Steve Leimberg's Asset Protection Planning Email Newsletter - Archive Message #76

Date: 01-Feb-06
From: Steve Leimberg's Asset Protection Planning Newsletter
Subject: Kaplan - Bankruptcy Case Settled

LISI Commentator **Jeffrey A. Baskies** , a partner in the Fort Lauderdale, Florida office of **Ruden McClosky** tells us that the first debtor Impacted by the new Homestead Provisions in the Bankruptcy Reform Act has settled the case and avoided a trial on the important issue of appreciation of equity.

LISI would like to express appreciation to Jeff's law partner, **Tom Messana** , and associate, **Scott Underwood** , in the preparation of this article.

EXECUTIVE SUMMARY

Elona Kaplan was the first debtor negatively impacted by the new bankruptcy law's homestead cap of $125,000. This week, she settled her case.

As previously reported, the very first case interpreting the application of the $125,000 homestead cap in the Bankruptcy Abuse Prevention and Consumer Protection Act - - found that it did not apply in opt-out states like Arizona and Florida (and others).

The next case interpreting the application of the Act - In re Kaplan, No. 05-14491-BKC-RAM (2005) – directly opposed McNabb and held that the homestead cap did apply in opt-out states (in that case, in Florida). Elona Kaplan thus was the first debtor caught in the Act's new web. Her settlement this month puts that case to rest without a trial on the issue of how passive appreciation in the equity of the home (through market forces) should be interpreted for purposes of the cap.

Since McNabb, another Florida case, two Nevada cases and a Texas case have all agreed with In re Kaplan that the $125,000 cap applies in opt-out states. And one Texas court has held that passive appreciation in equity on a home purchased more than 1215 days before filing bankruptcy is NOT available to creditors (even if in excess of the $125,000 cap amount).

MORE ON KAPLAN TO FOLLOW: BUT FIRST, EDITOR ANDY DeMAIO ISSUES A LISI LAWTHREADS ALERT:

DOES FORGIVENESS OF NOTE PRODUCE TAXABLE INCOME?

Participants in a recent online discussion agree that the forgiveness of a debt by

will, out of generosity toward the debtor-beneficiary, does not produce taxable income. Our newest LawThreads report links to a TAM on point, and explains why, despite the favorable tax ruling, forgiving a debt by will may not always be the best option.

To read this and other recent LawThreads reviews, log in at http://www.leimbergservices.com. Once logged in, click the blue LawThreads button under Recent Entries.

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NOW BACK TO JEFF BASKIES AND KAPLAN:

FACTS

In April of 2003, following a divorce, Elona Kaplan moved from New Jersey to a condo in Sunny Isles Beach in Miami-Dade County Florida.

She accumulated approximately $36,000 in credit card and other debt before filing for Chapter 7 bankruptcy on May 17, 2005.

She claimed her condominium was exempt and valued the condo at $280,000 with a first mortgage of $181,000.

Since she owned her condo less than 1215 days, the bankruptcy trustee, arranged an appraisal of the unit. Like most South Florida real estate, the appraisal showed a significant increase in value since she bought the unit. The appraisal valued Kaplan's condo at $335,000. Subtracting the $180,000 owed to the mortgage lender (she previously refinanced) and applying the $125,000 homestead exemption, Goldberg determined there was about $30,000 available to pay creditors.

As this equity was the only asset available to the trustee to satisfy the creditors, Goldberg filed a motion objecting to the claim of exemptions.

Relying on In Re McNabb, Kaplan's lawyer argued the $125,000 homestead cap doesn't apply as Florida opted out of the federal exemptions and Florida law offers an unlimited homestead exemption.

Our firm, specifically my partner, **Tom Messana** , represented the bankruptcy trustee Alan L. Goldberg and argued the logic of McNabb was wrong and the homestead cap did apply.

On October 6, 2005, US Bankruptcy Judge Robert A. Mark found 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 applied to the equity the debtor acquired in her home during the 1215 days prior to filing bankruptcy.

Post-hearing, Richard Birkenwald, Kaplan's North Miami Beach lawyer,

argued that even if the cap did apply in an opt-out state, like Florida, that the appreciation shouldn't count in determining how much equity should be applied to the $125,000 homestead exemption.

However, Elona Kaplan, agreed to pay $16,250 to settle with the bankruptcy trustee in the case. The amount would be reduced by $1,750 if she makes the payment within six months of the bankruptcy court's approval of the settlement.

There was a settlement hearing scheduled to approve the settlement on Friday the 20th.

COMMENTS

Elona Kaplan's settlement means the court will not get a chance to hear and rule on her argument that the passive appreciation in equity should not be counted. Nevertheless, her case was important as it was the first decision contradicting McNabb and its logic seems to have taken root in the bankruptcy bar.

DECISIONS, DECISIONS!

Looking at the landscape now, there are a few noteworthy decisions regarding the impact of the new Banrkuptcy Act on estate planning.

First, the logic of Kaplan seems to have prevailed over the logic of McNabb. Indeed, since McNabb came out, every other court has ruled that its logic was flawed, and the Act's homestead cap does apply in opt-out states.

Only days after Kaplan, U.S. Bankruptcy Judge Steven H. Friedman also held that the "homestead cap" applied in Florida (and by logical extension in any state that "opted-out" of the federal bankruptcy protections). (In re Wayrynen, Case No. 05-32144-BKC-SHF (2005).)

Then, on Oct. 31, 2005, Nevada U.S. Bankruptcy Judge Linda B. Riegle issued another opinion (covering two cases together) concurring with the two Florida rulings. (In re Virissimo and In re Heisel, Nos. BK-S-13605-LBR and BK-S-05-15667-LBR).

The debtors in the Florida and Nevada cases all argued that the logic in McNabb applied to their cases because Florida and Nevada had opted out of the federal exemptions.

However, in each instance, the judge concluded that the law was sufficiently unclear to allow an examination of the legislative history, which led to the inescapable conclusion that Congress intended the $125,000 cap to apply even in opt-out states.

IMPLICATIONS OF THREE MOST RECENT HOLDINGS:

For asset protection planners everywhere, these decisions are obviously very important. There are now three interpretations of the homestead cap in §522

(p) of the new bankruptcy law - all of which directly conflict with the first decision, McNabb. If these decisions are right, this interpretation has implications for planning in every state that has opted out of the federal exemptions and whose homestead exemption exceeds $125,000.

Second, there still appears to be a debate about what is meant by "any equity acquired" during the 1215 days prior to filing and whether or not passive appreciation in value during the 1215 days is part of the "any equity acquired" and similarly subject to the $125,000 cap.

For example, if a client owns a home valued at $2 million (with no debt) on the date that is 1215 days before filing, and if the property is valued at $2.5 million on the date of filing, is $375,000 ($500,000 of total equity "acquired" and only $125,000 exempted) of equity in the home available to satisfy creditors?

If that's the case, an order might be issued forcing the sale of the home to satisfy the creditors – or at the very least requiring a mortgage be taken out on the home to satisfy the creditors. This matter was not directly addressed in the Florida or Nevada cases. But if such a literal interpretation of "any interest acquired" applies, then the new §522(p) of the Bankruptcy Code will impact many more clients then otherwise might have been anticipated.

PASSIVE APPRECIATION ISSUE UNSETTLED:

However, a Texas court recently weighed in on that debate when it considered the issue of what is meant by the provision of the new Act limiting to $125,000 "any amount of interest that was acquired" the debtor. In a case published in late November, U.S. Bankruptcy Judge Harlin D. Hale ruled that where debtors' equity in their homestead increased during the 1215 days prior to filing bankruptcy, as a result at least in part of routine mortgage payments, the increased equity did not constitute an "interest" in homestead "acquired" within the 1215 days preceding filing. (In re Blair, No. 05-35922-HDH-7.)

Judge Hale found that for purposes of that section, the intent was to apply to people who acquire homes, not to those who have mere accretions in value to their existing homes. As he ruled, "one does not actually 'acquire' equity in a home. One acquires title to a home."

While the decision did not consider passive appreciation, the logic of Blair seems to extend to such equity. Thus, if other courts follow Blair, then homes purchased more than 1215 days before filing are exempted regardless of any appreciation in the equity caused by regular payments of mortgage, and presumptively regardless of any appreciation of equity by market forces.

However, even if Blair is followed, it is possible that irregular payments of mortgages (such as a lump sum payment to reduce the debt within 1215 days prior to filing) will not be dealt with the same way. Instead, they may be subject to the $125,000 cap, or they may be subject to the fraudulent conversion or fraudulent conveyance provisions and perhaps then subject to different rules.

For debtors, Blair is a big success. However, Blair is only the first decision on this subject.

HOPE THIS HELPS YOU HELP OTHERS MAKE A POSITIVE DIFFERENCE!

Jeff Baskies

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CITES:

In re Kaplan, No. 05-14491-BKC-RAM (2005); In re McNabb, 326 B.R. 785 (2005); In re Blair, No. 05-35922-HDH-7.