

Asset Protection

Riches Out of Reach

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Life insurance policies have long played a significant role in reducing taxes. They're favored under the Internal Revenue Code in several significant ways, as discussed in chapter 12. Specifically, (1) earnings within the life insurance policy are not taxable as they accumulate; (2) accumulated income generally can be withdrawn from the policy as loans without income tax effect; and (3) the policy's death benefit is generally not subject to income taxation. In addition, through the use of a properly drafted irrevocable "insurance" trust, the death benefit may also be made to pass to or for the benefit of the owner's intended beneficiaries without the imposition of estate or generation-skipping transfer taxes.

Tax savings are not, however, the only benefit that can be gained by owning life insurance. Potentially even more significant, at least to certain individuals, is that life insurance is one of a very few forms of investment that's often inherently protected from creditor claims. Private placement life insurance (PPLI), in particular, lends itself to so-called asset protection planning and for many individuals will be a principal motivation for the investment. But it is important to understand the broader asset-protection planning benefits of life insurance before considering the particular benefits that might be afforded by private placement life insurance policies.

This material appears as Chapter 4 of *The PPLI Solution: Delivering Wealth Accumulation, Tax Efficiency, and Asset Protection Through Private Placement Life Insurance*, edited by Kirk Loury. ©Copyright 2005 by Kirk Loury. Reprinted by permission of Bloomberg Press. [Click here to order.](#)

Public Policy

Certain classes of assets are favored by statute so as to provide their owner, or debtor, a greater level of protection from the claims of creditors than would other classes of assets. Usually this heightened creditor protection is provided because the asset class is a type that's considered essential for the debtor and/or the debtor's family to maintain at least a minimum level of financial well-being and thereby avoid becoming a burden to the state. In all cases, the extent of such creditor protection is, of course, tempered by society's proper concern for the creditor's competing rights to access the debtor's property toward satisfaction of the creditor's legitimate claims.

Exemption statutes frequently name life insurance as one such favored asset class. Life insurance is favored with an exemption from creditor attachment because it can help to ensure the financial subsistence of the debtor's spouse and/or dependents following the death of the "bread-winning" debtor. However, the statutory exemption afforded to life insurance varies (sometime extensively) by jurisdiction and is also likely subject to some lesser or greater extent to the vagaries of judge-made law.¹ Notwithstanding these differences, the potential value of such an exemption to a debtor or potential debtor means that the exemption for life insurance warrants a careful and considered review by estate and asset-protection planners.

Consideration of the potential creditor protection afforded to life insurance is, however, complicated by the several capacities in which the debtor may be interested in the policy—that is, whether the debtor is the owner of the policy, the insured, or both. Alternatively, the debtor may be the beneficiary of the policy, or the debtor may be the owner of a policy that names his or her estate as the beneficiary of the policy. Since the exemptions afforded to life insurance are intended to further particular public policy goals (that is, protecting the debtor's dependents from financial destitution in the event of the debtor's untimely demise), the relationships between the owner and the insured and between the owner and the beneficiary are often key to determining whether and to what extent the particular life insurance policy at issue may be protected from creditor claims.

The Federal Exemption

The federal bankruptcy exemption for life insurance policies owned by the debtor can be found at Section 522(d)(8) of the U.S. Bankruptcy Code.² The federal bankruptcy exemption for life insurance shields unmaturing policies owned by the debtor (other than a credit life insurance contract) and up to \$8,000³ of the debtor's aggregate interest in any accrued

dividend or interest under, or loan value of, an unmaturing life insurance contract, provided that the insured is either the debtor or an individual of whom the debtor is a dependent. Since federal bankruptcy law broadly defines a “dependent” as including a spouse, whether or not the debtor’s spouse is actually dependent upon the debtor, the exemption will apply without further inquiry as long as either the debtor or the debtor’s spouse is the insured.⁴

The effect of the foregoing exemption is obviously to protect the actual insurance element of the life insurance policy and little else, since only a minimal amount of the cash surrender value of the policy is afforded any exemption. That the primary intent of the Bankruptcy Code as it relates to the exemption of life insurance is to protect a dependent’s interest in the life insurance policy, rather than the owner’s own interest, is further supported by Section 522(d)(11)(C) of the Bankruptcy Code.⁵ That section concerns the beneficiary of the policy as the debtor (rather than the owner of the policy as the debtor) and exempts the debtor’s entitlement to the proceeds of a life insurance contract, without any specific dollar limitation, to the extent that such proceeds are “reasonably necessary” for the support of the debtor and any dependent of the debtor. Although the federal bankruptcy exemption of an unmaturing life insurance contract without the exemption of any significant portion of the cash surrender value may prove invaluable in certain limited circumstances (for example, if the debtor has become uninsurable since the life insurance policy was originally purchased), it obviously does not provide significant opportunities for asset protection or prebankruptcy planning for the insured.

The State Exemptions

Since the federal exemption scheme for life insurance owned by the debtor is so parsimonious, alternative state exemptions have become the primary focus in asset-protection planning with life insurance. **FIGURE 4.1**, page 50, contains a tabulation of the statutory exemptions afforded by each of the 50 states and the District of Columbia.

As can be seen in figure 4.1, some states follow the model of the federal exemption scheme and provide very limited exemptions for the cash surrender value of life insurance. For example, South Carolina offers an exemption of only \$4,000 for the cash surrender value of life insurance (provided that the insured is either the debtor or an individual upon whom the debtor is dependent).⁶ Proceeds payable to the insured’s spouse, children, or dependents are, however, generally fully exempt from the creditors of the insured.⁷ Wisconsin also exempts only \$4,000 (and only provided that the insured is either the debtor, a dependent of the debtor, or an individual upon whom the debtor is dependent).⁸ If the debtor is

the beneficiary of the life insurance policy, however, and provided that the debtor was dependent upon the insured, Wisconsin law exempts payments to the extent reasonably necessary for the support of the debtor and the debtor's dependents.⁹

Most states, however, have exemption schemes that provide for far greater protection of the cash surrender value of life insurance policies than does the federal exemption scheme. For example, in keeping with its generally pro-debtor stance, the state of Florida specifically exempts the entire cash surrender value of life insurance policies from the reach of creditors¹⁰ and the entire death benefit from the creditors of the insured unless the proceeds are payable to the insured's estate.¹¹ Hawaii similarly specifically exempts the entire death benefit and cash surrender value of life insurance policies from the reach of creditors of the owner of the life insurance policy, provided that the policy is payable to a spouse of the insured or to a child, parent, or other person dependent upon the insured, except (of course) as to premiums paid in fraud to creditors.¹² Louisiana also specifically exempts the entire proceeds (including the full cash surrender value) of life insurance policies from the reach of creditors, provided that the exemption is limited to \$35,000 of the cash surrender value if the life insurance policy was issued within nine months of a bankruptcy filing.¹³

New York's scheme for the exemption of life insurance¹⁴ is worth noting because it clearly distinguishes between the several permutations that can result depending on whether the debtor is the owner of the policy (referred to under the New York statute as the person "effecting the policy"),¹⁵ the insured, or the beneficiary, or some combination thereof. More specifically, the New York statutory exemption scheme for life insurance provides that:

(a) If the owner of a life insurance policy insures his or her own life for the benefit of another (that is, a beneficiary other than the owner's estate), that other person shall be entitled to the proceeds and avails of the policy as against the creditors of the owner.¹⁶ (In other words, the beneficiary's interest in a life insurance policy that is owned by another is protected from claims of the policy owner's creditors.)¹⁷

(b) If the owner of a life insurance policy insures the life of another for the owner's own benefit, the owner shall be entitled to the proceeds and avails of the policy as against the creditors of the insured.¹⁸ (In other words, the interest of an owner of life insurance in the policy is protected from the creditors of the insured.)

(c) If the owner of a life insurance policy insures the life of his or her spouse for the owner's own benefit, the owner shall also be entitled to the proceeds and avails of the policy as against his or her own creditors.¹⁹ (In

other words, the interest of an owner/beneficiary of life insurance in the policy is protected from the owner/beneficiary's own creditors if the insured is the owner's spouse.)

(d) If the owner of a life insurance policy insures the life of another person for the benefit of a third party, the third party shall be entitled to the proceeds and avails of the policy as against the creditors of both the owner and the insured.²⁰ (In other words, the beneficiary's interest in a life insurance policy is protected from claims of the creditors of both the owner of the policy and the insured.)

(e) The owner of a life insurance policy, regardless of the identity of the insured, shall be entitled to accelerated payments of the death benefit or accelerated payment of a special surrender value permitted under such policy as against the creditors of the owner.²¹ (In other words, the owner's interest in the cash surrender value of a life insurance policy is protected from claims of the owner's own creditors.)

Interestingly, even the extensive New York statutory exemption scheme does not cover all possible permutations. For example, in *Dellefield v. Block*,²² a husband took out two paid-up life insurance policies on his own life in favor of his wife. Thereafter, both the husband effecting the policy and his wife, the beneficiary of the policy, became debtors of the same judgment creditor. Since §166 of the New York Insurance Law (precursor to the current New York statute) provided that a life insurance policy insuring the owner's own life for the benefit of another is protected from a debtor owner's creditors but did not then expressly provide that the same life insurance policy is protected from a debtor beneficiary's creditors, the novel issue arose as to whether a joint judgment creditor could enforce its judgment against the life insurance policies. Based on a liberal interpretation of legislative intent to the effect that the statutory exemption of the debtor/owner's interest was intended to protect all cases in which a person by investment of his own money insured his or her own life for the benefit of another, the *Dellefield* court held that the life insurance policies could not be reached by the parties' joint judgment creditor.

As shall be seen, the liberal application of statutory creditor exemptions for life insurance policies appears to be the prevailing practice among our nation's judiciary. One example of this phenomenon exists in connection with the court's interpretation of the phrase "proceeds and avails" of an insurance policy pursuant to a statutory exemption. As a baseline, it might be noted that the phrase "proceeds and avails" as used in the New York statute, for example, is defined to include "death benefits, cash surrender and loan values, premiums waived, and dividends, whether used in reduction of premiums or in whatever manner used or applied, except where the debtor

has, after issuance of the policy, elected to receive the dividends in cash.”²³ Unlike New York, however, not all state statutes expressly define which incidents of value of a life insurance policy (that is, specifically, the debtor’s ability to shield the cash surrender value of a life insurance policy versus the debtor’s entitlement to the proceeds of a matured policy which insured the life of another) are covered by the exemption scheme at issue. Therefore, the issue has frequently arisen as to whether and to what extent the cash surrender value should be exempted when the statute refers only to “monies paid out of a life insurance policy” or similarly ambiguous language.

In the matter of *In re Worthington*,²⁴ the Bankruptcy Court, interpreting a Kentucky exemption statute which provided simply that “any money or other benefit to be paid or rendered by any assessment or cooperative life or casualty insurance company is exempt from execution or other process,”²⁵ determined that an unlimited exemption was provided for the cash surrender value of life insurance policies. The *Worthington* court stated that:

This statute does not restrict “any money or other benefit to be paid” as exemptible only upon death, but rather it denotes an exemption extending to the debtor on any monetary value or benefits accruing by virtue of ownership. Thus, the loan values or the cash surrender values by virtue of the enactment of the Kentucky legislature have been deemed exempt since the term “any money . . . to be paid” is not restricted as to time of election and offers no alternative but to include the cash surrender value within its definition. The Kentucky legislature has, after due deliberation and in its wisdom, determined that any monetary value in life insurance policies owned by its citizens is exempt without monetary limitation.²⁶

Similarly, it has generally been held that when reference is made to the “proceeds and avails” of a life insurance policy, such reference comprehends the protection of cash surrender values and other values built up during the life of the policy as well as the protection of its death benefit even if not expressly so provided by statute. The rationale behind such holdings is made clear in the matter of *In re Beckman*,²⁷ in which the court stated:

The legislature well knew that an insured would probably have creditors during his lifetime and no doubt fully realized that if the cash surrender value could be reached by creditors of the insured while he was living, there would not be in many cases any “proceeds and avails” to exempt or safeguard after death. Nowhere in the statute do we find a single word or expression indicating that the exemption is only to be effective after the death of the insured.²⁸

Moreover, the unlimited exemption for the cash surrender value of life insurance that exists in some state can be roundly abused by dishonest debtors and has been considered by the courts and disregarded as a basis for judicially recasting the liberally interpreted import of the exemption statutes. For example, in the matter of *In re White*,²⁹ the court rejected the bankruptcy trustee's objection to an unlimited exemption for the "proceeds and avails" of life insurance. The bankruptcy trustee's objection, rejected by the court, was that to exempt the cash surrender value of the debtor's life insurance policy would

provide a debtor with an avenue for depositing his funds in unlimited amounts in a species of property that would place it beyond the reach of his creditors but not beyond his own reach after his discharge in bankruptcy.³⁰

Similarly, the court in *In re Beckman*³¹ was not compelled by the bankruptcy trustee's argument that to hold the cash surrender value of the debtor's life insurance policy exempt would be to make an insurance policy "a refuge for fraud."³² In each case, the court responded to the creditor's argument by stating that such argument overlooks the fact that the exemption statute expressly provides that premiums paid in fraud of creditors would, nevertheless, inure to the benefit of creditors. Finally, it has been said that in any event "if abuses to enacted exemptions are deemed to exist, the remedy is by other than judicial legislation."³³

Therefore, for the residents of certain states, at least, valuable asset protection and prebankruptcy planning opportunities exist using life insurance policies, provided, as always, that the conversion of nonexempt assets into exempt assets (be they cash surrender value life insurance policies or otherwise) is not made with the intent to hinder, delay, or defraud creditors.³⁴

Insurance Trusts

Whether or not there exists in any particular jurisdiction a significant creditor exemption for life insurance policies, however, the greatest creditor protection will always be achieved through the use of trusts. For example, a policy may be transferred to an irrevocable spendthrift trust (or even better, an irrevocable spendthrift trust can acquire the life insurance policy in the first instance), thereby protecting the value of the life insurance policy not only from future creditors of the settlor and creditors of the trust beneficiaries but from taxation in the settlor's estate as well.³⁵ At the same time, there is little doubt that Section 541(c)(2) of the Bankruptcy Code

would also exclude the trust property from the settlor/debtor's bankruptcy estate as a spendthrift trust enforceable under applicable nonbankruptcy law. The use of a trust also avoids a potential creditor argument that, notwithstanding the existence of a statutory exemption, such exemption was never intended to extend to PPLI policies with cash value and a death benefit far in excess of what might be required for the subsistence of the debtor and/or his or her dependents.

Furthermore, the transfer of life insurance policies to an irrevocable life insurance trust need not have the effect of placing the potential use and enjoyment of the cash value beyond the settlor's reach. Provided that the settlor is married, the spouse may be named as a discretionary beneficiary of the trust. Therefore, to the extent that the trustees are amenable to making a distribution of property out of the trust to the settlor's spouse, the settlor can have an indirect benefit from the trust property for as long as the settlor's spouse is living and the parties have not separated or divorced. Where the settlor is concerned with the possibility of the spouse predeceasing or, alternatively, where the settlor is concerned with the possibility of a divorce, a so-called floating spouse clause may be appropriate. A floating spouse clause would define the spouse of the settlor as the person to whom the settlor is married at the time in question; therefore, if the settlor and the settlor's current spouse should divorce, or the settlor's spouse should predecease the settlor, the settlor could again have access to the trust fund provided only that the settlor remarries.

A less traditional alternative would have the settlor establish the trust under the laws of Alaska, Delaware, Missouri, Nevada, Oklahoma, Rhode Island, or Utah, since the law in each of those states provides that the owner of property (including the owner of a life insurance policy) may create a discretionary trust for his or her own benefit without leaving the transferred property subject to the claims of his or her future creditors (a so-called self-settled trust). Such trusts are frequently also called *domestic asset protection trusts*. A number of foreign jurisdictions, including Bermuda, the Bahamas, the Cayman Islands, and the Cook Islands, have similar laws regarding the use of self-settled trusts to protect against potential future creditor claims. Such trusts are frequently called *foreign asset protection trusts* and are generally considered to be more protective because they are not subject to potential "full faith and credit" and "federalism" attacks under U.S. constitutional law.³⁶

A transfer to an *asset-protection trust* settled under the law of one of the aforementioned jurisdictions, wherein the settlor retains no rights (other than those of a discretionary beneficiary), would be deemed a completed gift for U.S. gift-tax purposes because of the interplay between the Internal Revenue Code and the applicable law governing creditors' rights.

Furthermore, such a trust should cause the proceeds payable on death to be excluded from the settlor's estate for transfer-tax purposes, irrespective of the fact that the settlor may benefit from the cash value of the policy (albeit at the trustee's discretion) during the settlor's lifetime.³⁷

The use of PPLI policies can actually enhance the asset protection afforded by such trusts. This is so because the tax benefits that are expected to inure from the PPLI policy provide a rationale other than the hindrance, delay, or fraud of creditors (a so-called fraudulent transfer) in connection with the settlor's transfer of property to the trust in connection with its funding. As has been discussed in other chapters, the relatively large premium commitment required in connection with PPLI policies frequently warrants that the insurance trust crafted to hold them be established in a jurisdiction like Alaska, which imposes no state premium tax (generally 2 to 3 percent of each premium payment) or, at a minimum, a relatively low state premium tax.³⁸ An offshore asset-protection trust might be further justified by the fact that an offshore PPLI policy, which may be owned only by a non-U.S. person (such as a foreign asset-protection trust), can invest in foreign securities, which are not otherwise open for investment to U.S. persons because of Securities and Exchange Commission regulation. Moreover, offshore investment opportunities may provide greater flexibility and, perhaps, economies, again because of the absence of regulation over such investments by the SEC.

It's also important to note that similar to the state statutory exemptions discussed earlier, certain foreign jurisdictions with substantial life insurance industries have statutory law exempting life insurance from the reach of creditors. For example, Bermuda's Insurance Act of 1978 provides that:

- 1 Where a beneficiary is designated, the insurance money, from the time of the happening of the event upon which the insurance money becomes payable, is not part of the estate of the insured and is not subject to the claims of the creditors of the insured.
- 2 While a designation in favor of a child or grandchild . . . or a spouse or parent of a person whose life is insured, or any of them, is in effect, the rights and interests of the insured in the insurance money and in the contract are exempt from execution or seizure.³⁹

In a similar vein, in Barbados the interest of a policyholder is not liable to be applied to or made available in payment of the debts of the policyholder by any judgment, order, or process of any court.⁴⁰ The Bahamas has similarly protective legislation.⁴¹

In contrast to Bermuda, Barbados, and the Bahamas, however, the governing insurance law in the Cayman Islands (which is another relatively substantial offshore insurance jurisdiction) does not specifically ad-

dress whether there are any special creditor protections for policy values. The law of the Cayman Islands does, however, require that insurers keep separate accounts on behalf of its clients from which no payment can be made “directly or indirectly for any purpose other than those of the insurer’s long-term business.”⁴² This obviously presents a potentially powerful argument that the claims of creditors of a policy owner, insured, or beneficiary cannot be paid out of the cash value of a life insurance policy held with a Cayman insurer.⁴³

Therefore, the investment in a PPLI policy, whether domestic or foreign, might provide a concerned individual not only with the potential for tax-free income, but also with an asset that will be protected against even the most aggressive creditor claims. For many individuals, the exemption from creditor claim that is generally afforded to life insurance policies will provide a compelling argument in favor of life insurance as an investment. Even in jurisdictions that have generous exemptions for the cash surrender value of life insurance, however, the use of a properly structured “life insurance” trust to hold the policy remains important. This is especially true in light of the fact that through advanced planning, the use of an irrevocable life insurance trust need not have the effect of placing the potential use and enjoyment of the cash surrender value beyond the settlor’s reach.

FIGURE 4.1 *State Regulations on PPLI*

ALABAMA

Life Insurance Proceeds

Beneficiary’s interest in proceeds and avails wholly protected from creditors of owner and insured.

Owner’s interest in proceeds and avails wholly protected from creditors of insured if owner (or owner’s spouse) is insured, and spouse and/or children (or owner and/or children) are beneficiaries.

Applicable Section(s)

Ala. Code § 6-10-8

ALASKA

Life Insurance Proceeds

Owner’s interest in up to \$12,500 of value of unmatured policy is exempt.

Maximum interest of \$438 per week of spouse or dependent beneficiary is exempt.

Applicable Section(s)

Alaska Stat. §§ 09.38.025 and 09.38.030

Alaska Admin. Code Tit. 8 § 95.030

ARIZONA**Life Insurance Proceeds**

Cash value and proceeds wholly exempt from creditors of insured and beneficiaries.

Applicable Section(s)

Ariz. Rev. Stat. §§ 20-1131, 20-1131.01, and 33-1126(A)(1) and (6), and (C)

ARKANSAS**Note:**

In re Hudspeth, 92 Bankr. 827 (1988), the court held that the state exemption contained in Ark. Code Ann. § 16-66-209 of the value of all insurance benefits without limitation was unconstitutional since Article 9 § 2 of Arkansas's Constitution imposes a \$500 limited exemption from creditor claims. In *Federal Sav. & Loan Ins. Co. v. Holt*, 894 F.2d 1005 (8th Cir. 1990), the Court imposed a \$500 exemption ceiling on life insurance benefits and policies' cash surrender value.

CALIFORNIA**Life Insurance Proceeds**

Unmatured policy wholly exempt from creditors; provided, however, that loan value of only \$9,700 (\$19,400 if debtor married) is exempt.

Death benefits exempt to extent reasonably necessary for support of debtor, and spouse and dependents of debtor.

Applicable Section(s)

Cal. Code Civ. Proc. § 704.100

COLORADO**Life Insurance Proceeds**

Interest in up to \$50,000 of cash surrender value (except for increase attributable to previous 48 months' contributions) exempt from creditors of insured except where beneficiary is estate of insured.

Death benefit payable to beneficiary (other than estate of insured) wholly exempt from creditors of insured.

Applicable Section(s)

Colo. Rev. Stat. §§ 13-54-102(1)(l) and (s)

CONNECTICUT

Life Insurance Proceeds

Interest of beneficiary (other than insured) in proceeds wholly protected from creditors of insured.

Applicable Section(s)

Conn. Gen. Stat. § 38a-453

DELAWARE

Life Insurance Proceeds

Beneficiary's interest in "proceeds and avails" wholly protected from all creditors.

Applicable Section(s)

Del. Code Ann. Tit. 18 § 2725

DISTRICT OF COLUMBIA

Life Insurance Proceeds

Maximum exemption of \$200 per month for a beneficiary providing principal support of a family or \$60 per month for a beneficiary not providing principal support of a family.

Applicable Section(s)

D.C. Code Ann. § 15-503

FLORIDA

Life Insurance Proceeds

Beneficiary's interest in proceeds wholly protected from insured's creditors unless policy payable to insured or his estate.

Owner's interest in cash surrender value wholly exempt.

Applicable Section(s)

Fla. Stat. §§ 222.13 and 222.14

GEORGIA

Life Insurance Proceeds

Owner's interest in unmaturing policy (except credit life insurance) wholly exempt; provided that only \$2,000 maximum accrued dividend or interest, or loan or cash value, exempt (provided insured is debtor or individual upon whom debtor is dependent).

Beneficiary's interest in death benefit exempt to extent reasonably necessary for support or debtor and dependent if insured was individual of whom debtor was a dependent.

Applicable Section(s)

Ga. Code Ann. §§ 44-13-100(a)(2)(E), 44-13-100(a)(8), 44-13-100(a)(9) and 44-13-100(a)(11)(C)

HAWAII

Life Insurance Proceeds

Proceeds and cash value payable to insured's spouse, child, parent, or other dependent is wholly exempt from insured's creditors.

Applicable Section(s)

Haw. Rev. Stat. § 431:10-232

IDAHO

Life Insurance Proceeds

Beneficiary's interest in "proceeds and avails" wholly protected from all creditors.

Applicable Section(s)

Idaho Code § 41-1833

ILLINOIS

Life Insurance Proceeds

Proceeds and cash value payable to insured's spouse, child, parent, or other dependent is wholly exempt from insured's creditors.

Beneficiary's interest in payment under policy insuring individual of whom beneficiary was a dependent is exempt to extent necessary for support of beneficiary and dependents.

Applicable Section(s)

215 Ill. Comp. Stat. § 5/238(a), 735. Ill. Comp. Stat. § 5/12-1001(f) and (h)(3)

INDIANA

Life Insurance Proceeds

If contract so provides, benefits payable to person other than person effecting policy are wholly exempt from creditors.

Applicable Section(s)

Ind. Code § 27-2-5-1

IOWA

Life Insurance Proceeds

Interest in accrued dividend or interest, or loan or cash surrender value, wholly exempt if beneficiary is spouse, child, or dependent, provided that increases attributable to prior two years limited to \$10,000.

Maximum \$15,000 of death benefit exempt if payable to spouse, child, or dependent.

Applicable Section(s)

Iowa Code § 627.6(6)

KANSAS

Life Insurance Proceeds

Policy and its reserves, or their present value, wholly exempt from claims of all creditors unless purchased within past year.

Applicable Section(s)

Kan. Stat. Ann. §§ 40-414(a) and (f)

KENTUCKY

Life Insurance Proceeds

Beneficiary's interest in "proceeds and avails" wholly protected from all creditors.

Owner's interest in policy wholly exempt.

Applicable Section(s)

Ky. Rev. Stat. Ann. §§ 427.110(1) and 304.14-300

LOUISIANA

Life Insurance Proceeds

Interest of beneficiary (including estate of insured) in "proceeds and avails" wholly protected from all creditors.

Applicable Section(s)

La. Rev. Stat. Ann. § 22:647

MAINE

Life Insurance Proceeds

Beneficiary's interest in "proceeds and avails" wholly protected from all creditors.

Owner's interest in unmatured policy (except credit life insurance) wholly exempt; provided that only \$4,000 maximum accrued dividend or interest, or loan value, exempt (provided insured is debtor or individual upon whom debtor dependent).

Applicable Section(s)

Me. Rev. Stat. Ann. Tit. 24-A, § 2428. Tit. 14 §§ 4422(10) and (11)

MARYLAND

Life Insurance Proceeds

Proceeds wholly exempt if payable to the spouse, child, or dependent relative of the insured.

Applicable Section(s)

Md. Code Ann., Ins. § 16-111

MASSACHUSETTS

Life Insurance Proceeds

Beneficiary's interest in "proceeds" wholly protected from creditors of owner.

Applicable Section(s)

Mass. Gen. Laws ch. 175 § 125

MICHIGAN

Life Insurance Proceeds

Proceeds (including cash value) wholly exempt from creditors.

Applicable Section(s)

Mich. Comp. Laws § 500.2207

MINNESOTA

Life Insurance Proceeds

Proceeds wholly exempt from creditors of person effecting the policy.

Maximum \$20,000 of proceeds payable to a spouse or child is exempt from other creditors (increased by \$5,000 for each dependent of the spouse or child).

Maximum \$4,000 interest in any accrued dividend or interest, or loan value, exempt (provided insured is debtor or individual upon whom debtor dependent).

Applicable Section(s)

Minn. Stat. §§ 61A.12 and 550.37(10) and (23)

MISSISSIPPI

Life Insurance Proceeds

Proceeds (including cash surrender and loan value) wholly protected from creditors of insured; provided maximum \$50,000 cash surrender or loan value exempt if from premiums paid in past 12 months.

Applicable Section(s)

Miss. Code Ann. §§ 85-3-1 and 85-3-11

MISSOURI

Life Insurance Proceeds

Owner's interest in unmaturing policy (except credit life insurance) wholly exempt; provided that only \$150,000 maximum accrued dividend or interest, or loan value, exempt (and provided insured is debtor or individual upon whom debtor is dependent).

Applicable Section(s)

Mo. Rev. Stat. §§ 513.430(7) and (8)

MONTANA

Life Insurance Proceeds

Beneficiary's interest in "proceeds and avails" wholly protected from creditors of owner and insured.

Maximum \$4,000 in value of unmatured life insurance contract is exempt.

Applicable Section(s)

Mont. Code Ann. §§ 33-15-511 and 25-13-609(4)

NEBRASKA

Life Insurance Proceeds

Maximum \$10,000 of proceeds, cash value, and benefits exempt from insured's creditors (unless beneficiary is estate of insured); also exempt from beneficiary's creditors if beneficiary related by blood or marriage to insured.

Applicable Section(s)

Neb. Rev. Stat. § 44-371

NEVADA

Life Insurance Proceeds

Beneficiary's interest in "proceeds and avails" wholly protected from all creditors.

Owner's interest in all money, benefits, privileges, or immunities, exempt to extent premium not in excess of \$1,000 per year.

Applicable Section(s)

Nev. Rev. Stat. §§ 21.090(1)(k) and 687B.260

NEW HAMPSHIRE

Life Insurance Proceeds

Beneficiary's interest in proceeds wholly protected from creditors of person effecting policy unless policy payable to insured's estate.

Applicable Section(s)

N.H. Rev. Stat. Ann. § 408:2

NEW JERSEY

Beneficiary's interest in proceeds and avails wholly protected from all creditors provided beneficiary is not owner or insured.

Applicable Section(s)

N.J. Stat. Ann. § 17B:24-6

NEW MEXICO

Life Insurance Proceeds

Cash surrender value and withdrawal value wholly exempt from all creditors.

Applicable Section(s)

N.M. Stat. Ann. §§ 42-10-3 and 42-10-5

NEW YORK

Life Insurance Proceeds

Beneficiary's interest in proceeds and avails wholly protected from all creditors provided beneficiary is not owner or insured.

Owner's interest in proceeds and avails of policy insuring another is exempt as against creditors of insured (and owner's own creditors if insured is owner's spouse).

Applicable Section(s)

N.Y. Ins. Law § 3212

NORTH CAROLINA

Life Insurance Proceeds

Beneficiary's interest in proceeds wholly protected from creditors of insured provided beneficiary is not owner or insured.

Applicable Section(s)

N.C. Const. Art. X § 5; N.C. Gen. Stat. §§ 1C-1601 and 58-58-115

NORTH DAKOTA

Life Insurance Proceeds

Maximum exemption of proceeds or cash surrender value of \$100,000 per policy and \$200,000 aggregate (unless more is reasonably necessary for the support of insured and dependents), provided payable to spouse, children, or any dependent relative. Proceeds payable to the deceased, his representatives, heirs, or estate wholly exempt from creditors of owner and insured.

Applicable Section(s)

N.D. Cent. Code §§ 26.1-33-40 and 28-22-03.1

OHIO

Life Insurance Proceeds

Proceeds and avails wholly protected from creditors of insured provided beneficiary is spouse, child, or dependent.

Applicable Section(s)

Ohio Rev. Code Ann. § 3911.10

OKLAHOMA

Life Insurance Proceeds

Policy proceeds and cash values wholly protected from all creditors.

Applicable Section(s)

Okla. Stat. Tit. 36 § 3631.1(A)

OREGON

Life Insurance Proceeds

Beneficiary's interest in proceeds wholly protected from creditors of insured provided beneficiary is not owner or insured.

Owner/insured's interest in cash value wholly exempt provided beneficiary is not owner/insured's estate.

Applicable Section(s)

Or. Rev. Stat. § 743.046

PENNSYLVANIA

Life Insurance Proceeds

Proceeds payable to spouse, child, or dependent relative of insured wholly exempt from creditors of insured.

Proceeds exempt from own creditors to extent necessary to provide for maximum income or return of \$100 per month.

Applicable Section(s)

42 Pa. Cons. Stat. § 8124(C)

RHODE ISLAND

Life Insurance Proceeds

Beneficiary's interest in proceeds and avails wholly protected from creditors of insured, provided beneficiary is not owner or insured.

Applicable Section(s)

R.I. Gen. Laws § 27-4-11

SOUTH CAROLINA

Life Insurance Proceeds

Beneficiary's interest in proceeds and cash surrender values wholly protected from creditors of insured provided beneficiary is spouse, child, or dependent of insured.

Maximum \$4,000 exemption for owner's interest in accrued dividend or interest under, or loan value of, unmaturing policy under which insured is debtor or individual of whom debtor is dependent.

Applicable Section(s)

S.C. Code Ann. §§ 15-41-30(8) and 38-63-40(A)

SOUTH DAKOTA

Life Insurance Proceeds

Maximum \$10,000 exemption for proceeds payable to estate or maximum \$20,000 exemption for proceeds payable to spouse or children.

Applicable Section(s)

S.D. Codified Laws §§ 43-45-6 and 58-12-4

TENNESSEE

Life Insurance Proceeds

Beneficiary's interest in amounts payable under policy wholly protected from creditors of insured provided beneficiary is spouse, child, or dependent relative of insured.

Applicable Section(s)

Tenn. Code Ann. § 56-7-203

TEXAS

Life Insurance Proceeds

Policy proceeds and cash values wholly protected from all creditors (subject to disagreement among courts as to interpretation and interaction of statute).

Applicable Section(s)

Tex. Ins. Code § 1108.051

UTAH

Life Insurance Proceeds

Exemption for proceeds or benefits paid to a spouse or dependent upon death of insured to extent reasonably necessary for support of beneficiary and dependents.

Maximum \$5,000 exemption for owner's interest in unmatured life insurance.

Applicable Section(s)

Utah Code Ann. §§ 78-23-6 and 78-23-7

VERMONT

Life Insurance Proceeds

Owner's interest in unmatured policy (except credit life insurance) wholly exempt.

Beneficiary's interest in payment under policy insuring life of individual on whom debtor was dependent wholly exempt; otherwise exempt from creditors of owner and insured only.

Applicable Section(s)

Vt. Stat. Ann. Tit. 12 §§ 2740(18) and (19)(H) and Tit. 8 § 3706

VIRGINIA

Life Insurance Proceeds

Beneficiary's interest in proceeds wholly protected from creditors of owner and insured, provided that beneficiary is not owner or insured.

Applicable Section(s)

Va. Code Ann. § 38.2-3122

WASHINGTON

Life Insurance Proceeds

Beneficiary's interest in proceeds and avails wholly protected from all creditors.

Applicable Section(s)

Wash. Rev. Code § 48.18.410

WEST VIRGINIA

Life Insurance Proceeds

Beneficiary's interest in proceeds and avails wholly protected from all creditors of owner and insured, provided that beneficiary is not owner or insured.

Applicable Section(s)

W. Va. Code § 33-6-27

WISCONSIN

Life Insurance Proceeds

Maximum \$4,000 exemption for debtor/owner's interest in unmaturing policy (other than credit life insurance), if debtor, dependent, or individual of whom the debtor is a dependent is insured.

Beneficiary's interest in payment under policy insuring individual of whom debtor was dependent is exempt to extent reasonably necessary for support of debtor and dependents.

Applicable Section(s)

Wis. Stat. § 815.18

WYOMING

Life Insurance Proceeds

Beneficiary's interest in proceeds wholly protected from all creditors of owner and insured, provided that beneficiary is not owner or insured.

Applicable Section(s)

Wyo. Stat. Ann. § 26-15-129

Although the authors have attempted to interpret and reflect the most current and appropriate statutory authority, planners are urged to refer to the current statutes and court decisions in their jurisdictions.

Chapter Notes

1. The discussion in this chapter assumes, of course, that the purchase of the insurance contract does not constitute a fraudulent transfer under applicable federal or state law. Under that scenario, any protections that would otherwise be afforded are vitiated by the fact of the fraudulent transfer.

2. 11 U.S.C. §§ 522(d)(8).

3. Pursuant to 11 U.S.C. § 104(b) this amount is subject to periodic adjustment by a detailed formula for the purpose of avoiding the erosion of Bankruptcy Code protections by reason of periodic cost-of-living increases.

4. See 11 U.S.C. § 522(a)(1).

5. 11 U.S.C. § 522(d)(11)(C).

6. S.C. Code Ann. § 15-41-30(8).

7. S.C. Code Ann. § 38-63-40(A).

8. Wis. Stat. Ann. § 815.18(f).

9. Wis. Stat. Ann. § 815.18(i)(a).

10. Fla. Stat. Ann. § 222.14.

11. Fla. Stat. Ann. § 222.13.

12. Hawaii Rev. Stat. § 431:10-232(a).

13. La. Rev. Stat. Ann. § 22.647(A).

14. New York Insurance Law § 3212; see also New York Civil Practice Law and Rules § 5205(i).

15. The person “effecting the policy” under the New York statute need not have actually purchased the policy. See, for example, *Kaufman v. New York Life Ins. Co.*, 299 N.Y.S.2d 269 (1st Dep’t 1969), *aff’d* 309 N.Y.S.2d 929 (Ct. App. 1970) (husband who purchased life insurance policies that were later assigned to debtor/wife was treated as agent of debtor/wife for purposes of New York exemption statute); contrast *In re Bifulci*, 154 F. Supp. 629 (S.D.N.Y. 1957) (where a husband takes out insurance on his own life and names his wife as a beneficiary but does not assign the policy to her, the proceeds are exempt from the husband’s creditors [pursuant to New York Insurance Law § 3212(b)(2)], but they are not exempt from the wife’s creditors [under the same statute], even if the policy was taken out at the instigation of the wife).

16. New York Insurance Law § 3212(b)(1).
17. This exemption for a life insurance policy that insures the life of the owner for the benefit of another has been held to be protected from the owner/insured's creditors notwithstanding the fact that a power to change the beneficiaries of the life insurance policy has been reserved. See, e.g., *In Re Messinger*, 29 F.2d 158 (2d Cir. 1928); See also *Hechtkopf v. Mendlowitz*, 282 NYS 328 (N.Y. City Ct., Kings Cty. 1935) (life insurance policies fell under exemption statute where debtor was originally owner, insured, and beneficiary but changed beneficiary designation to wife after judgment for purpose of obtaining exemption).
18. New York Insurance Law § 3212(b)(2).
19. *Id.*
20. New York Insurance Law § 3212(b)(3).
21. New York Insurance Law § 3212(b)(6).
22. 40 F. Supp. 616 (S.D.N.Y. 1941).
23. New York Insurance Law § 3212(a)(2).
24. 28 B.R. 736 (Bankr. W.D. Kentucky 1983).
25. Ky. Rev. Stat. § 427.110(1).
26. *Worthington*, *supra* at note 24 at 737.
27. *In re Beckman*, 50 F. Supp. 339 (N.D. Ala. 1943).
28. *Id.* at 344. See also *In re White*, 185 F. Supp. 609 (N.D. W.Va. 1960).
29. *Id.*
30. *Id.* at 611.
31. *Supra* at note 28.
32. *Id.* at 342.
33. *Worthington*, *supra* at note 24 at 737.
34. The reorganization of a debtor's holdings into exempt assets prior to bankruptcy for the purpose of shielding such assets from creditors, however, is generally held to be acceptable prebankruptcy planning rather than transfers fraudulent as to creditors. See, e.g., the legislative history underlying the enactment of the Bankruptcy Reform Act of 1978 (H.R. Rep. No. 595, 95th Cong., 1st Sess. 361, 1977).
35. See 26 U.S.C. § 2042. But see 26 U.S.C. §2035(a)(2), which will include in the settlor's gross estate the proceeds of any life insurance policies that were transferred within the three-year period ending on the date of the settlor's death.
36. A discussion of which is well beyond the scope of this chapter.

37. See, e.g., Gideon Rothschild, "Coming in From the Cold—Estate Planning Using Alaska Trusts," *CCH Financial and Estate Planning* (August 1997); see also PLR 9837007 (gift by Alaska settlor to Alaska trust of which settlor was discretionary beneficiary deemed completed gift. However, the IRS refused to rule on whether the trust would be includible in the estate). Amounts transferred in excess of the gift tax exemption (currently \$1 million) would, however, be subject to gift tax. If larger amounts of premiums are anticipated, the settlor can make loans to the trust, which would be repayable upon the settlor's death.

38. Although state premium tax is generally paid by the insurer, the cost is then passed along to the life insurance policy owner.

39. Insurance Act (1978) of Bermuda, Art. 26. If it can be shown, however, that the insurance contract "was effected and the premiums paid with intent to defraud creditors of the insured, they shall be entitled to receive, out of the money payable under the contract a sum equal to the premium paid" (Insurance Act 1978 of Bermuda, Art. 35).

40. Insurance Act, 1996 of Barbados, § 128(1).

41. Bahamas' External Insurance (Amendment) Act, Part II § 3.

42. Cayman Islands' Insurance Law (1999 Revision) § 7(6)(b)(ii).

43. The insurance law of the British Virgin Islands is very similar to that of the Cayman Islands in this regard. See Insurance Act, 1994 of the British Virgin Islands, §§ 45(2) and (4).

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