the debtor into bankruptcy; if there are 12 or more unsecured creditors, then 3 creditors are required to force a bankruptcy. In Florida, small recurring debts (utilities, etc.) are not counted in determining the number of unsecured creditors. The filing of an involuntary bankruptcy petition must be made in good faith and for a valid bankruptcy purpose, and if it is not, the creditor can be liable for damages. Accordingly, creditors will think twice before filing an involuntary petition, but because the bankruptcy law is now so much more favorable to creditors than state law, it is an approach more creditors will consider.

## **EFFECTIVE DATES**

The new law is generally effective for bankruptcies filed on or after October 17, 2005, although certain provisions are effective immediately. Anyone considering filing bankruptcy may want to file before October 17 to avoid many of the restrictions imposed by the new law.

## PLANNING POINTERS

- The new rules only apply in bankruptcy court. Florida's more generous exemptions continue to apply in state court. Thus, avoiding being forced into bankruptcy may become very important.
- The express recognition of self-settled trusts (domestic and foreign) in the new law can be viewed as a confirmation of their effectiveness in bankruptcy. However, they should be considered only as a long-term wealth preservation strategy because of the 10 year look-back period. Additionally, there are still unanswered state law questions about the effectiveness of domestic self-settled trusts for assets of persons who are not residents of the state where the trust is established.
- Retirement plans continue to be well-protected in Florida, with the exception of IRAs over \$1 million that are not SIMPLE IRAs, SEP IRAs, or rollovers from other plans. If you have an IRA that is approaching \$1 million, and are concerned about wealth preservation, you should consider capping the balance at \$1 million.
- Florida's unlimited homestead exemption has always been one of the most important protections available to Florida residents. Under the new law, meeting the 40-month residency requirement will be very important, so the reinvestment of sales proceeds from one home to the next should be carefully documented. In addition, the strategy of maintaining a large mortgage on the home with the idea that it could be paid off just prior to filing bankruptcy may be risky under the new law.
- Many Florida law exemptions remain intact under the new law. These include TBE property, the cash value of annuities and life insurance, and wages accounts, as well as a limited exemption for 529 plans.
- Because the effective date of the new law is still 6 months away, now is the time for a thorough review of your wealth preservation and estate planning. Even recent planning should be reviewed in light of the new rules.