

Protecting Retirement Plans

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An ounce of prevention is worth a pound of cure. That this cliché contains a measure of truth is demonstrated by the value of prebankruptcy planning. Proper use of asset protection promotes the Bankruptcy Code's⁽¹⁾ goal of providing the "honest but unfortunate debtor" with a "fresh start" by maximizing the benefit of either excluding or exempting certain assets from the claims of creditors. To be sure, the advantages of asset protection are not limited to the bankruptcy context; many such devices are just as effective in thwarting attempts by creditors to reach assets outside of bankruptcy.⁽²⁾

Nevertheless, the best litmus test for the validity of an asset protection device is a bankruptcy proceeding. The ability of a debtor to retain an asset by either excluding or exempting⁽³⁾ it from "property of the bankruptcy estate" will typically be tested by a trustee, who is specifically charged with the duty of enlarging the pool of assets available for distribution to unsecured creditors.⁽⁴⁾ To accomplish this goal, the Bankruptcy Code endows trustees with myriad powers under federal and state law for attacking such protections.

This article focuses on employee retirement benefits, particularly pension plans and individual retirement accounts (IRAs), and the extent to which they are insulated from the claims of creditors. Such protections owe their existence to a public policy goal of ensuring pension benefits to retirees and their dependents, thereby preventing them from becoming a burden to society. Not surprisingly, the protection of such assets depends on the particular state or federal law at issue. Although the differences in state law that inevitably arise in a federal system will yield differences in result, the Bankruptcy Code provides a uniform framework for analyzing recent issues concerning the validity of these particular devices.

Exclusion of ERISA-Qualified Pension Plans

Under Section 541(a) of the Bankruptcy Code, upon the filing of a bankruptcy petition, an estate is automatically created that is composed of all of the debtor's "legal and equitable interests in property" as of the time of the filing of the petition. As this definition indicates, the bankruptcy "estate" is quite inclusive. However, Section 541(c)(2) states that there is a specific exclusion from the bankruptcy estate for property that is subject to a "restriction on the transfer of a beneficial interest of the debtor in a trust that is enforceable under applicable nonbankruptcy law."

The Supreme Court had an opportunity to consider the tension between these provisions in *Patterson v. Shumate*.⁽⁵⁾ In that case, it was faced with a dispute between a debtor and trustee in a Chapter 7 proceeding over entitlement to the debtor's interest in a pension plan, established pursuant to the provisions of the Employee Retirement Income Security Act (ERISA).⁽⁶⁾ The pension plan had an antialienation provision, as required by ERISA. The Supreme Court held that this antialienation provision was a restriction on transfer for purposes of Section 541(c)(2).

The primary legal issue addressed by the Supreme Court was whether the term "applicable nonbankruptcy law" of Section 541(c)(2) was limited to traditional spendthrift trusts under state law or included other federal law. The Court granted certiorari to resolve a conflict among the courts of appeals on this issue. The majority view, before the Supreme Court's decision in *Patterson*, was that a pension plan did not qualify as a spendthrift trust under state law if the participant had the right to exercise direct or indirect control over the plan.⁽⁷⁾ Relying on the plain language of the term "applicable nonbankruptcy law" as containing no limitation to state law, the Court held that this language also encompassed federal laws, such as ERISA, and that Section 541(c)(2) applied equally to the antialienation provision in the pension plan at issue.

In concluding that the pension plan was excluded from the bankruptcy estate, the Court rejected the trustee's argument that its holding would undermine the Bankruptcy Code's policy of ensuring a broad inclusion of assets. The Court reasoned:

Our holding gives full and appropriate effect to ERISA's goal of protecting pension benefits. See 29 U.S.C. §§1001(b) and (c). This Court has described that goal as one of ensuring that "if a worker has been promised a defined pension benefit upon retirement--and if he has fulfilled whatever conditions are required to obtain a vested benefit--he actually will receive it.

[O]ur holding furthers another important policy underlying ERISA: uniform national treatment of pension benefits. [citation omitted]. Construing "applicable nonbankruptcy law" to include federal law ensures that the security of a debtor's pension benefits will be governed by ERISA, not left to the vagaries of state spendthrift trust law.⁽⁸⁾

The breadth of the Supreme Court's holding in *Patterson* is underscored by its reliance on its earlier decision in *Guidry v. Sheet Metal Workers Pension Plan*.⁽⁹⁾ In *Guidry*, a labor union attempted to impose a constructive trust on funds held in a pension plan of a union official who breached his fiduciary duty and embezzled union funds. In rejecting the union's equitable arguments to the contrary, the Supreme Court stated that ERISA "reflects a considered congressional policy choice, a decision to safeguard a stream of income for pensioners (and their dependents, who may be and perhaps usually are, blameless), even if that decision prevents others from securing relief for the wrongs done them."⁽¹⁰⁾ Thus, the exclusion of Section 541(c)(2) applies with equal force to the honest as well as dishonest debtor.

Defining an ERISA-Qualified Plan

Notwithstanding the Supreme Court's strong endorsement of the use of pension plans in *Patterson*, some retirement plans are more protected than others. For one, practitioners should anticipate that trustees and creditors will focus their attacks on the formal requirements of ERISA pension plans. If a particular pension plan fails to satisfy the statutory requirements, the plan may lose its protected status and result in a windfall to the bankruptcy estate.

The case law has been slow to develop in this area largely because of the complexity of the laws involved. Most of the reported decisions involving ERISA and bankruptcy issues have failed to clearly articulate what is exactly required to establish a valid ERISA pension plan. Many simply accept the Internal Revenue Service's (IRS) determination that a plan is "qualified" or "nonqualified" and begin their analysis from that point.⁽¹¹⁾

One important exception to the dearth of case law is the opinion in *In re Hall*.⁽¹²⁾ In that case, the debtor was the president and sole shareholder of a printing company. The corporation established a pension plan, which at the time of its inception was qualified under the Internal Revenue Code (IRC) and ERISA and contained an anti-alienation provision. Because of the corporation's financial difficulties, payments on behalf of the corporation's employees were suspended five years before the commencement of the debtor's bankruptcy case and were never reinstated.

In analyzing whether the pension plan was qualified at the time that the debtor filed his bankruptcy petition, the court began by noting that even though the Supreme Court conclusively decided that an "ERISA-qualified" plan was not part of the bankruptcy estate, it did not address what is or is not an ERISA-qualified plan. Relying on the Sixth Circuit's decision in *In re Lucas*,⁽¹³⁾ which predated but was consistent with the *Patterson* opinion, the court held that an ERISA-qualified plan must be (1) subject to ERISA; (2) tax-qualified under Section 401 of the IRC; and (3) include an anti-alienation provision.⁽¹⁴⁾

Coverage by ERISA

In discussing the first element, the court noted that a pension plan subject to ERISA is, by definition, a plan that (1) provides retirement income to employees; or (2) results in a deferral of income by employees for periods extending to the termination of covered employment or beyond. Pursuant to rule-making authority the Secretary of Labor narrowed the definition of "employee" to exclude an individual and his or her spouse who wholly owns a trade or business, whether incorporated or unincorporated. Relying on the decision in *In re Witwer*,⁽¹⁵⁾ which had substantially similar facts, the court held that the debtor and his spouse, the only participants in the plan, were not employees and, thus, the plan was not ERISA-qualified. As a result, it held that the pension plan was not excluded from the bankruptcy estate pursuant to Section 541(c)(2).

Tax-Qualified Under IRC Section 401. Given its decision on the question of whether the plan was subject to ERISA, the *Hall* court next focused its discussion on the plan's tax qualification under Section 401(a) of the IRC, which it characterized as a "legal mountain." Such legal complexities often contain cracks that can cause the entire structure to collapse on the unwary. Such was the case for the debtor in *Hall*.⁽¹⁶⁾

Because the plan only benefited two out of six present and former employees, the court concluded that the plan did not satisfy the minimum participation rule and was not tax-qualified. Therefore, it was not exemptable under Section 522(d)(10)(E) either.

As the opinion in *Hall* demonstrates, there are numerous legal requirements under ERISA and the IRC that pension plans must satisfy in order to qualify for the exclusion of Section 541(c)(2). Not all courts agree that such avenues of attack should be available. For example, in *In re Youngblood*,⁽¹⁷⁾ a husband and wife filed a Chapter 7 petition and claimed as exempt the proceeds of their ERISA-qualified plan that had been rolled over into an IRA. A creditor objected to the exemption on the grounds that the funds were not "qualified" under the IRC and, therefore, were not exempt under the particular state statute.

When the husband's corporation established the pension plan, the IRS issued a favorable determination letter, ruling that the plan was "qualified" under Section 401 of the IRC. More than 10 years later, it issued another favorable determination letter based on proposed amendments to the plan. Just prior to the termination of the plan shortly thereafter, the IRS audited the plan and assessed penalties in the form of taxes but did not revoke its earlier determination that the plan was qualified. When the plan was subsequently terminated, the husband "rolled over" his distribution into an IRA.

In support of its objection, the creditor argued that the plan was, in fact, not qualified. It claimed that the plan was used to, among other things, provide working capital for the husband's corporation and to make business loans to the debtor. It also claimed, and the bankruptcy court agreed, that the bankruptcy court had the authority to make its own determination as to whether the plan was qualified. It then determined that the plan was not qualified and denied the exemption. The district court affirmed this decision.

On appeal, the Fifth Circuit reversed. In deciding whether the bankruptcy court had the authority to determine whether the plan was qualified, the court stated:

We answer this question in the negative. We are persuaded that the legislature intended for its own state courts (or bankruptcy

courts applying Texas law) to defer to the IRS in determining whether a retirement plan is "qualified" under the Internal Revenue Code. We see no reason that the legislature would want its courts, which are inexperienced in federal tax matters, to second-guess the IRS in such a complex, specialized area. We find it much more reasonable to assume that the legislature contemplated creating an exemption from seizure for a debtor's retirement funds that could be simply and readily determined by deferring to the federal tax treatment of those funds. Moreover, we do not believe that the legislature wanted to adopt a scheme that invites frequent, unseemly, conflicting decisions between the state court or bankruptcy court, and the IRS, such as occurred in this case.⁽¹⁸⁾

While the decision in *Youngblood* involved a state law exemption, the Fifth Circuit went out of its way in the quoted passage to point out that not only state courts but also bankruptcy courts must defer to determinations of the IRS as to whether a particular plan is or is not a qualified plan. The import of the *Youngblood* holding is that once the IRS has made the determination that a plan is qualified, that decision is final unless it is revoked by the IRS. While this approach has the benefit of giving debtors the comfort of being able to rely on the IRS's determinations, other courts, such as those in *Hall* and *Lane*,⁽¹⁹⁾ will be more inclined to scrutinize a debtor's compliance with the legal formalities of such plans, particularly if there is a perception that the plan at issue is being used in an abusive manner.

Inclusion of Antialienation Provisions

With respect to the third requirement concerning antialienation provisions, the reasoning of *In re Witwer* is instructive. On similar facts and analysis as in *Hall* the *Witwer* court concluded that the debtor's pension plan was not subject to ERISA. Nonetheless, the debtor claimed that it had an antialienation provision consistent with Section 401(a)(13). The debtor argued that Section 401(a)(13) was "the coordinate section" of Section 1056(d) of ERISA and constituted "applicable non-bankruptcy law" under Section 541(c)(2), as interpreted by the Supreme Court in *Patterson*. In rejecting the debtor's argument, the court reasoned:

The Debtor correctly states that under *Patterson*, § 541(c)(2) encompasses any relevant nonbankruptcy law so long as the transfer restrictions are "enforceable". [*Patterson*, 112 S. Ct. at 2247.] Under ERISA a plan participant, beneficiary, or fiduciary, or the Secretary of Labor may file a civil action to "enjoin any act or practice" which violates ERISA or the terms of the plan. 29 U.S.C. §§ 1132(a)(3), (a)(5). The "coordinate section" of the I.R.C., however, does not provide for a similar remedy.

The provisions of I.R.C. § 401(a) relate solely to the criteria for tax qualification under the Internal Revenue Code. Although a transfer in violation of the required antialienation provision could result in adverse tax consequences I.R.C. §401(a) does not appear to create any substantive rights that a beneficiary or participant of a qualified retirement trust can enforce.⁽²⁰⁾

Thus, in order to obtain the protection afforded pension plans under *Patterson*, planners should ensure that the plan is subject to ERISA, tax-qualified under the IRC, and contains an enforceable antialienation provision.

Other Vulnerable Aspects

Even if these requirements are met, some debtors' plans may still be vulnerable. One area of concern is attachment of federal tax liens. In *United States v. Sawaf*⁽²¹⁾ the IRS secured a judgment against the defendants for the amount of their assessed tax deficiency. In order to enforce that judgment, the IRS proceeded under the Federal Debt Collection Procedure Act (FDCPA). Section 3205(a) of that act allows the government to collect a judgment owed to it by garnishing property ". . . in which the debtor has a substantial nonexempt interest and which is in the possession, custody or control of a person other than the debtor."

Citing Section 1056(d) of ERISA and *Patterson*, the defendants claimed that the pension plan was exempt. In rejecting the defendants' argument, the court noted that the only express statutory exception from the antialienation provision of ERISA was for qualified domestic relations orders. However, the court relied on IRS Regulation Section 1.401(a)-13(b)(2), which provides that an antialienation provision pursuant to Section 401(a)(13) of the IRC does not preclude (1) the enforcement of a federal tax levy made pursuant to Section 6331 or (2) the collection by the United States on a judgment resulting from an unpaid tax assessment. The court went on to explain that its holding was consistent with ERISA, the IRC, and the FDCPA.⁽²²⁾

Unlike a federal tax levy however, a state tax agency may not levy on an ERISA plan, because ERISA preempts state tax law. As discussed subsequently, if the plan is not an ERISA plan, the state exemption statute will apply.

As noted, the only statutory exception to the protection afforded by an ERISA-qualified plan is with respect to court orders for spousal and child support. In order to create an exception to ERISA's antialienation rule, Congress created a statutory exception for Qualified Domestic Relations Orders (QDRO), which allows retirement plan balances to be assigned to either a spouse, child, or other dependent of the participant.⁽²³⁾

Distribution of Proceeds

Another concern relates to invasion of the corpus of the pension plan, as was the case in *Velis v. Kardanis*.⁽²⁴⁾ The debtor in that case had, among other property, approximately \$184,000 in an ERISA-qualified pension plan. Shortly after the filing of his

Chapter 11 petition, the debtor "borrowed" substantial funds from his pension plan. The debtor claimed that the amounts that he borrowed retained their excluded status under Section 541(c)(2) notwithstanding such distribution. In concluding that such assets lost their protected status, the Third Circuit stated:

With respect to the pension plan and the Keogh plan, we conclude that, to the extent the assets in these plans have already been distributed to or for the benefit of the debtor, the debtor no longer has available the protections which might otherwise have been accorded under the ERISA statute. Section 541(c)(2) requires recognition of restrictions upon transfer which are enforceable by law; it does not operate to require non-recognition of transfers which have already occurred, nor does it apply to assets in the possession of the debtor without restrictions. Here, it is undisputed that, shortly after the bankruptcy petition was filed, the debtor withdrew substantially all of the funds in his pension plan, Keogh plan and the IRA, and used the money to purchase the cooperative apartment--not as pension plan assets, or as part of the debtor's estate, but for his own purposes. To that extent, there can be no doubt that these moneys came into the unrestricted possession of the debtor, and were no longer pension assets.⁽²⁵⁾

The decision in *Velis* was expanded upon in *Trucking Employees of North Jersey Welfare Fund, Inc. v. Colville*.⁽²⁶⁾ In *Colville*, a union employee received overpayments of \$44,000 for disability payments. When he refused to return the payments, the union fund filed suit and withheld his retirement benefits. The district court granted the union fund judgment for the amount of the overpayments, but refused to place a constructive trust on Colville's retirement funds and ordered the union fund to release them to him.

When Colville received the funds, he placed them in a personal bank account. The union fund then served a writ of execution on the account. However, relying on the *Patterson* decision, the district court refused to order turnover of the funds. On appeal, the Third Circuit reversed. Relying on 26 CFR § 1.401(a)-13(c)(1) and the Tenth Circuit's decision after remand in *Guidry v. Sheet Metal Workers Pension Plan*,⁽²⁷⁾ the court held that a plan's antialienation provision applies to future payments on the plan's corpus, but not to amounts paid out to the participant. As a result, Colville had to turn over the funds in his account to satisfy the union fund's judgment.⁽²⁸⁾ Even though ERISA does not protect plan distributions, state exemptions may provide some relief. Some states exempt IRA rollovers from qualified plans,⁽²⁹⁾ while others protect such proceeds provided distributions remain segregated from other funds.⁽³⁰⁾

Finally, a debtor should also be aware of transactions that may be subject to avoidance by a trustee. The court in *Velis* alluded to this possibility. In discussing the protection given to pension plans, it stated that

[w]e believe it reasonable to conclude that Congress intended to provide protection against the claims of creditors for a person's interest in pension plans, unless vulnerable to challenge as fraudulent conveyances or voidable preferences. Presumably substantial and unusual contributions to a self-settled pension trust made within the preference period, or with intent to defraud creditors, should receive no protection under either §541(c)(2) or 522(d)(10)(E).⁽³¹⁾

Exemptions Under the Bankruptcy Code

In addition to the exclusion set forth in Section 541(c)(2), Section 522 of the Bankruptcy Code allows a debtor to "exempt" certain property from the bankruptcy estate. Whereas excluded property never enters the bankruptcy estate, exempt property becomes part of the bankruptcy estate but is removed from the estate by the debtor declaring it as exempt. This distinction is more than just conceptual. The exclusion of Section 541(c)(2) operates as a matter of law without any affirmative act of the debtor. An exemption requires the debtor to declare the particular exemption and allows the trustee and creditors an opportunity to object.

Section 522(d) sets forth a list of 11 relatively standard exemptions. The type of exemptions range from a homestead and household belongings to tools of the trade to financial instruments to health aids. Most have limitations on the extent of the value of the asset that may be exempted. Although the exemptions set forth in Section 522(d) are clear, it is not certain that they will always apply.

Section 522(b) provides states with a significant amount of authority by allowing them to choose between different possible exemption schemes, of which Section 522(d) represents only one. Section 522(b)(1) essentially authorizes states to affirmatively "opt-out" of the federal exemption scheme of Section 522(d). By doing so, states are free to enact their own exemptions. Most states have done so but with varying degrees of substantive difference. Florida, for example, has opted out of the Bankruptcy Code exemptions only to reenact a portion of them by reference.⁽³²⁾ Other states, including California, have opted out and then enacted a list identical to the bankruptcy exemptions as well as a separate set of exemptions containing significant differences and allowing the debtor to choose between the two different lists.⁽³³⁾ As one court noted, considering the differences in approach, outcomes often hinge on the particular statute at issue.⁽³⁴⁾

State Exemption of Nonqualified Plans

State exemptions are significant because they provide a second line of defense for the protection of pension plans. To the extent that a pension plan is not qualified under ERISA or the IRC or does not contain an enforceable antialienation provision, a debtor

may be able to exempt part or all of such an asset. In particular, state exemptions become important with respect to IRAs, SEPs (Simplified Employee Pensions), top hat plans, excess benefit plans, and those plans that cover only the owner and his or her spouse. Even though some of these plans may be subject to some ERISA requirements, they are not subject to the anti-alienation rule of Part 2 of Title I of ERISA and therefore are not excludable under Section 541 (c)(2).

In considering the protection of such exemptions, attention should be given to the question of whether the state statute in question is preempted by ERISA. Section 1144(a) of ERISA states that ERISA "shall supersede any and all State laws insofar as they may now or hereafter relate to any employee benefit plan." Some courts have held that state statutes authorizing pension plans were preempted by ERISA.⁽³⁵⁾ These decisions were based on an interpretation of the "relate to" language of Section 1144(a) as being sufficiently broad to preempt state statutes that make specific reference to ERISA as well as those that deal with the subject matter covered by ERISA.

More recent opinions have reached different conclusions.⁽³⁶⁾ These decisions have focused on the savings provision of Section 1144(d), which provides that ERISA's preemption clause "shall not be construed to alter, amend, modify, invalidate, impair, or supersede any law of the United States,." In *In re Schlein*, the Eleventh Circuit reasoned:

The Bankruptcy Code was enacted as a comprehensive scheme to regulate debtor-creditor relationships after the filing of a bankruptcy petition. As part of this scheme, responsibility for defining what property debtors will take out of bankruptcy is shared with the states. ERISA, on the other hand, is a comprehensive regulatory program that governs employer-employee relations in the area of private employee benefit plans. Congress made clear that it did not want the states to interfere in this area. But as the Supreme Court has taught us, this does not mean that Congress intended ERISA preemption to ride roughshod over other areas of federal legislation, whether it be Title VII, the Bankruptcy Code, or other comprehensive federal schemes. In relying on the approach adopted by the Ninth Circuit in the now-withdrawn *Pitrat* case, the district court fell into the same trap that Judge Sneed found the *Pitrat* majority had stumbled in the failure to accommodate or account for the policies and goals underlying the Bankruptcy Code.⁽³⁷⁾

Thus, the weight of recent authority supports the use of state exemption statutes to provide additional protection for pension plans that are not ERISA qualified. However, a state cannot make an exemption into an exclusion similar to Section 541(c)(2). Such purported exclusions are preempted by the Bankruptcy Code.⁽³⁸⁾

Exemption of IRAs

Even though IRAs are recognized as tax-qualified retirement plans under IRC Section 408, they are not ERISA-qualified plans.⁽³⁹⁾ State exemption statutes are far more important for their protection of individual retirement accounts than for pension plans. A growing number of states have enacted exemptions protecting IRAs. Although an IRA may not be specifically mentioned in the statute, states often employ certain language that is broad enough to encompass IRAs. A good example is the language in Section 522(d)(10)(E), which exempts "a payment under a stock bonus, pension, profit-sharing, annuity, or similar plan or contract on account of illness, disability, death, age, or length of service."

The Fifth Circuit recently addressed the exemptability of IRAs in *In re Carmichael*.⁽⁴⁰⁾

The debtor in *Carmichael* elected for the federal exemptions, which he was apparently able to do under Texas law, and claimed his IRA as exempt under Section 522(d)(10)(E). The Fifth Circuit held that IRAs were encompassed by the "similar plan or contract" language of Section 522(d)(10)(E). After analyzing the statutory language, the Fifth Circuit stated:

[T]o conclude that IRAs are not exempt would be to suggest that Congress intended to penalize self-employed individuals for their choice of the form in which their retirement assets are held. This result would be antithetical to Congress' solicitude for retirement benefits for self-employed individuals. By analogizing the treatment of IRAs to Congress' treatment of other retirement plans in § 522(d)(10)(E), we find it more than plausible to infer that Congress intended for IRAs to be treated similarly for purposes of exemption. Indeed, to hold otherwise would be to create a trap for the unwary in those frequent instances in which funds from other exempt plans are "rolled over" into IRAs when those other plans terminate or when employment ceases. After all, Congress has, in the overall retirement scheme of the IRC, selected the IRA to serve as a sort of universal conductor through which transfers must pass if they are to avoid the rocks and shoals of inadvertent tax-able events.⁽⁴¹⁾

While the decision in *Carmichael* was based upon Section 522, there has been a trend among the states to adopt language similar to it, although not all decisions have reached the same result.⁽⁴²⁾ Notwithstanding the holdings of some bankruptcy courts, the reasoning of *Carmichael* is likely to prevail given its consistency with the Supreme Court's decision in *Patterson*. As a result, there is little dispute that IRAs are considered an important aspect of retirement planning and that such assets are exemptable.⁽⁴³⁾

Even though IRAs are generally considered exemptable, only a few state statutes provide an unlimited and unqualified exemption for IRAs. More often, the exemption is usually qualified. Examples of ways in which states limit the exemption is by placing a specific percentage or dollar limitation on the exemption. Others provide that the exemption is valid except for contributions made within a certain number of days prior to the filing of the petition. Exhibit I contains a state-by-state tabulation of pension and IRA exemptions.

A frequently used qualification of the exemptability of IRAs is what is "reasonably necessary" for the support of the debtor and the debtor's dependents.⁽⁴⁴⁾ This standard is being adopted by an increasing number of states. The determination of what is reasonably necessary is fact-intensive. Factors that courts consider include:

- The debtor's present and anticipated living expenses;
- The debtor's present and anticipated income from all sources;
- Age of the debtor and dependents;
- Health of the debtor and all dependents;
- The debtor's ability to work and earn a living;
- The debtor's job skills, training, and education;
- The debtor's other assets, including exempt assets;
- Liquidity of other assets;
- The debtor's ability to save for retirement;
- The special needs of the debtor and dependents; and
- The debtor's financial obligations, such as alimony or support payments.⁽⁴⁵⁾

Obviously whether an exemption will be upheld under this standard in a given case will depend on a balancing of these factors.⁽⁴⁶⁾

Although the domicile of the IRA owner will generally determine which state exemption statute governs, one court recently applied the law of the state in which the plaintiff resided and in which the events giving rise to the cause of action occurred, even though the debtor lived in a state that exempted IRAs from attachment.⁽⁴⁷⁾

The decision in *Carmichael* is also significant because it also rejected an argument concerning the right to receive payment presently or in the future. Under the federal statute, the court held that "that which is exempt is the right to receive payments, whether future or present, not merely the current receipt of payments." What this holding indicates is that an IRA will be exempt to the same extent irrespective of whether the right to payment has matured.⁽⁴⁸⁾

The *Carmichael* decision appears to contradict certain lower court decisions that have placed a more rigid interpretation of similar language used in state statutes. The court in *In re Meehan*⁽⁴⁹⁾ held that the same language applied only to a payment and not the corpus of an IRA. Obviously, this interpretation would frustrate the purpose of the IRA, because there would be no corpus from which future payments could be made. Thus, *Carmichael's* holding that payment mean present or future payments would avoid the unintended result reached in *Meehan*.

Planning to Ensure Protection

In addition to the economic benefits afforded by retirement plans, the availability of federal and state exemptions from creditors make such plans ideal wealth accumulation vehicles. The extent of such protection will depend on whether the plan is ERISA-qualified, or if not, protected under the state exemption provisions. The planner should ascertain that clients with ERISA-qualified plans have engaged competent counsel to ensure that such plans are drafted and administered in accordance with ERISA and IRC requirements. Where a plan does not have common law employees it may be advisable to allow a common law employee to participate (if not otherwise eligible) in order to obtain ERISA protection. Furthermore, when a client is contemplating terminating an ERISA plan and rolling the proceeds into an IRA, the planner should advise the client as to any limitations on the protection of such funds under state law.

Exhibit I State Pension Plan and IRA Exemptions

<u>State</u>	<u>Pension Plan Exemption</u>	<u>IRA Exemption</u>	<u>Statute</u>
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			Creating Exemption
Alabama	100% of benefits provided under IRC.	100%	Ala. Code § 19-3-1(b)
Alaska	100% of assets and benefits of pension, except contributions within 120 days of filing for bankruptcy.	Same	AS § 9.38.017 (a)
Arizona	100%, except contributions within 120 days of filing for bankruptcy.	Same	ARS §§ 33-1126(C)
Arkansas	100% of assets held in or payments from plan qualified under IRC.	Same, except for contributions in excess of amounts deductible and any accrued earnings on such excess	ACA § 16-66-220
California	100% of retirement plans (support claims excepted); but limited to amounts necessary to support debtor and dependents (support claims excepted) for self-employed retirement plans; distributions in hands of debtor also exempt.	Amounts necessary to support debtor and dependents (support claims exempted)	CCP §§ 704.115; 703.140(b)(10) (E)
Colorado	100% of pension (child support claims excepted).	Same	CRS § 13-54-102(1)(s)
Connecticut	100% of interest in or amounts payable from plan qualified under IRC (except contributions less than 90 days before claim filed or fraudulent conveyance).	Same	CGS § 52-321a
Delaware	100% of assets held or amounts payable under a retirement plan.	Same	10 Del. C. § 4915(a)
District of Columbia	\$200 per month payments for principal supporter of family, \$60 per month payments for any other person.	Same	DCCE § 15-503 (a), 15-503(b)
Florida	100% of benefits and contributions to retirement or profit sharing plan qualified under IRC.	100% of interest in and payments therefrom	FSA §§ 222.21 (2)
Georgia	Payments under pension. or similar plan payable on account of age or length of service to extent reason-ably necessary	100% of undistributed IRA, distributions from	Ga. Code §§ 44-13-100(a)(2) (E); 44-13-100

	for support of debtor and dependents; interests in retirement plans to extent provided under Bankruptcy Code.	IRA to the extent reasonably necessary for support of debtor and dependents	(a)(2.1)(c); 44-13-100(a)(2)(F); 44-13-100(a)(2.1)(D)
Hawaii	100% of pension, retirement benefits, or any rights under any retirement plan qualified under IRC except for contributions within three years of bankruptcy filing or date civil action is initiated against debtor.	Same	HRS § 651-124
Idaho	100% of assets and benefits of pension, retirement, and profit-sharing plan qualified under IRC.	Same	IC §§ 11-604A; 55-1011
Illinois	100% of benefits, refunds and assets held in fund or system.	Same	735 IL CS §§ 5/12-704; 5/12-1006
Indiana	Interest in fund to extent of contributions and earnings that qualify under the IRC for tax-free treatment.	Same	BIS § 34-2-28-1 (a)(6)
Iowa	100%, except for payments resulting from excessive personal contributions within previous year and are above the normal and customary contributions made to plan.	No statutory exemption	CI § 627.6(8)(e)
Kansas	100% of money or assets payable to or any interest in retirement plan qualified under IRC.	Same	KSA § 60-2308 (b)
Kentucky	100% of right or interest in pension or retirement plan that qualifies under IRC (contributions within 120 days prior to filing are not exempt).	Same	KRS 427.150(2) (f)
Louisiana	100% of interests in and payments from pensions except for support payments and amounts contributed within one year.	100% of deductible contributions and earnings thereon, except for contributions made within one year of filing	LSA-RS § 20-33(1); LSA-RS § 13-3881D
Maine	Amounts reasonably necessary to support debtor and dependents of payments from or account under pension or profit sharing qualified under IRC on account of age or	Same	14 MRSA § 4422(13)(E)

	length of service.		
Maryland	100% of money or assets payable to or any interest in a retirement plan qualified under IRC, except for contributions in excess of amounts deductible and except for claims by the Department of Health and Mental Hygiene.	Same	ACM, C&JP § 11-504(h)
Massachusetts	100% of interest in pension or retirement plan or similar plan purchased with assets of qualified plan, except for individual contributions made during last five years in excess of 7% of income, and except for crime reparation and support claims.	Same	MGLA c.246 § 28; MGLA c.235§ 34A
Michigan	100% of pensions qualified under IRC.	100%, except contributions made within 120 days of filing	MSA § 27A-6023(1)(K), (1)
Minnesota	100% of present or future right to receive payments, or payments received by debtor on account of age or length of service from plan qualified under IRC, or to extent all plans and contracts that have a present value of \$51,000 (indexed for inflation) and additional amounts under all plans to extent reasonably necessary for support of the debtor and dependents.	Same	MS § 550.37 subds. 4a, 24
Mississippi	Amounts of payments from pensions qualified under IRC reasonably necessary to support debtor and dependents.	Same	MCA § 85-3-1 (b)(iii)
Missouri	Amounts of payments from pension, profit-sharing, stock bonus, or nonpublic retirement plan qualified under IRC reasonably necessary to support debtor and dependents and 100% of money or assets payable from or interest in retirement plan qualified under IRC §§ 401 (k), 403(a)(3), 403(b), or 409, except for fraudulent conveyances and contributions made within three years of the date of filing. Periodic payments pursuant to pension, or retirement plan also treated as "earnings," the garnishment of which is limited.	100% of IRAs except for fraudulent conveyances and contributions made within three years of the date of filing	VAMS §§ 513.430(10)(e), 513.430(10)(f); 525.030(2)
Montana	100% of benefits from qualifying retirement, pension, or similar plan, except	Same	MCA § 31-2-106(3)

	contributions made within one year that exceed 15% of debtors gross income.		
Nebraska	Interest in plan qualified under IRC to extent reasonably necessary for support of debtor or dependent, except for plans of insiders established or amended within two years.	Same	RRS, 1943, § 25-1563.01
Nevada	Amounts exempt cannot exceed \$500,000 in present value.	Same	NRS § 21.090 (q)
New Hampshire	No statutory provision.	Same	None
New Jersey	100% of assets in and distributions from plan qualified under IRC, except for support claims.	Same	NJSA 25:2-1(b)
New Mexico	100% of interest in or proceeds from pension or retirement funds.	No statutory provision	NMS §§ 42-10-1, 42-10-2
New York	100% of assets or interests in, or payments from, trust or plan qualified under IRC, except for additions made within 90 days before interposition of claim on which judgment is entered or which is a fraudulent conveyance; in bankruptcy, all payments under stock bonus, pension, profit sharing or similar plan unless such plan (other than one qualified under IRC §401), was established by debtor under auspices of insider.	100%	Debtor and Creditor Law § 282; NY CPLR § 5205(c)
North Carolina	None.	100% exempt	NC § 1C-1601
North Dakota	\$100,000 limit per plan or pension, retirement plan, SEP, or other qualified plans under IRC and proceeds therefrom, \$200,000 aggregate limit, OR amount necessary for support of debtor and dependents, whichever is greater.	Same	NDCC § 28-22-03.1(3)
Ohio	Exempt to the extent reasonably necessary for the support of the person and any of the person's dependents, except if assets were deposited for the purpose of evading creditors.	100%	ORC § 2329.66 (A)(10)
Oklahoma	100% of interests in retirement, pension, or profit-sharing plans if provided in plan;	100% of tax-exempt portions	60 OSA § 327; 31 OSA § 1A 20

	100% of tax-exempt portions of corporate retirement plans and arrangements qualified under IRC.		
Oregon	100% of amount qualified under IRC of interest in pension or retirement plan.	Same	ORS § 23.170
Pennsylvania	100% of retirement fund qualified under IRC and payments therefrom, except for amounts contributed within one year of filing for bankruptcy, amounts contributed in excess of \$15K within one-year period, and fraudulent conveyances.	100% of IRA payments therefrom, except for contributions within one year of bankruptcy filing and fraudulent conveyances	42 Pa. C.S. §§ 8124(b)(1)(vii); 8124(viii); 8124(ix)
Rhode Island	100% of pension, profit-sharing, or other arrangement qualified under IRC.	Same	GL §§ 9-26-4(11), 9-26-4(12)
South Carolina	100% of payments under stock bonus, pension, profit-sharing, or similar plans qualified under IRC.	Same	CLSC § 15-41-30(10)
South Dakota	Exempts up to \$250,000, subject to the discretion of the court if deemed excessive.	Same	S.D. Codified Laws § 43-45-16 and 43-45-17 and 43-45-18
Tennessee	100% of payments on account of death, age or length of service provided debtor has no right to receive payment other than monthly after age 58.	Same	Tenn. Code § 26-2-111
Texas	100% of interest or payments from IRC-qualified plan.	Same	Texas Property Code § 42.0021
Utah	100% of right or interest in pension or retirement plan that qualifies under the IRC, except contribution made within 1 year of filing bankruptcy.	Same	UCA §§ 78-23-5
Vermont	100% exempt.	Same	12 VSA § 2740(16)
Virginia	Amount of debtors interest in retirement plan necessary to provide annual benefit of \$17,500, except for contributions and earnings thereon in current and two preceding fiscal years.	Same	CV § 34-34

Washington	100% of qualified amounts of retirement benefits from employee benefit plan qualified under IRC, except for support payments.	Same	RCW § 6.15.020(3)
West Virginia	100% of benefits to the extent reasonably necessary for the support of the debtor and his/her dependents.	100% exempt (including SEP)	WVC § 38-10-4
Wisconsin	100% of the assets, unless it was created for the benefit of self-employed or owner-dominated plan, which is limited to the amount reasonably necessary for the support of the debtor and his/her dependents.	Same	WSA § 815.18
Wyoming	100% of pension benefits; 100% of amounts qualified under IRC of self-employed person's retirement benefits.	No statutory provision	WSA § 1-20-110(a)(i), (ii)

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¹ Codified at 11 USC §4101 et seq. Unless otherwise stated, all statutory citations are to sections of the Bankruptcy Code.

² In re Harless, 187 BR 719, 723 (Bankr. ND Ala. 1995).

³ The distinction between "exclusion" and "exemption" is significant. Whereas property excluded from the bankruptcy estate is technically not affected by the bankruptcy proceeding and has no dollar limitation, see 11 USC § 541(c)(2), exemptions are subject to objections of trustees and creditors and usually have some limitation on the amount of the exemption. See 11 USC § 522; see also In re Houck, 181 BR 187, 193 n.16 (Bankr. ED PA 1995).

⁴ 11 USC § 704.

⁵ Patterson v. Shumate, 112 S. Ct. 2242,2249, 119 L. Ed. 2d 519(1992).

⁶ ERISA, 29 USC § 1001 et seq.

⁷ In re Lichstral, 750 F2d 1488 (11th Cir. 1985).

⁸ Patterson, 112 Ct. at 2250.

⁹ Guidry v. Sheet Metal Workers Pension Plan, 493 US 365, 110 S. Ct. 680, 107 L. Ed. 2d 782 (1990).

¹⁰ Guidry, 110 S. Ct. 687.

¹¹ See, e.g., In re Youngblood. 29 F3d 225 (5th Cir. 1994) (court need not look further than the determination of the IRS); In re Rueter, 11 F3d 850, 852 (9th Cir. 1993) (same).

¹² In re Hall, 151 BR 412 (Bankr WD Mich. 1993).

¹³ In re Lucas, 924 F2d 597 (6th Cir; 1991).

¹⁴ Id. at 419; but see In re Conner, 73 F3d 258, 259 (9th Cir; 1996) (not requiring qualification under IRC to satisfy Section 541(c)(2)).

¹⁵In re Witwer, 148 BR 930 (Bankr; CD Cal. 1992)

¹⁶ IRC Reg. § 1.401(a)(26)-3(c) (emphasis added). The court noted that the IRC and its regulations did not have the same restrictive definition of the term "employee" as ERISA and its regulations. However, it was not necessary for its disposition of the tax qualification issue. Hall, 151 BR at 423-424 n.29.

¹⁷ In re Youngblood, 29 F3d 225 (5th Cir; 1994).

¹⁸ Id. at 229; see also In re Rueter, 11 F3d 850, 852 (9th Cir; 1993) (court need not look further than the determination of the IRS).

¹⁹ In re Fred Lane Jr., 149 BR 760 (Bankr; EDNY 1993).

²⁰ Witwer, 148 BR at 937; but see In re Wheat, 149 BR 1003, 1007 (Bankr; SD Fla. 1992) (antialienation provision of IRC is enforceable nonbankruptcy law).

²¹ United States v. Sawaf, 74 F3d 119(6th Cir; 1996); see also In re Raihl, 152 BR 615 (Bankr; 9th Cir; 1993).

²² See also IRC § 6334(c), which provides that "no property or rights to property shall be exempt from levy other than property specifically made exempt by subsection (a) (which does not exempt ERISA plan benefits). The IRS may also levy against a spouse's interest in a plan. See Hyde v. United States, 93-2 TC (CCH) ¶ 50.432 (D. Ariz.1993).

²³ IRC § 414(p)(8).

²⁴ Velis v. Kardanis, 949 F2d 78 (3d Cir. 1991). Although *Velis* predates *Patterson*, this portion of the Third Circuit's opinion continues to be followed. See, e.g., In re Hoist, 192 BR 194, 199 (Bankr; ND Iowa 1996); In re Collin, 182 BR 763,768 (Bankr. ND Ohio 1995); In re Houck, 181 BR 187, 189-190 (Bankr; ED Pa. 1995); In re Lamb, 179 BR 419,423(Bankr; DNJ 1994); In re Debolt, 177 BR 31,40 n.15 (Bankr; WD Pa. 1994).

²⁵ Id. at 82. The decision in *Velis* was probably wrong because the debtor's interest in property is determined as of the date of the filing of the petition. Subsequent transactions should not affect this determination, as it did in this case. Had the transactions occurred before the filing of the petition, however, the decision would be correct. Thus, to the extent that a debtor invades a pension plan, the portion distributed will lose its excluded status.

²⁶ Trucking Employees of N. Jersey Welfare Fund, Inc. v. Colville, 16 F3d 52 (3d Cir. 1994)

²⁷ Guidry v. Sheet Metal Workers Pension Plan, 10 F3d 700 (9th Cir. 1993).

²⁸ Colville, 16 F3d at 55-56. Of course, such amounts may still be exemptable.

²⁹ See, e.g., NYCPLR 5205(c).

³⁰ See, e.g., Cal. Civ. Proc. Code § 704.115(d).

³¹ Colville, 16 F3d at 55-56. Florida recently enacted a provision making conversions of non-exempt assets to exempt assets subject to the fraudulent conveyance statute. See Fla. Stat. § 222.30; See also In re Coplan, 156 BR 88 (Bankr; MD Fla. 1993) (discussing transfers that may be subject to state fraudulent conveyance law).

³² See Fla. Stat. § 222.20.

³³ See Cal. Code Civ. P. §§ 704.010 et seq., and 703.140.

³⁴ In re Caslavka, 179 BR 141, 146 (Bankr; ND Iowa 1995).

³⁵ See, e.g., *Pitrat v. Garlikov*, 947 F2d 419 (9th Cir; 1991); *Guidry*, 10 F3d 700.

³⁶ *In re Schlein*, 8 F3d 745 (11th Cir; 1993); *In re Nelson*, 180 BR 585 (Bankr. 9th Cir 1995).

³⁷ *Schlein* at 753; see also *In re Dyke*, 943 F3d 1435 (5th Cir. 1991); *In re Vickers*, 954 F2d 1426(8th Cir; 1992).

³⁸ See, e.g., *In re Van Nostrand*. 183 BR 82 (Bankr; DNJ

³⁹ *In re Houck*, 181 BR 187 at 191 (Bankr ED Pa 1995).

⁴⁰ *In re Carmichael*, 1996 US App. LEXIS 29592 (5th Cir; Nov. 13, 1996).

⁴¹ *Id.*

⁴² See, e.g., *In re Iacono*, 120 BR 691 (Bankr; EDNY 1990) (interpreting similar language under New York law but concluding that IRAs is not exempt). Interestingly, this decision was overturned by legislative enactment. See NYCPLR § 5205(c).

⁴³ Relying on the particular state exemption statutes at issue, two recent Court of Appeals decisions went so far as to hold that IRAs are *excluded* under Section 541(e)(2). *In re Meehan*, 102 F3d 1209(11th Cir; 1997); *In re Uhas*, 1997 US App. LEXIS 931 (3d Cir. Jan. 22, 1997).

⁴⁴ See 11 USC § 522(d)(10)(E); see also Fla. Stat. § 222.201 incorporating 11 USC § 522(d)(10)(E) by reference.

⁴⁵ *In re Vickers*, 954 F2d 1426, 1427 n.3 (8th Cir; 1992).

⁴⁶ See *In re Hoppes*, 1996 Bankr. LEXIS 1472 (providing thorough analysis of factors and decisions in other cases).

⁴⁷ *Johns v. Rozet*, 826 F Supp. 565 (DC 1993).

⁴⁸ See also *In re Schwartz*, 185 BR 479 (Bankr; DNJ 1995) (decided under New Jersey law); *In re Harless*, 187 BR 719 (decided under Alabama law).

⁴⁹ *In re Meehan*, 173 BR 818 (Bankr; SD Ga. 1994).

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