



WRNewswire

An AALU Washington Report

Friday, 14 March 2014

WRN# 14.03.14

The *WRNewswire* is created exclusively for AALU Members by insurance experts led by Steve Leimberg, Lawrence Brody, Linas Sudzius and AALU Staff. The *WRNewswire* provides timely reports and commentary on tax and legal developments important to AALU members, clients and advisors, delivered to your inbox as they happen.

TOPIC: Transfer from Life Insurance to Another Exempt Asset Protected in Bankruptcy

CITES: [In re Arends, 2014 WL 846179 \(U.S.Bankruptcy.Ct. N. D. IA., March 4, 2014\); 11 U.S.C. § 522\(o\)\(4\).](#)

SUMMARY: An Iowa federal bankruptcy court ruled that exempt life insurance cash values received during bankruptcy and used to pay down the mortgage of the debtors' homestead kept their character as exempt assets.

BACKGROUND: The month before filing for bankruptcy, Mr. and Mrs. Arends cashed in two personally owned Northwestern Mutual life insurance policies for \$28,000. They deposited the money in their bank account, and six days later used the funds to pay down their home mortgage.

After they filed for bankruptcy, they claimed their homestead as exempt. The bankruptcy trustee objected, arguing the homestead exemption should be reduced by \$28,000, because debtors converted non-exempt property into exempt property with the "intent to hinder, delay, or defraud a creditor" under 11 U.S.C. § 522(o)(4).

Both personal life insurance cash values and homestead values are generally exempt assets in a bankruptcy proceeding in Iowa. However, the values of a bank account in excess of \$1,000 are generally *not* exempt. In this case, the bankruptcy trustee's position was that the bank account into which the insurance proceeds were deposited was a non-exempt asset, and that the subsequent transfer of bank cash to the exempt homestead was improper.

The Arends took exception to the trustee's position, and the bankruptcy court was asked to decide whether the \$28,000 was exempt.

FACTS: The bankruptcy court analyzed whether the Arends made an improper transfer. The court noted that Iowa law applied regarding whether an asset was exempt or not in bankruptcy. However, for all other purposes, federal bankruptcy law would apply.

The improper transfer question was one of federal law. The court noted that there are four separate elements that an objecting creditor must meet to prove a pre-bankruptcy transfer is improper under U.S.C. § 522(o)(4):

- (1) the debtor disposed of property within the 10 years preceding the bankruptcy filing;
- (2) the property that the debtor disposed of was nonexempt;
- (3) some of the proceeds from the sale of the nonexempt property were used to buy a new homestead, improve an existing homestead, or reduce the debt associated with an existing homestead; and
- (4) the debtor disposed of the nonexempt property with the intent to hinder, delay or defraud a creditor.

RESULT: The court decided that the second and fourth elements were not met in this case.

It found that the life insurance money was only temporarily in a non-exempt bank account while in transit between two exempt assets. The court reasoned that the only practical way that the debtors could transfer the money from one exempt asset to another was to have the funds sit in their bank account for a few days while Northwestern Mutual's check cleared. Therefore, it concluded, the money the debtors used to pay down their home mortgage remained exempt.

In addition, with regard to the fourth requirement, the court decided that there was not enough evidence on the record to show that the Arends moved money from life insurance to home equity with the intention to cheat their creditors.

RELEVANCE: We've written before about how difficult it is to give reliable asset protection advice to clients regarding life insurance cash values and death benefits. Different states may have different rules with respect to protection of

- Cash value versus death benefit,
- Policy owner versus policy beneficiary or
- Different categories of policy owners or beneficiaries.

To make the asset protection waters even muddier, creditors may have varying levels of access to life insurance assets in different circumstances. For example, creditors in a debtor's bankruptcy proceeding may have more access to assets than creditors seeking to collect a claim in a lawsuit.

Life producers sometimes get asked by clients whether money in transit—pursuant to qualified plan rollover or 1035 exchange—exposes an otherwise bankruptcy-exempt asset to the potential claims of creditors. That's the issue in the center of the *Arends* case. The court decided that the bankruptcy exemptions did extend from one exempt asset to another—even though the money sat in a non-exempt bank account for a few days in between.

***WRNewswire* #14.03.14 was written by Linas Sudzius of [Advanced Underwriting Consultants](#).**

DISCLAIMER

In order to comply with requirements imposed by the IRS which may apply to the Washington Report as distributed or as re-circulated by our members, please be advised of the following:

THE ABOVE ADVICE WAS NOT INTENDED OR WRITTEN TO BE USED, AND IT CANNOT BE USED, BY YOU FOR THE PURPOSES OF AVOIDING ANY PENALTY THAT MAY BE IMPOSED BY THE INTERNAL REVENUE SERVICE.

In the event that this Washington Report is also considered to be a “marketed opinion” within the meaning of the IRS guidance, then, as required by the IRS, please be further advised of the following:

THE ABOVE ADVICE WAS NOT WRITTEN TO SUPPORT THE PROMOTIONS OR MARKETING OF THE TRANSACTIONS OR MATTERS ADDRESSED BY THE WRITTEN ADVICE, AND, BASED ON THE PARTICULAR CIRCUMSTANCES, YOU SHOULD SEEK ADVICE FROM AN INDEPENDENT TAX ADVISOR.

The AALU *WRNewswire* and *WRMarketplace* are published by the Association for Advanced Life Underwriting® as part of the Essential Wisdom Series, the trusted source of actionable technical and marketplace knowledge for AALU members—the nation's most advanced life insurance professionals.