Middle District Bankruptcy Court Weighs
In On Homestead Cap Dispute Under the BAPCPA

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Floridians, prior to the enactment of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA"), enjoyed an unlimited cap on their homestead exemption – both in and out of bankruptcy court. Among creditors there was a perception that the Bankruptcy Code contained a "mansion loophole" in that debtors with significant debt would buy large homes in states such as Florida which had a very liberal homestead exemption and then file bankruptcy claiming the home as exempt. To address the problem, Congress in the BAPCPA added Section 522(p) which states, in part: …as a result of electing under subsection (b)(3)(A) to exempt property under State or local law, 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 short, the BAPCPA attempted to limit the homestead exemption to $125,000.00 if the homestead was purchased within 3-1/3 years of a bankruptcy filing. Any amount over the cap becomes property of the estate and is used to pay creditors unless the transfer is from the sale of another homestead within the same state or the home is the principal residence of a family farmer.

However, at least one court has held that the celebration among creditors was premature as 522(p) includes a fatal drafting error. In *In re McNabb*, 326 B.R. 785 (B.R. D. Ariz. 2005) the court reasoned as follows: (1) 11 U.S.C. 522(b)(2) permits states to "opt-out" of the § 522(d) federal exemptions, limiting residents to state exemptions; (2) § 522(p) applies to debtors who "[elect] under subsection (b)(3)(A) to exempt property under State or local law…"; (3) debtors residing in "opt-out" states are unable to make an "election" between state and federal exemptions; (4) therefore, § 522(p) is only applicable to states where debtors may choose

between exemptions. In so holding, the *McNabb* court found that § 522(p) was unambiguous as written and refused to consider legislative history in its interpretation, even though it recognized that the result was likely a drafting "glitch". (Under this analysis, the only states where 522(p) would be applicable are Texas and Minnesota.)

The victory parade for debtors was short lived however as several bankruptcy courts issued opinions disagreeing with *McNabb*. *See In re Kane*, 336 B.R. 477 (Bankr. D. Nev. 2006); *In re Virissimo*, 33 B.R. 201 (D. Nev. 2005); *In re Wayrynen*, 332 B.R. 479 (Bankr. S.D. Fla. 2005); and *In re Kaplan*, 331 B.R. 483 (Bankr. S.D. Fla. 2005). Two lines of argument emerged from these cases: (1) "electing" as stated in § 522(p) referred not to the election between state or federal exemption allowances, but instead referred to "electing" to claim certain property as exempt; (2) the definition of "electing" under § 522(p) is ambiguous and therefore it is necessary to rely on legislative history which clearly demonstrates that Congress did not intend to limit §522(p) to debtors who live in non opt-out states. Accordingly, the majority of courts considering this issue hold that § 522(p) is a cap on all debtors, regardless of the state in which they file bankruptcy.

Fortunately for debtors and practitioners in the Middle District of Florida, this issue was presented in *In re Landahl*, 2006 WL 506034 (Bankr. M.D. Fla. 2006). Mr. Landahl sought to discharge approximately $166,000 of unsecured debt; per Mr. Landahl's bankruptcy schedules, the equity in his homestead was approximately $188,000.00. Judge May held that Mr. Landahl's homestead exemption claim was limited to $125,000, following the reasoning of *Kane, Virissimo and Kaplan*, and stated it would be "irresponsible for this Court to rule that an amendment added to existing law after considerable debate is inoperative in circumstances that are not clearly spelled out either in the statute itself or in its legislative history." Judge May concluded:

> The "result of electing" phrase does not, by its terms, compel the conclusion that Section 522(p) is inoperative in Florida and other opt-out states. That phrase can be read in harmony with applying the $125,000 in all states. Even if there is an ambiguity, the conclusion from the legislative history is inescapable--there is no expressed intent to make the $125,000 cap operative in some states, but not others.

Whether Congress will address the drafting "glitch" remains in question. Certainly if additional courts agree with the *McNabb* holding, creditors and lobbyists will once again travel to Capital Hill and ask Congress for assistance. At the end of the day, it is probable that either through judicial interpretation or an amendment to 522(p), those seeking to engage in pre-bankruptcy planning must factor in the 3-1/3 year limitation/$125,000 cap on the homestead exemption before filing.

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