

## Bankruptcy Law A Practice Focus

# Your Home Is a Castle

A new D.C. law gives residents generous protection during bankruptcy.

BY ALAN D. EISLER

On April 27, 2001, with little fanfare, the District of Columbia joined the ranks of states that allow residents to shield the full value of their homes from creditors. Previously, the District had no separate "homestead exemption" for a principal residence. Rather, it permitted householders to exempt from creditors "one horse or mule; one cart, wagon, or dray and harness . . . if used principally by the debtor in his trade or business."

It is understandable (with the decline in hoof traffic) that the abolishment of a special exemption for horses and mules received scant attention. But more than simply changing an arcane bankruptcy law, by updating its exemptions, what the District has done is craft a serious incentive for people in the D.C.-area suburbs to move back to the city.

### PROTECTING THE HOMESTEAD

The District of Columbia, Puerto Rico, the 50 states, and the federal Bankruptcy Code allow individuals (but not businesses) to protect from creditors a limited amount of assets so that citizens are not stripped of all of their assets during times of financial misfortune. The type and amount of exemptions available, however, vary greatly depending upon where you are domiciled (which is generally defined as the place where a person resides and intends to remain indefinitely).

Individuals are entitled to claim

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exemptions whether or not they file for bankruptcy protection. Outside of bankruptcy, individuals are limited to the exemptions available in the jurisdiction in which they are domiciled, as well as certain federal nonbankruptcy exemptions, such as the Employee Retirement Income Security Act of 1974 (ERISA).

Although Congress created federal exemptions under the Bankruptcy Code, it allows states (defined to include Puerto Rico and the District of Columbia) to "opt out" of the federal exemptions and limit their residents to the exemptions available under their respective state law. A total of 37 states, including Maryland and Virginia, accepted Congress' invitation and opted out of the federal exemptions.

The federal exemptions under the

Bankruptcy Code are available only to individuals who file for bankruptcy in jurisdictions that have not "opted out" of the federal bankruptcy exemptions. A person is entitled to file a bankruptcy case in the district in which he or she is domiciled, resides, or maintains a principal place of business or assets for 180 days prior to the date of the bankruptcy filing.

Many of the states that elected not to adopt the federal exemptions offer generous exemptions to residents. Florida and Texas gained particular notoriety for offering unlimited homestead exemptions. Other states, including Virginia and Maryland, allow married couples to exempt property titled as tenants by the entirety from the individual creditors solely of the husband or wife. These discrepancies have caused critics to clamor that even though Congress created a federal Bankruptcy Code, the protections debtors receive from creditors are far from uniform.

The District of Columbia offers residents the option of choosing either D.C. exemptions or the federal exemptions in bankruptcy cases. Until April 27, 2001, most D.C. residents elected to use the federal exemptions, which were far more generous than the exemptions then available under D.C. law. But now, the District's exemptions may be more favorable in bankruptcy cases.

### FEDERAL RULES VS. D.C. RULES

The federal exemptions—which were just increased on April 1, 2004—allow individuals to exempt the following assets:

- (1) Up to \$18,450 of a person's interest in a principal residence;
- (2) \$2,950 in one motor vehicle;
- (3) Up to \$9,850 in household goods and furnishings, but no more than \$475 per item;
- (4) \$1,225 in jewelry held primarily for personal, family, or household use;
- (5) Up to \$9,250 (but no more than \$975 per item) of any used portion of the \$18,450 available in paragraph (1) above;
- (6) \$1,850 for professional books or tools of a trade;
- (7) Any unmaturing life insurance contract owned by the debtor, other than a credit life insurance contract;
- (8) Up to \$9,850 of a debtor's interest in a life insurance contract owned by the debtor and under which the debtor or a dependent is insured;
- (9) Professionally prescribed health aids for the debtor or a dependent;
- (10) The debtor's right to receive:
  - (a) social security benefits, unemployment compensation, or local public assistance benefits;
  - (b) veterans' benefits;
  - (c) disability, illness, or unemployment benefits;
  - (d) alimony, support, or separate maintenance reasonably necessary for the support of the debtor or a dependent;
  - (e) payment under a stock bonus, pension, profit sharing, annuity or similar plan on account of illness, disability, death, age, or length of service (to the

extent reasonably necessary to support the debtor or a dependent), unless

(i) such plan was established by an insider, payment is on account of age or length of service, and such plan does not qualify under Internal Revenue Code §401(a), 403(a), 403(b), or 408;

(11) The debtor's right to receive, or property that is traceable to:

(a) a crime victim's reparation award;

(b) wrongful death payment (to the extent reasonably necessary to support the debtor or a dependent);

(c) payment under a life insurance contract (to the extent reasonably necessary to support the debtor or a dependent);

(d) Up to \$18,450 on account of personal bodily injury (excluding pain and suffering or compensation for actual pecuniary loss);

(e) Payment in compensation of loss of future earnings (to the extent reasonably necessary to support the debtor or a dependent).

The amended D.C. exemptions parallel the federal exemptions, with the notable exception of the District's unlimited exemption for a person's principal residence and a separate exemption for Individual Retirement Accounts and 401(k) plans. Unlike the federal bankruptcy exemptions, the amounts of which are increased every three years, the District's exemptions will not be adjusted. The District's significant amended exemptions are as follows:

- (1) Unlimited interest in a principal residence;
- (2) \$2,575 in one motor vehicle;
- (3) Up to \$8,625 in household goods and furnishings, and wearing apparel, but no more than \$425 per item;
- (4) No separate exemption for jewelry
- (5) Up to \$8,075 (but no more than \$850 per item) of any used portion of the homestead exemption available in paragraph (1) above;
- (6) \$1,625 for the debtor or a dependent's professional books or tools of trade; \$300 for the library, office furniture, and implements of a professional person or artist;
- (7) Any unmaturing life insurance contract owned by the debtor, other than a credit life insurance contract;
- (8) No separate exemption for a debtor's interest in a life insurance contract owned by the debtor and under which the debtor or a dependent is insured;
- (9) Professionally prescribed health aids for the debtor or a dependent;
- (10) The debtor's right to receive:
  - (a) social security benefits, unemployment compensation, or local public assistance benefits;
  - (b) veterans' benefits;
  - (c) disability, illness, or unemployment benefits;
  - (d) alimony, support, or separate maintenance reasonably necessary for the support of the debtor or a dependent;
  - (e) payment under a stock bonus, pension, profit sharing, annuity or similar plan on account of illness, disability, death, age, or length of service (to the

extent reasonably necessary to support the debtor or a dependent), unless

(i) such plan was established by an insider, payment is on account of age or length of service, and such plan does not qualify under Internal Revenue Code §401(a) or 403(b);

(11) The debtor's right to receive, or property that is traceable to:

(a) a crime victim's reparation award;

(b) wrongful death payment (to the extent reasonably necessary to support the debtor or a dependent);

(c) payment under a life insurance contract (to the extent reasonably necessary to support the debtor or a dependent);

(d) a payment on account of personal bodily injury (including pain and suffering or compensation for actual pecuniary loss);

(e) Payment in compensation of loss of future earnings (to the extent reasonably necessary to support the debtor or a dependent).

(12) Money or other assets payable to a participant or beneficiary under an IRA or 401(k) plan;

(13) Up to \$400 for family pictures and the family library.

It is important to note that while state and federal nonbankruptcy exemptions protect assets from most creditors, they do not shield assets from all creditors. A federal tax lien trumps nearly all state, federal bankruptcy, and federal nonbankruptcy exemptions. Similarly, property titled as tenants by the entirety is not exempt from joint creditors of husband and wife.

### HOME, OR HOME RULE?

The District's unlimited homestead exemption has drawn little attention. Proposed federal bankruptcy reform legislation has generated newspaper headlines over whether homestead exemptions should be uniform, and whether they should be capped at a certain threshold, such as \$125,000. Yet the District quietly created an unlimited homestead exemption. The District may be a more attractive "debtor's haven" than Florida or Texas—even if the winters aren't as mild—but you don't hear much about it.

As the word spreads, the District may attract new residents. In the past, it would have been difficult to contend that you were domiciled in Florida but commuted to work in the District or its suburbs. Now it is relatively easy for suburbanites to cross the District line to gain the same protections that previously required a move to the Sunbelt. While Home Rule still remains an elusive goal for District residents, the amendments to the District's exemptions make it clear that "the home does rule in D.C." It remains to be seen, however, whether people are willing to trade voting rights for unlimited homestead rights.

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