By Barry A. Nelson

Florida Surprise

Recent cases help keep the state's status as a haven—despite the 2005 Bankruptcy Act

To stop individuals who are on the verge of filing for bankruptcy from moving their wealth to states with laws that might better help them keep their assets, the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (the 2005 Bankruptcy Act) created two holding period requirements. To qualify for a state's homestead exemption with property worth more than $125,000, an individual must own that property for 1,215 days before filing for bankruptcy. There is also a residency requirement of 730 days, pre-bankruptcy filing, to take advantage of a state's other exemptions—including life insurance, annuities and retirement plans.

Since the 2005 Bankruptcy Act was adopted three years ago, there have been cases across the country involving homeowners who failed to satisfy either one, or both, of these holding periods. Yet, in six cases (five bankruptcy cases in Florida and one U.S. Court of Appeals for the Fifth Circuit case) decided from January 2006 through Jan. 4, 2008, homeowner debtors were able to retain all or a portion of the value of their properties after a bankruptcy proceeding. Indeed, recent decisions are producing some surprisingly good results for Florida homeowners who did not maintain a "Florida homestead":

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• In both *In re Schwarz*[1] and *In re Zolnierowicz*,[2] significant benefits were available to married couples who took title to their Florida homes as tenants by the entirety just days before a bankruptcy proceeding.

• *In re Cauley*[3] allowed a non-resident of Florida to exempt non-homestead Florida real property owned by the debtor and his spouse as tenants by the entirety—notwithstanding that Alabama law applied to determine other assets.

• Courts in *In re Reinhard*[4] and *In re Rogers*[5] found that Florida residents who, on the eve of bankruptcy, moved from one Florida residence that was used as their homestead, to another more expensive residence, merely owned by the debtors for 1,215 days before the bankruptcy filing (but not previously used as their homestead), are entitled to unlimited homestead protection for the more expensive residence.

Together, these cases provide a road map to enhancing asset protection for Florida real estate. Indeed, these rulings may open the door for unanticipated benefits for Florida residents and non-residents who invest in marketable securities titled as tenants by the entirety with Florida-based institutions.

Moreover, the cases seem to be providing guidance for states with similar homestead and tenants-by-the-entirety laws.[6] Just look at *In re Rogers*—in which the Fifth Circuit, following Florida's *In re Reinhard*, protected a Texas homestead from creditors.

Although one bankruptcy judge's decision is not

necessarily binding on others, several rulings, such as *Schwarz* and *Reinhard,* already have been followed. It's unclear whether a debtor can be assured that the cases will withstand further scrutiny. But estate planners and transactional attorneys should be familiar with them when recommending how assets should be titled and in determining the benefits and drawbacks of investing in Florida homestead or non-homestead real property, as well as Florida bank and investment accounts.

First, though, we need to understand how tenants-by-the-entirety ownership of a Florida residence effectively avoids the 730-day and 1,215-day pre-bankruptcy filing requirements. Then we can look at how investing in expensive Florida residential property that could be used as a vacation home or investment property might allow a Florida resident, and possibly a non-resident, to declare that property as homestead any time prior to filing for bankruptcy—so long as the property meets two requirements: (1) it must have been owned by the debtor for more than 1,215 days prior to the bankruptcy filing; and (2) the debtor must move into the property and declare it as homestead prior to filing for bankruptcy.

Tenants by the Entirety

In the case of *In re Schwarz*,[7] the Bankruptcy Court for the Southern District of Florida held that the 730-day residency requirement of the 2005 Bankruptcy Act did not apply to property held as tenants by the entirety for Florida domiciliaries. In *Schwarz*, the debtor had not lived in Florida for the full 730-day pre-filing period required under the act to take advantage of Florida's bankruptcy exemptions. The debtor acknowledged that he couldn't take advantage of the Florida homestead exemption—but argued that the home should be exempt from creditors in bankruptcy because it was owned by the debtor and his wife as tenants by the entirety.

The court determined that Bankruptcy Code Section 522(b)(3)(B) exempts property if the debtor had "any interest in the property immediately before the commencement of the case" that was exempt under applicable non-bankruptcy law. The opinion stated that under Florida common law, tenants-by-the-entirety property was exempt so long as (1) the debt was not a joint debt of husband and wife; and (2) there was no evidence of a fraudulent conveyance into the property. Judge John Karl Olson stated, "Congress determined to leave intact the pre-existing blanket exemption available to debtors who own property in tenants by the entirety form if applicable non bankruptcy law would exempt that property from that process."[8] Although the debtor in *Schwarz* occupied the residence five days after he'd filed his bankruptcy petition, the court looked to whether the deed granting the debtor title was executed before the bankruptcy petition. Because it was dated five months prior to the bankruptcy petition, the court concluded that the debtor held property as tenants by the entirety immediately prior to commencement of the case.

The court in *In re Zolnierowicz*[9] (an Illinois debtor moved into a Florida condominium purchased more than 10 years before establishing domicile in Florida) followed the holding in *Schwarz*. The *Zolnierowicz* debtor did not satisfy the 730-day pre-bankruptcy filing holding period. Nevertheless, Judge Paul M. Glenn in the *Zolnierowicz* opinion, citing *Schwarz*, stated, "I conclude that Florida Real Property owned by a Florida-domiciled debtor is exempt from administration as property of the estate regardless of when the debtor became a Florida domiciliary if the debtor had, immediately before the commencement of the case, an interest in that property held as tenants by the entireties with a spouse."[10]

Based upon *Schwarz* and *Zolnierowicz*, a married couple can acquire Florida real property as tenants by the entirety and, so long as the property was not acquired as a "fraudulent conveyance," the home should be protected from creditors, not as a "homestead," but based upon Florida's tenants-by-the-entirety law as long as the home was so titled prior to filing for bankruptcy.

Does this tenants-by-the-entirety protection extend in Florida to the real property of non-residents? A Florida Bankruptcy court thinks so.

In June of 2007, the Bankruptcy Court in *In re Cauley*[11] went a step further than *Schwarz* by extending tenancy-by-the-entirety protection of Florida real property investments to non-residents of Florida in a bankruptcy proceeding. In *Cauley*, a Delaware domiciliary owned Florida real property as tenants by the entirety and claimed that the property should be exempt from bankruptcy claims under Bankruptcy Code Section 522(b)(3)(B) based upon applicable non-bankruptcy law in Florida. The opinion states: "This court has found no authority to support that to claim Florida real property as exempt as tenancy by the entirety the person must be a Florida resident and this court finds no such requirement exists."[12] It appears that *Cauley* (if followed) provides an opportunity to sidestep the 2005 Bankruptcy Act by allowing non-residents of Florida to take advantage of Florida's tenants-by-the-entirety protection for real estate.

> It seems a Florida homestead can be upgraded from a less expensive home to a more expensive one—so long as the debtor owned the pricey house 1,215 days before filing for bankruptcy.

Intangible Assets

Recent case law also suggests that it's possible for a debtor to take the position that the *Schwarz* decision could be extended to intangible property. Although not a homestead case, *In re Robedee*[13] is worthy of comment as it could provide planning opportunities beyond homestead and real property.

In *Robedee*,[14] a New York debtor moved to Florida and established a tenants-by-the-entirety bank account within 730 days of his bankruptcy petition. The Bankruptcy Court found he'd failed to satisfy the 730-day domicile rules; thus, New York bankruptcy exemptions applied. But the court also looked at Bankruptcy Code Section 522(b)(3)(B), which exempts property owned as tenancy by the entirety if a debtor had any interest immediately before the case commenced, as long as the property is exempt under applicable non-bankruptcy law.

The same judge that had decided *Schwarz*, Judge Olson, held in *Robedee* that a New York debtor who relocated to Florida, deposited funds in a Florida tenants-by-the-entirety bank account and filed bankruptcy within 730 days of moving to Florida still was entitled to tenants-by-the-entirety protection, notwithstanding the fact that New York does not provide similar protection. Judge Olson held that there's no difference between real property and personal property, stating, "Once the property was held in a tenancy by the entirety in Florida by a Florida domiciliary . . . that property was immune from execution under Florida law and exempt under Section 522(b)(3)(B)."[15] As in *Schwarz*, the opinion notes that there was no fraudulent conveyance under the facts.

Read in conjunction with *Robedee's* assertion that there's no difference between real and personal property, one could argue that *Cauley* also should apply to Florida bank accounts held as tenants by the entirety by non-residents. While it's true that only these two cases have so far addressed these issues and they must be read together to reach such a conclusion, one can argue that Florida real estate and Florida intangible accounts (for example bank accounts, brokerage accounts and trust accounts managed by Florida institutions and administered in Florida) held as tenants by the entirety by Florida nonresidents should be protected in the event of a bankruptcy proceeding.

In light of *Schwarz*, *Cauley*, and *Robedee*, married couples willing to take advantage of Florida's tenancy-by-the-entirety protection should consider

investments in Florida real property and possibly even Florida bank accounts, brokerage accounts, or trust accounts. The 730-day and 1,215-pre-filing requirements would be avoided—provided these couples become Florida domiciliaries before filing bankruptcy and other courts follow *Robedee* and *Schwarz*.

Of course, a creative argument could be made that it would be an effective fraudulent conveyance to establish domicile in Florida after a judgment to take advantage of the tenancy-by-the-entirety protection described in *Robedee* and *Schwarz* for bank accounts and real estate owned in Florida. But this argument could be overcome by a debtor's claim that no transfer took place after the debt was incurred but only domicile was changed. Furthermore, based upon *Cauley*, it's possible that such accounts owned as tenants by the entirety by non-residents of Florida also may still be protected.

In Lieu of Homestead Protection?

Given these rulings, it's natural to wonder whether we should be relying solely on tenancy-by-the-entirety protection for married couples rather than homestead protection. The answer is, "No." There are two traps for owners of entirety property that are not problematic for those who own homestead property: (1) Joint debts of a husband and wife can be enforced against tenants-by-the-entirety property; and (2) an untimely death or a divorce results in the loss of tenants-by-the-entirety protection.

Clearly, it's safer for those who are married to have

the benefits of both the Florida constitutional homestead protection as well as tenants-by-the-entirety protection. So if, for example, a spouse dies, the surviving spouse can be assured that her home remains protected under the constitutional homestead exemption[16] whereas the same home would no longer be protected upon the death of a spouse if relying solely on tenants-by-the-entirety protection (that is to say, the home would pass by law entirely to the surviving spouse and thereafter no longer enjoy tenants-by-the-entirety protection).

Ace in the Hole

Recent case law suggests that Florida homestead can be upgraded from a less expensive home to a home also owned by the debtor but not previously used as his homestead regardless of whether the "upgrade" is made within the 1,215 day pre-filing period, as long as the debtor owned (but not necessarily occupied) such property 1,215 days prior to the bankruptcy petition.[17] In *In re Reinhard*, a Florida debtor owned two Florida homes for more than 1,215 days prior to filing for bankruptcy. He moved from the less expensive residence to the one worth approximately $4.5 million and then designated the more expensive property as his homestead shortly before filing for bankruptcy. The Bankruptcy Court stated that the 1,215 day holding period under the 2005 Bankruptcy Act was satisfied despite the fact that he only recently declared the more expensive home as his homestead, because the mere "designation" of homestead status is not deemed to be an acquisition of real property. The decision in *In re Reinhard* was followed in *In re Rogers*, where the Fifth Circuit applied the *In re Reinhard* reasoning to Texas homestead law.[18]

Based upon *Reinhard* and *Rogers*, it appears the 1,215 day requirement can be avoided if a person who has two residences moves, in the event of financial difficulties, into the more expensive home and changes the homestead status from the less expensive home to the more expensive home. Alternatively, it also would appear that a debtor who owns an expensive rental property or investment home but occupies a less expensive home (even if the debtor rents, but does not own the occupied home) prior to filing the bankruptcy petition could also move into the more expensive home and enjoy the same homestead benefits. If the less expensive home is owned as tenants by the entirety and the debt is only against one spouse, it would appear that the less expensive home would be protected from bankruptcy claims as well.

Reinhard involved a Florida debtor moving from one home that was homestead exempt to another that was not. Is it possible then that *Reinhard* can be used to extend the homestead protection to the real property of a person who was not a Florida resident, but owned the Florida home for 1,215 days? The answer is probably, "No." At a minimum, to be able to rely on Florida homestead exemption, residence of 730 days prior to filing the petition is required.

But possibly under *Robedee*, (if followed) a person who's not domiciled in Florida and unable to benefit from tenants-by-the-entirety protection (because he's unmarried or unwilling to use tenants by the entirety with his spouse), may be able to reduce the 1,215-day holding period to 730 days if a Florida residence is acquired (more than 1,215 days before bankruptcy filing) in anticipation of a potential move to Florida. The debtor relying on *Robedee* should be able to declare a Florida homestead after living in Florida 730 days; he would not have "acquired" the Florida residence within 1,215 days but rather the "status" of his home would be changed. While the law is unclear and the debtor in *Robedee* was a Florida domiciliary, one who's considering retirement to Florida may have additional motivation to acquire a Florida vacation home (to start the 1,215 day holding period) that could be converted into a primary residence if creditors become a problem.

Caution

It may be too early to tell if these cases will be followed and one certainly can argue that only aggressive attorneys and their clients should rely on them now. Still—when considering a number of options for asset protection—it's a good idea to take a fresh look at investing in Florida, especially for married non-residents. TE

Endnotes

1. *In re Schwarz*, 362 B.R. 532 (Bankr. S.D. Fla. 2007).
2. *In re Zolnierowicz*, 380 B.R. 84 (Bankr. M.D. Fla 2007).
3. *In re Cauley*, 374 B.R. 311 (Bankr. M.D. Fla. 2007).
4. *In re Reinhard*, 377 B.R. 315 (Bankr. N.D. Fla 2007).
5. *In re Rogers*, 2008 U.S. App. Lexis 129.
6. For a summary of state homestead laws, *see* Ryan Rivera, "State Homestead Exemptions and their Effect on Federal Bankruptcy Laws," *Real Property, Probate & Trust Journal*, Spring 2004. Arkansas, Iowa, Kansas, Oklahoma, South Dakota and Texas have some form of unlimited homestead exemption in

bankruptcy proceedings. There appear to be 22 states that provide some type of tenants-by-the-entirety protection. For a summary of all state's exemptions, including homestead and tenants by the entirety, *see* Peter Spero, *Asset Protection*, Warren Gorham & Lamont, supplemented semi-annually.

7. *Schwarz, supra* note 1.
8. *Ibid.*, at note 1.
9. *Zolnierowicz, supra* note 2.
10. *Ibid.*
11. *Cauley, supra* note 3.
12. *Ibid.*
13. *In re Robedee*, 367 B.R. 901 (Bankr. S.D. Fla. 2007).
14. *Ibid.*
15. *Ibid.*
16. For a discussion on moving to Florida to exploit favorable homestead laws prior to enactment of the 2005 Bankruptcy Act, *see* Barry A. Nelson and Kevin E. Packman, "Florida Homestead Traps," *Trusts & Estates* (July 2004). For a discussion of the 2005 Bankruptcy Act's effect on Florida Homestead, *see* Barry A. Nelson, "How Does the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 Affect Florida Homestead? Many Unanswered Questions," 79 No. 10 *Fla. Bar J.* 22 (November 2005), and Barry A. Nelson, "Rasmussen Court Allows Both Spouses $125,000 Exemptions and Protects Appreciation within 1,215 Days of Bankruptcy," 81 *Fla. Bar J.* 43 (Jan. 2007).
17. *Reinhard, supra* note 4.
18. *Rogers, supra* note 5.

ADDENDUM:

Barry Nelson's article in the May 2008 issue, "Florida Surprise," stated that under the 2005 Bankruptcy Act to qualify for a state's homestead exemption with property worth more than $125,000, an individual must own that property for 1,215 days before filing for bankruptcy. The $125,000 limitation is referred to in Bankruptcy Code Sections 522 (p) and 522 (q). Both of those sections are subject to periodic adjustments at three-year intervals under the Bankruptcy Code. Effective for bankruptcy cases filed on or after April 1, 2007 the amounts were adjusted to $136,875.