UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF NEBRASKA

IN THE MATTER OF	)	
	)	
KENTON L. THOMPSON and	)	
MARILYN K. THOMPSON,	)	CASE NO. BK86-2706
	)	
DEBTORS	)	

MEMORANDUM OPINION

This matter came on for hearing on June 24, 1987, upon the objection of the First Security Bank to the debtors' claimed exemptions. Appearing on behalf of the debtor was Charles Cuypers of Oxford, Nebraska. Appearing on behalf of the First Security Bank was John Guthery of Lincoln, Nebraska.

Facts

The debtors filed for relief under 11 U.S.C. Chapter 7 on September 19, 1986. Prior to August 12, 1986, Mr. Thompson had operated a used car and auto body repair business. That business suffered financial reverses in 1983 and 1984, and in 1985 Mr. Thompson tried unsuccessfully to refinance it. He then liquidated the used car inventory. On August 12, 1986, he sold the equipment, fixtures and inventory of the business, and on September 17, 1986, he deeded the building to the First Security Bank (the "Bank"). Mrs. Thompson has worked in a County Clerk's office for a number of years.

On June 9, 1986, the debtors obtained a loan in the amount of $40,000 from the Security State Bank of Holdrege, Nebraska, using the equity in their home as collateral. On June 16, 1986, the debtors purchased an annuity with the $40,000 in loan proceeds. Mr. Thompson was named as the annuitant. Mrs. Thompson was named as the sole owner of the annuity and its beneficiary.

Mr. Thompson testified that, prior to purchasing the annuity, he had discussed the possibility of filing bankruptcy with Mr. Cuypers, his Attorney. He also testified that he had looked into purchasing an annuity as a way to protect the equity in his home from creditors in the event that he and his wife filed bankruptcy. Thompson deposition. (8:8-17)

The Bank has filed an objection to the debtors' claimed exemptions, specifically alleging that the annuity was obtained with fraudulent intent and should, therefore, be disallowed as an exemption.

Issue

Was the debtors' annuity obtained with fraudulent intent, with the result that it must be disallowed as an exemption?

Decision

The annuity was obtained with fraudulent intent. Therefore, the annuity should be and hereby is disallowed as an exemption.

Discussion

The debtor cites the legislative history of the Bankruptcy Code in 1978 as support for the proposition that converting non-exempt property to exempt property before filing bankruptcy is not fraudulent as to creditors. This Court does not dispute the contention that a debtor may convert non-exempt assets into exempt assets prior to the filing of bankruptcy. However, some courts have been reluctant to accept that legislative history without qualification, See In re Johnson, 8 B.R. 650 (Bankr. D. S.D. 1981), In re Butts, 45 B.R. 34 (Bkrtcy. 1984), and at least one court has rejected it outright as being erroneous, See Mickelson vs. Anderson, 31 B.R. 635 (Bankr. D. Minn. 1982). This Court adopts the former view and the reasoning in Johnson:

> The act of converting non-exempt assets into exempt assets does not, by itself, constitute fraud on the creditors. Extrinsic facts and circumstances must be in evidence to prove that the conversion of non-exempt assets into exempt assets was done with a fraudulent intent.

In re Johnson, 8 B.R. at 654. The Bankruptcy Court for the District of North Dakota, having adopted a similar approach, discussed the application of equitable principles:

> Whether the legislative history is erroneous or merely ambiguous, the courts have construed the comments in a limited manner so as to allow a test which incorporates equitable principles. It appears to be universally acknowledged, therefore, that the debtors' exemption claim will be denied upon proof of conduct committed with fraudulent intent.

In re Butts, 45 B.R. at 36.It is necessary, then, to look at the debtors' conduct prior to the conversion of the non-exempt assets to exempt assets. It is clear from the evidence that the debtors had been experiencing financial difficulties for some time. They had already lost their business and deeded over the building to the Bank. Mr. Thompson testified that he had discussed the subject of an annuity with both his attorney and his insurance agent. He stated that he was looking for a way to protect the equity in his home from creditors. He then obtained a loan for the entire amount of that equity and purchased an annuity with it, after apparently transferring his half of the loan proceeds to his wife. After reviewing all of these circumstances, the Court believes that the debtors went beyond merely taking advantage of their allowed exemptions. They deliberately took steps to remove their main asset from their creditors. Therefore, this Court finds that the debtors converted non-exempt property to exempt property with the intent to fraudulently remove property from the hands of their creditors, and, therefore, the claimed exemption for the $40,000 annuity is disallowed.

DATED: October 16, 1987.

BY THE COURT:

Timothy J. Mahoney
U.S. Bankruptcy Judge

Copies to:

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Trustee at address of record