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Insurance Proceeds in Bankruptcy

The filing of a petition for relief under the federal bankruptcy statute creates an “estate” consisting of all of the debtor’s property, contract rights and claims. Any insurance policies owned by the debtor are property of the bankruptcy estate.

Although it is clear that a policy owned by the debtor is property of the bankruptcy estate, the situation is less clear with respect to the *proceeds* of an insurance policy owned by the debtor. A few years ago, a federal appeals court in New Orleans discussed the competing considerations which determine whether proceeds of an insurance policy owned by the debtor are also property of the bankruptcy estate.

The court explained that the determination of whether the insurance proceeds are property of the estate depends initially on whether the debtor would have the right to receive and keep the proceeds when the insurer pays on the insurance claim. If the debtor has no right to receive the proceeds, those proceeds are not property of the bankruptcy estate, even if the debtor owns the policy.

However, the result is different if there are multiple claimants for the insurance proceeds and the amount of the proceeds is insufficient to pay all the claims in full. In that case, the interest of the bankruptcy estate in having the proceeds applied equitably to all of the claimants, who are also creditors of the estate, dictates that the insurance proceeds come into the bankruptcy estate for distribution to the creditors.

In re OGA Charters, LLC, 901 F.3d 599 (5th Cir. 2018).

HUD Grabs Tax Refund

The federal bankruptcy statute permits an individual debtor to keep certain property. The property that may be kept is referred to as “exempt”. The statute states that

property which is exempted “is not liable during or after the case for any debt of the debtor that arose before the commencement of the case.” This means that pre-bankruptcy creditors may not satisfy their debts from exempt property. However, another federal statute requires the United States Treasury to set off against any tax refund amounts which the taxpayer owes the federal government. A federal appeals court in Richmond recently resolved a conflict between these two statutes.

Mr. and Mrs. Wood borrowed money to finance the purchase of a mobile home. The loan was guaranteed by the United States Department of Housing and Urban Development. Six years later, the Woods defaulted on the loan and filed a bankruptcy case. HUD paid the lender and stepped into its shoes as the creditor of the Woods. The Woods exempted their tax refund in their bankruptcy case. The Treasury sought to retain the tax refund and apply it to the debt owed to HUD. The court determined that the government’s setoff rights were superior to the bankruptcy exemption and permitted collection of the debt to HUD from the exempted refund.

In re Wood, 993 F.3d 255 (4th Cir. 2021).



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