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THE NEW BANKRUPTCY LAW

HOW WILL IT AFFECT ASSET PROTECTION?

By David . Holmes
August 2005

On April 20, 2005, President Bush signed The Bankruptcy Abuse Prevention and Consumer Protection Act, which will result in significant changes to the United States bankruptcy system when it takes effect in October. Bankruptcy can be the last step in the asset protection process for clients who have planned ahead. This is because a debtor in bankruptcy can keep all of his or her exempt assets. Bankruptcy courts traditionally recognize all exemptions available under the law of the state in which a debtor declares bankruptcy. Florida has a number of generous exemptions that are maximized in the asset protection planning process—including exemption of the homestead from the claims of most creditors, with no limitation on the exempt value of the homestead.

WHY CONSIDER BANKRUPTCY?

If you have a properly developed asset protection plan, most of your assets will be held in an entity or form of ownership that is exempt under Florida law. If a judgment is entered against you, the judgment holder can't take your exempt assets. At the same time, your access to and use of exempt assets can be significantly impaired while the judgment is in place. Moreover, wages and other forms of income can be garnished by a judgment creditor. A Chapter 7 bankruptcy proceeding allows a debtor to retain all exempt assets, obtain a discharge of all debts and judgments, and emerge free from past obligations. Thus, a Chapter 7 bankruptcy is often preferable to enduring the ongoing limitations that can be imposed by a judgment for up to 20 years.

FLORIDA EXEMPTIONS UNDER THE NEW LAW.

Under the old system, a debtor residing in Florida at least 91 days before filing bankruptcy is entitled to the protection of Florida's liberal asset exemptions. The new law increases this residency requirement to 730 days (i.e., 2 years). If you file bankruptcy within 730 days of moving to Florida, you must use the exemptions of the state from which you moved.

In addition, under the new law, you must live in your Florida homestead for 3 years and 4 months (40 months) before you can protect an unlimited amount of homestead value in bankruptcy. If you move from one or more Florida homesteads within 40 months before filing bankruptcy, the time you resided in the prior homestead(s) is counted toward the time of residence in your current homestead. If you have not maintained a Florida homestead for 40 consecutive months before filing bankruptcy, the homestead exemption will be limited to $125,000 under the new law.

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LIMITATIONS ON CHAPTER 7 FOR HIGH INCOME INDIVIDUALS.

Another significant limitation on Chapter 7 filings will be the so called means test. If your family's income is above the annually determined median income for Florida, your net income for bankruptcy purposes will be calculated by a formula utilizing IRS standard expense figures. If your calculated net income exceeds a fairly nominal threshold (less than $200 per month) you will not be permitted to file Chapter 7 bankruptcy unless special circumstances apply. The only option for these above median income debtors will be a less favorable Chapter 13 bankruptcy where a more significant repayment of debts out of future income is required.

The means test applies only to people whose obligations are primarily (typically more than 50%) consumer debts—debts incurred for personal, family or household items. Most asset protection clients are concerned with large, unanticipated negligence or malpractice judgments rather than consumer debts they are unable to repay. For these clients, Chapter 7 will remain a viable option, regardless of income.

THE BOTTOM LINE.

While the new bankruptcy law imposes significant limitations on bankruptcy filings, Chapter 7 bankruptcy will remain a viable option so long as you have lived in Florida for at least 730 days, have owned a Florida homestead for at least 40 months, and your debts are not primarily consumer obligations. Of course, maximizing exemptions before a claim arises is the most crucial component of the planning process. Once a claim is made (even before suit is filed) your ability to take advantage of exemptions is limited by Florida's fraudulent transfer statute.

There are a number of other features to the new bankruptcy law that are beyond the scope of this article. Contact a qualified attorney before making bankruptcy related decisions.

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