

**IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF KANSAS**

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| IN RE: |) | |
| |) | |
| LINDA SUZANNE HOUSER, |) | Case No. 03-13889 |
| |) | Chapter 7 |
| |) | |
| Debtor. |) | |
| <hr style="width:50%; margin-left:0;"/> |) | |

**ORDER SUSTAINING TRUSTEE’S OBJECTION TO
EXEMPTION OF ANNUITY**

Debtor Linda Houser claims as exempt under KAN. STAT. ANN. § 40-414(a) (2000) a single premium deferred life annuity (“Annuity”) she purchased from State Farm Life Insurance Company with proceeds from a life insurance policy on her husband who died pre-petition. The case trustee objects to the exemption. The parties have stipulated to the pertinent facts and submitted this issue to the Court on briefs.¹ After careful review of the papers filed herein, the Court makes the following findings and orders.

Jurisdiction

This is a core proceeding over which the Court has jurisdiction.²

Statement of Facts

Ms. Houser’s husband, Steven, died on February 27, 2003. Ms. Houser was the beneficiary under a State Farmlife insurance policy on Steven in the face amount of \$15,000. On March 19, 2003, State Farm paid Ms. Houser \$13,591.92 after paying Steven’s burial expenses. Ms. Houser deposited

¹ Dkt. 19.

² 28 U.S.C. § 157(b)(2)(B).

this check in her checking account. On April 4, 2003, Ms. Houser applied to State Farm for a deferred life annuity and sent State Farm a check for \$12,000. The annuity policy was issued on June 20, 2003.³ Although the parties do not directly state as much, there appears to be no dispute that the proceeds from Steven's life insurance policy funded the purchase of the Annuity.

The annuity contract provides that on or before the Annuity Date, June 19, 2025, Ms. Houser can elect to receive equal payments under the contract for as long as she lives or a ten-year stream of payments. Ms. Houser must be alive to receive the annuity payments. If she dies prior to the Annuity Date, State Farm will pay the premium plus interest to her heirs in equal shares. Until the Annuity Date, she can withdraw some or all of the "cash surrender value," subject to a withdrawal penalty.

Ms. Houser filed her bankruptcy case on July 18, 2003 and Carl Davis was appointed as case trustee. Ms. Houser claimed the Annuity exempt on Schedule C.⁴ The trustee timely objected to the exemption and sought turnover over the Annuity.⁵

Analysis

In responding to the trustee's objection, Ms. Houser bases her exemption of the Annuity as "insurance" under KAN. STAT. ANN. § 40-414(a) on two grounds: (1) that the Annuity is per se exempt as insurance under that statute; and (2) that the Annuity is exempt because it was purchased with the death benefit from the admittedly exempt life insurance policy. The trustee has the burden of proving

³ A copy of the Annuity policy is attached as Exhibit F to the stipulations.

⁴ On Schedule C, Ms. Houser originally claimed the Annuity exempt as retirement funds under KAN. STAT. ANN. § 60-2308 and valued it at \$12,000. Pursuant to the parties' stipulations, however, Ms. Houser claims the Annuity exempt under KAN. STAT. ANN. § 40-414(a)(4).

⁵ See 11 U.S.C. § 522(l); Fed. R. Bankr. P. 4003(b).

that the exemption is not properly claimed.⁶

The life insurance exemption statute describes the types of policies or contracts protected.

KAN. STAT. ANN. § 40-414(a) states, in relevant part:

If a life insurance company or fraternal benefit society issues *any policy of insurance* or beneficiary certificates *upon the life of an individual* and *payable at the death of the insured*, or in any given number of years, *to any person or persons having an insurable interest in the life of the insured*, the policy and its reserves, or their present value, shall inure to the sole and separate use and benefit of the beneficiaries named in the policy and shall be free from: (1) The claims of the insured or the insured's creditors and representatives; (2) the claims of any policyholder or the policyholder's creditors and representatives . . . and (4) *the claims and judgments of the creditors and representatives of any person named as beneficiary in the policy of insurance*. (Emphasis added.).

There is no reported state court decision determining whether this exemption statute protects annuity contracts, but a close reading of the statute makes it clear that annuities are not clothed with that protection. Annuities are not payable at the death of the insured; nor are they payable to persons having an insurable interest in the life of the insured. Rather, they are payable to the annuitant during his or her life.

As succinctly stated by one commentator, an annuity is a purchased right to receive fixed or periodic payments for life or a stated period of time.⁷ The annuitant has an interest only in the right to receive the payments, not in the principal fund which is their source. Life insurance, by contrast, is an absolute obligation for a stipulated consideration to pay a sum certain at the death of the insured.⁸ The Kansas federal court has so held.

⁶ Fed. R. Bankr. P. 4003(c).

⁷ 4 Am. Jur. 2d *Annuities*, § 1 (2003).

⁸ 43 Am. Jur. 2d *Insurance*, § 5 (2003). *See also*, 1 *Couch on Insurance*, §§ 1:22, 1:39 (3rd ed. 2003).

In *In re Stutterheim*,⁹ the bankruptcy court rejected the exemption of a single premium annuity and held that the contract was not an insurance policy because it was not payable upon the death of the insured nor payable to persons having an insurable interest in the life of the insured. Instead, the annuity contract was simply an investment vehicle. The District Court affirmed *Stutterheim*, stating that “[t]he annuity does not provide the protection intended to be preserved by the statutory exemption for life insurance because it is not issued ‘upon the life of an individual’ as required by the language of K.S.A. §40-414(a).”¹⁰ The annuity, standing alone, is not protected by the KAN. STAT. ANN. § 40-414(a) life insurance exemption.

Ms. Houser also argues that because the Annuity was purchased with the proceeds of an exempt life insurance policy, the Annuity should also be held exempt. KAN. STAT. ANN. § 40-414(a) states that the policy “and its reserves, or their present value, shall inure to the sole and separate use and benefit of the beneficiaries named in the policy . . . ,” making it clear that the death benefit in Ms. Houser’s hands was exempt.¹¹ Sadly, her use of the insurance death benefit to acquire the Annuity does not make the *annuity* exempt. Kansas law has long held that mere use of exempt property to acquire an otherwise non-exempt asset does not render it exempt.¹²

⁹ 109 B.R. 1006, 1008 (Bankr. D. Kan. 1988).

¹⁰ 109 B.R. 1010, 1013 (D. Kan. 1989). *See also, In re Vinzant*, 108 B.R. 752 (Bankr. D. Kan. 1989) (holding that an annuity is not “insurance” for purpose of determining whether a security interest in an annuity was properly perfected under former Article Nine).

¹¹ *See Osment v. Trout*, 156 Kan. 120, 131 P.2d 640 (1942) (proceeds of life insurance policy paid to beneficiary are exempt); *In re Douglas*, 59 B.R. 836, 837 (Bankr. D. Kan. 1986) (life insurance proceeds payable to debtor as beneficiary are exempt).

¹² *See Independence Savings & Loan Ass’n v. Sellars*, 149 Kan. 652, 88 P.2d 1059 (1939) (stock purchased by insurance beneficiary with life insurance death benefit not exempt); *Pefly v. Reynolds, Sheriff*, 115 Kan. 105, 222 Pac. 121 (1924) (land acquired by beneficiary with money paid under life insurance policy on husband’s life is not exempt).

Ms. Houser's final argument is essentially an appeal to equity. Her schedules reflect that, after the death of her husband, she was left with over \$200,000 in medical debt. The Annuity appears to be the only asset of note in her estate. Per her Schedules I and J, she lives on a minimal income and is barely able to meet expenses. Hers is a difficult situation at best, but not one which would justify this Court's simply ignoring the plain import of both the pertinent statute and case law.

Were Ms. Houser a debtor in chapter 13, she could retain the Annuity irrespective of its exempt status. In chapter 7, however, the trustee is duty-bound to the creditors to marshal non-exempt assets for their benefit and is entitled to the relief he seeks notwithstanding the compelling equities in favor of allowing this chapter 7 debtor to retain her Annuity. The trustee's objection to the exemption of the annuity is SUSTAINED. The motion for turnover is GRANTED, but turnover is STAYED for a period of ten days from the date of the entry of this order on the docket.

Dated this 25th day of February, 2004.

ROBERT E. NUGENT
CHIEF BANKRUPTCY JUDGE
UNITED STATES BANKRUPTCY COURT
DISTRICT OF KANSAS

CERTIFICATE OF SERVICE

The undersigned certifies that a copy of the **Order Sustaining Trustee's Objection to Exemption of Annuity** was deposited in the United States mail, postage prepaid on this 25th day of February, 2004, to the following:

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Janet Swonger,
Judicial Assistant to
The Honorable Robert E. Nugent