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DATE: March 30, 2001

**HOUSE OF REPRESENTATIVES
AS REVISED BY THE
COUNCIL FOR SMARTER GOVERNMENT
ANALYSIS**

BILL #: HB 791
RELATING TO: Property Exempt from Legal Process
SPONSOR(S): Representative Hogan
TIED BILL(S): none

ORIGINATING COMMITTEE(S)/COUNCIL(S)/COMMITTEE(S) OF REFERENCE:

- (1) JUDICIAL OVERSIGHT YEAS 10 NAYS 0
 - (2) COUNCIL FOR SMARTER GOVERNMENT YEAS 8 NAYS 0
 - (3)
 - (4)
 - (5)
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I. SUMMARY:

Federal and Florida laws provide that certain property is exempt from the claims of creditors. Currently, an individual's interest in a credit or refund resulting from the Earned Income Tax Credit is not exempt, and can thus be taken by creditors of a debtor.

This bill amends s. 222.25, F.S., to provide that a debtor's interest in an Earned Income Tax Credit is exempt from attachment, garnishment, or seizure by creditors.

This bill does not appear to have a fiscal impact on state or local government.

II. SUBSTANTIVE ANALYSIS:

A. DOES THE BILL SUPPORT THE FOLLOWING PRINCIPLES:

- | | | | |
|-----------------------------------|------------------------------|-----------------------------|---|
| 1. <u>Less Government</u> | Yes <input type="checkbox"/> | No <input type="checkbox"/> | N/A <input checked="" type="checkbox"/> |
| 2. <u>Lower Taxes</u> | Yes <input type="checkbox"/> | No <input type="checkbox"/> | N/A <input checked="" type="checkbox"/> |
| 3. <u>Individual Freedom</u> | Yes <input type="checkbox"/> | No <input type="checkbox"/> | N/A <input checked="" type="checkbox"/> |
| 4. <u>Personal Responsibility</u> | Yes <input type="checkbox"/> | No <input type="checkbox"/> | N/A <input checked="" type="checkbox"/> |
| 5. <u>Family Empowerment</u> | Yes <input type="checkbox"/> | No <input type="checkbox"/> | N/A <input checked="" type="checkbox"/> |

For any principle that received a "no" above, please explain:

B. PRESENT SITUATION:

Florida law provides various exemptions from garnishment, attachment, and other legal process by creditors, including, but not limited to:

- A debtor's homestead of up to 160 acres if located outside of a municipality, or one-half acre if located inside of a municipality. Art. X, s. 4, Fla.Const.
- \$1,000 worth of personal property. Art. X., s. 4, Fla. Const.
- Certain disposable earnings of a head of family. Section 222.11, F.S.
- The proceeds of a life insurance policy. Section 222.13, F.S.
- The cash surrender value of a life insurance policy and the proceeds of an annuity contract. Section 222.14, F.S.
- Disability benefits payable from any insurance. Section 222.18, F.S.
- Pension, retirement, or profit sharing benefits. Section 222.21, F.S.
- Prepaid College Trust Fund monies and medical savings account funds. Section 222.22, F.S.
- A debtor's interest in a motor vehicle, up to \$1,000 and the debtor's interest in any professionally prescribed health aids. Section 222.25, F.S.

The United States Bankruptcy Code provides a process by which certain debts may be discharged. In theory, receipt of a bankruptcy discharge is conditioned upon surrender of all of the debtor's property to the creditors. In practice, numerous forms of property are "exempt" from surrender to the bankruptcy estate, and numerous types of debt are "non-dischargeable." The Bankruptcy Code contains a list of exempt property, but states are allowed to opt-out of the list, that is, a state may elect that only exemptions provided by state law and by federal law other than the Bankruptcy Code will apply to resident debtors filing bankruptcy. Florida has exercised the opt-out provision. See s. 222.20, F.S.

The Earned Income Tax Credit (EITC) is a special federal refundable tax credit available for low-income, working taxpayers who meet eligibility requirements. Originally established by Congress in 1975, it is intended to help offset increases in living expenses and Social Security taxes and to encourage low-income persons to seek employment versus welfare. Based on the earned income

amount and the number of qualifying children a taxpayer has, the EITC increases until it is capped as follows:

Number of Children	Maximum Amount of the Credit	Earned Income Amount	Threshold Phaseout Amount	Completed Phaseout Amount
None	\$353	\$4,610	\$5,770	\$10,380
1	\$2,353	\$6,920	\$12,690	\$27,413
2 or more	\$3,888	\$9,720	\$12,690	\$31,152

See, 26 U.S.C. § 32 (for the 2000 tax year).

Florida law does not provide a specific exemption for monies due to, or received by, a debtor as a result of the Earned Income Tax Credit. While the EITC can be factored into an employee's W-2, and therefore become a reduction in withholding tax, many persons who receive the EITC do not take advantage of this. Thus, the EITC is primarily distributed in the spring of every year when tax refund checks are distributed.

Outside of the bankruptcy context, only a very lucky creditor who holds a judgment against a debtor and is able to garnish a debtor's bank account when the debtor deposits the tax refund check would ever be able to attach and seize the EITC (sovereign immunity prevents a garnishment action against the IRS). However, in bankruptcy cases filed in the winter and spring, bankruptcy trustees will commonly demand that debtors turn over their tax refund check to the trustee for distribution to creditors, which checks may include the EITC payment. Florida bankruptcy courts consider the EITC to be a non-exempt asset available for distribution to creditors.

In general, "a deposit of exempt funds in a bank does not affect a debtor's exemption, nor change the exempt character of the fund, so long as the source of the exempt funds is reasonably traceable. If it is impossible to separate out exempt from non-exempt funds, the general rule is that an exemption cannot lie." *Beardsley v. Admiral Insurance Co.*, 647 So.2d 327, 329 (Fla. 3rd DCA 1994).

Among the Florida exemptions available to an individual is an exemption for the wages of a head of household. See s. 222.11, F.S. Section 222.11(3), F.S., provides that exempt earnings of a head of household and that "are credited or deposited in any financial institution are exempt from attachment or garnishment for 6 months after the earnings are received by the financial institution if the funds can be traced and properly identified as earnings. Commingling of earnings with other funds does not by itself defeat the ability of a head of family to trace earnings." The EITC is not considered earnings of a head of household.

C. EFFECT OF PROPOSED CHANGES:

This bill amends s. 222.25, F.S., to provide that a debtor's interest in a refund or a credit received or to be received, or the traceable deposits in a financial institution of a debtor's interest in a refund or credit, pursuant to the Earned Income Tax Credit provisions of the Internal Revenue Code, is exempt from attachment, garnishment, or seizure by creditors.

D. SECTION-BY-SECTION ANALYSIS:

See "Present Situation" and "Effect of Proposed Changes".

III. FISCAL ANALYSIS & ECONOMIC IMPACT STATEMENT:

A. FISCAL IMPACT ON STATE GOVERNMENT:

1. Revenues:

None.

2. Expenditures:

None.

B. FISCAL IMPACT ON LOCAL GOVERNMENTS:

1. Revenues:

None.

2. Expenditures:

None.

C. DIRECT ECONOMIC IMPACT ON PRIVATE SECTOR:

For the tax year 1998, almost 20% of the 7,100,000 federal income tax returns filed in Florida claimed an earned income tax credit totaling an estimated \$2,050,000. See IRS, Florida Individual Income and Tax Data by State, SOI Bulletin, Spring 2000, and IRS Information Services, Martinburg Computing Center, Development Center Branch. The exemption under this bill may benefit low-income working debtors who are eligible for earned income credit and who elect to file a bankruptcy action in the winter or spring by exempting this class of tax credits from legal process. This exemption may accordingly result in a reduction in monies available for distribution to creditors.

D. FISCAL COMMENTS:

None.

IV. CONSEQUENCES OF ARTICLE VII, SECTION 18 OF THE FLORIDA CONSTITUTION:

A. APPLICABILITY OF THE MANDATES PROVISION:

This bill does not require counties or municipalities to spend funds or to take an action requiring the expenditure of funds.

B. REDUCTION OF REVENUE RAISING AUTHORITY:

This bill does not reduce the authority that counties or municipalities have to raise revenues in the aggregate.

C. REDUCTION OF STATE TAX SHARED WITH COUNTIES AND MUNICIPALITIES:

This bill does not reduce the percentage of a state tax shared with counties or municipalities.

V. COMMENTS:

A. CONSTITUTIONAL ISSUES:

None.

B. RULE-MAKING AUTHORITY:

None.

C. OTHER COMMENTS:

This bill as originally filed may provide that monies owed to a debtor representing the earned income tax credit could not be garnished or attached for payment of child support or spousal support.

VI. AMENDMENTS OR COMMITTEE SUBSTITUTE CHANGES:

On March 29, 2001, the Council on Smarter Government adopted one amendment to this bill, which amendment provides that the exemption created by this bill does not apply to a debt owed for child support or spousal support. The bill was then reported favorably as amended.

VII. SIGNATURES:

COMMITTEE ON JUDICIAL OVERSIGHT:

Prepared by:

Nathan L. Bond, J.D.

Staff Director:

Lynne Overton, J.D.

AS REVISED BY THE COUNCIL FOR SMARTER GOVERNMENT:

Prepared by:

Nathan L. Bond, J.D.

Staff Director:

Don Rubottom