Steve Leimberg's Asset Protection Planning Email Newsletter - Archive Message #73

Date: 25-Oct-05
From: Steve Leimberg's Asset Protection Planning Newsletter
Subject: **Wayrynen 2nd Florida Bankruptcy Court Confirms $125,000 Homestead Cap in "Opt-Out" States**

"Congress clearly intended for the exemption limitations provided under § 522(p)(1) to apply to all debtors".

Wayrynen , notes **Jeffrey Baskies** and **Tomas Messana** of **Ruden, McCloskey** in Ft. Lauderdale, Florida, not only confirms the $125,000 Homestead Cap in "Opt-Out" states but also offers our first insight into the definition of "Previous Principle Residence" as Provided in the new Bankruptcy Act.

Please, at the bottom, also see my Post Script commentary on the Smith Case which I reported on yesterday in Estate Planning Newsletter # 885 (http://www.leimbergservices.com/openfile.cfm?filename=D:\inetpub\wwwroot\all\lis_notw_885.html&fn=lis_notw_885)

EXECUTIVE SUMMARY:

On October 14, 2005, US Bankruptcy Judge Steven H. Friedman issued the second decision in a month holding that the "Homestead Cap" of $125,000 as reflected in Section 522(p) of the Bankruptcy Code as amended by Section 322 of the Bankruptcy Abuse Prevention and Consumer Protection Act ("BAPCPA") applied in Florida (a state that "opted-out" of the federal bankruptcy protections and a state also famous for its extremely liberal homestead exemption).

BUT, in Wayrynen, the debtor was saved by the application of new section 522(p)(2)(B) (as adopted in BAPCPA), as he "rolled over" equity from prior Florida homes he owned.

FACTS:

May 19, 1989 (5,824 days before filing bankruptcy): Charles H. Wayrynen , the debtor, bought a home in Lake Worth, Florida for $99,500.

Aug 20, 2002 (983 days before filing): Wayrynen sold that house for $250,000.

September 6, 2002 (966 days before filing): Wayrynen purchased a home in Hobe Sound, Florida for $174,800.

March 14, 2005 (46 days before filing): Wayrynen sold that property on

for $271,500.

March 16, 2005 (44 days before filing): Wayrynen bought a home in Port St. Lucie, Florida for $146,000.

April 29, 2005: Wayrynen filed a voluntary petition for bankruptcy protection under Chapter 7.

Wayrynen claimed an exemption for the full value of his homestead residence and listed the value at $150,000.

In June, the trustee conducted a Meeting of Creditors, and subsequently filed an Objection to the Claimed Exemptions, pursuant to Bankruptcy Rule 4003(b). In the Objection, the trustee argued that as a result of Wayrynen's purchasing his residence within the 1215 days prior to filing, §§ 522(b)(2) and (p)(1) limited the homestead exemption available to Wayrynen to $125,000. Unfortunately, the opinion does not address the amount of indebtedness at each sale, and as such the amount of "equity" cannot be determined from the opinion.

The debtor argued first that the $125,000 homestead cap did not apply in Florida (an opt-out state) in reliance on In re: McNabb, 326 B.R. 785 (Bankr. D. Ariz. 2005), which held that the $125,000 cap added by BAPCPA did not apply to "opt-out" states like Florida.

Alternatively, he argued his exemption for equity in the home was not limited to $125,000 but included the equity he "rolled over" from his previous Lake Worth home which was purchased well in advance of 1215 days before filing.

The trustee argued first that McNabb was incorrect, and second that both the debtor's current home and the "previous personal residence" were both acquired during the 1215 days before filing for bankruptcy and as such the extent of the homestead protection was capped at $125,000.

The Court agreed with the trustee that McNabb was wrong. Consistent with the recent Kaplan case in Florida, (See Asset Protection Planning Newsletter # 72 at http://www.leimbergservices.com/openfile.cfm?filename=D:\inetpub\wwwroot\all\lis_app_72.html&fn=lis_app_72) Judge Friedman found that

"Congress clearly intended for the exemption limitations provided under § 522(p)(1) to apply to all debtors".

However, the Court disagreed with the trustee's limited reading of the "previous principal residence" exclusion. Ultimately, the Judge held that the § 522(p)(2)(B) "safe harbor" for 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 1215 days prior to filing.

COMMENT:

McNABB NO LONGER GOVERNS:

Previously, in Arizona (the case was In re McNabb which LISI reported in Asset Protection Planning Newsletter # 69 at http://www.leimbergservices.com/openfile.cfm?filename=D:\inetpub\wwwroot\all\lis_app_69.html&fn=lis_app_69), US Bankruptcy Judge Haines had held that Section 322 of the BAPCPA (which creates new Section 522(p) of the Bankruptcy code, providing a cap on homestead value) did not apply in Arizona because Arizona opted out of the federal exemptions found in the Bankruptcy Code.

In that case, the judge found the provisions of BAPCPA unambiguous and therefore ignored legislative history. Yet he found a "glitch" in drafting that he ruled permitted the debtor to exempt the homestead without regard for the cap. If Judge Haines' interpretation were adopted in Florida, then the $125,000 homestead limitation would likewise not apply in Florida.

In October, two courts in Florida have now ruled contrary to McNabb on its interpretation of Section 522(p).

The debtors in both of the Florida cases, Elona Kaplan and Charles Wayrynen, both argued that the logic in McNabb similarly applied to their cases as Florida also opted out of the federal exemptions. However, in both cases, the Judges concluded that the BAPCPA itself was sufficiently unclear on its face and entered into an examination of the legislative history.

Both courts, after examining that legislative history, decided that it was an inescapable conclusion that Congress intended the $125,000 cap to apply - even in opt-out states (or perhaps maybe especially in opt-out states, like Florida).

Judge Friedman wrote:

"If this Court were to construe the language of § 522(p)(1) literally, the $125,000 limitation as to the value of a home acquired by a debtor within 1215 days of the debtor's bankruptcy filing would be rendered inconsequential. ... To exclude Florida residents from the limitations provided in § 522(p)(1) would be contrary to the intention of the Reform Act's drafters."

A VERY IMPORTANT CASE WITH VERY IMPORTANT IMPLICATIONS!

For asset protection planners everywhere, these decisions are obviously very important. Wayrynen is now the second interpretation of the homestead cap in Section 522(p) of BAPCPA which directly conflicts with McNabb. If the Florida courts are right, THIS INTERPRETATION OF BAPCPA HAS IMPLICATIONS FOR PLANNING IN EVERY STATE THAT HAS OPTED OUT OF THE FEDERAL EXEMPTIONS AND WHOSE HOMESTEAD EXEMPTION EXCEEDS $125,000 (FL, TX, KA, SD, IA, MN, AND AZ).

SO VAT'S NEW?

The novel issue presented in Wayrynen is its interpretation of the previous primary residence exclusion.

First, Section 522(p)(1) of the Bankruptcy Code states in part:

"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;"

Second, Section 522(p)(2)(B) provides an EXCLUSION from that calculation as follows:

"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."

As noted above, the trustee contended that for purposes of this exclusion, the debtor's previous residence should only apply to the one immediately owned before the one claimed exempt in the filing. And in Wayrynen, the previous residence was purchased only 966 days before filing.

However, Judge Friedman held that $150,500 of equity was built as a result of the purchase and sale of the Lake Worth home. And since that home was purchased 5,824 days before filing the petition, the equity from that transaction which passed through to the home claimed exempt on the petition was excluded from the calculation of the "interest" of the debtor subject to the $125,000 cap.

Jude Friedman stated:

"Since the amount of the "interest" transferred from the Debtor's previous principal residence ($150,500), which is excluded in

calculating the "interest" of the Debtor subject to being exempted, actually exceeds the value of the Debtor's present principal residence ($125,000) (sic), there is no portion of the value of the Debtor's present principal residence which constitutes non-exempt property."

The Judge simply held the trustee's interpretation of that exclusion to be too narrow.

"The gravamen of § 522(p)(1) is to limit the ability of individuals desiring to take advantage of the lenient exemption provisions of "debtor-friendly" states by relocating to such states. H.R. Rep. No. 109-31, pt. 1, at 102 (2005). To the contrary, the "safe harbor" language of § 522(p)(2)(B) would appear to have been intended to afford protection to individuals like the Debtor who, rather than seeking to take advantage of Florida's exemption provisions to shelter illicitly – or improperly – obtained funds, simply have benefited as a result of their ownership of Florida real property and the general appreciation of property values attributable to previous intra-state transactions."

INTEREST AQUIRED BY DEBTOR – WHAT DOES THIS PHRASE MEAN?

Finally, this case offered no insight into the potential issue of what is meant by "any amount of interest that was acquired by the debtor" in § 522(p)(1). We previously asserted the potential for a literal reading of the statute raising the argument that the date of the purchase of the home is not relevant. Instead, any equity ACQUIRED during the 1215 days prior to filing (whether by paying down mortgage principal or by rapid appreciation in the real estate market) would be exempted only up to the value of $125,000 of equity.

If THAT interpretation applies, then procedurally, whenever a client files bankruptcy with a homestead, there will need to be an appraisal of the property value and the outstanding debt on the date of filing AND on the date that is 1215 days before filing. And to the extent that the net equity increased by more than $125,000 in that time period, the excess would be an asset available to satisfy the claims of creditors.

That issue was not directly addressed in this case. However, unlike Kaplan, this case involved a previous residence acquired more than 1215 days before filing, and conceivably, had the issue been argued, it might have been apt in this case. It is not possible to tell from the record how much of the $150,500 of equity grew during the 1215 days pre-filing. Although given how long the Lake Worth house was owned, it seems likely that $125,000 of equity developed before 1215 days prior to filing.

Again, the issue of what was meant by "acquired" was not squarely addressed in this case.

HOPE THIS HELPS YOU HELP OTHERS!

Jeff Baskies Tom Messana

Edited by Steve Leimberg

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CITES:

In re McNabb, 326 B.R. 785 (Bankr. D. Ariz. 2005); In re Kaplan, Chapter 7, Case No. 05-14491-BKC-RAM (Bankr. S.D. Fla. 2005); In re Wayrynen, Chapter 7, Case No. 05-32144-BKC-SHF (Bankr. S.D. Fla. 2005).

P.S.

Steve Akers of **Bessemer Trust** , who in my opinion is one of the most scholarly – as well as practical and highly respected authorities in the estate planning world today – shared some thoughts about the Smith decision which I felt were quite important.

I expect to receive a more full blown commentary from Steve on Smith – but didn't want to wait to share his following introspection with LISI members:

"A skepticism that I have is that I don't remember ever seeing any gift tax cases saying that the agreement must be binding before it can be considered for gift tax purposes.

Most of the "buy sell agreement fixing the value" cases are ESTATE tax cases. In that context, it DOES make sense that the agreement must be binding on the estate (i.e., the estate MUST sell at the agreement price either under a mandatory sale agreement or if the entity or another owner exercises call rights under the agreement.)

However, in the GIFT tax context, it does NOT seem to me to make sense that the agreement must be binding on the DONOR in determining the gift tax value of a block of the stock (or partnership interest) that is transferred, as long as the agreement is binding on the DONEE for the block of stock that is given to the donee.

The Smith case involved a gift of limited partnership interests (less than

a 50% interest) to the donor's children. They had no ability to change the partnership agreement or to block a change to the partnership agreement that was made by the general partners and approved 50% of the limited partners (under the terms of that partnership agreement.) Similarly, if a parent gives a child an undivided 10% interest in a vacation home, the courts value that 10% interest just based on the rights of that 10% donee owner--NOT based on the combined rights of the 10% donee AND the 90% donor after the gift transaction.

There have been cases indicating that a buy-sell agreement cannot "fix" the value for gift tax purposes, but the agreement IS a factor to be taken into consideration in determining the gift tax value of interests that are given that are subject to the agreement. Therefore, it does NOT make sense to ignore the restrictions under the buy-sell agreement for purposes of valuing the gift of the limited partnership interests based on a perceived "binding on the parties" requirement under pre-2703 law.

The issue would then come back to whether section 2703 applied so that the agreement must be disregarded in determining the gift tax value. The magistrate "punted" without deciding whether the safe harbor of section 2703(b) applied to prevent the application of section 2703."

As I said, I'm sure we'll hear more from Steve Akers – but I thought his comments were so "on target" that I wanted you to have them as soon as possible.