

Idaho Code § 41-1836—An Arrow or Shield: Annuity Exemption Considered.

Idaho Code § 41-1836 (the “annuity exemption”) has been part of Idaho’s exemption repertoire for years. The annuity exemption has received recent significant judicial and legislative attention. Current legislative developments, however, appear to grant limited execution and turnover arrows to judgment creditors and bankruptcy trustees, respectively. Further, the recent enactment firmly affixes the debtors’ shield against recovery found in the generally, unlimited deferred annuity exemption outside the new 6-month look back period.

Background

In a November 2012 appellate decision issued by the federal district court, Chief Judge Winmill reversed the bankruptcy court’s decision, which had sustained the trustee’s objection to a claim of exemption of certain annuities. Framing the issue as to “whether the debtors’ failure to elect a payout option somehow prevents them from claiming the exemption” the district court summarized § 41-1836 by stating, “creditors cannot reach the ‘benefits, rights and privileges’ of any annuity contract, whether it is ‘due or prospectively due’ to the annuitant, subject to certain exceptions.” *Aden v. Gugino (In re Aden)*, 484 B.R. 379, 385-86 (D. Idaho 2012).

Judge Winmill went on to explain that § 41-1836(1)(b) & (c) provide limits to the exemption, “if the benefits are ‘presently due and payable’” limiting the exemption at \$1,250.00 a month, with the excess over \$1,250.00 a month subject to garnishment limitations and the “reasonable requirements of the judgment debtor and his family” as the court deems “just and proper.” *Id.*; I.C. § 41-1836(1)(b) & (c). However, “the \$1250 monthly limitation comes into play only if the annuitant is ‘presently’ receiving benefits. If benefits are only ‘prospectively’ due, the \$1250 limitation is not yet relevant, and creditors have no right to reach into the future and claw back payments to satisfy the annuitant’s debts.” *Id.*

Unless the transfer is avoidable under either state or federal law, where no annuity payments are presently due and owing (i.e. a deferred annuity), the entire annuity is exempt.

Legislative Response

In apparent response to district court’s decision, the 2013 Idaho Legislature adopted Senate Bill 1109Aa, adding subsection (d) to § 41-1836(1):

§ 41-1836. EXEMPTION OF PROCEEDS—ANNUITY CONTRACTS—ASSIGNABILITY OF RIGHTS. (1) The benefits, rights and privileges and options which under any annuity contract heretofore or hereafter issued are due or prospectively due the annuitant, shall not be subject to execution nor shall the annuitant be compelled to exercise any such rights, powers, or options, nor shall creditors be allowed to interfere with or terminate the contract, except:

....

(d) As to any deferred annuity contract having a cash surrender provision and from which no periodic payments are being made, the cash surrender value of the deferred annuity contract, not to exceed premiums paid into the deferred annuity contract within six (6) months prior to the filing of a bankruptcy petition, as defined in 11 U.S.C. section 101, or the date of attachment or levy on execution, as defined in section 11-201, Idaho Code, whichever is applicable.

Essentially, subparagraph (d) provides exemption limitations on a “deferred annuity contract.” The effective date of this exemption limitation is July 1, 2013.

Projected Exemption Status

As determined by the district court, the annuity exemption is extremely broad and favorable to debtors. That said, there are limitations, but those limitations will depend on the class of annuity at issue.

With the adoption of S1099aa, there appear to be two classifications of annuities under § 41-1836: (i) the current *presently due and owing annuity* under subparagraphs (b) and (c); and (ii) the newly created *deferred annuity* under subparagraph (d).

With respect to presently due and owing annuities the statutory limits appear to remain unchanged by the district court’s decision and the recent statutory amendment. It appears that juxtaposing the district court’s decision against S1099aa reinforces the distinction between a *presently due and owing annuity* and a *deferred annuity*.

With respect to the exemption in a deferred annuity, in order for the exemption limit in subparagraph (d) to apply, the deferred annuity (i) must have a cash surrender provision, and (ii) the annuitant is not presently receiving payments.

If these two conditions are met, then debtor is granted a limited exemption. This newly created exemption does not include the cash surrender value of the value of premiums paid within six (6) months prior to the bankruptcy or date of attachment or levy, whichever applies. In other words, I.C. § 41-1836(d) limits the deferred annuity exemption to premiums paid six months or more prior to bankruptcy or execution.

As such, 11 U.S.C. § 544, together with I.C. §41-1836(d), provides bankruptcy trustees with an additional avoidance arrow as to deferred annuities, but only for cash surrender amount of the annuity premiums paid during the 6 months prior to the petition date.

Under state law, judgment creditors also enjoy the same benefit. Judgment creditors must be sensitive to the 6-month look-back period from the date of attachment or levy. Fail to catch the deadline and you miss the chance to contest the debtor's exemption.

Given the fact that the Idaho Legislature added subparagraph (d) in apparent response to Judge Winmill's decision, it appears that outside of the 6-month timeframe, the debtor benefits from a generally unlimited exemption on any deferred annuity.

Those with anticipated bankruptcies and annuity assets should consider whether to file prior to July 1, 2013 and avoid any novel legal theories asserted by trustees and creditors, as well as the 6-month look back arising out of the amended exemption statute.

Debtors will likely take advantage of I.C. § 41-1836(1) as a pre-bankruptcy planning tool. Whether such exemption planning will rise to the level of abuse, bad faith or fraud remains to be seen. However, in his closing comments, Chief Judge Winmill dismissed concerns regarding abuse:

Moreover the potential for abuse is ameliorated by at least two factors: (1) the annuity-exemption statute itself has a fraud exception, see Idaho Code § 41-1836(1)(a); and (2) the Idaho legislature is, of course, free to modify or eliminate the exemption if presented with evidence of its misuse. *Aden v. Gugino (In re Aden)*, 484 B.R. at 387.

And the Idaho legislature did not tinker with that fraud exception.

But debtor's counsel: Be wary! While your judgment debtor is counting-off those critical six (6) months to this exemption's safe harbor, an enterprising judgment creditor's attorney may sweep in and snatch up an easily identifiable pot of money.

In sum, judgment creditors, trustees and debtors should understand the issues raised in *Aden v. Gugino* and the recent amendments to *Idaho Code* § 41-1836(1). Certainly arrow-and-shield arguments and theories abound, but the enactment of S1099a is not a singular panacea to either debtors or trustees. There is plenty of opportunity for both benefit and caution.

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