

# Hidden in Plain View: The Pension Shield Against Creditors

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#### INTRODUCTION: A TALE OF TWO DEBTORS

Imagine that you have been found liable in a civil tort action—wrongful death, perhaps—and you are required to pay a judgment. The plaintiff in your case discovers that you have significant accumulated investments which will provide you quite a comfortable income, perhaps \$300,000 per year before taxes. Is there

any way to prevent your opponent from reaching your assets and income to collect the judgment? Well, yes, as the parents of Nicole Brown Simpson and Ronald Goldman discovered in their civil trial victory over O.J. Simpson in early 1997. Their efforts to recover the \$33 million judgment against Simpson foundered almost immediately upon the protections against creditors provided for tax favored retirement funds and pension payments under federal and California law.<sup>1</sup>

Contrast this happy ending for Mr. Simpson with the less fortunate outcome for another debtor, Wilma Wilbur, who lived for eighteen years with Noel DeLapp but never married him.<sup>2</sup> They separated when Ms. Wilbur was 63 years old and Mr. DeLapp was 46 years old, at which point an Oregon court awarded Ms. Wilbur approximately half of Mr. DeLapp's \$30,000 in accumulated pension, plus interest, apparently in recognition of Ms. Wilbur's contributions to the couple's joint preparations for retirement.<sup>3</sup> Mr. DeLapp was to pay this amount to Ms. Wilbur in annual installments of \$3000. Ms. Wilbur later filed for bankruptcy, and attempted to exclude from her creditors' claims the \$3000 per year retirement payments, which she used for various necessities.<sup>4</sup> Unfortunately

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1. See Jeffrey Krasner, *O.J. Has Protection—Court Can't Touch His Retirement Funds*, BOSTON HERALD, Feb. 6, 1997, at 5, available in LEXIS, News Library, U.S. File.

The key to shielding assets from a judgment—whether it be an \$8.5 million civil penalty in a wrongful death suit or an overdue telephone bill—is advance planning. Here, the experts give O.J. Simpson high marks. According to published reports, Simpson has stashed the bulk of his assets in two pension and retirement funds set up long before Nicole Brown Simpson and Ronald Goldman were murdered. It's unlikely that outsiders will be able to touch these funds, yet Simpson can borrow from them and use them to fund his retirement. Similarly, pension checks Simpson will receive for his football and acting careers are also off-limits.

*Id.*; see also Janc Bryant Quinn, *Asset Protection: Playing Fair vs. Playing Dirty*, PITT. POST-GAZETTE, Mar. 24, 1997, at B8, available in LEXIS, News Library, U.S. File.

There are many . . . ways of dodging creditors . . . For example, take O.J.'s \$4.1 million pension fund. It's unreachable by lawyers but he can add to it, borrow against it, and use it in retirement at will, says Chicago bankruptcy attorney Keith Shapiro of Holleb & Coff. In this respect, O.J. lucked out. Some states—but not California—allow creditors to seize pension-fund withdrawals that exceed what you need for basic living expenses.

*Id.*

2. See *Wilbur v. DeLapp*, 850 P.2d 1151 (Or. Ct. App. 1993).

3. In a suit filed in equity to divide the assets acquired during the period of their cohabitation, the Oregon Court of Appeals awarded the debtor \$16,750 plus 9% interest, payable by Mr. DeLapp in annual installments of \$3000 and due on June 1 of each year. See *id.* at 1154. Of the \$16,750, \$16,000 represented the debtor's "contribution to the parties' financial provisions for retirement." *Id.* Although the court recognized that "[t]echnically, . . . [Wilbur] has no legal entitlement to the PERS benefits because, at the time of trial, she was not a beneficiary[.]" the court nonetheless concluded that the debtor was "entitled to an award that recognizes her contribution to the parties' financial circumstances, including their provisions for retirement." *Id.* at 1153. The court added in a note: "Oregon does not recognize common law marriages, but it does allow for the equitable division of property accumulated during cohabitation." *Id.*

4. See *Stricka v. Wilbur*, 126 F.3d 1218, 1219 (9th Cir. 1997).

for Ms. Wilbur, at about the time the Goldmans were abandoning their efforts to reach O.J. Simpson's \$300,000 per year retirement income, the Ninth Circuit Court of Appeals ruled that Ms. Wilbur's payments should be made available to her creditors in bankruptcy, because those payments were not made from a "pension plan" qualified or exempt from tax under the Internal Revenue Code ("I.R.C."), as required for exemption under the Oregon statute.<sup>5</sup>

The contrasting cases of Mr. Simpson and Ms. Wilbur demonstrate that efforts to recover from debtors whose accumulated assets are held in a tax-qualified pension trust or individual retirement account ("IRA")<sup>6</sup> will more than likely be futile. Most such arrangements are covered by federal or state laws protecting "retirement accounts" from creditors, no matter how solvent those funds might render the debtor, or how well the debtor may be able to live in the future on pension payments taken in early or voluntary "retirement."<sup>7</sup> In contrast, payments

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5. *See id.* at 1220.

The district court found that the judgment was "granted" to debtor "in recognition" of her "period of employment by or service for . . . [Mr. DeLapp]," and that, therefore, the judgment was a "retirement plan" under section 23.170(1)(d)(C). We disagree.

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Oregon law exempts "a beneficiary's interest in a retirement plan" from execution. ORS 23.170(2). A retirement plan, under (A) and (B) of § 23.170(1)(d) can be in a "pension plan and trust" or an "individual retirement account or annuity," each of which must be described in specified sections of the Internal Revenue Code. Debtor does not argue that the judgment qualifies under either (A) or (B) of § 23.170(1)(d).

That only leaves subparagraph (C) for consideration. The definition of retirement plan there includes "[a]ny pension . . . granted to any person in recognition of or by reason of a period of employment by or service for . . . any . . . person." A pension is a "retirement benefit paid regularly (normally, monthly), with the amount of such based generally on length of employment and amount of wages or salary of pensioner." BLACK'S LAW DICTIONARY I134 (6th ed. 1990).

The payments to be made by Mr. DeLapp are payable because of a judgment based on *property*, not employment or services. . . . Thus, the payment is not based on a period of employment or service and cannot be considered to be a retirement plan. In the absence of a sustainable showing of the existence of a plan, the payments are not exempt from execution.

*Id.* (emphasis, alteration, and parenthetical in original).

6. An IRA is a tax-advantaged savings account. *See* I.R.C. § 408(a) (West Supp. 1998).

7. The most prominent public example of using retirement trusts as a shelter from litigation awards is O.J. Simpson, but current law protects retirement assets in most cases. *See* discussion *infra* Part I.D. There are restrictions on the amounts that can be deposited each year in an IRA under I.R.C. § 408(a)(1) (limiting the amount of contribution in the taxable year to \$2,000 and prohibiting non-cash contributions other than rollovers). However, these restrictions do not apply to amounts transferred from qualified pension plans or from other IRAs in rollover transactions. *See id.* §§ 402, 408. Moreover, the limitations for deposits allowed for IRAs under I.R.C. § 408(a)(1) are required to be stated in the trust instrument, so that only the trustee of the trust, usually the bank in which the IRA is established, is in a position to enforce prohibitions against deposits of types or excess amounts of property or cash. *See id.* § 408(a).

clearly necessary to avert destitution in old age, such as Ms. Wilbur's, are unlikely to be protected if they are not part of a plan qualified under the I.R.C. or covered by the Employee Retirement Income Security Act.

In the balance of interests represented by creditor-debtor laws, funds held in recognized tax-favored retirement accounts have increasingly assumed a presumptively favored position, even as those tax-favored vehicles for "retirement" savings have proliferated, diversified and become widely used for non-retirement purposes.<sup>8</sup> In essence, as a result of blanket protections extended to retirement accounts under the guise of a "fresh start," creditors in many cases have unwittingly shouldered part of the burden of insuring their well-advised and frequently well-heeled debtors' retirement.<sup>9</sup>

In addition, using tax qualification as the basis for bankruptcy treatment imports into bankruptcy law the distributional effects of the tax laws governing private pensions. Because the benefits of tax-favored pension and savings

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Since violations of most rules result in penalties but not elimination of the account's IRA status, even a transfer of property or of cash in excess of \$2,000 may be protected under the bankruptcy laws. *See id.* § 4973(a) (imposing a penalty tax on contributions exceeding the allowable amount); § 4975(a) (imposing a 15% tax on prohibited transactions between a plan and a disqualified person). Prohibited transactions include the sale, exchange, or lease of property, *see id.* § 4975(c)(1)(A); the loaning of money or extension of credit, *see id.* § 4975(c)(1)(B); and the furnishing of goods, services or facilities, *see id.* § 4975(c)(1)(C). So long as an account's trustee is flexible enough (or sufficiently unwatchful) to accept as a deposit anything presented by the holder, the possibility for abuse exists. The fraudulent transfer provisions of the bankruptcy laws, of course, may lead a bankruptcy court to disregard both state and federal protections for retirement accounts, but it may be possible to avoid application of those rules also. *See* Jack E. Karns, *ERISA Qualified Pension Plan Benefits As Property of The Bankruptcy Estate: The Unanswered Questions After Patterson v. Shumate*, 16 CAMPBELL L. REV. 303, 322-23, 329-30 (1994). For an insightful analysis of the impact of debtor protection laws on the concept of liability itself as a means of enforcing law, *see* Lynn M. LoPucki, *The Death of Liability*, 106 YALE L.J. 1 (1996).

8. *See* Regina T. Jefferson, *A Farewell To Pension Policy: The Impact of Flexible IRAs on Current Tax Policy*, 69 TEMPLE L. REV. 1451, 1459-61 (1996); *infra* notes 255-83.

9. Of course, retirement is a condition with no universally accepted definition. *See* Buffalo Bills, Inc. v. United States, 31 Fed. Cl. 794, 802-03 (1994) (The Internal Revenue Service and the taxpayer present competing definitions of "retirement" for a professional football player "retiring" from football.). Mr. Simpson was viewed as using payments out of his two retirement funds for retirement income purposes, even though he had not yet reached age 50 when he began drawing payments from one fund, and could begin receiving payments from his NFL pension plan at age 50. *See O.J. Simpson Turns 50*, COLUMBIAN (Vancouver, WA), July 9, 1997, at A6, available in LEXIS, News Library, CURNWS File. "O.J. Simpson doesn't have any special plans for his 50th birthday today. . . . With the milestone, Simpson can begin drawing on his National Football League pension, which can't be seized to satisfy a \$33.5 million civil judgment." *Id.* Mr. Simpson made clear, in several public interviews, that he made a deliberate choice not to seek employment after the civil judgment was entered in order to prevent those future earnings from being seized to satisfy the judgment. *See Simpson Says He Won't Work to Pay Judgment*, LIABILITY WEEK, July 14, 1997, available in LEXIS, News Library, CURNWS File.

arrangements flow primarily to higher income workers and business owners,<sup>10</sup> basing the protection of pensions against creditors on the tax status of the pension exacerbates those upward income distributional effects. Thus, current bankruptcy law, under which preservation of a retirement account is generally dependent on its tax status, results in protection of a comfortable retirement for debtors with a history of high earnings that allowed large accumulated retirement savings, while exposing lower income debtors with no qualified plan assets to impoverishment in old age.

At the core of this preferential treatment is the striking and almost unquestioned assumption of lawmakers, commentators and the courts that, above all other possible types of accumulations, tax-favored *retirement* savings should be allowed to resist the dissolution of debtor property rights that generally occurs in the face of creditor claims in bankruptcy.<sup>11</sup> These preferences have endured, essentially taken for granted by commentators and unassailed by critics of current bankruptcy law, even as Congressional and creditor pressure to restrict consumer creditor access to bankruptcy protection builds<sup>12</sup> in the wake of what has been decried as a tidal wave of consumer creditors seeking relief from debt under Chapter 7 of the Bankruptcy Code.<sup>13</sup>

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10. Because the tax benefits are in the form of deferral on income from high tax years to low tax years, and a deduction from taxable income for the employer, the higher the employee's and the employer's tax bracket, the greater the economic benefit to each. For an illustration of the benefits for employees, see JOHN H. LANGBEIN & BRUCE A. WOLK, *PENSION AND EMPLOYEE BENEFIT LAW* 156-59 (2d ed. 1995).

11. See, e.g., Laurence B. Wohl, *Pension and Bankruptcy Laws: A Clash of Social Policies*, 64 N.C. L. REV. 3 (1985). "The sanctity and protection of retirement benefits cannot be maintained if those benefits can be attached by creditors." *Id.* at 5.

12. See, for example, the comments of Congressman Gekas, Chair of the Subcommittee on Commercial and Administrative Law of the House Judiciary Committee, on the passage of the Subcommittee's version of bankruptcy reform in June 1998:

"We are responding to a cry across the nation. We have to meet this crisis head on," Gekas said, noting the bill-writers "did a deliberate and well thought-out" job. . . . He argued the bankruptcy system needed an urgent fix because some who declare "have the ability to repay some of their bills, but few do. The safety net of bankruptcy is constantly being expanded, while the role of personal responsibility is becoming less a factor in each and every filing."

*Gekas Bill Clears Subcommittee in Spite of Opposition*, CONSUMER BANKR. NEWS, May 21, 1998, at 9, available in WESTLAW, LRP-CBN database.

13. See 11 U.S.C. §§ 521-525 (1994). The Bankruptcy Code was enacted by the Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549, and has been amended since then several times, including in the Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, 98 Stat. 333; the Bankruptcy Judges, United States Trustees, and Family Farmer Bankruptcy Act of 1986, Pub. L. No. 99-554, 100 Stat. 3088; and the Bankruptcy Reform Act of 1994, Pub. L. No. 103-394, 108 Stat. 4106.

In this Article, I will use the term "Bankruptcy Code" to refer to this body of law; the term "I.R.C." refers to the Internal Revenue Code of 1986, as amended. Individuals in general may seek relief and immediate liquidation of their outstanding debts under Chapter 7 of the Bankruptcy Code, the provisions of which require the debtor to surrender her existing assets to creditors to satisfy from nonexempt ones as much of the debtor's liability as possible. In return, the debtor is relieved of any further liability to pay remaining debts that were incurred prior to the bankruptcy proceeding. See 11 U.S.C. §§ 725-727 (1994). This Article will not

For example, the recent report of the National Commission on Bankruptcy Reform concluded that there were no serious problems in connection with the proper treatment of pension payments and retirement trusts in bankruptcy,<sup>14</sup> a conclusion with which Ms. Wilbur and the Goldmans might disagree. The Commission's only recommendation concerning the treatment of pension assets in bankruptcy was enactment of a blanket federal exemption in bankruptcy for all types of tax-favored retirement and savings arrangements which would cement even more tightly the link between the income tax and bankruptcy treatment of retirement assets.<sup>15</sup> Nowhere in the Commission's report is there any examination of the assumption that tax-favored status for a retirement account should entitle that account to protection in bankruptcy.

Congress has been even more protective of retirement assets in the course of developing bankruptcy reform legislation focused primarily on "means-testing" access to Chapter 7 bankruptcy protection.<sup>16</sup> The bankruptcy bill agreed to by

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address bankruptcy proceedings under either Chapter 11 or Chapter 13 of the Bankruptcy Code, under which a court supervised plan is established for the repayment of some or all debts out of the debtor's actual cash flow rather than liquidation of existing assets.

14. National Bankruptcy Review Commission, *Property Exemptions* (visited Jan. 21, 1999) <<http://www.nbrc.gov/report/05ccons.html>> [hereinafter NBRC Report].

15. *See id.* at Section 1.2.5.

Retirement plans that are ERISA-qualified or meet the legal requirements for spendthrift trusts already are protected under current laws in all jurisdictions and are not included as property of the bankruptcy estate. *The Commission recommends that the exclusive federal bankruptcy exemptions for other pension plans rely on the federal tax restrictions, exempting retirement funds in bankruptcy to the extent they are exempt under federal tax laws.* By exempting all funds held indirectly or directly in a trust that are exempt under sections 408 or 501(a) of the Internal Revenue Code, the debtor would be able to protect self-employed KEOGH plans and individual defined benefit plans, as well as other plans that have federal tax protection. This permits the bankruptcy laws to employ the developed supervision of the Internal Revenue Code to evaluate what kinds of plans and what kinds of contributions are encouraged as a matter of public policy.

*Id.* (emphasis added) (footnote omitted). This recommendation in effect would liberalize the current exemption provision of § 522(d)(10) of the Bankruptcy Code which exempts pension benefits only to the extent reasonably necessary for support.

16. *See* H.R. 3150, 105th Cong. (1998) (reported by the House-Senate Conference on Oct. 9, 1998). The conference report was approved by the House but was not taken up by the Senate. The 1998 bankruptcy reform legislation had its origin in a House bill which, according to the statements of its sponsors and supporters, was primarily intended to require debtors to meet a needs test in order to qualify for Chapter 7 bankruptcy, under which most, or all of their debts would be discharged and thus not be repaid to creditors. *See, e.g., Bankruptcy Issues Council Hails Introduction of Bankruptcy Reform Bill*, BUS. WIRE, Feb. 4, 1998, available in LEXIS, News Library, BWIRE File ("The Bankruptcy Issues Council (BIC) today praised the introduction of comprehensive reform legislation in the House of Representatives that would return fairness to the bankruptcy system by ensuring that individuals who file for bankruptcy are not allowed to walk away from debts they have enough income to repay."); Vicki M. Young & Valerie Seckler, *House Gets Bankruptcy Bill*, WOMEN'S WEAR DAILY, Feb. 4, 1998, at 21, available in 1998 WL 8773287.

Low-income shoppers, who borrow the most heavily, are going to feel a credit

House and Senate conferees, and approved by the House shortly before the 105th Congress adjourned, largely ignored the Commission's recommendations, with the notable exception of the suggestion to expand retirement account protections.<sup>17</sup> The presence of a provision protecting virtually unlimited amounts of retirement savings in a bill which mainly seeks to prevent the use of Chapter 7 bankruptcy protection by those able to pay all or part of their debts present a curious paradox, to say the least.

If current and proposed protections for pension assets against creditor claims were uniform, or were based on either reasonable policy goals or the rigorous application of basic tax and bankruptcy principles, or at least produced consistent and reasonable results from state to state, there might be no reason to doubt this seeming consensus on the treatment of retirement accounts in bankruptcy. Even a cursory examination of the statutes and the case law, however, reveals that the treatment of retirement accounts varies wildly among jurisdictions, is based on misapprehensions of fundamental tax and pension principles, and is aimed at satisfaction of bankruptcy and retirement policy goals that are confused at best and contradictory at worst.<sup>18</sup> The proposed federal exemption for Chapter 7 bankruptcy proceedings would eliminate only a part of this confusion, while

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pinch if proposed changes in the bankruptcy code are put in place—including measures introduced in a House bill Tuesday.

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"Total losses written off in U.S. bankruptcies for 1997 are estimated at \$40 billion, or about \$400 per U.S. household," said Mallory Duncan, general counsel and credit specialist at the NRF. "Not all of that could be recovered under a needs-based system, but a substantial portion could be recovered if a needs test were mandated."

"The tide of personal bankruptcies continues to rise, even as the economy improves, suggesting that the bankruptcy process needs to be changed," observed Morrison Cain, senior vice president of government affairs at the International Mass Retail Association.

*Id.*

17. Section 330 of H.R. 3150, as agreed to by the House and Senate conferees, would have provided essentially complete protection for tax qualified plans, by amending the Bankruptcy Code, 11 U.S.C.A. § 522 (West 1993 & Supp. 1998), to add to the list of property exempt from creditors' claims, "retirement funds to the extent that those funds are in a fund or account that is exempt from taxation under section 401, 403, 408, 408A, 414, 457 or 501(a) of the Internal Revenue Code of 1986." H.R. 3150, § 330. The provision specifies that if a state law applicable to the debtor "specifically does not so authorize," the retirement account in question will not be exempt. *Id.* The provision also applies several specific extensions of the exemption to any retirement fund which has received a favorable ruling from the Internal Revenue Service ("IRS") and has not had it revoked as of the time of declaring for bankruptcy, and to rollover distributions from qualified plans into other exempt trusts. *See id.*

18. For example, Colorado law exempts from attachment, execution, or garnishment only a limited portion of the debtor's disposable earnings, providing no special protection for pension trusts or payments. *See* COLO. REV. STAT. ANN. § 13-54-104(2)(a) (West Supp. 1998). In contrast, California law exempts all Keoghs, IRAs, and IRA annuities, up to the amount exempt from federal income tax, from enforcement of any money judgment. *See* CAL. CIV. PROC. CODE § 703.010(a) (West 1987); *id.* § 704.115(a)(3), (b) (West Supp. 1998).



perpetuating the dependence of bankruptcy law on income tax treatment of retirement assets.

This Article examines the virtually unquestioned protection of retirement assets from creditors, in both state and federal law, with a view to determining whether tax qualification or even retirement itself is a sufficient rationale for preserving debtor assets in the face of creditors' claims, and if so, what the limits of such protection should be. The problems of current law stem in large part from the use of tax qualified status as a convenient shortcut for determining the appropriate bankruptcy treatment of retirement accounts. The result is a wide disparity in the treatment of debtors epitomized by the cases of O.J. Simpson and Wilma Wilbur. Proposed law would only accentuate the disparity, providing protection in bankruptcy for essentially unlimited retirement assets while denying access to bankruptcy for those with retirement income but few assets. So long as the bankruptcy law is based largely on protection of assets, rather than a necessary level of income, and so long as that protection is based on the tax treatment of so-called retirement accounts, rather than on the actual use of those funds for retirement income support, glaring inequities will inevitably result.

#### ASSETS VS. INCOME PROTECTION

The theoretical and policy bases for the preference granted retirement savings are confused at best and frequently produce perverse results. Part of the confusion arises simply from the confluence of three bodies of complex federal and state law—bankruptcy, tax, and pension law all have distinct policy purposes and theoretical frameworks, and the combination of the three rarely produces an obviously defensible result. It has been the unenviable task of individual bankruptcy judges to interpret federal tax and labor law in addition to the bankruptcy statutes, and determine whether public policy favoring retirement requires them to either support creditors' rights, or apply the protection of the state statute to a broad range of retirement savings arrangements.<sup>19</sup>

This statutory "Bermuda Triangle" nonetheless does not by itself completely account for the problem. In this Article, I suggest that a larger problem is the blanket protection of tax-favored retirement accounts, whether based on a spendthrift trust theory or on a misapprehension of the implications of federal tax qualification, which allows unlimited accumulation of funds without regard to whether those funds will actually be used for retirement or will even be necessary for the debtor's support in old age. Such extraordinary protection is the product of the combined demands of the retirement imperative, a highly developed and powerful cultural force and labor management tool; the credit-based economy that requires satisfaction of creditor claims; and the traditional goal of American

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19. See, e.g., *In re Harris*, 188 B.R. 444, 449 (Bankr. M.D. Fla. 1995) (Exclusion of pension plan depends on judicial determination of whether the plan meets tax and ERISA qualification requirements.). But see *In re Youngblood* 29 F.3d 225, 227 (5th Cir. 1994) (stating that a court must defer to an IRS determination of plan qualification).

bankruptcy laws to provide a "fresh start" for debtors engaged in the ups and downs of a dynamic economy.<sup>20</sup>

Because the benefits of tax-favored retirement arrangements are substantially greater for higher income taxpayers,<sup>21</sup> the benefits of exempting such accounts from creditors in bankruptcy must inevitably be skewed toward upper income debtors. As a result, the continuing focus of federal and state bankruptcy statutes on preservation of assets rather than specific levels of income, apparently in an effort to further the "fresh start" goal,<sup>22</sup> creates the highest degree of protection for a class of debtors who need it least—those who had sufficient excess income during their working careers to channel substantial amounts into tax-favored retirement income vehicles, and were financially sophisticated enough or well-enough advised, to do so.

This preference is neither inevitable nor necessary. While a reasonable policy argument can be made for protecting payments being made to a currently retired debtor, at least to a level sufficient to prevent destitution, it is more difficult to discern a clear basis for protecting unlimited amounts held in tax-favored retirement accounts that may in fact be available for consumption long before retirement. Yet neither federal nor state statutes protecting retirement accounts adequately (or, in the case of the most recent congressional effort, even minimally) distinguish between current retirement payments and current retirement accumulations which may be intended but are not necessarily destined to support future retirement income needs. Retirement and bankruptcy policy may support the protection of a retiree's current income stream from pension payments, in order to prevent destitution and recourse to state support in old age. It is not at all clear, however, that any public policy goal is served by the preservation long before retirement of assets that are ostensibly, but not necessarily, destined for consumption in old age, and that if preserved until retirement might provide the debtor with a retirement income well in excess of any reasonable minimum.

Moreover, the reliance on tax-qualification as the acid test for funds that should not be considered currently available for the payment of debts is misplaced. The term "qualified" is frequently used in state bankruptcy statutes and judicial opinions as a signal that a particular account, benefit or arrangement is designed and will be used for retirement income purposes, and thus, under one theory or another, deserves protection from creditors in bankruptcy.<sup>23</sup> However, the fact that a plan might have been given preferential tax treatment in return for providing benefits for low-paid as well as highly paid employees (the primary

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20. See ELIZABETH WARREN & JAY LAWRENCE WESTBROOK, *THE LAW OF DEBTORS AND CREDITORS* 220, 246 (3d ed. 1996); see also LoPucki, *supra* note 7, at 12. Section 119 of H.R. 3150, the pension exemption provision of the House-approved bankruptcy reform measure, was entitled "Reinforcement of Fresh Start." H.R. 3150, § 119.

21. See generally ALICIA MUNNELL, *THE ECONOMICS OF PRIVATE PENSIONS* (1982) (discussing the impact of the social security and federal tax systems on the development of private pension plans and on individual taxpayers).

22. See discussion *infra* Part I.A.

23. See, e.g., FL. STAT. ANN. § 222.21(2)(a) (West 1998); KAN. STAT. ANN. § 60-2308 (1994); see also NBRC Report, *supra* note 14.

purpose of the qualification rules)<sup>24</sup> does not in itself provide a principled basis for excluding the trust in whole or in part from the reach of creditors. Most importantly, a debtor's income does not necessarily cease to be income that should be available to repay creditors simply because taxation of some or all of it has been deferred in order to encourage retirement savings.<sup>25</sup>

#### THE ELEVATION OF RETIREMENT SAVINGS

The Supreme Court's 1992 decision in *Patterson v. Shumate*<sup>26</sup> ostensibly clarified the treatment under the Bankruptcy Code of assets held by retirement trusts governed by the Employee Retirement Income Security Act ("ERISA").<sup>27</sup> *Patterson* held that "ERISA-qualified" trusts are excluded from the bankruptcy estate by virtue of ERISA's anti-alienation clause.<sup>28</sup> Apart from some ambiguous statements in dicta, however, the decision did not address the treatment of plans that are not covered by ERISA,<sup>29</sup> but that nonetheless may be established for purposes of funding retirement income, such as non-qualified deferred compensation arrangements,<sup>30</sup> or IRAs or Keogh<sup>31</sup> plans which are granted special tax status under the I.R.C.

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24. For an early and still current summary of the rationale for the tax qualification rules, see *Revenue Revision of 1942: Hearings on H.R. 7378 Before the House Comm. on Ways and Means*, 77th Cong. 2405-06 (1942) (statement of Randolph Paul, special tax advisor to the Secretary of the Treasury).

25. See *infra* Part III.C.1 for a discussion of the tax doctrine of constructive receipt.

26. 504 U.S. 753, 757-66 (1992) (interpreting 11 U.S.C. § 541(c)(2) language referring to the application of "nonbankruptcy law" to mean that ERISA's anti-alienation provision applies to retirement plans and trusts covered by ERISA, preempting state laws governing spendthrift trusts under the Bankruptcy Code's broad preemption provision).

27. 29 U.S.C.A. § 1056(d) (West Supp. 1998); I.R.C. § 401(a)(13) (West Supp. 1998).

28. 504 U.S. at 756.

29. See *id.* at 762-63.

30. An example of a nonqualified deferred compensation arrangement would be a so-called "rabbi trust" arrangement, under which the employee may defer compensation without immediate tax consequences so long as the amounts deferred remain the property of the employer and subject to the claims of the employers' creditors. See Rev. Proc. 92-64, 1992-2 C.B. 422, and Rev. Proc. 92-65, 1992-2 C.B. 428, for descriptions of the circumstances under which amounts set aside in a nonqualified trust arrangement will not result in immediate taxation to the employee. See also Ridgeley A. Scott, *Rabbis and Other Top Hats: The Great Escape*, 43 CATH. U. L. REV. 1 *passim* (1993) (describing the requirements for the successful creation of a rabbi trust).

31. A "Keogh" plan, also known as an H.R. 10 plan, is a retirement plan maintained by a sole proprietor or self-employed persons (including partners in a partnership) according to the requirements set forth in Treas. Reg. § 1.401(e)-1 to -3 (1963). Unlike IRAs, Keogh plans may be either a defined contribution arrangement in which the participant receives the cash account balance, or a defined benefit arrangement, in which the participant receives a fixed benefit which is funded over the participant's working life. Substantially higher amounts may be contributed to a Keogh plan each year than are allowed for IRAs. See GARY I. BOREN & NORMAN P. STEIN, *QUALIFIED DEFERRED COMPENSATION PLANS* § 1:19 (West Group 1998) (Keogh or H.R. 10 Plans). See *infra* Part IV.A.1.a for a discussion of the historical roots of IRAs in the development of Keogh plan legislation in the 1940s through the 1960s.

As a result, there are continuing significant conflicts among the federal judicial circuits regarding the appropriate treatment of such arrangements under federal bankruptcy and state creditor protection laws.<sup>32</sup> Moreover, the *Patterson* decision was based on a narrow reading of ERISA and the Bankruptcy Act that failed to address the larger policy issues raised by the extraordinary protection afforded retirement plans as a result of the Court's reliance on a literal connection between ERISA's anti-alienation clause and the Bankruptcy Code's exclusion clause.<sup>33</sup>

Many of the issues left open after *Patterson* have been examined primarily from the perspective of bankruptcy law, with a view to predicting future treatment given the trends in case law since *Patterson*, and based on an unquestioning acceptance of the necessity for protection of retirement savings.<sup>34</sup> In an attempt to draw a bright line separating assets worthy of protection from those that are not according to traditional trust law criteria, some analysts have approached the problem of the appropriate treatment of pension trusts in bankruptcy through a close dissection of the qualities of pension trusts that either make them similar to, or set them apart from, traditional spendthrift trusts protected under state debtor-creditor laws.<sup>35</sup>

In contrast, this Article will attempt to determine whether retirement assets in general should be protected in bankruptcy prior to retirement, and if so, whether the protection of IRAs specifically is equivalent to protecting retirement trusts in either principle or policy. Both courts and legislatures have relied too heavily on the slender reed of income tax provisions designed to encourage retirement savings, as well as on ERISA's anti-alienation rule meant to enforce employer pension promises, as the basis for protection in bankruptcy of unlimited amounts of retirement assets for debtors who are not yet retired. This reliance is unjustified from either a theoretical or policy perspective, and should be abandoned in favor of an exemption structure that more directly satisfies the retirement policy goal of preventing impoverishment in old age.

Nonetheless, based on the current state of both pension and bankruptcy law, there may well be a public consensus that retirement is such an important part of American cultural and economic life that unlimited retirement savings, even substantial amounts accumulated well in advance of retirement, should be relatively sacrosanct. If so, clearer criteria must be developed to identify true retirement savings vehicles accurately and to determine to what extent the protection of those vehicles is consistent with both bankruptcy and retirement policy goals. This Article argues that the principal policy rationale for protection of retirement savings—the prevention of impoverishment and reliance on state

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32. See discussion *infra* Part IV.D.

33. See *infra* text accompanying notes 132-45.

34. See, e.g., Karns, *supra* note 7, at 319-30. See generally Noel C. Ice, *What Are Creditors' Rights in Retirement Plan Benefits?*, 21 EST. PLAN. 30 (1994); Anthony Michael Sabino & John P. Clarke, *The Last Line of Defense: The New Test for Protecting Retirement Plans from Creditors in Bankruptcy Cases*, 48 ALA. L. REV. 613 (1997); Michael A. Urban, *Revisiting the Scope and Implications of Patterson v. Shumate in Light of In Re Lyons*, 3 AM. BANKR. INST. L. REV. 379 (1995).

35. See, e.g., David B. Young, *The Pro Tanto Invalidity of Protective Trusts: Partial Self-Settlement and Beneficiary Control*, 78 MARQ. L. REV. 807, 825-36 (1995).

income support in the debtor's old age—can support protection of only a narrow category of retirement trusts. That category is far less expansive than either the Supreme Court's "ERISA-qualified" standard established in *Patterson v. Shumate*,<sup>36</sup> or the tax-favored standard used in many state statutes.

#### THE QUESTIONABLE STATUS OF IRAS AS RETIREMENT ACCOUNTS

Even if a coherent rationale for protecting retirement trusts can be articulated, it is not clear that any such rationale necessarily applies to IRAs. It is important to address the treatment of IRAs in particular, even though they have limited usefulness as "new" savings vehicle, because they are assuming increasing importance as repositories for rollovers of accumulated retirement savings in plans such as 401(k) cash or deferred arrangements, as workers move from one employer to another.<sup>37</sup> In light of the publicity and marketing surrounding the latest legislative creations—the Roth IRA and its brethren—it is imperative to set out, at the very least, a clear line dividing those few types of IRAs that may be legitimate retirement savings vehicles from the vast majority that are not.<sup>38</sup>

Despite the continuing differences among jurisdictions, the trend in judicial decisions appears to be in favor of treating IRAs as legitimate retirement accounts, at least under certain conditions.<sup>39</sup> However, the range of possible circumstances that may lead a court to conclude that a particular IRA should be protected from creditors creates even more confusion in both state and federal court decisions, and leaves individual debtors and creditors with little or no certainty as to what accounts will be preserved and which will not. Upon closer examination, only one type of IRA—a "rollover" IRA that is the repository for a mandatory distribution from an employer-provided defined benefit pension plan—has even a remote theoretical or policy claim for protection against creditors.

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36. 504 U.S. 753, 757-60 (1992).

37. See, e.g., LANGBEIN & WOLK, *supra* note 10, at 51-52; see also Janet Hook, *Proposals Seek to Retool IRAs to Boost Savings*, L.A. TIMES, June 20, 1997, at A1; Francine Knowles, *Mutual Funds Gaining on Banks as Nest Egg*, CHI. SUN-TIMES, June 12, 1998, at 52.

38. See, e.g., Jerry Morgan, *Roth IRA to Cause Quite a Stir in Investment Industry*, BALTIMORE SUN, Oct. 5, 1997, at 7H; Daisy Whitney, *IRA Makes Return Thanks to Roth*, DENVER POST, Mar. 15, 1998, at 10 of "Your Money's Worth" Section. An examination of IRAs is particularly important in light of the pension exemption provision of the bankruptcy reform legislation of the 105th Congress, the final version of which exempted Roth IRA accounts from the reach of creditors in bankruptcy, despite the lack of connection between Roth IRAs and retirement savings goals. See *infra* Parts IV.A.1.d and IV.B; see also, e.g., Scott Hanson, *Roth IRA Is a Great Vehicle for Higher-Education Savings*, SACRAMENTO BEE, Jan. 12, 1998, at IB6.

39. See *Carmichael v. Osherow* (*In re Carmichael*), 100 F.3d 375, 377-78 (5th Cir. 1996) (holding that an IRA is exempt from creditors' claims in bankruptcy under 11 U.S.C. § 522(d)(10)(E), because an IRA is a similar plan or contract to a retirement plan); see also *Meehan v. Wallace* (*In re Meehan*), 102 F.3d 1209 (11th Cir. 1997); *In re Rawlinson*, 209 B.R. 501 (B.A.P. 9th Cir. 1997); *In re Harless*, 187 B.R. 719 (Bankr. N.D. Ala. 1995); discussion *infra* Part IV.D.

BANKRUPTCY AND PENSION LAWS: SAFEGUARDING THE  
RETIREMENT ENTITLEMENT

This Article analyzes and suggests solutions to the current confusion surrounding the appropriate treatment of retirement accounts in bankruptcy. Part I describes the statutory protections afforded retirement accounts under the Bankruptcy Code and state bankruptcy statutes, which in turn reference the I.R.C. and ERISA provisions concerning pension plans and individual retirement arrangements. Part II analyzes the bankruptcy judicial opinions that both preceded and followed the Supreme Court's decision in *Patterson v. Shumate*, and argues that the narrow frame of the judicial debate leading up to *Patterson*—around the meaning of the phrase “applicable non-bankruptcy law”—virtually insured a lack of analysis of the appropriate basis for protection of retirement assets against creditors.

Part III analyzes the theoretical frameworks and policy goals of the relevant bodies of law—the Bankruptcy Code, state bankruptcy exemption statutes, the I.R.C, and ERISA—in an attempt to develop a coherent approach to preservation of retirement income for debtors in bankruptcy. Pension tax policy is characterized by a fundamental contradiction: Encouragement of retirement savings through tax deferral, coupled with continued, although penalized, access to those deferred savings before retirement. Bankruptcy law similarly contains a basic contradiction in the application of bankruptcy principles to retirement savings, excluding pension trust amounts from the bankruptcy estate without regard to the financial or retirement status of the debtor, while granting a limited, partial exemption, only for an amount necessary for support, for payments actually being made as retirement income.

Analysis of the protections accorded retirement savings in judicial opinions as well as in state and federal statutes reveals the cultural significance of the retirement phenomenon, which has taken on the status of a right, rather than a choice.<sup>40</sup> In such a context, the vehicles protected against creditors because of their connection to ensuring the right to retire should arguably be limited to those requiring an irrevocable commitment to delaying consumption to the period of retirement, and to amounts supporting a reasonable but not excessive retirement income.

However, the “fresh start” principle has traditionally implied complete protection of assets—such as retirement accounts—rather than partial protection limited to discrete amounts necessary for income maintenance—for example, specific amounts contained in an account.<sup>41</sup> The “asset protection” approach necessarily contradicts the income maintenance goal of retirement policy, as well as the prevailing economic analyses of the nature of pension savings. Moreover, the qualified plan anti-alienation rules alone do not, I argue, provide an adequate

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40. See Patricia E. Dilley, *The Evolution of Entitlement: Retirement Income and the Problem of Integrating Private Pensions and Social Security*, 30 LOY. L.A. L. REV. 1063, 1106-38 (1997). See generally WILLIAM GRAEBNER, A HISTORY OF RETIREMENT (1980).

41. See *infra* Part III.A.3; see also *In re Dyke*, 943 F.2d 1435, 1449 (5th Cir. 1991).

basis in principle for such blanket protection of retirement accounts, even though the relationship between the I.R.C. and ERISA anti-alienation rules and longstanding treatment of spendthrift trusts in bankruptcy has provided a focus for much of the analysis of the treatment of qualified plans in bankruptcy.

Perhaps most importantly, I argue in Part III that the delay in timing of income recognition for tax purposes that is the chief result of qualification under the I.R.C.—the basis for most statutes protecting *qualified* pension trusts—in reality has little relationship to any principled basis for excluding or exempting amounts in bankruptcy. In fact, tax qualification is simply a matter of timing of the imposition of tax, not of timing of receipt of income itself, and is not an adequate basis for protection of any pension arrangement, even if most courts were capable of and willing to determine whether a particular arrangement is qualified or not.

Finally, even if a coherent bankruptcy or tax explanation for protecting retirement trusts in bankruptcy can be found, the underlying premise of all of these protections for retirement trusts needs careful reexamination: Why should savings for "retirement", a voluntary change in work status, deserve any special protection from creditors over savings for loss of ability to work or loss of a job or any other involuntary limitation on the debtor's earning capacity? I argue in Part III that the only persuasive rationale is the protection of state interests against the impoverishment and resort to state support of its citizens when they are deemed to have become too old to be productive workers. This rationale has little or nothing to do with the traditional goal of bankruptcy: to provide a fresh start in economic life to debtors.

Part IV addresses the specific circumstances surrounding the tax and bankruptcy treatment of a specific category of protected arrangement, individual retirement accounts, and demonstrates why IRAs should not be protected by even a generous exemption policy for retirement plans. The faulty reasoning pursued by courts and legislatures alike has created several problems specific to IRAs that must be addressed. First, reliance on the fact of "qualification" as a basis for protection of both qualified pension plans and IRAs has resulted in the erroneous conclusion that IRAs are similar to pension plans because their tax treatment can be similar.<sup>42</sup> Qualified plans are subject to a complex structure of ongoing compliance whereas IRAs are not, making the analogy between "qualified plans" and "tax-qualified IRAs" imperfect indeed.<sup>43</sup>

Second, the complete exclusion or exemption of IRAs under the fresh start approach can result in protection of IRAs containing cash or other assets the value of which is greatly in excess of any amounts reasonably necessary for retirement support. Even more troubling is the resulting protection of IRAs that may have been maintained in violation of tax code requirements and used to shelter other assets that would be vulnerable to creditors.<sup>44</sup> If no other changes can be made, it should at least be possible to eliminate the use of IRAs by wrongdoers to shelter their assets from creditors. The lack of a coherent rationale for protection of some, all, or no individual retirement accounts has created

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42. See *infra* text accompanying notes 74-87.

43. See *infra* text accompanying notes 207-10.

44. See *infra* text accompanying notes 306-12.

confusion and conflicts in court decisions. It should be possible to clarify which IRAs ought to be protected under whatever rationale is accepted for protection of retirement generally; however, few if any IRAs fit easily into any protected category.

I conclude with some thoughts on the connections between bankruptcy and retirement entitlements and the predictable consistency in the makeup of the most protected groups. While the persistence of a bankruptcy and pension structure whose motto might well be "Them that's got, shall have"<sup>45</sup> is not surprising, surely in a democratic society we can at least attempt to provide the same protection against destitution in old age for debtors like Wilna Wilbur<sup>46</sup> as we give to celebrity athletes and other well-advised and well-off debtors.

#### I. A STATUTORY MAZE: BANKRUPTCY, TAX, AND PENSION LAW INTERTWINED

The protection of individual debtors against the full limit of their creditors' claims is based on both federal bankruptcy law and state law governing bankruptcy and creditor claims outside of formal bankruptcy proceedings.<sup>47</sup> The substantive law governing retirement plans and accounts is based on two federal laws, ERISA and the I.R.C. The interplay among these four sets of statutes, and the varying interpretations of the relationship, are a principal source of confusion about how retirement accounts are and ought to be protected against creditors' claims.

State and federal bankruptcy and debtor protection statutes and judicial decisions have relied on cross-references to provisions of ERISA and the I.R.C. for definitions and determinations of retirement trust status in the bankruptcy context, without regard to whether those definitions are consistent with bankruptcy purposes. In essence, the bankruptcy system has entrusted enforcement of the goals of the bankruptcy laws—in particular, the provision of a "fresh start" to debtors—to the tax law's determination of special tax status for retirement trusts.<sup>48</sup> The continuing confusion concerning the proper treatment of debtor retirement assets is evidence of the flaws in this approach.

The purposes and structure of debtor-creditor law center on extracting the maximum repayment for creditors that is consistent with the provision of a fresh start to debtors after the bankruptcy process is complete. It is not immediately obvious why this task should be so difficult to carry out with respect to retirement accounts, or why the federal and state debtor-creditor laws should rely on the federal income tax and pension laws to enforce bankruptcy goals and principles. Yet the complexities in this area almost wholly derive from the reluctance of state and federal legislators to define the limits of appropriate protection for retirement plans within the confines of the bankruptcy law.

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45. BILLIE HOLIDAY, *God Bless the Child*, on BILLIE HOLIDAY'S GREATEST HITS (Columbia 1967).

46. See *supra* text accompanying note 2.

47. See discussion *infra* Part I.A.

48. See discussion *infra* Part I.A-C.



The proposed federal exemption for IRAs and other tax-favored, but not "ERISA-qualified," retirement arrangements would simplify the maze for debtors seeking protection under federal bankruptcy law.<sup>49</sup> However, for debtors seeking to protect assets from judgment creditors outside of bankruptcy, the variations in state laws will continue to pose significant problems, and may determine whether the judgment debtor should declare bankruptcy under Chapter 7. A brief explanation of the statutory gauntlet that still must be run in reaching decisions about whether to protect a bankrupt debtor's retirement assets is therefore in order.

#### *A. Federal—State Bankruptcy Structure*

The treatment of individual debtors seeking liquidation of debts in exchange for part or all of the debtor's assets is in general controlled by Chapter 7 of the Federal Bankruptcy Code,<sup>50</sup> the product of the Bankruptcy Reform Act of 1978.<sup>51</sup> One purpose of the 1978 Act was to establish clear statutory categories for property that would be either excluded from the bankruptcy estate (all of which is generally available to satisfy claims of creditors), or, if included, partially exempt from claims of creditors. This approach was intended to eliminate the need for courts to engage in lengthy analysis of which assets should be excluded from the estate to provide the debtor with a "fresh start," and which should be included because they were currently available in a liquid form to the debtor and were in excess of the minimum necessary for her support.<sup>52</sup> The revised federal structure relies on an extremely inclusive definition of property to be included in the bankruptcy estate, combined with specific limited exemptions from creditor's claims for certain types of property or income otherwise included under that definition.

Three provisions of the Federal Bankruptcy Code are most relevant to the treatment of retirement trusts in bankruptcy: § 541(a), which defines the property of the debtor that must be included in the bankruptcy estate and therefore available to at least some extent to pay creditors; § 541(c)(2) which excludes from the bankruptcy estate any property on which "applicable nonbankruptcy law" places an enforceable restraint on alienation; and § 522(d)(10)(E) which provides a partial federal exemption for pension plans and other "similar" plans, but only up to amounts necessary for reasonable income maintenance.<sup>53</sup> Debtors governed by the federal exemption structure may choose to apply state statutory exemptions, or federal nonbankruptcy law exemptions, in place of the exemptions provided under § 522(d).<sup>54</sup> States may in addition "opt out" of the federal

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49. See H.R. 3150, 105th Cong. § 203 (1998); *supra* note 16.

50. 11 U.S.C. §§ 701-766 (1994).

51. Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549 (as amended).

52. See *In re Reagan*, 741 F.2d 95, 97 (5th Cir. 1984) (holding that section 541 of the Bankruptcy Act of 1978 supplanted the court's pre-Code analysis of what property should be included in the estate).

53. 11 U.S.C. § 541(a), (c)(2) (1994); 11 U.S.C.A. § 522(d)(10)(E) (West Supp. 1998).

54. 11 U.S.C.A. § 522(d)(1), (f)(3).

bankruptcy exemption, in which case a debtor will necessarily be governed by the state's own exemption statutes in place of the federal structure.<sup>55</sup>

Under § 541(a), the property of the bankruptcy estate encompasses the broadest possible scope of debtor property interests, including "all legal or equitable interests of the debtor in property . . . wherever located and by whomever held" in the bankruptcy estate as of the date of the bankruptcy petition.<sup>56</sup> The inclusiveness of this definition of the estate is both emphasized and tempered by exclusions from the estate under § 541(c). While § 541(c)(1) provides that a debtor's interest in any property becomes part of the bankruptcy estate notwithstanding any contractual or non-bankruptcy law restrictions, § 541(c)(2) provides a limited exception to that rule for restrictions "enforceable under applicable nonbankruptcy law" on the transfer of beneficial interests in a trust.<sup>57</sup>

Further limits on the inclusive effect of § 541 are found in the exemptions of § 522 which allow certain property to be exempt from the bankruptcy estate notwithstanding their inclusion in the bankruptcy estate under § 541. Under § 522(d), several types of property may be exempted up to specific dollar limits (e.g., interests in a residence, household goods, cars, professional tools, life insurance, etc.).<sup>58</sup> Under § 522(d)(10), a debtor's right to receive a variety of benefits such as social security, disability, and veteran's benefits are exempt from the bankruptcy estate without dollar limits.<sup>59</sup> However, this section exempts the debtor's right to receive payments under a pension plan or similar plan only to the extent "reasonably necessary for the support of the debtor," and only if the plan was not established by an "insider" employer of the debtor and qualifies under one of a variety of I.R.C. sections<sup>60</sup> including § 401(a), the qualification provision

55. See 11 U.S.C. § 522(b)(1) (1994).

56. 11 U.S.C. § 541(a)(1) provides:

(a) The commencement of a case under section 301, 302, or 303 of this title creates an estate. Such estate is comprised of all the following property, wherever located and by whomever held:

(1) Except as provided in subsections (b) and (c)(2) of this section, all legal or equitable interests of the debtor in property as of the commencement of the case.

*Id.*; see also *In re Harless*, 187 B.R. 719, 722 (Bankr. N.D. Ala. 1995) ("The House and Senate reports accompanying the Bankruptcy Reform Act of 1978 make it clear that Congress intended a broad, and expansive definition of property interests included in the estate. The Supreme Court of the United States reiterated that construction in *United States v. Whiting Pools, Inc.*") (footnote and citation omitted).

57. 11 U.S.C. § 541(c)(2).

58. 11 U.S.C.A. § 522(d)(1) (residence), (2) (car), (3) (household goods), (6) (professional tools), (7) (life insurance).

59. *Id.* § 522(d)(10)(A) (social security, unemployment compensation or local public assistance benefits), (B) (veterans' benefit), (C) (disability, illness, or unemployment benefit).

60. 11 U.S.C.A. § 522(d)(10)(E) exempts:

[A] payment under a stock bonus, pension, profitsharing, annuity, or similar plan or contract on account of illness, disability, death, age, or length of service, to the extent reasonably necessary for the support of the debtor and any dependent of the debtor, unless—

(i) such plan or contract was established by or under the auspices of an insider that employed the debtor at the time the debtor's rights under such plan or contract arose;

for employer-provided pension and profit-sharing plans, and § 408, the section providing for special tax treatment of IRAs and simplified employer pension plans ("SEPs").<sup>61</sup> While the bankruptcy reform legislation approved by the House and Senate conferees shortly before Congress adjourned in October 1998 does not eliminate the limited exemptions of § 522(d)(10), it effectively renders them moot with respect to retirement accounts accorded special tax status under the I.R.C., by exempting all retirement accounts as defined in I.R.C. §§ 401(a) and 408 from the claims of creditors.<sup>62</sup>

The final additional wrinkles in the Bankruptcy Code's approach to inclusions in the bankruptcy estate are the "opt-out" provisions of § 522(b). First, § 522(b)(1) effectively permits a state to require its citizens to use state rather than federal exemptions.<sup>63</sup> In addition, § 522(b)(2)(A) allows the individual debtor to apply either the federal exemptions of § 522(d), or, alternatively, exemptions provided under the state law applicable to the debtor as well as exemptions provided by federal law other than those listed in § 522(d).<sup>64</sup> These state-provided exemptions are not necessarily subject to any "reasonable support" limit such as the federal limit contained in § 522(d)(10)(E).<sup>65</sup> Thus, the statutory exemptions available to any particular debtor depend first on whether his state of domicile requires him to use state rather than federal exemptions, and, if not, on his own choice as to which set of exemptions to use.

The complete exclusion of pension trusts and accounts that is available under § 541(c)(2) is of course far preferable to the partial exemption for pension payments offered under § 522(d)(10)(E). However, if exclusion of an asset cannot be achieved under the federal statute, the next refuge of the debtor is state law, the exemptions of which may be substituted for the federal exemptions if the

(ii) such payment is on account of age or length of service; and

(iii) such plan or contract does not qualify under section 401(a), 403(a), 403(b), 408, or 409 of the Internal Revenue Code of 1986 (26 U.S.C. 401(a), 403(a), 408, 409).

*Id.* Section 522(d)(10)(D) similarly exempts alimony, support or separate maintenance payments only to the extent reasonably necessary for support of the debtor and dependents. *Id.* § 522(d)(10)(D).

61. For further discussion of the special tax treatment provided for IRAs and SEPs under § 408, see *infra* Part IV.A.2.C.

62. See *supra* note 17.

63. 11 U.S.C.A. § 522(b) provides in part:

Notwithstanding section 541 of this title, an individual debtor may exempt from property of the estate the property listed in either paragraph (1) or, in the alternative, paragraph (2) of this subsection. . . . Such property is—

(1) property that is specified under subsection (d) of this section, unless the State law that is applicable to the debtor under paragraph (2)(A) of this subsection specifically does not so authorize; or, in the alternative,

(2)(A) any property that is exempt under Federal law, other than subsection (d) of this section, or State or local law that is applicable on the date of the filing of the petition . . . .

64. *Id.* § 522(b)(2)(A).

65. See *id.*

debtor wishes.<sup>66</sup> Debtors may look to state bankruptcy and debtor protection laws for protection of certain types of assets and usually a minimum level of income.<sup>67</sup>

State law governs three types of debtor-creditor claims: (1) bankruptcy cases in states which have "opted out" of the Federal Bankruptcy Code exemption provisions; (2) bankruptcy cases in which an individual debtor has exercised the choice provided by the federal bankruptcy law to come under state rather than federal exemption protections; and (3) non-bankruptcy debtor situations. Most state statutes which protect "retirement accounts" simply cross-reference one or more sections of the I.R.C. and base the protection on the status of the account as a "qualified" arrangement under the tax law.<sup>68</sup> For example, the Florida statute, which is typical of the majority of state laws dealing with retirement accounts, provides as follows:

[A]ny money or other assets payable to a participant or beneficiary from, or any interest of any participant or beneficiary, in a retirement or profit-sharing plan that is qualified under § 401(a), § 403(a), § 403(b), § 408 or § 409 of the Internal Revenue Code of 1986, as amended, is exempt from the claims of creditors of the beneficiary or participant.<sup>69</sup>

A few statutes require a showing that the amounts contained in the account are necessary for the support of the debtor. These statutes base the protection on the use made and necessity for income maintenance of the funds held in the account.<sup>70</sup> For example, before a legislative change in 1987, Nebraska's statute essentially copied the Bankruptcy Code's partial exemption for pension payments only to the extent necessary for the debtor's support.<sup>71</sup> Several statutes limit the exemption

66. *See id.*

67. *See infra* Appendix A. See also generally the NBRC Report, *supra* note 14, for a discussion and critique of the various state exemption statutes.

68. *See, e.g.*, WASH. REV. CODE ANN. § 6.15.020(3)-(5) (West Supp. 1999).

69. FLA. STAT. ANN. § 222.21(2)(a) (West 1995) (citation omitted). *But see* FL. STAT. ANN. § 222.201, which confusingly allows Florida debtors to "opt in" to the federal exemption statute, even though Florida is an "opt-out" state.

70. *See, e.g.*, OHIO REV. CODE ANN. § 2329.66(A)(10)(c) (Anderson 1995).

71. *See* Oliver B. Pollak & David G. Hicks, "Please, Sir, I Want Some More,"—*Loopholes, Austerity and the Cost of Living—Nebraska Exemption Policy Revisited*, 73 NEB. L. REV. 298, 320 & n.151 (1994).

Until 1987, Nebraska was one of the few states to offer only minimal protection for retirement benefits. The passage of section 25-1563.01, which tracks 11 U.S.C. § 522(d)(10)(E), cured this omission. [Certain city, county, and state employees had specific exemptions. The income sources cited in section 522(d)(10)(A), (B), and (C) were exempt.]

....

... The expression "to the extent reasonably necessary for the support of the debtor and any dependent of the debtor" is identical to that found in 11 U.S.C. 522(d)(10)(E). This language raises two questions: How much is "reasonably necessary," and does the exemption apply to future and current income? Both questions are resolved on a case by case analysis.

*Id.* (n.151 text is bracketed).

to the amount of the contribution to the account that was exempt from federal income tax (and usually earnings thereon).<sup>72</sup>

Every state except Delaware, Montana, New Hampshire, West Virginia, and Wyoming has enacted a statute specifically protecting to some extent retirement accounts or plans including "private" retirement plans such as IRAs and Keogh plans, but there are a variety of statutory approaches.<sup>73</sup> Appendix A provides a summary of state statutes addressing the treatment of tax favored retirement accounts in bankruptcy and garnishment proceedings.

The federal blanket exemption for tax favored retirement accounts that was proposed in the 1998 legislation (and that was recommended by the National Bankruptcy Commission) would very likely simplify the choices for those debtors who are not in "opt-out" states and thus eligible for the federal exemption structure. However, for debtors in opt-out jurisdictions, the various state statutes continue to apply and provide wide variations in the treatment of debtors from jurisdiction to jurisdiction. Moreover, as discussed below, the proposed legislation would continue and extend the questionable reliance of bankruptcy law on the tax status of retirement plans for the determination of which assets should be exempt from creditors.

### *B. Tax Treatment of Retirement Plans*

The other federal statutory schemes which affect how a debtor's retirement account assets are protected in and outside of bankruptcy are the labor law provisions governing enforcement of employer pension promises that were enacted as part of ERISA, and the closely related sections of the I.R.C. which govern the tax treatment of pension plans and trusts. Both the labor portion of ERISA and the I.R.C. provisions governing pension plans predate the enactment of the Bankruptcy Reform Act; the I.R.C. pension provisions predate most current state exemption statutes as well. As a result, both the federal bankruptcy and the state debtor-creditor laws use ERISA and the I.R.C. as a convenient source for the definition of retirement arrangements worthy of protection from creditors, usually exempting benefits or trusts "qualified" under I.R.C. §§ 401(a), 403, 408, and 409.

The tax treatment of retirement plans can be seen as a quid pro quo scheme under which the entity or person establishing the plan receives certain tax benefits in exchange for obeying the qualification rules contained in various I.R.C. sections. I.R.C. § 401(a) is the basic qualification section, under which trusts maintained under an employer-sponsored plan meeting all of the requirements of § 401(a)'s myriad subsections will qualify for special tax treatment.<sup>74</sup> Plans

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72. For examples, see ARK. CODE ANN. § 16-66-220(a)-(b) (Michie Supp. 1997), and CAL. CIV. PROC. CODE §§ 703.010(a) and 704.115(a)(3) (Deering 1996).

73. West Virginia, for example, simply exempts from execution or other process personal property not exceeding \$1000 in value. *See* W. VA. CODE § 38-8-1 (1985).

74. I.R.C. § 401(a) has 34 paragraphs setting forth various requirements for qualification, such as vesting employees in their benefits after a given period of employment and limited discrimination in coverage or benefits in favor of highly paid employees. I.R.C. § 401(a)(1)-(34) (West Supp. 1998).

qualified under I.R.C. § 401(a) allow employers to set aside amounts in a trust for the benefit of their participating employees. The employers may take a deduction for those contributions, without those amounts being taxed currently to the employees.<sup>75</sup> The tax advantages for participating employees can be substantial. Neither the contribution itself, nor the accrued earnings on that contribution over the years, are taxed to the participant until she begins to withdraw them, presumably (although not necessarily) in retirement.<sup>76</sup>

Most state statutes also protect employer-provided annuities, governed by I.R.C. § 403(a) and (b). Taxable employers may provide employee annuities under I.R.C. § 403(a), while plans for employees of tax-exempt or governmental entities are generally addressed by I.R.C. § 403(b). The tax results for the participating employees are generally the same as for participants in plans qualified under I.R.C. § 401(a); funds set aside for them will not be taxed to them until they are actually distributed as benefits.<sup>77</sup> Many statutes also cross-reference I.R.C. § 408, which provides special tax treatment for IRAs established by either employers for their employees, or by individuals, and I.R.C. § 409, which governs tax credit employee stock ownership plans. While very few employees are covered by plans under § 409, the importance of IRAs under § 408 has escalated considerably over the last five years.<sup>78</sup>

### C. ERISA Regulation of Employer-Provided Plans

There seems to be a substantial and persistent level of confusion, at least among commentators in the bankruptcy literature, about the relationship between ERISA and the provisions of the I.R.C. governing employee benefit plans. This situation was probably created by the duplication of existing and amended I.R.C. provisions in Title II of ERISA when the latter was enacted in 1974.<sup>79</sup> Many of these I.R.C. provisions had already been in existence for thirty to fifty years by then, having established the tax treatment for qualified pension plans dealing with employee benefits and pensions as early as 1921. Notwithstanding the close links between the pension provisions of the I.R.C. and the pension regulatory provisions of Title I of ERISA, the tax provisions remain part of the I.R.C. and

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75. See *id.* §§ 402, 404.

76. See *id.*; see also I.R.C. § 72(m) (1994).

77. See *id.* § 403(a)-(b) (West Supp. 1998).

78. See *supra* text accompanying note 37.

79. See DAN M. MCGILL & DONALD S. GRUBBS, JR., *FUNDAMENTALS OF PRIVATE PENSIONS* 39 (4th ed. 1979).

The other major section of [ERISA] (Title II) is primarily concerned with tax matters and, in form, is an amendment to the Internal Revenue Code of 1954. Thus, it pertains primarily to qualified pension plans. It contains the same requirements in respect of participation, vesting, and funding that are found in Title I, but in the context of conditions that must be satisfied for qualification of a plan.

*Id.* (parenthetical in original).

the rest of ERISA is codified in the U.S. Code as part of the labor laws.<sup>80</sup> Strictly speaking, there is no single statute that can be identified as "ERISA."

Perhaps the most important example of the misuse of the term "qualified" in the bankruptcy context can be found in the Supreme Court's opinion in *Patterson v. Shumate*, which used the term "ERISA-qualified plans" to identify plans that should be excluded from the bankruptcy estate.<sup>81</sup> The problem with this particular usage is that outside of that *Patterson* opinion, the phrase "ERISA qualification" has no meaning, at least as ERISA is read and understood by pension and tax law specialists.<sup>82</sup> A plan may be *subject to* ERISA, and its sponsors and fiduciaries risk penalties and lawsuits if they or the plan do not comply with ERISA, but there is no particular treatment under ERISA for any plan to "qualify" for.<sup>83</sup>

Prior to the enactment of ERISA in 1974, the I.R.C. rules governing tax treatment of pension trusts, including the availability of current deductions for trust contributions by the employer and rules for taxing distribution in retirement of benefits to employees, were the principal source of federal regulation of pensions. As a result, the concept of a "qualified plan" or "qualified pension plan" developed long before ERISA, and has long been generally used to describe a plan satisfying the requirements for qualification for favorable income tax treatment under § 401(a) of the I.R.C.<sup>84</sup>

The Treasury established specific tax treatment for employee pensions and pension trusts very soon after enactment of the income tax in 1913,<sup>85</sup> and preferential tax treatment for them has been a part of the I.R.C. since the 1920s.<sup>86</sup> Employers were not required to actually set aside funds to pay for promised pensions, or provide more than minimal pensions for all but the longest-tenured rank and file employees, until passage of ERISA in 1974.

80. Title I of ERISA is a labor law title establishing a regulatory framework and various funding and disclosure requirements designed to ensure that employers keep promises made to employees in connection with their pensions. The provisions of Title I of ERISA are codified in the U.S. Code with other labor law statutes in Title 29; all tax provisions dealing with employee benefits, pensions, and deferred compensation remain codified as part of the I.R.C. in Title 26 of the U.S. Code.

81. 504 U.S. 753, 765-66 (1992).

82. See, e.g., Charles Falk, *New Developments In Bankruptcy Taxation*, 24 *Pens. & Ben. Rep.* (BNA) No. 25, at 1494 (June 23, 1997). "Pension plans are generally 'subject to ERISA,' not 'qualified under ERISA.'" *Id.* at 1495.

83. ERISA applies, by its terms, to "employee benefit plans," defined in the Act as either "employee welfare benefit plans" or "employee pension benefit plans." 29 U.S.C. § 1002(1)-(2) (1994). Pension benefit plans are defined as plans maintained by the employer, providing retirement income to the employee, or resulting in deferral of income. See *id.* § 1002(B)(i)-(ii).

84. See MCGILL & GRUBBS, *supra* note 79, at 23-25, 39-41; see also I.R.C. § 401(a) (West Supp. 1998) ("A trust . . . shall constitute a *qualified* trust [upon satisfaction of numerous requirements set forth in the Code] . . .") (emphasis added).

85. The Department of the Treasury issued a ruling in 1914 allowing deductions for pensions at the time paid to employees. See T.D. 2090, 16 *Treas. Dec. Int. Rev.* 259, 281 (1914); see also O.D. 110, 1 C.B. 224 (1919) (holding that employer contributions to a pension fund were deductible so long as the fund was a separate and distinct entity).

86. See Revenue Act of 1921, Pub. L. No. 67-98, § 219(f), 42 Stat. 227, 247 (repealed 1939); Revenue Act of 1926, Pub. L. No. 69-20, § 219(f), 44 Stat. 9, 33 (repealed 1939).

As a result, the main purpose and function of ERISA was to enforce the pension promises that employers make to employees. In addition, ERISA was intended to limit the ability of employers to require extraordinarily long periods of service before an employee is entitled to benefits.<sup>87</sup> The focus of Titles I, III, and IV of ERISA is on vesting requirements,<sup>88</sup> disclosure of information to participants and employees, fiduciary responsibilities of plan administrators and sponsors,<sup>89</sup> (including employee and Department of Labor rights to sue plan sponsors and fiduciaries),<sup>90</sup> and funding requirements for defined benefit plans, including the mechanism and funding institution (the Pension Benefit Guaranty Corporation)<sup>91</sup> to provide a federal system of insurance for underfunded pension plans.

ERISA also contained a tax title, Title II, which reproduced, amended, and expanded the provisions of the I.R.C. dealing with tax qualification rules for qualified plans. However, those provisions remained part of and continue to be amended as part of the I.R.C. and are not codified as part of ERISA.<sup>92</sup> Moreover, ERISA applies to all employee benefit plans, including "welfare benefit plans," which provide fringe benefits such as health insurance and have either different or no qualification rules comparable to those applicable to pension plans.<sup>93</sup> In addition, ERISA may apply to deferred compensation arrangements that do not qualify for special tax treatment under the I.R.C., with the result that the employer providing such a plan may be subject to reporting, disclosure and fiduciary duty rules without any tax benefit at all.<sup>94</sup>

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87. See generally Michael S. Gordon, *Overview: Why Was ERISA Enacted?*, in SPECIAL COMM. ON AGING, U.S. SENATE, THE EMPLOYEE RETIREMENT INCOME SECURITY ACT OF 1974: THE FIRST DECADE 1-25 (Comm. Print 1984) (hereinafter SPECIAL COMM. ON AGING). The impetus for ERISA probably had less to do with the tax treatment of plans than with enforcement of pension promises. Much of the support for ERISA came from labor unions and their allies seeking to require employers to provide employees with a vested right to benefits for fewer than the 20 or 30 years of service frequently required by employers and to induce federal guarantees of underfunded pension plans. The legislation originated with the congressional committees with jurisdiction over labor issues, because of their strong interest in the legislation, and the tax-writing committees only asserted jurisdiction as passage of some form of ERISA became inevitable, even though administration tax and labor staff were equally involved in the bill. The labor and tax provisions of ERISA are contained in separate titles of the Act, and do not always apply to the same pension arrangements. See *id.*

88. See 29 U.S.C.A. § 1053 (West Supp. 1998).

89. See 29 U.S.C. § 1104 (1994 & Supp. II 1996); *id.* §§ 1105-1106 (1994); 29 U.S.C.A. § 1107 (West 1985 & Supp. 1998); *id.* § 1108 (West Supp. 1998); 29 U.S.C. §§ 1109-1110 (1994).

90. See 29 U.S.C. § 1451 (1994).

91. See *id.* § 1302.

92. One example is the Taxpayer Reform Act of 1986, P.L. 99-514, 100 Stat. 2085, which extensively amended the pension qualification sections of the I.R.C., discussed *supra* text accompanying notes 74-78.

93. See I.R.C. §§ 125(a), 104(a)(4), 105(a) (1994).

94. See Pension & Welfare Benefit Programs, Op. Dept. Labor 89-24A (1989), available in 1989 ERISA LEXIS 24 (deciding that a top hat plan that distributed lump sum benefit payments to former employees could be governed by ERISA when the employees receive pressure from the corporation to loan money from the benefit payment back to the corporation); see also *id.* 89-21A, available in 1989 ERISA LEXIS 14.



In short, ERISA is best understood as a body of law providing certain rights to beneficiaries and placing specific duties on sponsors and fiduciaries of employee benefit arrangements including, but not limited to, qualified plans under the I.R.C. However, the favorable tax treatment of qualified plans, which is the entire point of qualification, depends solely on compliance with the relevant provisions of the I.R.C.<sup>95</sup>

#### D. ERISA and I.R.C Anti-Alienation

Because the focus of ERISA is on enforcement of employer promises to employees, and not on the size or nature of the benefits provided under those plans for employees, few of ERISA's provisions have any bearing on whether a particular debtor's assets should be protected from her creditors. The principal focus of most court opinions as well as of scholarly consideration of how to treat pension assets in bankruptcy has been the anti-alienation provisions of ERISA and the I.R.C., which appear to provide a clear, if narrow, basis for excluding plans from the bankruptcy estate. The anti-alienation rules of I.R.C. § 401(a)(13), and the corresponding ERISA Title I provisions in § 206(d) have been cited repeatedly as the source of similarity between spendthrift trusts and qualified employee plans, in that such plan provisions theoretically prevent access to funds contained in an employee benefit trust for both employees and plan sponsors, and limit access of creditors to benefits being paid out of the trust.<sup>96</sup>

Prior to the amendment of the I.R.C. as part of ERISA, the tax qualification rules did not explicitly prohibit alienation of benefits. However, even as far back as the original revenue acts of the 1920s that established favorable tax treatment for pension and profit-sharing plans, the principal qualification requirement for such plans was that the plan be "for the exclusive benefit of some or all of [the] employees" of the employer establishing the plan.<sup>97</sup> Under current I.R.C.

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95. Much of the commentary on *Patterson v. Shumate* by bankruptcy specialists has reproduced the Supreme Court's misleading use of the phrase "ERISA-qualified," 504 U.S. 753, 755 (1992), leading to analyses of the treatment of IRAs that overlook the real differences between IRAs and qualified plans. See, e.g., Robert M. Lawless, *Legisprudence Through a Bankruptcy Lens: A Study in the Supreme Court's Bankruptcy Cases*, 47 SYRACUSE L. REV. 1, 50-54 (1996).

Thus, the Supreme Court's holding is limited to ERISA-qualified pension plans that have an anti-alienation provision. Even after *Patterson*, pension plans without anti-alienation provisions may be included in the bankruptcy estate. See, e.g., *Meehan v. Wallace (In re Meehan)*, 173 B.R. 818, 820-21 (S.D. Ga. 1994); *In re Brillley*, 148 B.R. 39, 41 (Bankr. C.D. Ill. 1992) (both including in bankruptcy estate an IRA without enforceable anti-alienation provisions).

*Id.* at 52 n.243. The author, Lawless, equates IRAs with pension plans.

96. See Yvette Spielman Sherman, Note, *ERISA Benefits Under the Bankruptcy Code and a New York Debtor's Rights*, 58 BROOKLYN L. REV. 177, 186-89 (1992). See generally Kahler v. Craig (*In re Craig*), 204 B.R. 756 (D.N.D. 1997).

97. Revenue Act of 1921, Pub. L. No. 67-98, § 219(f), 42 Stat. 227, 247 (repealed 1939). This original provision provided tax-exempt treatment for contributions to and earnings of stock bonus or profit-sharing trusts established by an employer. This treatment was later extended to pension plan trusts other than stock plans in the Revenue Act of 1926, Pub. L. No.

§ 401(a)(2), the exclusive benefit rule is restated as a positive requirement for qualification and is intended to prohibit the employer maintaining the plan and trust from diverting trust assets for purposes other than paying benefits and maintaining the trust.<sup>98</sup>

ERISA amended the I.R.C. to add § 401(a)(13) and simultaneously created a similarly worded labor law provision, ERISA § 206(d),<sup>99</sup> both of which go beyond merely protecting the trust, and attempt in addition to protect the benefits to be paid under the plan. However, neither the I.R.C. nor the ERISA provision is a straightforward prohibition on assignment or alienation of benefits, abrogation of which would result in penalties or prosecution under federal law; rather, each provision requires the language of the pension plan itself to contain the appropriate clause. The I.R.C. makes it a requirement for qualification that "the plan of which [the] trust is a part provides that benefits provided under the plan may not be assigned or alienated."<sup>100</sup> Similarly, ERISA § 206(d)(1) states that "[e]ach pension plan shall provide that benefits provided under the plan may not be assigned or alienated."<sup>101</sup> Each of these provisions also allows for disregarding voluntary and revocable assignments of up to ten percent of any benefit for purposes other than plan administrative costs,<sup>102</sup> as well as loans to participants under certain circumstances.<sup>103</sup>

The statutory language of both ERISA and the I.R.C. states only that benefits may not be assigned or alienated, which might be interpreted to prohibit only an act of the beneficiary or trustee, leaving open the possibility of attachment

69-20, § 219(f), 44 Stat. 9, 33 (repealed 1939). Immediately before the enactment of the I.R.C. amendments in ERISA in 1974, I.R.C. § 401(a) read, in part,

(a) Requirements for Qualification—A trust . . . forming part of a stock bonus, pension, or profit-sharing plan of an employer for the exclusive benefit of his employees or their beneficiaries shall constitute a qualified trust under this section-

.....  
 (2) if under the trust instrument, it is impossible, at any time prior to the satisfaction of all liabilities with respect to employees and their beneficiaries under the trust, for any part of the corpus, or income to be . . . used for, or diverted to, purposes other than for the exclusive benefit of his employees or their beneficiaries.

I.R.C. § 401(a)(2) (1970) (amended 1980).

98. *Id.* § 401(a)(2) (West Supp. 1998).

99. 29 U.S.C.A. § 1056(d) (West Supp. 1998).

100. I.R.C. § 401(a)(13).

101. 29 U.S.C.A. § 1056(d)(1).

102. *See* I.R.C. § 401(a)(13)(A); 29 U.S.C.A. § 1056(d)(2).

103. *See* I.R.C. § 401(a)(13)(B), (C); 29 U.S.C.A. § 1056(d)(1). These anti-alienation provisions were a part of legislation drafted by both the labor and the tax congressional committees which separately drafted the bills that were eventually combined and passed as ERISA. The tortured legislative history of ERISA is summarized in the form of a chronology in William J. Chadwick & David S. Foster, *Federal Regulation of Retirement Plans: The Quest for Parity*, 28 VAND. L. REV. 641, 668-71 (1975). The "pre-history" of ERISA, detailing the forces leading Senator Javits to push for labor and tax pension legislation is described in Gordon, *supra* note 87, at 6-24.

through the actions of the beneficiary's creditors.<sup>104</sup> However, the regulations promulgated under I.R.C. § 401(a)(13) elaborate on the "assignment or alienation" language to state that the plan must provide that benefits may not be "anticipated, assigned (either at law or in equity), alienated or subject to attachment, garnishment, levy, execution or other legal or equitable process."<sup>105</sup> The regulation goes on to define assignment and alienation to include all direct or indirect arrangements that would result in an employee's benefits under the plan being paid instead to the employer, as well as any arrangement under which the participant or beneficiary gives a third party "a right or interest enforceable against the plan" in any part of the participant's or beneficiary's benefit under the plan.<sup>106</sup> Failure to include an anti-alienation clause in a pension trust document would presumably result in disqualification of the plan under the I.R.C.;<sup>107</sup> under ERISA, the lack of an anti-alienation requirement could result in a lawsuit against the plan sponsor by the Secretary of Labor, but only if a participant requested such an action be taken, and only if the Secretary determined that the lack of such a provision affects the benefits of participants or beneficiaries under the plan.<sup>108</sup>

These anti-alienation provisions are analogous to traditional spendthrift trust provisions recognized under many state laws, particularly as the types of arrangements addressed in both statutes involve different parties as plan sponsors and plan beneficiaries. For example, I.R.C. § 401(a)(13) applies only to plans qualified under I.R.C. § 401 which by definition must be established by an employer for the benefit of his employees and their beneficiaries.<sup>109</sup> Similarly, ERISA § 206(d) applies specifically to "pension plans,"<sup>110</sup> defined elsewhere in ERISA as plans maintained by an employer for the benefit of his employees.<sup>111</sup> Thus, these restrictions do not invoke the traditional lack of recognition for anti-alienation provisions of self-settled trusts, as they apply only where the employer/sponsor of the qualified plan, not the participant/beneficiary, is the settlor of a trust which she has presumably established for the benefit of another, namely the participant/beneficiaries of the plan and trust.<sup>112</sup>

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104. See Ice, *supra* note 34, at 31.

105. Treas. Reg. § 1.401(a)-13(b)(1) (as amended in 1988) (parenthetical in original).

106. *Id.* § 1.401(a)-13(c)(1)(i)-(ii). Both the I.R.C. and its accompanying regulations, as well as ERISA, exempt federal, state, or local tax withholding arrangements, as well as recovery of benefit overpayments made to the participant.

107. See I.R.C. § 401(a)(1), (13).

108. See 29 U.S.C. § 1132(b)(1)(B) (1994).

109. I.R.C. § 401(a)(13) (providing in part that a trust shall not constitute a qualified trust "under this section" unless it contains the required anti-alienation language) (emphasis added). Thus, only plans qualified under I.R.C. § 401 are governed by this provision, including pension, profit-sharing and stock bonus plans, cash or deferred arrangements under I.R.C. § 401(k), but excluding, for example, tax-deferred annuities under I.R.C. § 403(b), and IRAs under I.R.C. § 408.

110. 29 U.S.C.A. § 1056(d)(1) (West Supp. 1998).

111. See 29 U.S.C. § 1002(2)(A) (1994) (defining a "pension plan").

112. See *infra* text accompanying notes 132-44 for a discussion of the *Patterson v. Shumate* opinion's reliance on these anti-alienation provisions in finding that qualified plans are not included in the bankruptcy estate under § 541(c)(1) of the Bankruptcy Code.

The anti-alienation provisions of ERISA and the I.R.C. provide a statutory link to the Bankruptcy Code, which excludes from the bankruptcy estate property which is subject to a restriction on transferability that is enforceable under "applicable non-bankruptcy law."<sup>113</sup> The debate in the federal courts that led up to the *Patterson v. Shumate* decision was whether the I.R.C. and ERISA anti-alienation provisions were such "applicable non-bankruptcy law."<sup>114</sup> The framing of the argument around the interpretive parameters of the bankruptcy statute inevitably led to a Supreme Court decision that has largely precluded any subsequent examination of the underlying policies of protections under any of the statutes at issue.

## II. *PATTERSON V. SHUMATE*: RIGHT ANSWER, WRONG QUESTION

The evolution of the debate in federal courts leading up to the Supreme Court's decision in *Patterson v. Shumate* has been well documented in scholarly legal literature,<sup>115</sup> and need not be repeated in great detail here. However, even the brief summary that follows reveals the incidental nature of the connection between ERISA's anti-alienation rules and the Bankruptcy Code's exclusion provisions, on which the current protection of plans covered under ERISA has come to rest. Perhaps as importantly, it is clear from the variety in rationales presented in court opinions relating to both ERISA and non-ERISA pension trusts before and since *Patterson* that the reliance on the tax qualification rules for decisions about which retirement plans should be protected under both state and federal bankruptcy laws has produced inconsistent results generally unrelated to reasonable pension or bankruptcy policy.

### A. *Incidental Protection of Retirement: The Pre-Shumate State of the Law*

In the period between passage of the Bankruptcy Reform Act in 1978 and the *Patterson* decision in 1992, the debate in the federal courts concerning how to treat pension plans under the Bankruptcy Code focused in large part on the interpretation of Bankruptcy Code § 541(c), and on whether ERISA's anti-alienation provision should be considered "applicable non-bankruptcy law" resulting in the exclusion of pension trusts subject to ERISA from the bankruptcy estate.<sup>116</sup> Eventually, the circuit court decisions formed two discernible lines of reasoning, creating a conflict ripe for resolution by the Supreme Court in *Patterson*.

One line of cases focused on the legislative history and congressional intent behind Bankruptcy Code § 541(c), holding that the exclusion based on restrictions on alienation under "applicable non-bankruptcy law" was intended

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113. 11 U.S.C. § 541(c)(2) (1994).

114. See *infra* text accompanying notes 116-31.

115. See *supra* note 34.

116. See Karns, *supra* note 7, at 304-05.

solely to exclude trusts that would be protected from creditors under an extensive body of state law upholding valid spendthrift trusts.<sup>117</sup> The rationale for this interpretation appears to have been that the recognition of spendthrift trusts, historically recognized as valid under state law, should not be overturned by federal law, notwithstanding the federal law's general purpose of insuring uniformity in treatment of assets and inclusiveness in the reach of the bankruptcy estate.<sup>118</sup>

Spendthrift trusts have been used traditionally by settlors to preserve family assets while providing for the support of an improvident heir, and came under fierce attack by legal commentators at the turn of the century as undue "dead hand" restraints on the right of free contract.<sup>119</sup> Despite the lack of theoretical support for the notion of spendthrift trusts, they appear to be so tightly woven into the fabric of American common law that they have proved impossible to dislodge. The key requirement of spendthrift trust law, however, is generally that the beneficiary of the trust has no right of independent distribution of trust assets outside the income payments provided under the spendthrift provisions.<sup>120</sup> Thus, the trust beneficiary can be viewed as having only limited ownership rights in the trust principal, to which the beneficiary's creditors should not have access.

Consistent with this theory, ERISA and I.R.C. anti-alienation provisions were viewed by the courts following this line of reasoning as meeting the requirements of the Bankruptcy Code § 541(c) only if the anti-alienation clause in the plan at issue would qualify for treatment as a spendthrift trust under the state law of the jurisdiction.<sup>121</sup> This was a difficult test to satisfy, and several circuits (the Fifth, Eighth, Ninth, and Eleventh) held that trusts governed by ERISA's anti-alienation provision did not qualify as valid spendthrift trusts.<sup>122</sup> The rationale for denying spendthrift trust status under state law varied, based in some cases on the self-settled nature of the plan in question since some types of plans, such as Keogh

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117. See Lawless *supra* note 95, at 51; see also Goff v. Taylor (*In Re Goff*), 706 F.2d 574, 582 (5th Cir. 1983). The Goff court defined a spendthrift trust as

a trust created to provide a fund for the maintenance of a beneficiary, with only a certain portion of the total amount to be distributed at any one time. The settlor places "spendthrift" restrictions on the trust, which operate in most states to place the fund beyond the reach of the beneficiary's creditors, as well as to secure the fund against the beneficiary's own improvidence.

*Id.* at 580.

118. See Urban, *supra* note 34, at 380-81.

119. See Young, *supra* note 35, at 808-10. Young notes further that spendthrift trusts are nonetheless usually vulnerable to the claims of certain favored classes of creditors: "These favored creditors usually include the beneficiary's spouse and children when they are entitled to support or alimony; creditors who have supplied essential goods or services to the beneficiary; those who have preserved or enhanced the beneficiary's interest in the trust; and the federal government or a state government." *Id.* at 810.

120. See 2A WILLIAM FRANKLIN FRATCHER, SCOTT ON TRUSTS § 153, at 130-46 (4th ed. 1987).

121. See *In re Goff*, 706 F.2d at 581-86; see also Wohl, *supra* note 11, at 12-24.

122. See Heitkamp v. Dyke (*In re Dyke*), 943 F.2d 1435, 1444 (5th Cir. 1991); Reed v. Drummond (*In re Reed*), 951 F.2d 1046, 1049 (9th Cir. 1991); Lichstrahl v. Bankers Trust (*In re Lichstrahl*), 750 F.2d 1488, 1490 (11th Cir. 1985); Samore v. Graham (*In re Graham*), 726 F.2d 1268, 1271 (8th Cir. 1984).

plans, are covered by ERISA but are nonetheless established both by and for the participant-beneficiary. Such self-settled trusts are generally not recognized as valid under state spendthrift trust law.<sup>123</sup> In other cases, the court denied spendthrift trust status because the participant's access to amounts held in trust violated state law standards for spendthrift treatment.<sup>124</sup>

If the linchpin of spendthrift treatment is the inaccessibility of the trust principal to the participant-beneficiary, few if any pension trusts are likely to satisfy any state spendthrift law standard. Neither ERISA nor the tax qualification rules governing both defined contribution plan pension trusts (which hold an account balance to be paid out to the beneficiary either as an annuity or a lump sum of cash) and defined benefit plan trusts (which provide for benefits in the form of an annuity but may under some circumstances be cashed out as a lump sum), completely prevent a participant from reaching amounts held in the trust before retirement.<sup>125</sup>

The second line of reasoning generally took a "plain meaning" approach to Bankruptcy Code § 541(c), and held that the phrase "applicable nonbankruptcy law" was not limited to state law, but rather included any state or federal law restricting alienability. These courts interpreted ERISA § 206(d)(1) and I.R.C. § 401(a)(13) as sufficient restraints on alienation of employee benefit trust amounts (without inquiring into whether the participant had any actual access to those amounts before retirement) to warrant excluding trusts governed by those provisions from bankruptcy estates under § 541(c).<sup>126</sup> It was the conflict between these two lines of reasoning that led the Supreme Court to hear *Patterson v. Shumate*, framing the issue almost solely as one of statutory interpretation, with little examination of the purposes of the statutes at issue.<sup>127</sup>

These two lines of interpretation, however, do not represent the only issues facing courts dealing with various types of retirement plans in personal bankruptcy cases. First, there were a broad range of cases involving plans or trusts not governed by ERISA, or by the I.R.C.'s anti-alienation provision, such as individual retirement accounts, or governmental pension plans.<sup>128</sup> Second, courts addressing state law protection of pension trusts had to address the question of preemption by ERISA of state laws protecting pension trusts, and the resulting complete exposure of pension plans to the claims of creditors, unprotected by either the Bankruptcy Code's § 541(c) or state statutes enacted specifically to protect them.<sup>129</sup>

Some courts holding that pension plans were included in the bankruptcy estate because ERISA's anti-alienation provision was not "applicable non-bankruptcy

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123. See *In re Goff*, 706 F.2d at 587-88.

124. See cases cited *supra* note 122.

125. See *infra* discussion at Part III.C.2.

126. See *Velis v. Kardanis*, 949 F.2d 78, 83 (3d Cir. 1991); *Anderson v. Raine (In re Moore)*, 907 F.2d 1476, 1477 (4th Cir. 1990).

127. 504 U.S. 753 (1992).

128. See e.g., *In re Snyder*, 206 B.R. 347 (Bankr. M.D. Pa. 1996); *In re Van Nostrand*, 183 B.R. 82 (Bankr. D.N.J. 1995).

129. See *Starkey v. Daily (In re Starkey)*, 116 B.R. 259, 263-64 (Bankr. D. Colo. 1990); *Gaines v. Nelson (In re Gaines)*, 121 B.R. 1015, 1023-24 (W.D. Mo. 1990).

law” consequently wrestled with the question of whether debtors were nonetheless entitled to an exemption under Bankruptcy Code § 522(b)(2)(A), and in some cases ruled that they were not.<sup>130</sup> State laws specifically exempting pension trusts or benefits from bankruptcy left open a host of issues of their own, including precise definitions of what types of accounts were excluded, to what extent, and even, in some cases, whether to include the proceeds of plans in the bankruptcy estate once those amounts were distributed out of the plan.<sup>131</sup>

None of these issues were addressed by the Supreme Court in *Patterson v. Shumate*, and it is thus not surprising that courts continue to struggle with many of them. More significant, however, is the lack of examination of the underlying assumptions of both the federal and state laws at issue: why should the tax and ERISA status of pension plans provide a basis for the treatment of such plans in bankruptcy? While ERISA’s anti-alienation provision bears a superficial resemblance to state spendthrift trust law which most likely was the origin of the Bankruptcy Code § 541(c) exclusion, the context of each body of law is quite different.

The historical development of spendthrift trust law has more to do with traditional protection of property rights than with deliberate policy choices to protect worker retirement trusts from employer improvidence that were the springboard for ERISA’s anti-alienation requirement. Nonetheless, this was the single issue on which the Supreme Court based its exclusion of all pension trusts covered by ERISA and the I.R.C. from bankruptcy estates generally.

#### B. *Patterson v. Shumate: The Problem in a Nutshell*

The Supreme Court’s decision in *Patterson v. Shumate*<sup>132</sup> addressed and resolved some of the conflict in the federal circuit courts as to how retirement trusts fit into the Bankruptcy Code’s exclusion provisions for trusts with enforceable anti-alienation provisions. Yet the *Patterson* decision settled very little, as the narrow frame of the argument over the proper application of § 541(c) of the Bankruptcy Code inevitably precluded consideration of the underlying question of whether, and how best, to protect debtors from impoverishment in old age.

It should be noted that the Supreme Court had signaled the importance it attached to ERISA’s anti-alienation provisions in a 1990 case, *Guidry v. Sheet Metal Workers National Pension Fund*,<sup>133</sup> in which the Court ruled (not in a bankruptcy setting) that the pension benefits of a union official who had embezzled funds from the union could not be attached by the union at the point of payment from the pension trust, based on ERISA § 206(d). The Court based

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130. See *Samore v. Graham (In re Graham)*, 726 F.2d 1268, 1274 (8th Cir. 1984) (holding that a debtor was not entitled to the exemption under Bankruptcy Code § 522(d)(10), because legislative history showed that Congress did not view ERISA as the type of “[f]ederal law” referred to in the statute).

131. See *Pollak & Hicks*, *supra* note 71, at 316-17 (discussing *In re Block*, Neb. Bkr. 86:258); see also discussion *infra* Part IV.D.

132. 504 U.S. 753 (1992).

133. 493 U.S. 365 (1990).

its ruling to some extent on the overall purpose of ERISA, which was assumed to be to insure a stream of income for retirees and their families.<sup>134</sup>

The decision in *Patterson* can be seen as consistent with *Guidry*, but the Court's opinion in *Patterson* was primarily centered on upholding a "plain meaning" approach to interpreting § 541(c) of the Bankruptcy Code.<sup>135</sup> The case involved the CEO of a company which sponsored a qualified pension plan in which the CEO, Joseph Shumate, was a participant, along with the company's 400 other employees.<sup>136</sup> The plan, as required by ERISA and the tax qualification rules, contained the obligatory anti-alienation provision.<sup>137</sup> When the corporation and Shumate filed for bankruptcy, converting eventually to Chapter 7 proceedings, Patterson, the trustee of Shumate's bankruptcy estate, attempted to reach Shumate's interest in the corporate pension plan.<sup>138</sup>

The district court, in the original case involving the corporation's bankruptcy trustee and the plan, held that the exclusion in Bankruptcy Code § 541(c)(2) for trusts containing a transfer restriction enforceable under applicable nonbankruptcy law, applied only to trusts protected under state spendthrift laws, and that the pension trust in question did not qualify as a spendthrift trust under applicable Virginia state law.<sup>139</sup> The Fourth Circuit reversed the lower court, consistent with its position taken in earlier cases that the plain meaning of this section of the Bankruptcy Code clearly encompassed ERISA as "applicable nonbankruptcy law."<sup>140</sup>

The Supreme Court in its *Patterson* decision upheld the Fourth Circuit, based primarily on a plain meaning reading of the Bankruptcy Code and ERISA.<sup>141</sup> There is nothing in the Bankruptcy Code that limits "applicable nonbankruptcy law" to any particular law or even state law in general; therefore, according to the Court, there is no reason not to interpret ERISA's anti-alienation provision as a restriction enforceable under applicable nonbankruptcy law.<sup>142</sup> In addition, the Court saw its decision as harmonizing pension and bankruptcy law by placing pension trust assets beyond the reach of creditors, based on the protection of the anti-alienation provision required by ERISA and generally respected under state law.<sup>143</sup>

The Court did not delve to any extent into the purposes of ERISA and tax qualification of pension plans beyond a general statement that the purpose of ERISA is to preserve pension income for the participant in retirement.<sup>144</sup> Yet

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134. *See id.* at 376.

135. *Patterson*, 504 U.S. at 757-59.

136. *See id.* at 755.

137. *See id.*

138. *See id.* at 755-56.

139. *See* *Creasy v. Coleman Furniture Corp.*, 83 B.R. 404, 406-09 (W.D. Va. 1988), *rev'd sub nom.* *Shumate v. Patterson*, 943 F.2d 362 (4th Cir. 1991), *aff'd*, 504 U.S. 753 (1992).

140. *Shumate v. Patterson*, 943 F.2d 362 (4th Cir. 1991), *aff'd*, 504 U.S. 753 (1992).

141. *See Patterson*, 504 U.S. at 757 ("In our view, the plain language of the Bankruptcy Code and ERISA is our determinant.").

142. *See id.* at 758-59.

143. *See id.* at 763-65.

144. *See id.* at 765.



preservation of the trust assets is only an indirect way of realizing the principal purpose of ERISA, which is to insure adequate pension income in retirement. The narrow focus of the *Patterson* decision on asset preservation thus obscures the larger point, which is that if an account does not guarantee true retirement income—that is, consumption during retirement in old age—its relationship with the overall retirement security scheme of ERISA is negligible at best.

By focusing on the anti-alienation requirement for ERISA trusts, the Court allowed this minor and largely undocumented addition to ERISA during its enactment in 1974 to become the basis for the preservation of virtually unlimited amounts held in pension trusts. This result runs directly counter to one of the other major goals of ERISA, which was to prevent abuse of the pension tax rules by wealthy individuals using pension funds simply as tax shelters.<sup>145</sup> The Supreme Court probably produced the right answer in *Patterson*, as § 206(d) of ERISA certainly appears to be enforceable nonbankruptcy law, but that result begs the more important question—*should* pension trusts be protected from creditors at all?

### C. Post-Shumate Confusion

The *Patterson* decision settled the question of whether tax-qualified pension plans governed by ERISA should be excluded from the bankruptcy estate, but the narrow focus on ERISA and I.R.C. anti-alienation rules as the sole basis for exclusion posed new questions while leaving unresolved several others. Among the most important questions are not only the appropriate treatment of retirement accounts not covered by ERISA, such as IRAs and Keogh plans, but also the effect of failure to meet the tax qualification rules while satisfying ERISA's procedural requirements.<sup>146</sup>

Courts in the post-*Patterson* era have also continued to struggle with application of state statutes which base protection of retirement accounts on the tax status of the account. While a pension plan governed by ERISA and qualified under the I.R.C. clearly cannot be reached by creditors under either federal or state statute, most state statutes also protect, in whole or in part, accounts qualified under various sections of the I.R.C.<sup>147</sup> As a result, courts are required to address the proper characterization of both ERISA and non-ERISA accounts based primarily on the tax characteristics of those accounts, rather than on the likelihood of funds held in the account supporting the debtor in retirement. In short, while *Patterson* closed the door on one area of debate in the treatment of pensions in bankruptcy, it left open a perhaps wider array of contentious issues, at the heart of which is the unresolved question of whether and how best to prevent an impoverished old age, even for debtors.

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145. See Thomas C. Woodruff, *The Goals of ERISA and the Impact of ERISA on Plan Participants*, in SPECIAL COMM. ON AGING, *supra* note 87, at 26, 42-43.

146. See *In re Harris*, 188 B.R. 444, 448 (Bankr. M.D. Fla. 1995), *aff'd*, 116 F.3d 1492 (11th Cir. 1997).

147. See *infra* Appendix A for a state-by-state description of these statutes.

III. WHEN THEORIES COLLIDE: DO BANKRUPTCY, ERISA,  
AND TAX CODE PRINCIPLES JUSTIFY SPECIAL TREATMENT  
FOR RETIREMENT TRUSTS?

The Supreme Court arrived at its conclusion that pension trusts governed by ERISA, and qualified under the I.R.C., should be excluded from the bankruptcy estate through a strict statutory interpretation of the bankruptcy, ERISA and tax statutes. The more interesting question, however, is whether such exclusion is consistent with either the underlying principles or policy goals of any of the three bodies of law.

For example, the anti-alienation requirements of ERISA and the I.R.C. are, without doubt, "applicable non-bankruptcy law," in light of *Patterson*. However, the property right basis for traditional anti-alienation principles underlying spendthrift trusts—that is, the preservation of the right of the trust settlor to place whatever limits he chooses on the use of his property placed in trust for another—is largely irrelevant in the pension trust context, where a strong argument can be made that the pension promise is funded with the worker's own earned but deferred wages.<sup>148</sup> Nonetheless, in both cases the anti-alienation provisions can have the effect of preserving trust assets for consumption at a later approved date. The policy question that needs to be addressed is whether these provisions in fact do result in pension trust assets actually being preserved for consumption in retirement, which might justify treating ERISA anti-alienation rules in the bankruptcy setting with the same respect given to similar spendthrift trust provisions.<sup>149</sup>

Similar questions arise with respect to state laws that protect only tax-qualified retirement accounts from creditors, because the tax-favored status of an account, especially outside the context of defined benefit qualified pension plans, is not a particularly reliable indicator of the account's connection to providing income support for the account-holder in retirement. Finally, the narrow focus on the Bankruptcy Code's respect for enforceable anti-alienation provisions has obstructed inquiry into the more important question of whether this application of § 541(c) allows abuse of bankruptcy protections by those who can afford to pay their creditors and provides a "fresh start" only to debtors who scarcely need one.

The larger question, of course, which has gone virtually unaddressed in the literature, is whether retirement trusts or accounts of any description should receive the heightened level of protection they are granted under bankruptcy law. Certainly, there is no suggestion that such protection should be reexamined in the 1998 conference agreement on bankruptcy reform legislation, given its essentially blanket protection for tax-favored retirement accounts.<sup>150</sup> This legislation is virtually certain to be revisited early in the 106th Congress, a

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148. See generally MUNNELL, *supra* note 21.

149. See discussion *infra* Part III.A-D.

150. See H.R. 3150, 105th Cong. (1998) (reported by the House-Senate Conference on Oct. 9, 1998).

prospect which provides an opportune moment to raise questions about the assumption that tax qualification of accounts intended for retirement is a sufficient basis for protection of those accounts against creditors, and, indeed, about the rationale for the heightened protection provided for retirement savings, as contrasted with other types of savings.

#### *A. Protecting Retirement Under the Bankruptcy Code*

The Bankruptcy Code is the product of centuries of trust and debtor-creditor law which attempts to simultaneously protect three sets of interests: first, the interests of the creditor, by making at least a substantial portion of the debtor's property available for payment of liabilities; second, the interests of the debtor, by preserving certain assets necessary to provide a "fresh start" so that the debtor's future ability to earn and accumulate is not permanently stunted by a past episode of indebtedness and bankruptcy; and finally, the interests of both the debtor and the state, by preserving at least a minimal income stream for the debtor that will prevent destitution and the need for state support of the debtor and her family. Thus, the statute forces the debtor to include virtually all property interests in the bankruptcy estate in order satisfy creditors' claims, but, at least in theory, cuts off those creditors' claims short of reaching earnings and assets realized after the filing of the Chapter 7 bankruptcy proceeding in order to provide a "fresh start."<sup>151</sup> If assets or rights to income are included in the bankruptcy estate, the exemption provisions protect certain categories of rights to the extent reasonably necessary for income maintenance.<sup>152</sup>

Even though the 1978 bankruptcy legislation was intended to eliminate much of the factual and theoretical inquiry that courts had previously been required to undertake in determining which property of a debtor to exempt from creditors' claims, courts have continued to engage in such an inquiry with respect to retirement trusts, which seem to elude clear characterization under the federal exemption statute, particularly IRAs.<sup>153</sup> Upon close examination, the separate threads of the theoretical basis for the Bankruptcy Code's exemption structure—the fresh start principle, protection of assets rather than income, and payment of creditors to the extent the debtor can afford—appear to provide little

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151. *Andrews v. Riggs Nat'l Bank (In Re Andrews)*, 80 F.3d 906, 910 (4th Cir. 1996) (holding that the Bankruptcy Code leaves the bankrupt free after the filing of a bankruptcy petition "to accumulate new wealth so that he might make a fresh start following a bankruptcy").

152. *Compare, e.g.*, 11 U.S.C.A. § 522(d)(1) (West Supp. 1998) (exempting interest in a residence only up to \$15,000 in value), *with* § 522(d)(10)(B) (exempting the debtor's right to receive a veterans' benefit), *and* § 522(d)(10)(E) (exempting payments under pension and similar plans to the extent reasonably necessary for support).

153. *See In Re Barshak*, 106 F.3d 501 (3d Cir. 1997); *Meehan v. Wallace (In Re Meehan)*, 102 F.3d 1209 (11th Cir. 1997); *Eisenberg v. Houck (In Re Houck)*, 181 B.R. 187 (Bankr. E.D. Pa. 1995). In addition, because more than half of the states have exercised the "opt-out" choice and chosen to apply their own state exemption statutes, courts in many respects have had to continue the same type of inquiry required before the Bankruptcy Reform Act was passed. *See* discussion *infra* Part IV.D.

direct support for a blanket exemption of retirement trusts, at least before the debtor retires.

### I. Basic Principles: Trusts, "Fresh Starts," and Protection of Basic Needs

Federal and state bankruptcy laws rely on two approaches for protecting debtor assets from creditors: *exclusion* of an item from the bankruptcy estate, which places it beyond the reach of creditors and outside the jurisdiction of the bankruptcy trustee, and, to a much lesser extent, *partial or complete exemption* of an item from the claims of creditors even though it is technically included in the bankruptcy estate.<sup>154</sup> The terms "exclusion" and "exemption" are used interchangeably in much of the bankruptcy literature, and both are generally understood as furthering the basic goal of the bankruptcy laws, that is, to give the bankrupt debtor a "fresh start" by tempering the harsh results of unrestricted enforcement of the debtor-creditor contract.<sup>155</sup> The fresh start theory is the principal basis for limitations on the creditor's ability to take all of the debtor's assets. The theory is premised on the desirability of giving the debtor a new start in economic life after bankruptcy by eliminating a creditor's ability to continue to pursue future assets or income of the debtor to satisfy a claim once that claim is included in the bankruptcy proceeding.<sup>156</sup>

It is possible, however, to discern an additional principle, distinguishable from the "fresh start" rationale, at work in most federal and state exemption provisions, particularly in partial exemption clauses which protect property only up to a certain level of income. One way to think about this principle is as an "income maintenance" approach, the goal of which is to leave the debtor with enough income to sustain a reasonable standard of living but allow creditors to take the rest.<sup>157</sup> The fresh start rationale is distinguishable from the income maintenance perspective in that giving the debtor a fresh start requires that there be no income or asset limit on the debtor's ability to accumulate—once the bankruptcy proceeding is complete, the fresh start principle implicitly encourages unlimited earnings and accumulation. A goal of income maintenance, on the other hand, implies a kind of social welfare theory, under which income only up to a

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154. See 11 U.S.C. § 541(b) (1994); 11 U.S.C.A. § 522(d).

155. See, e.g., Lawrence Ponoroff & F. Stephen Knippenberg, *Debtors Who Convert Their Assets on the Eve of Bankruptcy: Villains or Victims of the Fresh Start?*, 70 N.Y.U. L. REV. 235, 236 n.1 (1995).

156. See, e.g., *Burlingham v. Crouse*, 228 U.S. 459, 473 (1913) (holding that the dual purpose of the Bankruptcy Act is to distribute the assets of the estate to the creditors while exemptions from the estate allow the debtor a fresh start). See generally William T. Bodoh & Michelle M. Morgan, *Inequality Among Creditors: The Unconstitutional Use of Successor Liability to Create a New Class of Priority Claimants*, 4 AM. BANKR. INST. L. REV. 325 (1996).

157. What I am calling the "income maintenance" purpose may usually be regarded by bankruptcy specialists as part of the "fresh start" goal; I have drawn a distinction here that may not be generally recognized in the bankruptcy literature. Nonetheless, I believe this distinction is useful in determining what purposes are served by preserving sources of *retirement* income, either in whole or in part, given the special problems of dealing with amounts saved for a retirement that may not occur for 10 or 20 years after the bankruptcy proceeding is over.

“reasonable” level should be preserved from creditors. Such an approach requires both setting the level of income needed, and then protecting only the portion of an asset or benefit payment not in excess of that level, thus affecting the debtor’s income for the indefinite future outside the bankruptcy proceeding.

The contradictions in the bankruptcy approaches to retirement trusts arise out of the divergent results of the fresh start and the income maintenance principles. Statutory protections that *exclude* assets from the reach of creditors altogether allow debtors to shelter amounts that will provide income far in excess of amounts reasonably necessary for income maintenance in retirement. On the other hand, while broad application of the income maintenance goal might suggest a need to prevent “excessive” accumulations above the level of reasonable support, the prospect of continued monitoring of debtor assets and income beyond the bankruptcy proceeding, particularly where the actual consumption is slated to occur years in the future as is frequently the case with retirement trusts, would appear to violate the fresh start principle.<sup>158</sup>

## 2. Protecting Trust Property Interests

The definition of the bankruptcy estate contained in § 541 of the Bankruptcy Code, while deliberately expansive and inclusive of all “legal or equitable” interests of the debtor, nonetheless incorporates the principle of debtor fresh start in the few types of interests excluded from the bankruptcy estate.<sup>159</sup> The principal general exclusion applies to interests in trusts that are subject to transfer restrictions that are enforceable under applicable nonbankruptcy law.<sup>160</sup> This provision was apparently intended to effectively override any private restrictions on the transfer of property that would thwart the general purpose of the Act if triggered by insolvency or bankruptcy, but at the same time preserve spendthrift trust transfer restrictions that are recognized under nonbankruptcy law.<sup>161</sup>

Protection of only those trusts with restraints on alienation that are recognized under state law of course preserved a substantial body of existing state case law as well as statutory authority, but more than preservation of precedent was achieved by allowing this exclusion. In essence, exclusion from the bankruptcy estate has traditionally been a recognition of a property interest that remains unimpaired and undiminished by the fact of bankruptcy or the existence of

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158. While the Bankruptcy Code anticipates possible continuing attachment of payments made to a debtor after the bankruptcy proceeding is concluded, those payments must be related to earnings or payments for services performed before the date of the bankruptcy proceeding. See 11 U.S.C. § 541(a)(6). The validity of applying this clause to payments from pension trusts, therefore, can depend on whether those payments are viewed as substitutes for earnings at the time of receipt, that is, after the bankruptcy proceeding, or alternatively, as relating to earnings for services performed prior to the bankruptcy. See *infra* text accompanying notes 232-36.

159. See 11 U.S.C. § 541.

160. See *id.* § 541(c)(1)-(2).

161. See H.R. REP. NO. 95-595, at 369 (1977), reprinted in 1978 U.S.C.C.A.N. 5963, 6325.

creditors.<sup>162</sup> Because the bankruptcy trustee and court system have no access to trusts thus excluded, there is no limit on the amount of property that is placed beyond the reach of creditors as a result of the exclusion.

Thus, public policy supportive of an active credit-financed economy dictates that the creditor attempting to collect a debt should have a right to as much of the debtor's assets and income as are freely available for the debtor to dispose of at the time the liabilities are being settled in the context of the bankruptcy proceeding.<sup>163</sup> Nonetheless, because inalienable interests are not freely available to the debtor, it is consistent to remove them from the creditors' reach. Spendthrift trusts, the apparent focus of congressional attention in this provision, are designed to take control over trust assets out of the beneficiary's hands, as well as to insulate trust assets from the claims of creditors, to prevent wasting of trust assets before the time and manner of desired distribution.<sup>164</sup> Interests in a spendthrift trust, therefore, are theoretically unavailable to the debtor either to waste or to pay creditors' claims as even the beneficiary has no unfettered right to dispose of the amounts in the trust. In essence, such funds are not wholly the property of the debtor and thus may reasonably be excluded from the bankruptcy estate.<sup>165</sup>

### 3. Fresh Starts and Adequate Incomes

Separate and apart from the distinctions in rights to property that may provide a theoretical basis for at least some exclusions from the bankruptcy estate, the Bankruptcy Code also attempts to further specific policy goals with respect to debtors in bankruptcy. The first is to give debtors a fresh start in economic life by cutting off creditors' access to future earnings (that is, those realized after the commencement of the bankruptcy proceedings) and any other interests that serve as a substitute for future earnings.<sup>166</sup> The second, closely related to the fresh start principle, is to ensure that the debtor is left, after the creditors' claims have been

162. See Daniel Spitzer, Comment, *Contra Goff: Of Retirement Trusts and Bankruptcy Code § 541(C)(2)*, 32 UCLA L. REV. 1266, 1269 (1985).

163. See *id.* at 1284-85; see also Wohl, *supra* note 11, at 7-12. See generally LoPucki, *supra* note 7.

164. See 2A FRATCHER, *supra* note 120, § 151, at 82-84.

165. But see H.R. DOC. NO. 93-137, pt. I, at 17; *id.* pt. II, at 147-48, 151 n.10 (1973) (noting the Bankruptcy Review Commission recommendation that the bankruptcy trustee have access to spendthrift trusts beyond what is necessary for support of the debtor).

166. See Wohl, *supra* note 11, at 7-9. See also *Local Loan Co. v. Hunt*, 292 U.S. 234, 244 (1934), stating in dicta that

[o]ne of the primary purposes of the bankruptcy act is to "relieve the honest debtor from the weight of oppressive indebtedness and permit him to start afresh free from the obligations and responsibilities consequent upon business misfortunes" . . . in that it gives to the honest but unfortunate debtor who surrenders for distribution the property which he owns *at the time of bankruptcy*, a new opportunity in life and a clear field for future effort, unhampered by the pressure and discouragement of pre-existing debt.

*Id.* (emphasis in original) (quoting *Williams v. United States Fidelity & Guar. Co.*, 236 U.S. 549, 554-55).

satisfied, with the minimum income necessary for support—an “income maintenance” approach.<sup>167</sup>

The fresh start principle is a longstanding tenet of bankruptcy law, which prior to the Bankruptcy Act of 1978 was reflected in judicial opinions concerning the types of assets to exclude from the bankruptcy estate.<sup>168</sup> Giving the debtor a fresh start implies closure of the episode of bankruptcy: once the door on the bankruptcy proceeding has shut, the debtor sheds the identity of bankrupt and can begin her economic life over again without continuing claims on earnings or accumulation of assets occurring after the bankruptcy. In applying the fresh start principle to interests in pension trusts, courts have characterized pensions as substitutes for future wages, which justifies exempting pension funds in their entirety in order to prevent a cloud of pre-bankruptcy debt from lingering over what would, in the absence of retirement, be income from wages rather than from a pension.<sup>169</sup>

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167. See H.R. REP. NO. 95-595, at 126 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6087.

The historical purpose of these exemption laws has been to protect a debtor from his creditors, to provide him with the basic necessities of life so that even if his creditors levy on all of his nonexempt property, the debtor will not be left destitute and a public charge. . . . [The bill] adopts the position that there is a Federal interest in seeing that a debtor that goes through bankruptcy comes out with adequate possessions to begin his fresh start.

*Id.*

168. See *Lines v. Frederick*, 400 U.S. 18, 19-20 (1970); *Local Loan Co.*, 292 U.S. at 244 (1934); *Burlingham v. Crouse*, 228 U.S. 459, 473 (1913); see also S. Rep. No. 95-989, at 83 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5868.

[Section 541(a)(1)] has the effect of overruling *Lockwood v. Exchange Bank*, 190 U.S. 294 (1903), because it includes as property of the estate all property of the debtor, even that needed for a fresh start. After the property comes into the estate, then the debtor is permitted to exempt it under proposed 11 U.S.C. [§] 522, and the court will have jurisdiction to determine what property may be exempted and what remains as property of the estate.

*Id.*

169. See, e.g., *Turpin v. Wentle (In re Turpin)* 644 F.2d 472 (5th Cir. 1981).

[A]warding the bankrupt's retirement benefits to the trustee [in bankruptcy] would deprive the bankrupt of a genuine fresh start not because of the bankrupt's immediate need for the funds but because to recognize the trustee's claim against the funds would leave a cloud of pre-bankruptcy debt hanging over the bankrupt's future. Providing the bankrupt with a “fresh start” means assuring him that assets to which he may become entitled *in the future* will be acquired free of any prebankruptcy obligations. Future wages may not be garnished to pay those obligations and pension benefits received in the future, even though they may be the product of pre-bankruptcy contributions to a pension fund, are a substitute for future wages and thus pass to the bankrupt free of the claims of pre-bankruptcy creditors.

*Id.* at 475 (emphasis added). Congress apparently agreed with this characterization of pension payments, stating in the report accompanying the 1978 Act that the exemptions under § 522(d)(10) applied to several types of interests, such as social security and veterans benefits, as well as pensions, that were “akin to future earnings of the debtor.” H.R. REP. NO. 95-595, at 362, *reprinted in* 1978 U.S.C.C.A.N. 5963, 6318.

However, the pension exemption section of the statute, § 522(d)(10)(E), does not give a blanket exemption to all amounts contained in the pension trust, but rather exempts only "[t]he debtor's right to receive . . . a payment under a . . . pension . . . plan . . . to the extent reasonably necessary for the support of the debtor and any dependent of the debtor."<sup>170</sup> The murkiness of this language has posed a variety of interpretive challenges for courts. First, because the exemption applies, not to the trust, but to "the right to receive" a payment, some courts have refused to exempt any part of a retirement trust from which debtors have not yet begun to receive payments because they have not yet reached retirement age.<sup>171</sup>

Second, if the language is interpreted to permit application of the exemption provisions to the corpus of the trust itself, or to a future right in addition to a present right to payment, the limitation of the exemption to the amount needed for a reasonable level of support requires courts to struggle with how to set that level where distribution of benefits is to take place several years in the future. In this connection, courts have been required to address issues of timing (i.e., what is currently exempted if payments have not yet begun) and valuation (i.e., is the exemption limited to the present value of a future right to receive and, if so, how is the exemption applied).<sup>172</sup> The difficulty in implementing such limits in pension trust cases, particularly if the debtor will not retire for several years, lies in determining what will be reasonably necessary for income maintenance at the point the debtor will begin to draw benefits from the trust.

Such issues might be resolved as a practical matter by determining how much of a pension trust or account to exempt based on the present values of the trust calculated according to actuarial assumptions concerning life expectancy, interest earnings of the trust, and an assumed retirement age for the debtor.<sup>173</sup> The

170. 11 U.S.C.A. § 522(d)(10)(E) (West Supp. 1998).

171. See *Velis v. Kardanis*, 949 F.2d 78, 82 (3d Cir. 1991); *Clark v. O'Neill* (*In re Clark*), 711 F.2d 21, 23 (3d Cir. 1983); *Bohm v. Brewer* (*In re Brewer*), 154 B.R. 209, 213 (Bankr. W.D. Pa. 1993); *In re Chick*, 135 B.R. 201, 203 (Bankr. D. Conn. 1991).

172. See *infra* Part IV.D for an analysis of the various federal district and appellate court opinions in this issue in connection with IRAs.

173. For an example of such an approach, see *Reitmeyer v. Gralka* (*In re Gralka*), 204 B.R. 184, 190-91 (Bankr. W.D. Pa. 1997).

Factors pertinent to a determination of reasonable necessity under § 522(d)(10)(E) are:

- (1) debtor's present and anticipated living expenses;
  - (2) debtor's present and anticipated income from all sources;
  - (3) the age of the debtor and his dependents;
  - (4) the health of the debtor and his dependents;
  - (5) debtor's ability to earn a living;
  - (6) debtor's job skills, training and education;
  - (7) debtor's other assets, including exempt assets;
  - (8) the liquidity of other assets;
  - (9) debtor's ability to save for retirement;
  - (10) the special needs of the debtor and his dependents; and
  - (11) debtor's continuing financial obligations, e.g., alimony or support payments.
- Several of these factors are pertinent in this case, none of which indicate that the debtors' right to receive payment from their IRAs are reasonably necessary for their support.



theoretical issues, however, are more troubling than the practical calculations required. If retirement trust amounts (both the contributions and the interest earnings thereon) are seen as a substitute for wages that would otherwise be earned in old age, then taking any part of those accumulations to pay claims of creditors constitutes an invasion of the future earnings of the debtor, something the "fresh start" is supposed to prevent. On the other hand, allowing the debtor to accumulate unlimited sums in the name of retirement clearly violates the policy principle expressed in the "to the extent reasonably necessary for the support" language of § 522.<sup>174</sup> The income maintenance goals of the Bankruptcy Act appear to be the paramount principle expressed by the exemptions contained in § 522(d)(10)(E), while the "fresh start" principle is more readily furthered through the clear-cut exclusion of assets from the bankruptcy estate under § 541(c)(2).

#### 4. Protecting Retirement Accounts: Neither Principle nor Policy

The proposed blanket exemption for tax-qualified retirement accounts, contained in the 1998 bankruptcy reform bill, appears to tip the balance of considerations strongly in favor of the fresh start over any limited income maintenance goal.<sup>175</sup> The limited exemptions of § 522(d)(10)(E) would continue to apply to non-tax-qualified pension assets and payments, but any debtor with a tax-favored plan, such as an IRA, would be able to use it to shelter unlimited sums from creditors.<sup>176</sup> However, even though this provision was titled "Reinforcing the Fresh Start," in the House version of H.R. 3150,<sup>177</sup> it is not at all clear that the complete protection of retirement assets in any way furthers the fresh start goal or, for that matter, is consistent with the property control notions underwriting spendthrift trusts, for several reasons.

First, if the point of giving debtors a fresh start is to allow them to reenter economic life as productive workers or investors, the need to insure a fresh start for retirees, who are by definition consumers rather than producers, is less than compelling. Second, because retirement assets are intended to be consumed in retirement, there is little or no connection (particularly for a worker with twenty or thirty years to go before retirement) between funds held in a retirement trust and reentry into current economic life. In addition, as discussed in more detail below, it is difficult to argue that amounts held in a pension trust represent a substitute for future earnings (particularly in the case of defined contribution plans) when under most economic analyses, those amounts represent deferred wages that have already been earned.<sup>178</sup>

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*Id.* at 190 (citation omitted).

174. 11 U.S.C.A. § 522(d)(10)(E).

175. See H.R. CONF. REP. NO 105-794, at 799 (1998).

176. See *id.*

177. H.R. 3150, 105th Cong. § 119 (1998).

178. See DAN M. MCGILL ET AL., FUNDAMENTALS OF PRIVATE PENSIONS 141-44 (7th ed. 1996).

Finally, there is the nagging question of whether it is appropriate to treat employee benefit trusts, from which the participant may well be able to take pre-retirement distributions, as valid spendthrift trusts. If the rationale for respecting spendthrift trusts rests on the inability of the beneficiary to reach the trust principal before the time set by the settlor, it is difficult to apply that rationale to most defined contribution trusts, and particularly to IRAs. If the rationale is protection of the property rights of the settlor, entitled to set whatever limits she chooses on when and how trust assets are to be dissipated, then pension trusts are a bad fit here as well, given the economic theory that pensions are deferred earned wages of the participant. The only workable rationale may simply be a policy of protecting amounts designated as retirement trusts, on the grounds that the debtor should be able to count on a financed retirement despite her debts. However, under that reasoning, there may be no reason to draw distinctions between tax-qualified and non-tax-qualified retirement trusts, or between ERISA and non-ERISA covered plans, in determining who should be protected and who should not.

It is thus not readily apparent that the policy goals of the bankruptcy statute, that is, providing a fresh start as well as adequate but not excessive levels of income from retirement plans, can be internally reconciled when applied to retirement trusts. The bankruptcy law's exclusion of the entire pension trust, so long as it is governed by the appropriate restraint on alienation, in essence requires the creditor to subsidize a more than adequate retirement for the debtor. This outcome is in direct contradiction of the limited income maintenance goals of the bankruptcy exemption provisions applicable to retirement income.

#### *B. ERISA—Regulation of Employers and Trusts*

ERISA was enacted in 1974 in response to a series of public scandals surrounding the management of pension funds, including employer bankruptcies that revealed the weaknesses of an unenforceable employer promise to pay employee pensions, and the practice of small employers to use pension trusts as a tax shelter that would eventually pay benefits only to the employer.<sup>179</sup> As a result, the focus of ERISA is on regulating the administration of plans, particularly in giving notice to employees of plan provisions and changes, and giving both employees and the Department of Labor the ability to sue plan administrators and sponsors for violations. Only the minimum vesting requirements—meant to force employers to actually pay at least some benefits to less than life-long employees—regulate any substantive aspect of pension plans. The question of limiting the use of pension plans as tax shelters was addressed to some extent in the tax changes enacted as part of ERISA.<sup>180</sup>

Section 206(d), the anti-alienation provision of ERISA, which is the focus of almost all bankruptcy decisions, was inserted along with the vesting provisions with virtually no discussion. It may be, as some commentators have pointed out, that the anti-alienation provision can be taken at face value—that it was intended

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179. See Gordon, *supra* note 87, at 15-17.

180. See *id.* at 6-25.

to insure that the promised benefits would be preserved until the worker's retirement and protected from creditors in the pre-retirement period.<sup>181</sup> However, it is important to remember the context in which ERISA was developed as a plan regulation statute, a context which has radically changed in the intervening twenty-five years.

In the 1970s, the dominant pension form was still the defined benefit pension plan, sponsored and financed by the employer, the hallmark of which was a guarantee of benefits paid in the form of an annuity by the employer to the employee.<sup>182</sup> ERISA was enacted primarily as regulation aimed at employers, not employees, because defined benefit plans generally require employers to pay benefits to employees out of a trust maintained and managed by the employer in its role as plan sponsor and trustee. The various instances of wrongdoing that eventually prompted the legislation were almost all connected with employer failure to make good on the pension promise.

Thus, for example, the case of the Studebaker pension plan, which was underfunded and therefore unable to pay promised benefits to workers who had decades of employment with the company, led (along with other such examples) to minimum funding requirements for defined benefit plans and to the establishment of the Pension Benefit Guaranty Corporation ("PBGC"), which insures at least partial payment of pensions from plans that are unable to pay their obligations and are covered by PBGC premiums.<sup>183</sup> The misappropriation and mismanagement by the Teamsters Union of funds in the Central States pension funds and many other smaller examples of employer mishandling of pension funds led to the notice requirements and procedures for employee and government suits against plan sponsors.<sup>184</sup> The lengthy employment requirements for receiving benefits—frequently as long as twenty continuous years and occasionally employment with the employer at the time of retirement—which prevented many long term workers from receiving any pension prompted the minimum vesting rules which generally limited such years of service requirements to ten years.<sup>185</sup>

The anti-alienation provisions of ERISA (both § 206(d) of ERISA and § 401(a)(13) of the I.R.C.) were contained in the section of the bill which established these minimum vesting requirements.<sup>186</sup> As mentioned above, there is little legislative history accompanying these provisions, and thus it is difficult to discern the precise reasoning of the statute's authors. However, the provisions are consistent with the vesting requirements in the defined benefit context, as they help to guarantee that pension funds under the control of the employer remain in the pension trust, inaccessible to any creditors, until the employee has retired and begun to receive benefits.

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181. See LANGBEIN & WOLK, *supra* note 10, at 143.

182. See DEPT. OF THE TREASURY, BLUEPRINTS FOR BASIC TAX REFORM 56-58 (1977). "Most pensions are . . . defined benefit-pensions." *Id.* at 56. See generally Gordon, *supra* note 87 (discussing reform suggestions in 1965 through 1974).

183. See Gordon, *supra* note 87, at 8-9, 16-17, 19.

184. See *id.* at 12 & n.39, 19.

185. See *id.* at 19, 23.

186. See *Joint Explanatory Statement of the Committee of Conference on ERISA*, in ERISA: SELECTED LEGISLATIVE HISTORY 1974-1986, at 1, 20 (1986).

It may be significant that the anti-alienation provisions were included as part of the vesting provisions designed to force employers to pay benefits rather than simply building up a pension fund that could eventually revert to the employer (instead of providing retirement benefits to the employees). In fact, nothing in ERISA required that pension funds in excess of the amounts required to pay current benefits be credited or distributed to employees at any point. Until legislation enacted during the mid-1980s made changes in the pension reversion rules, such funds were assumed to be entirely the employer's money available for reversion in case of termination of the pension plan.<sup>187</sup> So while economic theory argues that these funds are deferred wages already earned by the employee (under ERISA and the I.R.C. at the time of enactment of ERISA and for more than a decade afterward), the law considered (and still does to a large extent) pension trusts to be the employer's funds to the extent they exceeded amounts necessary to pay promised benefits.<sup>188</sup>

The anti-alienation provisions govern pension trusts both funded and maintained by the employer and apply only during the time that the employer has control over the funds—there is no provision in ERISA or the I.R.C. that preserves the employee's benefits from her creditors once those amounts are actually distributed from a pension fund to the employee.<sup>189</sup> Moreover, defined benefit plans normally do not allow distribution of funds prior to retirement, unless the employee ceases working for the employer and can be "cashed out" in a lump sum because her benefit is small enough.<sup>190</sup> Thus the anti-alienation provisions prevent the pension trust from paying over a beneficiary's benefits directly to a creditor under a garnishment or other required payment process, but they do not prevent creditors from reaching those sums once they are in the debtor's hands. Most importantly, since under the defined benefit structure the participant has extremely limited, if any, access to funds before retirement, the anti-alienation requirements can be viewed as simply reinforcing that lack of pre-retirement access. In this traditional, defined benefit retirement annuity context, the anti-alienation provisions make sense as part of the overall structure designed to insure the payment of annuity benefits at retirement.

The question to be considered now is whether the changing landscape of deferred compensation arrangements has diminished the role of anti-alienation provisions in protecting retirement annuity payments. Defined benefit plans comprise a smaller and smaller percentage of all employer-provided plans; taking

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187. See Daniel Fischel & John H. Langbein, *ERISA's Fundamental Contradiction: The Exclusive Benefit Rule*, 55 U. CHI. L. REV. 1105, 1149-52 (1988).

188. For a discussion of the prevailing economic view, and as a counter-theory, see generally DENNIS E. LOGUE, *LEGISLATIVE INFLUENCE ON CORPORATE PENSION PLANS* (1979).

189. See *Guidry v. Sheet Metal Workers National Pension Fund*, 10 F.3d 700 (10th Cir. 1993), *aff'd on reh'g*, 39 F.3d 1078 (10th Cir. 1994) (en banc), in which the funds protected in the Supreme Court's 1990 decision, see discussion *supra* notes 133-34, while they were still in the pension trust, were ruled not protected from garnishments under federal law as soon as they were distributed into the participant's bank account, although Colorado state law ultimately protected the amounts. See also *Trucking Employees of N. Jersey Welfare Fund, Inc. v. Colville*, 16 F.3d 52 (3d Cir. 1994).

190. See *McGILL & GRUBBS*, *supra* note 79, at 132-33.

their place are various types of defined contribution plans, such as § 401(k) cash or deferred arrangements, which provide much easier pre-retirement access, albeit at a penalty.<sup>191</sup> If the purpose of the anti-alienation rules was to help insure the payment of benefits at retirement by prohibiting plan administrators from paying the benefits out to creditors, it may not be appropriate to allow those provisions to insulate defined contribution accounts—which can easily be cashed out or borrowed against and used for nonretirement purposes—from legitimate claims of creditors.

A final major concern of legislators at the time ERISA was enacted was the ability of small business owners and managing executives of companies to use the tax-qualified pension structure as a tax shelter for themselves. These owners and executives could put virtually unlimited sums into a qualified pension plan that would (because of the fairly generous interpretations of the nondiscrimination rules by the Treasury) pay almost all of its benefits to them and little if anything to less highly paid employees.<sup>192</sup> The solution appeared to be placing limits on the amounts that could be contributed to a plan for any one employee—this approach was eventually embodied in the limits found within § 415 of the I.R.C., which must be observed as a prerequisite for tax qualification. While these limits are typically quite generous, the concern that led to their enactment also should be taken as an indication that ERISA was not intended to preserve unlimited sums for a participant's use in retirement—something that the current interpretation of the anti-alienation rules can easily produce.

### C. Tax Incentives for Retirement Trusts

Serious internal contradictions exist in federal tax law applicable to pension trusts and other tax-favored retirement savings arrangements. In general, the income tax provisions designed to encourage retirement savings are based on a "quid pro quo" theory that gives the taxpayer (or the taxpayer's employer) a current deduction for a limited amount of contributions to the trust and a tax-free build-up of earnings on amounts retained in the trust. In exchange the taxpayer must refrain from consuming the amounts in the trust until retirement.<sup>193</sup> Under the tax doctrines of constructive receipt and economic benefit, amounts set aside in such trusts would ordinarily be currently taxed to the employee, even though the employee will not receive the cash until later when it is distributed from the pension trust.<sup>194</sup> Nonetheless, if the trust is established and maintained in adherence to tax qualification rules, those doctrines are overridden and no amounts will be taxed until actually distributed from the trust.<sup>195</sup>

The rationale for this favorable tax treatment is that the foregone (or deferred) tax revenues are a social cost worth paying given the importance of encouraging

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191. I.R.C. § 401(k) (West Supp. 1998).

192. See Gordon, *supra* note 87, at 10.

193. See STAFF OF THE JOINT COMM. ON TAXATION, GENERAL EXPLANATION OF THE TAX REFORM ACT OF 1986, 99TH CONG. 624-32 (Joint Comm. Print 1987) [hereinafter 1986 GENERAL EXPLANATION].

194. See discussion *infra* at Part III.C.1.

195. See *infra* Part III.C.1.

reasonable provision for retirement. Such a rationale implies that delayed consumption in retirement is the sine qua non of true retirement trust arrangements. Despite the importance of deferring consumption in order to assure adequate retirement income, however, limits on the individual's pre-retirement access to amounts in most types of trusts are not absolute. First, because limitations on current access to amounts in the trust will discourage taxpayers from deferring current income into pension trusts at all, early withdrawals are frequently allowed before retirement, albeit penalized, for certain types of pension plans.<sup>196</sup> Moreover, the distribution penalties apply normally to payments made before age fifty-nine-and-a-half, a presumptive early retirement age that is unconnected to the actual condition of retirement; amounts distributed after that age will not be penalized, whether or not they are used to support the individual in retirement.<sup>197</sup>

Restricting current access to retirement savings in order to force a delay in consumption until retirement can also be seen as consistent with the bankruptcy law's protection of retirement savings against creditors, at least as part of an overall policy to allow debtors to assure themselves an adequate stream of income in old age. However, if debtors are allowed under the tax laws to consume retirement savings long before retirement, the rationale for protection in bankruptcy for plans qualified under the tax law collapses, even if such early consumption would subject the taxpayer to penalties and additional tax liability. Moreover, even if amounts set aside in tax-favored accounts of one sort or another are not subject to income tax currently, there is no reason to necessarily ignore these amounts for bankruptcy purposes. Economic income that might be used to satisfy creditor claims need not necessarily be passed over simply because it has not been recognized as income for tax retirement policy purposes.

Because the private employer-provided pension system is voluntary, employers are offered tax incentives to offer pension plans, in the form of the immediate deduction for pension contributions. Participants in the plan are not taxed on amounts set aside for them until retirement, so long as the plan complies with a set of complex qualification requirements.<sup>198</sup> Thus, the term "qualified" in this context accurately conveys the sense of a result following from certain actions—that is, if the employer's plan satisfies certain requirements, the plan will *qualify for* certain tax benefits. The I.R.C. qualification rules in general apply to trusts which are a part of a pension plan, and require compliance throughout the life of the plan with a variety of measures (nondiscriminatory benefits or contributions, vesting over a certain period of time, maximum funding levels, non-alienation of benefits or trust assets, distribution after retirement age, etc.)<sup>199</sup>

The scope of the I.R.C. tax qualification rules for pension plans is far too broad to be addressed in detail here. Moreover, most of the specific qualified plan requirements relate to objectives such as provision of some level of pension

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196. See *infra* Part IV.A.2.d.

197. See *infra* Part IV.A.2.d.

198. See I.R.C. § 404 (West Supp. 1998) (allowing a deduction to the employer in the year a contribution is made to a pension trust qualified under I.R.C. § 401).

199. See *generally* I.R.C. § 401(a) (West Supp. 1998).

benefits to low-paid as well as highly-paid employees, and limiting the tax benefits flowing to employers and highly paid employees, that in general attempt to encourage employers to establish employee pensions for workers at all income levels.<sup>200</sup> These objectives have little relation to either the "fresh start" or "reasonable support" principles and goals of the bankruptcy statutes protecting some portion of a debtor's assets in retirement.

However, several aspects of the tax qualification rules are particularly relevant to an effort to establish a coherent analytical framework for the treatment of retirement accounts under the bankruptcy statutes. First, the fundamental principles governing tax treatment of deferred compensation may not be consistent with or even relevant to the appropriate treatment of deferred compensation in bankruptcy. Second, the specific qualification rules restricting access to amounts accumulated in a participant's account until retirement, including prohibition of alienation of trust amounts, may be consistent with some but not all goals of the bankruptcy laws, and in any event may not be restrictive enough to justify wholesale protection of retirement trusts under all circumstances. Third, the ongoing regulatory function of the qualification rules as a whole must be understood as a process, rather than as an event, in order to understand the distinctions between the tax treatment of qualified pension and profit-sharing plans, and the tax treatment of non-qualified arrangements such as IRAs which nonetheless must satisfy specific I.R.C. requirements to achieve the desired tax result.

Finally, the distributional consequences of the qualified plan rules have direct implications for bankruptcy policy makers hoping to use the qualification rules as a short cut to determining which pension plans or trusts should be protected in bankruptcy. At a time when Congress is debating various means-testing mechanisms for Chapter 7 bankruptcy, in an effort to prevent those who can afford to pay their creditors from hiding behind the bankruptcy shield, it seems incongruous to provide a blanket exemption only for qualified plan assets which are most likely, because of the structure of tax incentives, to belong to those with higher income while they were working.

### 1. Constructive Receipt, Economic Benefit, and Tax Qualification

The general purpose of the qualification rules is to override the basic income tax doctrines of constructive receipt and economic benefit only for trusts established under benefit plans which meet the qualification requirements. Taxpayers using the cash method of accounting, as most individual wage-earning taxpayers do, must include all items of gross income in their income for tax

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200. See generally Nancy J. Altman, *Rethinking Retirement Income Policies: Nondiscrimination, Integration, and the Quest for Worker Security*, 42 TAX L. REV. 433 (1987); Bruce Wolk, *Discrimination Rules for Qualified Retirement Plans: Good Intentions Confront Economic Reality*, 70 VA. L. REV. 419 (1984).

purposes in the year in which it is "actually or constructively received."<sup>201</sup> Once income is credited to a taxpayer's account or set apart for him so that he may draw on it without any substantial restrictions, the taxpayer will be considered, under long-standing tax principles, to have constructively received the income.<sup>202</sup> An unsecured promise to pay, such as in a nonqualified deferred compensation arrangement in which the employer agrees with the employee, prior to the performance of the services for which the employee is being paid, to defer those payments until some point in the future, will not trigger the constructive receipt rules.<sup>203</sup>

The concept of economic benefit is a related income tax doctrine, probably first expressed in the case requiring an inquiry into whether any arrangement, such as establishment of a trust in an employee's name and transfer of funds to it, results in treatment of any economic or financial benefit being conferred on the employee as current compensation.<sup>204</sup> However, current tax consequences from the establishment of such trusts can be avoided if the beneficiary of the trust runs a substantial and real risk of forfeiting the amounts in the trust during the entire period before receipt of the cash—this treatment is provided under § 83 of the I.R.C. Thus, for example, if an employee is required to perform services for a specific period and will forfeit the amounts or property held in the trust if she terminates employment before the end of that period, she will not be deemed to have taxable income from the property until the period is up.<sup>205</sup>

Both the constructive receipt and economic benefit doctrines are implicated in the tax treatment of qualified pension plans, in that compliance with the qualification rules is generally the price for a statutory override of both doctrines. Without this statutory override, employee benefit trust contributions and investment income would be current taxable income to employees, whereas under the qualified plan structure, taxability of amounts held in the trust is delayed until

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201. Treas. Reg. § 1.451-1(a) (as amended in 1993) ("Gains, profits, and income are to be included in gross income for the taxable year in which they are actually or constructively received by the taxpayer unless includible for a different year in accordance with the taxpayer's method of accounting."); see also Treas. Reg. § 1.446-1(c)(1)(i) (as amended in 1997) ("[U]nder the cash receipts and disbursements method in the computation of taxable income, all items which constitute gross income (whether in the form of cash, property, or services) are to be included for the taxable year in which actually or constructively received.") (parenthetical in original).

202. See Treas. Reg. § 1.451-2(a) (as amended in 1979).

Income although not actually reduced to a taxpayer's possession is constructively received by him in the taxable year during which it is credited to his account or set apart for him so that he may draw upon it at any time. However, income is not constructively received if the taxpayer's control of its receipt is subject to substantial limitations or restrictions.

*Id.* This regulation "accords with prior regulations extending back to, and including, Article 53 of Regulations 45 under the Revenue Act of 1918." Rev. Rul. 60-31, 1960-1 C.B. 174, 178.

203. See *Minor v. United States*, 772 F.2d 1472, 1474 (9th Cir. 1985); Rev. Proc. 92-65, 1992-2 C.B. 428; Rev. Rul. 60-31, 1960-1 C.B. 174.

204. See *E.T. Sproull v. Commissioner*, 16 T.C. 244, 247, *aff'd*, 194 F.2d 541 (6th Cir. 1952); see also Rev. Rul. 60-31, 1960-1 C.B. 174, 179-80 (discussing Situation 4).

205. See I.R.C. § 83(a), (c) (1994); Treas. Reg. § 1.83-3(a)(3) (1985).



they are actually distributed to the beneficiary. Nonqualified deferred compensation arrangements, such as executive stock option plans and other deferral plans, avoid current taxation to the employee only because the employee is considered to have a substantial risk of forfeiting the amounts held in the trust, or, in the arrangements known as "rabbi trusts," the amounts in the trust are subject to the claims of the employer's creditors and therefore are considered to still be the property of the employer.<sup>206</sup>

Nonetheless, the tax result obtained by plan qualification—treatment of compensation as if it were not current income to the employee—does not necessarily alter the character of amounts set aside in plan trusts: those amounts are still current compensation to the employee for services rendered. The qualified plan rules at their core simply set the timing of inclusion in the tax base of those amounts (ideally, after the employee's retirement) and of the deduction taken by the employer for the contribution to the trust (ideally, in the year the contribution is made to the trust), as part of the bargain intended to insure retirement income security for the worker.<sup>207</sup>

The qualification rules generally do not, as discussed below, actually restrict access of employees to amounts in the trust until retirement (much less require them to actually use the amounts for retirement income support).<sup>208</sup> The suspension of the constructive receipt principle is compromised, to one extent or another, by the ability of beneficiaries under the most common types of plans to take distributions from the trust prior to retirement. For example, profit-sharing plan participants may take distributions after any set period of at least two years of employment.<sup>209</sup> Even the distribution requirements of § 401(k) plans which disqualify a plan that allows premature distributions nonetheless allow penalty-free distributions after age fifty-nine-and-a-half.<sup>210</sup> To the extent an employee can take a distribution, she can be said to have a current right to those amounts, and thus to have constructively received all amounts held in the trust. Nonetheless, so long as the plan continues to be qualified, the constructive receipt principle is not applied to amounts not distributed, even though they are theoretically "available" to the beneficiary.

## 2. Restrictions on Access: Delay of Consumption and Anti-Alienation

The tax qualification rules contain two types of restrictions on access to and use of pension funds: restrictions on the timing of distribution of funds from the trust, and a requirement that the trust contain restrictions on alienation of amounts held. First, most of the I.R.C. provisions addressing the consequences and timing of distribution of benefits from pension plans apply penalties for distributions prior

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206. See generally *Minor v. United States*, 772 F.2d 1472 (9th Cir. 1985); Rev. Proc. 92-64, 1992-2 C.B. 422; Rev. Rul. 60-31, 1960-1 C.B. 174.

207. See MUNNELL, *supra* note 21, at 35-39.

208. See *infra* text accompanying notes 211-15.

209. See Treas. Reg. § 1.401-1(b)(1)(ii) (1963); Rev. Rul. 71-295, 1971-2 C.B. 184; Rev. Rul. 73-553, 1973-2 C.B. 130.

210. I.R.C. § 401(k) (West Supp. 1998).

to retirement, but do not actually prohibit such distributions. One exception is a long-standing regulation under I.R.C. § 401(a) which governs the qualification requirements for employee benefit plans, requires *pension* plans, *but not* profit-sharing plans, to provide benefits to participants in the plan over a period of years after retirement, in order to qualify under the I.R.C.<sup>211</sup> Apart from this regulatory interpretation of the *intent* of the statute, however, there are no specific qualification rules in the I.R.C. that require delay of consumption of amounts deferred in the pension trust to either the age or the actual condition of retirement, at least for traditional profit-sharing or pension plans.

Moreover, the separate qualification rules applicable to profit-sharing plans with a cash or deferred arrangement feature, popularly known as "401(k)" plans, specifically provide that premature distributions from such plans (i.e., before age fifty-nine-and-a-half, termination of employment, disability, etc.) will disqualify the plan.<sup>212</sup> The only exception to these rules is in the case of hardship demonstrated by the employee to the trustee of the plan, and even then the distributable amount is limited to the employee's accumulated elective contributions to the plan.<sup>213</sup> These "cash or deferred arrangements" bear a closer resemblance to savings accounts than to traditional pension plans, since they consist of separate accounts for each employee, in which deferred salary amounts chosen by the employee, as well as any employer matching contributions and investment earnings on all amounts held in the account, accumulate. The temptation to withdraw these amounts prior to retirement is correspondingly more difficult for employees with pressing financial needs to ignore, and more stringent restrictions on distributions apparently seemed appropriate to Congress in order to reinforce the non-discrimination rules for these plans.<sup>214</sup>

211. Compare Treas. Reg. § 1.401-1(b)(1)(i) (as amended in 1976) ("A pension plan within the meaning of section 401(a) is a plan established and maintained by an employer primarily to provide systematically for the payment of definitely determinable benefits to his employees over a period of years, usually for life, after retirement."), with Treas. Reg. § 1.401-1(b)(1)(ii):

A profit-sharing plan is a plan established and maintained by an employer to provide for the participation in his profits by his employees or their beneficiaries. The plan must provide . . . for distributing the funds accumulated under the plan after a fixed number of years, the attainment of a stated age, or upon the prior occurrence of some event such as layoff, illness, disability, retirement, death, or severance of employment.

*Id.*, and Rev. Rul. 74-254, 1974-1 C.B. 91 (money purchase plan ruled not to be a qualified pension plan because it permitted distributions to be made to employees prior to the normal retirement age or termination of employment), and Rev. Rul. 71-224, 1971-1 C.B. 124 (profit-sharing plan did not fail to qualify because it allowed employees to withdraw vested account balance in case of hardship).

212. I.R.C. § 401(k)(2)(B). The same disqualification attaches to premature distributions from tax-deferred annuities under § 403(b). See *id.* § 403(b)(11)(A) (West Supp. 1998).

213. See *id.* § 401(k)(2)(B)(i)(IV).

214. The statutory qualification rules dealing with distribution of benefits from a defined benefit pension plan, or of amounts set aside for an employee's account in a defined contribution plan, do set limits on the *latest* date on which distribution of benefits must begin and on the form in which benefits must be distributed. See *id.* § 401(a)(9), (a)(14). The mechanism used to discourage distributions under both profit-sharing plans and defined benefit pension plans is the special tax treatment applied to the recipient of such distributions under

The anti-alienation provision in the I.R.C., § 401(a)(13), was, as previously discussed, added as part of ERISA in 1974 as part and parcel with the new minimum vesting rules. While a strong anti-alienation rule clearly helps to insure that the employee's creditors cannot reach amounts held in the trust, this provision can also be looked at in another way, when examined in light of the defined benefit context of ERISA.

The exclusive benefit rule, discussed briefly above,<sup>215</sup> was the original expression of the theory that amounts in a trust can be non-taxable to the employee-beneficiary and at the same time deductible to the employer-settlor, only if the trust itself is not susceptible to use for current cash or security purposes by the employer. The anti-alienation rules apply to the employer and trustee as well, prohibiting, on pain of disqualification from beneficial tax status, any assignment or alienation of benefits, not simply the beneficiary's assignment or alienation. Thus, these rules can be seen as both insurance that the benefits will be available to support the beneficiary's retirement, instead of going directly from the trust to pay his current debts, *and* as reinforcement of the exclusive benefit rule, placing restrictions on the employer's use of amounts held in the trust for anything but payments to the beneficiaries.

This kind of restriction is consistent with a defined benefit structure in which the employer will be making annuity payments directly to the employee. By definition, those annuity payments are available only at retirement age and are paid in a form conducive almost exclusively to provision of current consumption in retirement. The drafters of ERISA most likely did not, however, envision the current use of such alienation restrictions to preserve large amounts of cash in an individual account that is available for loans or early distributions to satisfy consumption needs long before retirement.

### 3. Plan Qualification—Process, Not Event

Qualification of a pension plan under the I.R.C. is an ongoing process, subject to constant modification and examination, rather than an event which permanently establishes the character of both a plan and the amounts held in trust under a plan. Most of the qualification rules require plan administrators to test their plans each year or periodically to determine whether the plan in operation—for example, participation by low-paid and high-paid employees—continues to meet the

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I.R.C. § 72(t) which apply, in general, unless distribution is delayed until after the employee reaches age fifty-nine-and-a-half, becomes disabled, or dies. I.R.C. § 72(t)(1) applies an additional 10% income tax on all distributions from qualified retirement plans; § 72(t)(2) exempts from that additional tax distributions which are made on or after the employee's attainment of age fifty-nine-and-a-half, death, disability, or termination of employment after age fifty-five. *See id.* § 72(t) (West Supp. 1998). This emphasis is consistent with the Code's underlying purpose of limiting the extent of the tax subsidy provided to highly paid employees, who in the absence of a requirement to actually consume amounts held in a retirement trust might be more likely to pass on the trust assets to their heirs than would lower paid employees who are more likely to need to consume those amounts to survive in old age.

215. *See supra* text accompanying notes 97-98.

qualification requirements.<sup>216</sup> Thus, a plan may be qualified one year, disqualified the next and then re-qualified after corrective measures have been taken.

This ongoing regulatory function of the qualification rules of the I.R.C. stands in contrast to most income tax requirements which must be satisfied at the moment a transaction takes place, or which permanently characterize an item of income or expenditure at the moment it is realized or made. As is discussed in more detail below, the qualified plan regulatory scheme can be sharply distinguished from the requirements for IRAs set out in § 408 of the Code, which are structured (with one or two exceptions) around requirements pertaining to trust language, rather than trust operation, and under which IRAs can lose their tax status only under specific, relatively extreme circumstances.<sup>217</sup>

The difficulty the qualification process poses in the bankruptcy context is created by the "snapshot" nature of the Chapter 7 bankruptcy filing, in contrast to the year by year tax qualification process. First, just because a plan is initially qualified, and has, for example, a determination letter to that effect from the Internal Revenue Service ("IRS"), does not mean that it is still qualified at the time the debtor files for bankruptcy. Moreover, because the IRS does not (and cannot possibly) audit every plan every year carefully for violations of the qualified plan rules, there is likely to be no timely judgment by the IRS as to a plan's status at the moment of the bankruptcy filing. This means that the bankruptcy judge must either ignore the plan's current operational characteristics and assume it is qualified now because it was qualified when it was established, or else step in and make the qualification judgment herself in the place of the IRS.

#### 4. Distributional Effects of Tax Qualification

The final aspect of the tax qualification rules that affects the impact of the bankruptcy exemptions based on qualification, is not a deliberate design choice, but rather a by-product of the progressive income tax structure and the different effects, by income range, gender, and ethnicity, of the qualification incentive and the context in which qualified plan benefits are likely to be earned. The distributional impact of the private pension tax expenditure—that is, the exemption from income tax of earnings deposited in a qualified trust—necessarily favors higher income workers, male workers, and white workers over other groups, for several reasons.

First, the very nature of the tax expenditure in the context of the progressive income tax structure means that taxpayers with higher marginal tax rates—30%, for example, on the top \$20,000 of income—will benefit more from the exemption from tax of \$10,000 of that amount when it is contributed to a qualified pension plan.<sup>218</sup> Second, the higher the income of the worker, the more likely she is to have sufficient excess income to defer into a qualified plan; lower

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216. See I.R.C. § 401(a)(4), (k)(3); Treas. Reg. § 1.401-1(a)(4)-3 (1991).

217. See *infra* Part IV.C.

218. See LANGBEIN & WOLK, *supra* note 10, at 158. See generally Alicia H. Munnell, *Current Taxation of Qualified Pension Plans: Has the Time Come?*, NEW ENG. ECON. REV., Mar./Apr. 1992, at 12 (detailing the benefits of deferred taxation to upper income taxpayers and arguing for current taxation of pension plans).

income workers are more likely to have to spend more of their income on current necessities and are less likely to have excess income at all. The entire structure of the nondiscrimination rules for I.R.C. § 401(k) plans, which require at least some low income workers to defer wages under the plan in order for higher income workers to defer the maximum they are allowed, is designed to allow employers to give more incentives to lower income workers to contribute, since higher income workers already have more incentive to defer.<sup>219</sup>

Third, because higher pension benefits generally result from long-term employment at relatively high wages with the pension provider, those workers most likely to have this employment pattern will necessarily be more likely to have substantial pension assets. Since white male workers are substantially more likely to have this employment pattern than either white women or black or Hispanic men or women,<sup>220</sup> it is hardly surprising that poverty rates among elderly women of all races, and among minority men, are much higher, reflecting little or no pension income as well as lower Social Security benefits.<sup>221</sup>

As a result of this strong upward distributional tilt of the pension tax expenditure, the reliance of the bankruptcy and debtor-creditor laws generally on tax qualification as a requirement for exemption or exclusion from the bankruptcy estate results in a substantial preference for protection of the retirement assets of upper-income, white male workers. The bankruptcy approach generally is to protect an asset, or a specific account, without regard to the value of the asset or the level of funds contained in the account. As a result, those debtors with substantial retirement assets have an automatic advantage, in terms of post-bankruptcy income security, over debtors with similar current incomes and debt histories but few or no pension assets.

#### *D. Is There A Consistent Framework for Protecting Retirement?*

A theoretical framework for exclusion of deferred compensation and pension trusts or payments from the claims of a bankrupt's creditors can be developed from two different perspectives. Such a framework could be constructed from the perspective of bankruptcy and tax law principles which if consistently applied require a specific treatment as the end result which nonetheless may violate important policy goals of one or both statutes. Alternatively, an approach to the problem could be designed from the perspective of bankruptcy, tax, and retirement policies, the goals of which would shape the policy without regard to the consistent application of basic principles. It is not clear whether a principled basis is even possible to construct, but if it can be, it may not be applicable to all types of deferred compensation arrangements. It is also not clear that a policy-

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219. See I.R.C. § 401(k).

220. See generally Rose C. Gibson, *The Black American Retirement Experience*, in *AGING IN BLACK AMERICA* 277, 278 (James Jackson et al. eds. 1993); Lois Shaw, *Special Problems of Older Women*, in *THE OLDER WORKER* 55 (Michael Borus et al. eds. 1989); Diana Kunde, *Short Changed in Retirement*, *DALLAS MORNING NEWS*, Aug. 27, 1997, at 1D.

221. See U.S. HOUSE OF REPRESENTATIVES, *COMM. ON WAYS AND MEANS, WHERE YOUR MONEY GOES: THE 1994-95 GREEN BOOK*, tbl. 16-3 at 683, and app. A (Brassey's 1994).

based analytical framework can be designed that can comfortably accommodate bankruptcy, tax, and retirement policy goals simultaneously.

### 1. A Principled Approach: Constructive Receipt, Anti-Alienation, and Exclusion over Exemption

There is an important connection between the I.R.C. and ERISA principles of preserving pension benefits for employee-beneficiaries and the underlying tax principle of constructive receipt which is overridden in the case of qualified plans. Both the anti-alienation provisions and the override of constructive receipt are based on a common conception of the function of pension plans generally that is embodied in their structure. The employer, as the settlor of the trust, has established the trust for the benefit of her employee, whose status with respect to the trust is that of a beneficiary, with necessarily limited current access or right to the amounts contained in the trust. This limited access justifies suspension of the constructive receipt doctrine, while also furthering the general goal of encouraging delay of consumption of amounts in the trust until the beneficiary's retirement.

The question, then, is whether the bankruptcy laws should interpret the suspension of constructive receipt with respect to deferred compensation as a sufficient rationale for excluding those amounts from current income legitimately available to satisfy creditors in bankruptcy. In other words, if income is realized at the time the employee performs services and the employer sets aside amounts associated with that performance, there is not necessarily any reason to disregard that realization of income for debtor-creditor law purposes, simply because *recognition* of income for tax purposes is delayed. The problem is to determine whether these disparate principles—constructive receipt, self-settled spendthrift trusts, and anti-alienation—can converge to form a bridge between tax and bankruptcy principles, and provide at least something of a principled basis for the exclusion of qualified retirement plans from the bankruptcy estate.

The constructive receipt doctrine, at its core, is based on the principle that income belongs to the party with control over the earnings—the employee may not, in the words of Revenue Ruling 60-31, “deliberately turn his back upon income and thereby select the year for which he will report it.”<sup>222</sup> It is the existence of a choice, exercisable even if not exercised, over the timing of receipt that renders the payment taxable income in the year set aside. Similarly, under the economic benefit principle, funds set aside for the employee's benefit, in a trust or other form, will create current income to the employee even if no amounts are withdrawn from the trust. If the employee is deemed to have control—in the form of a property right to the amounts in the trust that protects those amounts from the employer's creditors—those amounts are in fact his income and will be taxed as such in the absence of a statutory exception even if the employee did not choose to have the specific amounts contributed to the trust.

These doctrines are based on principles of choice and control that seem closely akin to the principles guiding state law disregard of self-settled spendthrift trusts

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222. Rev. Rul. 60-31, 1960-1 C.B. 174, 178.

in determining the extent of a bankruptcy estate and exemptions. State laws normally do not recognize the anti-alienation provisions of self-settled trusts, since the settlor himself in essence is attempting to use such provisions to disavow his actual control over the funds placed in the trust.<sup>223</sup> Thus, under both tax and trust principles, control is the wellspring of ownership rights, and thus defeats the individual's attempts to disavow ownership, for purposes of avoiding either taxation or creditors.

An employee may nonetheless avoid constructive receipt of deferred compensation if the qualification rules of the I.R.C. are followed when the employer establishes a pension trust on the employee's behalf. It does not necessarily follow, however, that bankruptcy principles should also dictate exclusion of qualified trust accumulations from the claims of creditors simply because the qualified plan rules provide a statutory exception that allows the taxpayer to avoid recognition of income that is nonetheless hers.

The principle of an all-inclusive bankruptcy estate that underlies the Bankruptcy Code is also avoided in the case of trusts whose "ownership" identity is clouded by an enforceable restraint on alienation, under § 541(c)(2) of the Bankruptcy Code.<sup>224</sup> This principle does not override the general policy against respecting restraints on alienation for self-settled trusts, but where the trust is established by one party for the benefit of another, a restraint on alienation will generally defeat creditors' claims.<sup>225</sup> It is therefore consistent to view the anti-alienation provision required by ERISA and for qualification under the I.R.C., as restrictions on actual control and ownership of trust assets that might justify complete exclusion of qualified pension trusts from the bankruptcy estate.

The qualification rules are, not coincidentally, applicable to employer-provided pension plans and not to individual retirement arrangements.<sup>226</sup> Thus, trust and tax principles seem to be most closely aligned in the case of traditional employer-provided pension trusts, in which the plan is applicable to more than one employee, is established by the employer under the qualification rules, through a plan instrument which limits access of employee-beneficiaries to amounts in the trust until at least retirement age if not conditioned on the act of retirement itself, and which is governed by the anti-alienation provisions of both the I.R.C. and ERISA.

It is the qualified plan's combination of override of constructive receipt with imposition of anti-alienation restrictions that may adequately support putting the pension trust in the category of trusts to be excluded from the bankruptcy estate—the override of constructive receipt alone does not provide a principled basis for exclusion of qualified plans from the bankruptcy estate. This result compels the conclusion that deferred compensation arrangements that are in some sense "qualified" under some part of the I.R.C., but that have few other characteristics in common with employer-provided pension plans in form or

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223. See Young, *supra* note 35, at 810-11.

224. 11 U.S.C. § 541(c)(2) (1994).

225. See 2A FRATCHER, *supra* note 120, §§ 150-150.1, at 75, 82.

226. I.R.C. § 401(a) provides that a trust created or organized in the United States shall constitute a qualified trust if it forms part of an employer-provided stock bonus, pension, or profit-sharing plan for the exclusive benefit of the employees or their beneficiaries.

function, cannot justifiably be excluded from the bankruptcy estate on principled grounds. However, further exploration of the policy goals of both the tax qualification rules and the bankruptcy statute may yield more comprehensive alternative grounds for excluding deferred compensation or retirement accounts from the claims of creditors in bankruptcy.

## 2. A Policy Approach: Protecting Retirement Income Through Partial Exemptions

Both the I.R.C.'s statutory exception from constructive receipt for certain deferred compensation arrangements, and the Bankruptcy Code's reliance on alienation restraints to identify trusts that should be excluded from the bankruptcy estate, are essentially starting principles that dictate certain results under each body of law. However, each principle also can be made to serve specific policy goals. For example, even though an employee in some sense has access before retirement to funds held on her behalf in most types of deferred compensation arrangements, she will avoid constructive receipt and immediate income recognition if the qualified plan rules are followed. Her actual use of the trust amounts, however, is limited to personal consumption, by virtue of the anti-alienation rule required by both the I.R.C. and ERISA, which prevent her from transferring her interest to a third party.<sup>227</sup> Restraints on the ability of either employer or employee to transfer interests in an employee benefit trust established by the employer, or to use the amounts in the trust for any purpose other than the exclusive benefit of the employee-beneficiaries, can therefore be seen as an enforcement of the deferral of consumption that is the desired outcome of the qualified plan rules override of constructive receipt.

In other words, the qualification rules result in an override of constructive receipt, requiring in return, by virtue of the anti-alienation rules, that plan assets be used for current consumption by the beneficiary when distributed (even though that might mean immediate garnishment by a creditor once the amounts are disbursed out of the trust).<sup>228</sup> This combination both limits employee control over pension trust assets and encourages delay of consumption until retirement. The delay in consumption until retirement enforced by the qualification rules is in service of the same goal as the "income maintenance" principle expressed in the Bankruptcy Code exemptions of § 522(d)(10)(E) which preserve pension payments up to the level of reasonable maintenance, to prevent the debtor from having to revert to state assistance in old age.<sup>229</sup>

The exemption provisions of § 522(d)(10)(E) appear to spring almost directly from the same policy concerns about maintenance of the institution of retirement and of the retiree in old age as ERISA and the I.R.C. provisions concerning deferred compensation. Thus, the principal goal of provisions excluding a

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227. See I.R.C. § 401(a)(13) (West Supp. 1998); 29 U.S.C.A. § 1056(d) (West Supp. 1998).

228. See *Guidry v. Sheet Metal Workers Nat'l Pension Fund*, 493 U.S. 365, 371-72 (1990). But see I.R.C. § 401(a)(13)(C), added by the Taxpayer Relief Act of 1997, which creates an exception to the anti-alienation provision where the participant has committed a crime involving the plan itself and allowing recovery of judgments from such a participant's benefits.

229. 11 U.S.C.A. § 522(d)(10)(E) (West Supp. 1998).



pension trust, or, alternatively, exempting certain amounts in the trust, seems to be to insure that the debtor has adequate income support in retirement, to further the “income maintenance” goal of bankruptcy laws. This goal is supported to some extent by the tax qualification rules and penalties on pre-retirement distributions generally applicable to qualified retirement plans which, taken as a whole, tend to limit consumption of the pension until actual retirement.

### 3. Combining Principle and Policy

Two themes are evident in both the policy goals and the principled bases for protecting retirement accounts. The first is the removal of retirement assets from the debtor’s control as a rationale for preventing creditors from taking those assets. This rationale is consistent with the exclusion provided for property with restrictions on alienation under § 541(c)(2) of the Bankruptcy Code.<sup>230</sup> Property to which the debtor does not have unfettered access and which she cannot liquidate freely seems logically beyond the reach of current creditors in bankruptcy. Lack of current access to or control over retirement accounts is also consistent to some extent with the fresh start goal; cutting creditors off from those accounts because the debtor is unable to spend today the amounts reserved for retirement means that those amounts can be consumed later without the shadow of the debt collector hanging over them.

The second theme is the importance of providing for the debtor’s retirement, as for example, in the language of the exemption for pension payments in § 522(d)(10)(E), in which the debtor’s right to receive payments under a pension plan that are necessary for support are exempt from the property of the estate.<sup>231</sup> This language presupposes that it is a reasonable goal of the bankruptcy laws to insure adequate but not excessive income maintenance in retirement, by exempting those amounts from creditors’ claims. The goal of providing a fresh start is also linked to the retirement assumption—if payments in retirement are substitutes for wages that would otherwise be earned at that time, then they can be viewed as properly exempt from creditors’ claims, just as wages actually earned after the bankruptcy proceeding are exempt. These rationales are both based on the assumption that the debtor has a right to retire, and will do so as a matter of course.

One problem with this application of the fresh start principle is that it relies on a misunderstanding of what pension payments actually represent—are those payments forgone wages at the time of retirement, or are they deferred wages from pre-retirement labor? Many economists view pension benefits as deferred wages, in essence an agreement to delay the receipt of earnings that workers would otherwise demand currently for services being performed long before retirement.<sup>232</sup> This economic analysis postulates that regardless of the form of

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230. 11 U.S.C. § 541(c)(2) (1994).

231. 11 U.S.C.A. § 522(d)(10)(E).

232. See MCGILL & GRUBBS, *supra* note 79, at 19-20; see also MUNNELL, *supra* note 21, at 2-3 (1982) (citing numerous economic studies attempting to measure the wage-pension trade-off).

pension plan—either a traditional employer-financed defined benefit plan that guarantees a specific pension benefit amount in retirement, or a 401(k) cash or deferred arrangement to which both employer and employee contribute—all trust contributions would, in the absence of the plan, have been paid to the employee as current wages.<sup>233</sup>

From this perspective, pensions should not be viewed as a substitute for wages that would be earned at the time of retirement, but rather as wages that relate back to services performed before retirement, with receipt deferred until old age. Garnishment of such benefits would not violate the “fresh start” principle, any more than attachment of any normal savings account would, since the employee in essence chose to defer receipt through the retirement savings vehicle.

Some commentators have suggested that it would be possible to separate the “deferred savings” element from the “retirement pension” element of qualified pension trusts, allowing the deferred savings to be available to satisfy claims of creditors in bankruptcy.<sup>234</sup> However, if the entire initial deferral—regardless of its nominal status as either an “employer” or “employee” contribution—represents deferred wages which, along with investment earnings on that amount, constitute the final retirement benefit, there is no basis for bifurcating a pension trust or payment into employee savings on one hand and employer provided savings on the other. As a result, the “fresh start” rationale for protecting pension trusts loses much of its appeal.

The “income maintenance” principle provides a stronger rationale for protection of pension assets and pension payments in retirement. In particular, the qualified defined benefit pension plan structure, under which it is very difficult for the debtor to obtain access to amounts in the trust prior to retirement and other than in the form of a monthly pension benefit, most closely fits the purposes of the Bankruptcy Code exemptions under § 522(d)(10)(E) which are to insure that the debtor will not fall into destitution at retirement and become a charge upon the state.<sup>235</sup> However, if debtors are to be left with only the amount reasonably necessary for their support and the support of their family, even the traditional pension plan would logically be subject to partial garnishment, based on a present value analysis of amounts in the trust, that would leave only enough principal in the trust to produce, by the time of retirement, an adequate but not lavish level of support.

Defined contribution plan accumulations, in contrast, can be and frequently are taken as a lump sum distribution, are available to participants as early as age fifty-nine-and-a-half, and usually can be borrowed by the participant at relatively low interest rates.<sup>236</sup> As a result, it is difficult to make a persuasive case for

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233. See MCGILL & GRUBBS, *supra* note 79, at 19-21; MUNNELL, *supra* note 21, at 2-3.

234. See Wohl, *supra* note 11, at 31-35.

235. 11 U.S.C. § 522(d)(10)(E).

236. See generally G. LAWRENCE ATKINS, SPEND IT OR SAVE IT?: PENSION LUMP SUM DISTRIBUTIONS AND TAX REFORM 5, 30 (1986). For a vivid illustration of the change in attitude toward retirement planning from the 1970s emphasis on protection of defined benefit plans, see Ellen E. Schultz, *Ready Cash: A 401(k) Plan Can Give You a Nice Retirement-Or Nice Time Today*, WALL ST. J., Oct. 17, 1997, at A1. It is not at all clear that the family in this article, which uses the husband's 401(k) plan account as a source of borrowed cash for boats

preservation of such plan accounts from creditors under any bankruptcy rationale, fresh start or income maintenance. Nonetheless, the high priority placed on encouraging savings for retirement may be a strong enough policy goal to dictate preservation of an amount necessary to provide a reasonable life annuity at the time of retirement, as suggested for defined benefit plans. In this instance, policy may overwhelm theory, and even though pre-retirement access to defined contribution accounts might logically destroy the "retirement" character of those accounts, some limits on creditor access may nevertheless be appropriate.

In sum, the requirements that must be satisfied by retirement plans under the qualification provisions of the I.R.C., and the continuing obligations placed on administrators of employee benefit plans by ERISA, generally have only a limited relationship to the policies underlying protection of retirement plan assets from creditors. Only in the case of the employer-provided defined benefit pension plans, which directly provide for a stream of income in retirement, and only in retirement, do the requirements of ERISA and the I.R.C. appear to coalesce more or less completely with the purposes of the bankruptcy laws. Even in the case of defined contribution plans, however, the qualification requirements tend to constrain the availability of pension fund resources for purposes other than retirement income, and thus to some extent (although not completely) may justify the distinction drawn in the courts between qualified and non-qualified arrangements.

For defined contribution accounts generally, however, and to some extent for defined benefit plans as well, there appears to be no basis for preserving accumulated assets far above what would be necessary to finance a reasonable standard of living in old age. Even if the fresh start goal is considered to be the paramount consideration in determining which assets should be preserved in the face of bankruptcy, amounts saved for retirement cannot be considered to be accessible for use in starting over in current economic life if they must be available for consumption in old age.

#### *E. Why Protect Retirement?*

The preservation of tax-qualified retirement assets from creditors' claims, when all other sorts of personal savings are included in the bankruptcy estate or open to garnishment by general creditors, appears to be based on the presumed predictive value of qualification—that is, simply by virtue of being held in a qualified trust sanctified as such by the I.R.C., savings are viewed as ineluctably destined to support the debtor in old age. A reasonable case can be made for preservation of at least a portion of funds held in qualified pension plans from the claims of creditors, based on the combination of the anti-alienation provisions and the restrictions on distributions required for qualified plans. Both of these measures further the policy goal of insuring adequate retirement income that is common to both the tax qualification rules' override of constructive receipt and

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and vacations, should be entitled to preservation from creditors of anything left in that account on the grounds that it is "retirement savings." *See id.*

the bankruptcy statute's current exemptions of pension benefits to the extent necessary to support a reasonably adequate standard of living.

However, the underlying assumption—that provision for retirement should receive stronger protection from creditors than other types of savings—still requires examination. There are a variety of risks and large expenditures in life that a debtor might consider both worth saving for and worth protection against creditors—college education, for example, or catastrophic disability. But no other expenditure, no other savings for any other eventuality, has been given the degree of insulation against creditor claims that the debtor-creditor law generally grants retirement savings.

The twentieth century concept of retirement, developed during about the first third of the century and cemented in popular consciousness with the enactment of the Social Security retirement program, has become the modern version of Heaven—an extended period of leisure, as work ceases at age sixty-five, or, for many, as early as sixty or fifty-five, long before the individual's ability to work fades.<sup>237</sup> The wealthy have always been able to retire and live into extreme old age on income derived from accumulated property, but with the onset of industrial capitalism and the domination of western economies by wage labor, the notion of retirement became more than the preserve of the well-to-do merchant or prosperous farmer.<sup>238</sup>

Retirement as the broad-scale, middle class institution it has become in the late twentieth century had its roots in industrial workforce management, as a way to escort out the factory door workers whose productivity was diminishing with age, something that appeared to occur much earlier in manufacturing and service industry than in the agrarian world that had dominated the American economy until the mid-19th century.<sup>239</sup> The growth of private pensions in the post-war period reflects the cementing of the retirement expectation for almost all Americans, who anticipate not only economic survival once work ends, but in fact prosperity—indeed, the selling of retirement advice and investments in the 1990s shows a vision of leisure in which the retiree appears to be much better off in retirement than while working.<sup>240</sup>

What, then, is the nature of the state's interest so strongly protecting, indeed promoting retirement itself? After all, before the advent of Social Security and widespread, middle-class retirement in the post-World War II period, only about a third of men in the labor force actually retired at age sixty-five or even later.<sup>241</sup> It appears that the expectation of retirement at a relatively young age (sixty-five

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237. See GRAEBNER, *supra* note 40, at 193.

238. See DAVID HACKETT FISCHER, *GROWING OLD IN AMERICA* 143 (expanded ed. 1978); CAROLE HABER & BRIAN GRATTON, *OLD AGE AND THE SEARCH FOR SECURITY: AN AMERICAN SOCIAL HISTORY* 95-97, 101-04 (Harvey J. Graff ed., 1994).

239. See ANN SHOLA ORLOFF, *THE POLITICS OF PENSIONS* 95-120 (1993).

240. See, e.g., Becky Yerak, *Planning for Retirement: 401(k)s and IRAs Should Be the 1st Step*, PLAIN DEALER (Cleveland), Feb. 23, 1998, at 7S. "'When I first got into the business 15 years ago,' financial counselor Shelli Zasa said, 'they'd say 50 to 70 percent of what you use now is what you'd need in retirement. Now we talk 90 to 100 percent for the basic reason that people who retire want to do things.'" *Id.*

241. See Dilley, *supra* note 40, at 1116.

or earlier) is so deeply embedded now in the culture that protection of the ability to stop working without a reduction in standard of living is the paramount value driving both the tax treatment and the protection of pensions against creditors, whether or not the amounts in such accounts are really necessary for income support in old age. Thus, at the heart of protections of qualified retirement accounts from creditors is the state's interest, not in preventing impoverishment and resort to government assistance by the elderly, but rather in preserving retirement itself—as a workforce management tool, and as a way to maintain levels of consumption of consumer goods throughout the individual's lifetime.

Nonetheless, while the accumulation of retirement assets well above the level needed for subsistence appears to be an accepted goal of private pensions and retirement savings, as reflected in the tax incentives provided for employer-sponsored pensions,<sup>242</sup> the distributional results are questionable. These incentives favor those who have stable work histories, work for stable employers who are able to provide pension plans, and who have high enough earnings throughout their working lives to build up assets for later consumption.<sup>243</sup> As a result, the linkage of bankruptcy protections to tax qualification of retirement plans reinforces the advantages of higher-wage workers, even in bankruptcy.

#### IV. IRAS IN BANKRUPTCY: WHAT'S RETIREMENT GOT TO DO WITH THEM?

The protection given tax-qualified and ERISA-covered pension plans under the *Patterson* decision can only be justified, as a policy and principle matter, if the protection is limited to defined benefit retirement plans, whose annuity structure and most stringent limits on pre-retirement access most closely fit the policy goals of guaranteeing retirement income for the debtor. Protection for defined contribution accounts, such as those accumulated under § 401(k) plans and other types of profit-sharing plans, is much more difficult to justify, given the relatively easy access allowed to the account holder long before retirement, and the possibilities for use of those sums, even after age fifty-nine-and-a-half, for purposes completely unconnected to daily support needs in retirement.

Even if a coherent framework for exempting all or part of retirement trusts generally from the claims of creditors in bankruptcy can be developed, however,

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242. See Gordon, *supra* note 87, at 22. In 1972, the Senate Committee on Labor and Public Welfare introduced a comprehensive pension reform bill and accompanying committee report that was one of the factors leading to the enactment of ERISA. In the report, the committee stated that it

“enthusiastically endorses the concept of a comprehensive private pension reform program. . . . Its most important purpose will be to assure American workers that they may look forward with anticipation to a retirement with financial security and dignity, and without fear that this period of life will be lacking in the necessities to sustain them as human beings within our society.”

*Id.* (quoting S. Rep. 92-1150, at 13 (1972)) (omission added).

243. See MUNNELL, *supra* note 21, at 171-77; *id.* at 176 tbl. 7-2 (entitled, “Comparison of Benefits for a Four-Job Worker and a One-Job Worker Over Forty Years of Employment, at Different Rates of Inflation and Wage Growth”).

the analysis may have little or no applicability to IRAs, despite the reliance of most courts on the similarity between employer-provided retirement plans and IRAs as a basis for exemption or exclusion. The tax treatment of IRAs is generally based on the same deferral of consumption, deferral of tax rationale that is applicable to qualified pension plans. However, pre-retirement access to amounts held in IRAs is generally easier to obtain than for qualified plans, and in an increasing number of cases withdrawals before retirement are allowed for specific purposes without any penalty.<sup>244</sup> The continuing transformation of the private pension system into employer-sponsored tax-favored savings arrangements (such as 401(k) plans), whose accumulations can be easily transferred to IRAs when the worker moves on to other employment, has increased both the visibility and importance of IRAs as retention pools for tax-favored savings which are destined to be the worker's major source of income in retirement. Nonetheless, while IRAs are popularly characterized as retirement vehicles, they are in fact merely tax shelters that may or may not serve as a source of income in retirement.

The inconsistencies in purpose and principle of both bankruptcy and tax law have created substantial difficulties in applying bankruptcy protections to IRAs. First, neither state legislatures nor the courts can seem to decide why such accounts should be protected beyond a general sense of the importance of saving for retirement. Moreover, if an IRA is determined to be in some way worthy of protection against creditors, the scope of possible protection ranges from all IRAs, characterized generally as "for retirement" and therefore protected,<sup>245</sup> to IRAs that only contain amounts rolled over from qualified employer-provided retirement plans<sup>246</sup> to IRAs that contain only enough cash and assets to sustain a reasonable standard of living for the particular individual's retirement.<sup>247</sup> Without a consistent rationale for protection—either protecting the IRA account, under a property right/"fresh start" principle, or alternatively, protecting certain amounts in the IRA account under an income maintenance approach—courts and state statutes will continue to differentiate between protected and unprotected retirement accounts based on a confusing amalgam of retirement policy, tax principles, and bankruptcy goals, with a predictably crazy quilt result across jurisdictions.

Moreover, examination of both types of funds contained in IRAs and the status of the IRA itself, as courts seem compelled by the complex structure of the statutory protections to undertake, inevitably leads to disparate interpretations of

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244. See I.R.C. § 72(t) (West Supp. 1998) (imposing a 10% penalty tax on early distributions and providing a list of events that allow early distributions without penalty). Congress has added categories of expenses for which early distributions from IRAs will not trigger this penalty. See Taxpayer Relief Act of 1997, Pub. L. No. 105-34, 111 Stat. 809, 829-31 (amending I.R.C. § 72(t)(2)(E)-(F)). See *infra* notes 303-05 for a discussion of the distribution rules since enactment of the 1997 Act.

245. See, for example, state statutes described in Appendix A which protect "retirement plans" or "retirement accounts," and cross-reference both I.R.C. §§ 401(a) and 408 (West Supp. 1998).

246. See *Youngblood v. FDIC (In re Youngblood)*, 29 F.3d 225, 227-29 (5th Cir. 1994).

247. See *Rcitmeyer v. Gralka (In Re Gralka)*, 204 B.R. 184, 190 (Bankr. W.D. Pa. 1997).

the I.R.C. and its accompanying regulations.<sup>248</sup> Bankruptcy courts have been forced to attempt interpretation of the Code and ERISA simply because the state legislatures were apparently reluctant to spell out the characteristics that would make specific retirement accounts eligible for protection against creditors. Instead, most states have chosen the easy approach of defining state law exemptions from creditors' claims through cross-references to the I.R.C. sections dealing with the tax treatment of deferred compensation (pension plans, IRAs, tax-deferred annuities, etc.).

Many courts have as a result based their decisions on their own determinations of the "qualified" status of the IRA in question.<sup>249</sup> Yet, the concept of "qualification" as it has developed in the context of employer-provided pension plans is of little or no use when applied to IRAs. The blurring of the distinction between "qualified pension plans" and "qualified IRAs" has also led state legislatures to enact statutes essentially, and mistakenly, equating IRAs with qualified pension plans, thus providing no reasonable basis for distinguishing IRAs that should be protected against creditors from those that should not.<sup>250</sup>

The sole consistent element of the various approaches to protecting IRAs from creditors is a respect bordering on reverence for the concept of retirement itself, and for the necessity of protecting savings designed to support the debtor in old age. Yet the connection between this concept of entitlement to retirement and the IRA as a vehicle for supporting retirement grows ever more tenuous, as Congress has continued to expand the notion of IRAs to include accounts meant to fund education and housing, and to provide easier penalty-free access before retirement age to even traditional IRA accounts.<sup>251</sup> Thus, just when many courts appear to have concluded that IRAs are true retirement accounts on a par with qualified employer-provided pension plans governed by ERISA, Congress has substantially weakened the connection between IRAs and retirement income.<sup>252</sup> The status of the IRA itself as a "retirement account" therefore requires fundamental re-examination. The tax-preferred status accorded IRAs did not ever necessarily give them the same role as qualified pension plans have traditionally played in ensuring a stream of income in retirement, and the provisions of the Taxpayer Relief Act of 1997 only accentuate the tax shelter, as opposed to retirement savings, characteristics of IRAs generally.

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248. See discussion *infra* Part IV.D.

249. See *Meehan v. Wallace (In re Meehan)*, 102 F.3d 1209, 1211-12 (11th Cir. 1997) (finding that an IRA is excluded from the bankruptcy estate if the IRA contains an anti-alienation provision or one is found under state law); *Walker v. G.M. Mather (In re Walker)*, 959 F.2d 894, 896-99 (10th Cir. 1992) (finding the debtor's IRA was not exempted by virtue of 11 U.S.C. § 541 because it did not contain an anti-alienation provision, but was still found exempt under an Oklahoma state statute); *In re Paul Ervin Bates*, 176 B.R. 104, 109 (Bankr. Ma. 1984) (finding that an IRA qualifies for an exemption from the bankruptcy estate "whether or not the right is fully and freely exercisable on the date of his or her bankruptcy petition").

250. See *infra* state statutes described in Appendix A.

251. See *infra* text accompanying notes 303-05.

252. See *infra* text accompanying notes 304-05.

*A. Are IRAs True Retirement Savings?*

In identifying "retirement accounts" that are to be exempt from garnishment in and outside of bankruptcy, most state laws simply use cross-references to Code sections, and most such cross-references include § 408 which sets forth the requirements for IRAs. As a result, most of the bankruptcy and federal district court decisions concerning protection of retirement accounts have involved some degree of interpretation of I.R.C. definitions and requirements.<sup>253</sup> The underlying assumption of state legislatures in using the IRA cross-reference "shorthand" in state statutes dealing with retirement accounts appears to be that IRAs are equivalent in most essential respects to tax-qualified employer-provided pension plans and thus should receive roughly equivalent treatment.<sup>254</sup>

However, IRAs are not equivalent to qualified pension plans in most important respects, particularly with respect to the characteristics of pension plans most relevant to the question of whether creditors should have access to IRA accumulations: imposition and enforcement of qualification requirements; anti-alienation provisions; and access to funds prior to retirement. This is true of IRAs as they have been structured under the I.R.C. since 1974, as modified by the Tax Reform Act of 1986, and it is even more true of IRAs under § 408 and the Roth IRA under § 408A, as modified by the Taxpayer Relief Act of 1997. In fact, the term "IRA" has come to mean any type of tax-favored savings arrangement, to the extent that new tax-advantaged savings accounts intended to help parents finance their children's college education are labeled, in the statute as well as the popular press, "education IRAs," even though the "R" for "retirement" is clearly a non-sequitur in this context.<sup>255</sup>

A brief examination of the life history of the IRA from its origins in agitation by attorneys and physicians for tax-favored deferred compensation arrangements for themselves, to its current incarnation as a jack of most trades savings account, reveals that the connection between retirement and IRAs has never been as close as many courts and commentators appear to assume. After the 1997 tax legislation, that connection is tenuous indeed. It is also important to consider the theoretical distinctions between an individual's rights in a pension trust

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253. See ARIZ. REV. STAT. ANN. § 33-1126(c) (West 1990); FL. STAT. ANN. § 222.21(2)(a) (West 1989).

254. See *In re Harless*, 187 B.R. 719, 724 (Bankr. W.D. Ala. 1995) (exemption of IRAs from bankruptcy under state "spendthrift trust" law). "The legislature, when it enacted Ala. Code § 19-3-1(b), intended to treat *all* retirement assets which received preferential treatment under the Internal Revenue Code equally, and it intended to protect all from creditors, within bankruptcy and without." *Id.* at 731 (emphasis in original).

255. See Taxpayer Relief Act of 1997, Pub. L. No. 105-34, § 203, 111 Stat. 788, 809 (adding I.R.C. § 72(t)(2), (t)(8), providing for penalty-free withdrawal from an IRA for qualified higher education expenses). For an example of the lack of connection between IRAs and retirement in the popular policy press, see John O'Sullivan, *Here's a Tax Reform Proposal the GOP Might Buy*, CHI. SUN-TIMES, Nov. 23, 1998, at 29. "[Lawrence] Kudlow proposes to build on the present [tax] system by expanding . . . tax-free Individual Retirement Accounts. . . . Why not also allow people [to use IRAs] to squirrel away tax-free savings for other good purposes . . . [?]" *Id.*



established and maintained by an employer, and an individual's rights in an individual savings trust established and controlled in most important aspects by the individual himself. Can or should rights in the two types of trusts be considered equivalent? Moreover, should the tax treatment of each type of trust—especially the extent to which the tax law limits the application of the tax concept of constructive receipt to amounts held in each type of trust—determine the appropriate treatment of those amounts when the trust beneficiary enters bankruptcy?

### I. IRAs: From Savings Account to . . . Savings Account

IRAs represented from their inception an alternative to employer-provided pension trusts, one that emphasized individual choice and responsibility for saving out of the worker's own excess income, an alternative to proposals for expansion of employer responsibility for funding and paying retirement benefits which eventually formed the basis for ERISA.<sup>256</sup> In many ways, however, the idea of IRAs can be said to have originated with the early versions of legislation to provide pension savings opportunities for self-employed persons, which were first introduced in 1951.<sup>257</sup>

#### a. Pre-History of IRAs: Doctors and Lawyers and Self-Employed Pension Plans

Before passage of the Self-Employed Individuals Tax Retirement Act of 1962, which provided for "Keogh" plans for self-employed persons,<sup>258</sup> only employees were allowed to be covered by qualified pension plans. In the case of a self-employed professional or a sole proprietorship, there were no employees for whose exclusive benefit a pension trust could be established. As a result, self-employed persons were not able to take advantage of the tax-deferral opportunities of qualified plans on the same basis as corporations or other employers with more than a single principal.<sup>259</sup> The Keogh-Reed legislation of 1951 was the culmination of several years of efforts by professional groups, notably attorneys, to secure for themselves, and other self-employed professionals (such as physicians), the ability to establish qualified pension plans. These pension plans included current deductions for contributions to a trust but delayed taxation of the amounts in the trust until retirement, on an equal footing with employer-provided plans that were restricted to employees under the exclusive benefit rule of I.R.C. § 401(a).<sup>260</sup> However, the Keogh-Reed bills went beyond providing for self-employed persons. The bills would have allowed every individual whose employer did not provide a pension plan to contribute, and take

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256. See MCGILL & GRUBBS, *supra* note 79, at 34-35.

257. The first bills were introduced by Congressmen Keogh and Reed in 1951. See H.R. 4371, 82nd Cong. (1951) (Keogh); H.R. 4373, 82nd Cong. (1951) (Reed).

258. Pub. L. No. 87-792, 76 Stat. 809.

259. See generally Leslie Rapp, *The Quest for Tax Equality for Private Pension Plans: A Short History of the Jenkins-Keogh Bill*, 14 TAX L. REV. 55 (1958).

260. See *id.* at 57-60.

a deduction from taxable income for, up to 10% of earned net income or \$7500 to a "restricted retirement account."<sup>261</sup> Moreover, even those employees already participating in employer-provided pension plans would have been allowed to contribute to such accounts to the extent their employer's contribution did not exceed the 10%/\$7,500 limit.<sup>262</sup> In addition, restrictions on access would have been more or less absolute, with withdrawals being prohibited before age sixty, except in cases of total and permanent disability.<sup>263</sup>

The form of trust in which the contributions by either employees (covered or not covered by a qualified pension plan) or self-employed persons could have been deposited was also quite restrictive. The trust remained a far cry from the self-directed IRA accounts of the 1990s. Under the original Keogh-Reed legislation, the "restricted retirement fund" into which contributions were required to be placed, was "a trust forming part of a retirement plan set up by a bona fide agricultural, labor, business, industrial, or professional association or similar organization, for the exclusive benefit of its participating members."<sup>264</sup> Thus, the trust itself would have been established and maintained by a third-party industry or professional association, rather than by the individual beneficiary, therefore retaining the characteristics of independent trustees and accounts that continue to be the hallmarks of the employer-maintained trusts established under the qualified pension plan rules.

The Keogh plan legislation that eventually made its way into law in 1962 was restricted to self-employed individuals and essentially provided for coverage under a form of qualified pension plan for self-employed individuals; yet it had many additional restrictions on excess contributions and on distributions.<sup>265</sup> That legislation nonetheless paved the way for IRAs to form a principal part of the response of the Nixon administration in the late 1960s to calls for more expansive federal regulation of private pensions.

#### b. Enactment of IRAs—Nixon's Answer to ERISA

The first legislative proposal for individual retirement accounts that would allow workers other than self-employed professionals and business owners to establish Keogh-type individual deferred savings arrangements was put forth by the Nixon Administration in 1970. The proposal responded to calls throughout the late 1960s for stronger federal regulation of private pension plans.<sup>266</sup> The

261. *Id.*

262. *See id.* at 60.

263. *See id.* at 61.

264. *Id.* at 61.

265. For a detailed discussion of the provisions of the 1962 Keogh plan legislation, see Chadwick & Foster, *supra* note 103, at 658-65.

266. *See* MCGILL & GRUBBS, *supra* note 79, at 30-37.

When the Nixon administration came into power, the [Pension Benefit Security Act] was dropped in favor of a legislative approach that would encourage the expansion of coverage through more attractive tax incentives to self-employed persons, modest deductions for contributions to individual retirement accounts by

escalation of pressure for a federal law that would go beyond the tax qualification rules and force employers to fulfill the pension promises made to employees culminated in 1974 with the passage of ERISA.<sup>267</sup>

The original administration counter-proposal to ERISA in 1970 would have allowed workers covered by pension plans, but with low vested benefit amounts, as well as workers without pension plan coverage, to establish deductible IRAs.<sup>268</sup> It is significant that this proposal was not included in the ERISA legislation that originated with the House and Senate Labor Committees, but rather was added, substantially revised, as part of other tax provisions in the tax section of ERISA. These provisions originated in the Senate Finance and House Ways and Means Committees when those tax-writing committees began to assert joint jurisdiction over the pension bills in 1973 and 1974.<sup>269</sup>

IRAs were conceived of, even by their proponents on the tax committees, not as true pension plans but rather as a tax-favored savings opportunities for those without pension coverage. That opportunity arose outside the framework of ERISA's fiduciary responsibility, reporting and funding requirements, and qualified plan rules requiring nondiscrimination and vesting, a framework designed to protect the interests of rank and file employees. The many critics of IRAs viewed them from the beginning as not only outside the qualified plan framework, but more importantly, only tangentially related to retirement at all, serving as pure and simple tax-sheltered savings opportunities for well-off individuals. They saw IRAs as primarily aiding the doctors and lawyers and other high income individuals who would have sufficient excess earned income to save \$1500 per year with or without tax incentives.<sup>270</sup>

As finally enacted under §§ 219 and 408 of the I.R.C., only individuals with earned income and no pension coverage were eligible to make deductible contributions to an IRA each year.<sup>271</sup> The original structure of the IRA provision gave individuals without pension plan coverage three options for retirement savings: an individual retirement account; individual retirement annuities; and retirement bonds, to any of which the individual could contribute (and deduct under § 219 of the I.R.C.) a maximum of \$1500 or, if less, 15% of compensation,

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individuals not covered by an employer-sponsored plan, and limited deductions for employee contributions to employer-sponsored plans.

*Id.* at 35.

The termination of the Studebaker Corporation pension plan in 1964, which caused thousands of Studebaker workers close to retirement, and with 20 years or more of credit under the company pension plan, to lose substantially all of their pension benefits, and the congressional hearings that followed, revealed to the public-at-large the weaknesses of a private pension system that had no funding or fiduciary requirements. *See* Chadwick & Foster, *supra* note 103, at 668-69; *see also* Gordon, *supra* note 87, at 8, 15-16.

267. *See* Gordon, *supra* note 87, at 16-24; *see also* MCGILL & GRUBBS, *supra* note 79, at 34-37.

268. *See* MCGILL & GRUBBS, *supra* note 79, at 35; *see also* Jefferson, *supra* note 8, at 1454 n.21.

269. *See* MCGILL & GRUBBS, *supra* note 79, at 36-37.

270. *See* Chadwick & Foster, *supra* note 103, at 692-97.

271. *See id.*

each year.<sup>272</sup> The differences between employer-provided plans and IRAs, even in the original design, provided a clear line of demarcation between tax-deferred savings accounts, IRAs, on one hand, and qualified employer-provided pension plans on the other. Premature distributions from IRAs prompted an excise tax, while premature distributions from qualified pension plans could result in disqualification.<sup>273</sup>

### c. Evolution of IRAs in 1981 and 1986: The Brief Flowering and Sudden Curtailment

In light of the equal emphasis placed on individual retirement annuities and retirement bonds as alternative retirement savings vehicles in the original formulation of IRAs, at least some credence may be granted to the assertions made at the time that the original 1974 IRA provisions encouraged individuals without access to an employer-provided pension plan to save for retirement. However, the emphasis shifted dramatically with the passage of the Economic Recovery Tax Act of 1981 ("ERTA"), which for the first time, allowed employees covered by qualified plans to deduct contributions to IRAs, for reasons that, based at least on the rhetoric surrounding the bill, had as much to do with increasing the national personal savings rate as with ensuring an adequate retirement for individual workers.<sup>274</sup>

The 1981 revisions to I.R.C. § 408 were in many ways a fulfillment of the original IRA proposed in 1970 as a riposte to ERISA: deductible IRAs became available even to those workers already covered by a pension plan, and the limit on contributions was increased from \$1500 to \$2000 (\$2250 for a married couple of which one spouse had no earned income).<sup>275</sup> These changes were ostensibly designed to increase the retirement security of all workers, even those already covered by an employee pension plan, and to increase national savings which was perceived to be at an already low rate and continuing to fall.<sup>276</sup> Immediately upon passage of ERTA, banks and other financial institutions began an advertising blitz (on a scale not seen when IRAs were available only to those who were not covered by qualified pension plans) aimed at inducing taxpayers to establish deductible IRAs.

In the aftermath of ERTA in 1981 and up to the Tax Reform Act of 1986, little hard evidence emerged to support the contention of IRA proponents that universal availability of deductible IRAs would increase the nation's savings rate. In fact,

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272. See I.R.C. §§ 219, 408(a)-(c) (West Supp. 1998).

273. See *id.* § 401(a); Treas. Reg. § 1.401-1(b)(1)(i) (1998).

274. Economic Recovery Tax Act of 1981 (ERTA), Pub. L. No. 97-34, 95 Stat. 274-76 (codified as amended in scattered sections of 26 U.S.C.). For examples of the rhetoric accompanying passage of the IRA provisions of ERTA, see 127 CONG. REC. 18063, 18071, 18091 (1981) (statements of Congressmen Pickle, Kramer, and Mattox on the need for and effects of savings incentives in ERTA).

275. See Economic Recovery Tax Act § 311.

276. See S. REP. NO. 97-144, at 112-13 (1981); see also STAFF OF THE JOINT COMM. ON TAXATION, 97TH CONG., GENERAL EXPLANATION OF THE ECONOMIC RECOVERY TAX ACT OF 1981, at 199 (Comm. Print 1982).

economic data accumulated by 1986 showed that IRAs were being used primarily by upper-income taxpayers who shifted funds from normal savings accounts. This shift generated taxable interest income into IRAs to achieve both a deduction for otherwise nondeductible savings and accumulation of tax-exempt rather than taxable interest earnings.<sup>277</sup> Moreover, in the high-interest environment of the early 1980s, bank campaigns for IRAs frequently centered around the interest arbitrage opportunities. Banks would borrow money to establish a deductible IRA, and take the money out some period later, long before retirement, having accumulated sufficient interest income to make up for the taxability and penalty assessed on the withdrawn amount.<sup>278</sup> As a result, the 1986 Tax Reform Act rolled back many of the liberalizations of the 1981 legislation, limiting the availability of IRAs to individuals at all income levels without pension coverage, and to lower-income persons with pension coverage.<sup>279</sup>

d. The Taxpayer Relief Act of 1997: Taking  
the "R" Out of IRA, or "Everything Old  
Becomes New Again"

The identification of the term "IRA" with any form of tax-deferred savings for any purpose, even those not remotely connected with retirement, became virtually complete with the passage of the Taxpayer Relief Act of 1997.<sup>280</sup> The 1997 Act, in general, made access to IRA accumulations for non-retirement uses easier, and created two new types of "IRAs"—the Roth IRA, under new I.R.C. § 408A, and the "education IRA" under the new I.R.C. § 530. Since the new types of IRAs are not governed by I.R.C. § 408, there will not be immediate cross-reference problems under current state exemption laws that use I.R.C. § 408 as a handy definition of "retirement account" for bankruptcy exclusion purposes.

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277. See 1986 GENERAL EXPLANATION, *supra* note 193, at 625-26.

Congress determined that, since 1981, the expanded availability of IRAs had no discernible impact on the level of aggregate personal savings. . . . Further, Congress determined that data had consistently shown that IRA utilization was quite low among lower-income taxpayers who could be the least likely to accumulate significant retirement savings in the absence of a specific tax provision. For example, for the 1984 tax year, only 7.8 percent of returns with adjusted gross income (AGI) under \$30,000 (who represent 76 percent of all taxpayers) made IRA contributions, whereas 59 percent of returns with AGI of \$50,000 or more made IRA contributions. . . . Congress believed that those taxpayers for whom IRA utilization was the largest (i.e., higher-income taxpayers) would generally have saved without regard to the tax incentives.

*Id.* (parentheticals in original).

278. See Competitiveness Policy Council, *Saving and US Competitiveness*, 95 TAX NOTES TODAY 184-34, Sept. 20, 1995, available in WESTLAW, TNT Database (Abuse of IRAs in early 1980's prompted Congress in the Tax Reform Act of 1986 to eliminate deduction for consumer interest payments.); see also Laurence J. Kotlikoff, *The Crisis in U.S. Saving—Its Cause and Remedy* (Feb. 2, 1995) (testimony before the Senate Finance Committee), available in 1995 WL 39748.

279. See Tax Reform Act of 1986, Pub. L. No. 99-514, §§ 1101-1102, 100 Stat. 2085, 2411-16 (amending § 219 and § 408 of the I.R.C.).

280. Pub. L. No. 105-34, 111 Stat. 788.

Nonetheless, the blurring of distinctions between tax-advantaged savings for retirement and tax-advantaged savings for other purposes reinforces doubts about the validity of including even traditional IRAs in the definition of "retirement accounts" for purposes of protection against creditors.<sup>281</sup>

The changes made to IRAs under § 408 of the I.R.C., as well as the new "education IRAs" and Roth IRAs, were accompanied by a wealth of rhetoric about increasing the national savings rate while encouraging workers to set aside additional savings for retirement.<sup>282</sup> Nonetheless, the cumulative effect of changes designed to encourage middle class taxpayers to use IRAs as savings vehicles is to further weaken the connection between IRAs and retirement income. In addition, the establishment of the Roth IRA, which allows permanently tax-free build-up of earnings on already taxed contributions that may subsequently be withdrawn for several purposes after as few as five years, casts grave doubt on the utility of such accounts as a retirement savings vehicle for all but those upper middle-income taxpayers who are more likely to be well-provided with retirement income options.

In essence, the 1997 bill results in almost a reversion to the status of IRAs after the 1981 legislation with some new twists. For example, the Roth IRAs are designed to encourage even higher rates of tax sheltered savings by middle and upper income taxpayers. However, changes such as allowing readier access to accumulations long before retirement and allowing the use of the Roth IRA account as a repository for appreciating property in addition to cash have little or nothing to do with ensuring adequate levels of income in retirement. These measures, along with IRAs and Roth IRAs themselves, are better seen as general savings subsidies rather than as part of a national retirement income policy.<sup>283</sup>

## 2. Basic IRA Characteristics

The essential characteristics that distinguish a traditional IRA from a normal, unrestricted savings account are first, the form and terms of the trust which must be established; second, the tax deduction available under certain circumstances for amounts placed in the trust; third, the tax-exempt status of the trust, allowing interest earnings to accumulate tax-free; and fourth, the restrictions on access to and investment of amounts held in the trust. While these requirements in some ways resemble the restrictions generally placed on qualified plans under the I.R.C., the resemblance is almost entirely superficial, particularly after the 1997 legislation.

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281. See *infra* Part IV.C (concerning distinguishing IRAs from qualified plans).

282. See Jefferson, *supra* note 8, at 1456; see also *supra* notes 37-38.

283. See Gene Steuerle, *Be Wary of Economic Proclamations on Back-Loaded IRAs*, 76 TAX NOTES 1775, 1775-76 (1997); see also Ellen E. Schultz, *Well-to-Do Benefit from IRA Loopholes: Some Affluent Retirees Are Now Able to Make Deductible Contributions, Use New Roth for Estate Planning*, CHI. TRIB., Jan. 29, 1998, at 3 of "Your Money" Section.

## a. Trust Terms

Under § 408 of the Code, an IRA is defined as a trust established by an individual (or in some cases by an employer for their employees) which meets several specific requirements.<sup>284</sup> The principal requirements center on the IRAs trust characteristics which make it recognizable at least nominally as a separate account. This account has as its trustee someone other than the IRA account holder, such as a bank, as defined in I.R.C. § 408(n), or a non-bank person or entity approved by the Commissioner of the IRS.<sup>285</sup> The deposit of funds into a bank account will not constitute establishment of an IRA in the absence of a specific written plan or agreement.<sup>286</sup>

An IRA must be a domestic trust established for the exclusive benefit of an individual or his beneficiaries,<sup>287</sup> with a formal written agreement containing several distinct limitations on the use of and access to the account. As a result, these positive requirements for IRAs must be enforced by the trustee bank as the manager of the trust according to the trust agreement. First, the agreement must state that no contribution of property other than cash will be accepted, except in the case of a rollover contribution properly made under I.R.C. § 408(d)(3).<sup>288</sup> Second, no contribution in excess of \$2000 for the taxable year will be accepted, except in the case of rollovers under I.R.C. § 408(d)(3).<sup>289</sup> Third, none of the funds will be invested in life insurance contracts.<sup>290</sup> Fourth, the individual's interest in the fund is nonforfeitable.<sup>291</sup> Fifth, the funds held in the trust may not be commingled with other assets except as part of a common investment fund or

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284. I.R.C. § 408 (West Supp. 1998).

285. *See id.* § 408(a)(2).

286. *See* Phelan v. United States, No. CIV.A. 83-1997-z, 1984 U.S. Dist. LEXIS 23634, at \*2-3 (D. Mass., Sept. 13, 1984).

287. *See* I.R.C. § 408(a). In general, individuals must establish an IRA with a bank or other financial institution using either IRS Form 5305, or another IRS-approved prototype written trust instrument. *See* I.R.C. § 408(e)(2)-(3). In addition to individually established IRAs, employers may establish a simplified employee plan, or "SEP-IRA." Simplified Employee Pension, or "SEP" plans, are a type of IRA which may receive from the IRA-holder's employer more than the \$2000 per year contribution generally allowed for IRAs—up to a maximum of \$30,000 or 15% of compensation paid to employees during the tax year. *See id.* §§ 408(j), 408(k)(5); § 415(c)(1)(A) (West Supp. 1998). Almost any employer, including a one-person sole proprietorship, can establish a SEP, but all employees must have IRAs to which the employer must contribute. In order for a SEP to qualify for these higher contribution limits under I.R.C. § 408(k), contributions must be made under a written plan specifying the contribution formula and requirements for allocations to each employee. *See id.* § 408(k). Since SEPs are a form of IRA, all of the IRA requirements discussed here (with the exception of the contribution limits), apply to SEP-IRA accounts as well.

288. *See* I.R.C. § 408(a)(1).

289. *See id.*

290. *See id.* § 408(a)(3).

291. *See id.* § 408(a)(4).

common trust fund.<sup>292</sup> While the statute requires that the trust agreement contain these clauses, there are no direct requirements as to the actual compliance with these clauses during the life of the IRA, or consequences for noncompliance.

#### b. Contribution and Deduction Limits

Under I.R.C. § 219(a), a taxpayer may deduct up to \$2000 per year in contributions to an IRA, under certain circumstances.<sup>293</sup> Deductions are only allowed for cash contributions,<sup>294</sup> and the \$2000 amount is reduced or eliminated for IRA owners who are active participants in a qualified pension plan and certain other retirement plans<sup>295</sup> or who have taxable earnings of less than \$2000 during the taxable year.<sup>296</sup> Nondeductible contributions may also be made to an IRA; nondeductible cash contributions are limited to \$2000 in combination with any deductible contributions to the IRA.<sup>297</sup> Contributions of property other than cash are required to be prohibited by the terms of the trust instrument, except in the case of a rollover of property being distributed from a qualified plan.<sup>298</sup> This places further restrictions on the opportunities for sheltering assets on traditional IRAs than are present for the new Roth IRA.<sup>299</sup>

#### c. Tax-Exempt Trust and Nondeductible Contributions

Amounts held in an IRA meeting all of the requirements of the I.R.C. are exempt from income tax until distributed to the beneficiary, or until the account has ceased to be an individual retirement account.<sup>300</sup> IRAs and SEP-IRAs may receive contributions of property other than cash (including stock or other securities) only as part of a qualifying rollover distribution from a qualified pension plan, or as part of a direct transfer between a qualified plan (or another IRA) and the IRA.<sup>301</sup> The rollover rules are designed to insure that cash or property paid out from a retirement plan will continue to receive tax-favored treatment; however, the taxpayer must immediately (within sixty days for most

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292. *See id.* § 408(a)(5). An employer may establish an IRA for the benefit of their employees, but the IRA generally must meet the same trust requirements of I.R.C. § 408(a). *See id.* § 408(c). I.R.C. § 408 also allows individual retirement annuities, which must generally meet most of the same rules that apply to individual retirement accounts. *See id.* § 408.

293. *Id.* § 219.

294. *See id.* § 219(e)(1).

295. *See id.* § 219(g).

296. *See id.* § 219(b)(1).

297. *See id.* § 408(a)(1).

298. *See id.* § 408(d)(3).

299. *See id.* § 408(d)(3). Under I.R.C. § 408A, there is a \$2000 limit on contributions to the Roth IRA, but there is no requirement that contributions be made only in cash. *Id.* § 408A (West Supp. 1998).

300. *See id.* § 408(e)(1).

301. *See id.* § 408(a)(1), (d)(3)(A)(i).



rollovers) deposit the property or cash into an IRA, without any opportunity to make use of the funds or property for other purposes.<sup>302</sup>

#### d. Penalties on Distributions

Finally, of course, IRAs are at least nominally connected to retirement by the penalties and immediate income tax to which the IRA beneficiary is subject if she withdraws amounts from the IRA trust before age fifty-nine-and-a-half.<sup>303</sup> This structure is essentially the same as that applicable to defined contribution plans generally, except that there is no risk of disqualification of the IRA if amounts are withdrawn early. This penalty structure is not a particularly severe threat, as depending on the interest rate applicable to the account, and the amount of time that interest has been compounding, the account holder might view herself as still coming out ahead in taking an early withdrawal, despite the penalties.

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302. *See id.* § 408(d)(3). The term “rollover” encompasses two general kinds of deposits of cash or property to an IRA from another IRA or certain retirement plans. First, a rollover can occur when a participant receives a distribution of his account from a retirement plan or another IRA and contributes it in a timely fashion to the IRA. *See id.* § 408(d)(3)(A)(i); § 402(a)(5)(C) (West Supp. 1992) (repealed 1993). Second, where the trustee or plan administrator moves the account balance or assets in the account directly to an IRA in the name of the participant, the transaction is also a rollover, since it is deemed to be a distribution of the funds or property to the participant followed by a deposit to the IRA. *See id.* § 408(d)(3)(A)(ii). It is therefore subject to all the rollover rules. *See, e.g.,* Priv. Ltr. Rul. 83-40-098 (July 11, 1983). A distribution from a plan qualified under I.R.C. § 401(a) may be rolled over tax-free into an IRA provided that (1) the property is contributed to the IRA within 60 days of distribution from the plan; and (2) if the property is something other than cash, for example, stock or other securities, the contribution must be the property itself, or the proceeds of the sale of the property. I.R.C. § 402(a)(5) should be used for distributions in years prior to 1993, and I.R.C. § 402(c) (1994) should be used for distributions in 1993 and later. For distributions prior to 1993, only a “qualify[ing] total distribution” or a “partial distribution” from a qualified plan was eligible for rollover treatment. *Id.* § 402(a)(5)(B). A “qualified total distribution” generally was a distribution of the participant’s entire account balance under the plan resulting from the termination of the plan, discontinuance of contributions to the plan, the participant’s retirement, death, disability, or separation from service. *Id.* § 402(a)(5)(E)(i); § 402(e)(4)(A) (West Supp. 1998). A “partial distribution” generally included a distribution of at least 50% of the participant’s account made as a result of the participant’s death, separation from service, or disability. *Id.* § 402(a)(5)(D)(i). The changes made in 1993 generally eliminated the requirements for a total or partial distribution, so that nearly any distribution of cash or property from a qualified plan will be eligible for rollover treatment. *See generally* § 402(c). However, a qualified rollover must still be made within 60 days of distribution, and the property other than cash that is distributed must be the same property contributed, or the proceeds of its sale. *See id.* The other major change made for rollovers after 1992 is that the plan must withhold 20% of any eligible rollover distribution actually paid to the participant, to be paid to the IRS and applied toward the participant’s income tax liability for the year of distribution. *See id.* § 3405(c)(1)(B) (1994). This withholding requirement can be avoided if the amount or property to be distributed is placed directly into the participant’s IRA by the plan administrator, rather than being paid out to the participant for later deposit to the IRA. *See id.* § 3405(c)(2).

303. *See id.* § 72(t)(2)(A)(i) (West Supp. 1998).

Moreover, changes made in the Taxpayer Relief Act of 1997 further reduce the consequences of taking at least limited sums out of IRAs before retirement. Taxpayers are now allowed to withdraw up to \$10,000 for buying a first home with no penalty;<sup>304</sup> similarly early, penalty-free withdrawals are allowed for higher education costs.<sup>305</sup> As a result, taxpayers are now even more likely to treat IRAs as funding mechanisms for purposes completely unconnected to retirement.

In summary, a traditional IRA under § 408 of the I.R.C. can be distinguished from an unrestricted savings account in several ways. These distinctions are primarily intended to limit the size of the tax benefit inuring to the taxpayer as a result of the deferral of taxation on deductible contributions and interest earnings on accumulations in the account. However, the restrictions on early withdrawals from the account are not actual restrictions, but rather penalty mechanisms that have the effect of requiring repayment of some or all of the tax subsidy inherent in the deferral of tax on amounts contributed and held in the IRA. Because there is no annuity payment requirement, and no actual restrictions that force payouts only in retirement, it is difficult to consider IRAs true retirement plans.

### *B. Roth IRAs: A Further Remove from Retirement Security*

The shortcomings of traditional IRAs as true retirement income vehicles, discussed above, are magnified in the case of the newly enacted Roth IRAs, under I.R.C. § 408A.<sup>306</sup> While state laws generally do not yet refer to Roth IRAs specifically, since Roth IRAs were a recent federal legislative creation, the proposed federal bankruptcy reform legislation did include I.R.C. § 408A as one of the categories of tax-favored retirement accounts that would receive essentially blanket exemption from the bankruptcy estate under federal law.<sup>307</sup>

However, in light of the lack of connection between the requirements for Roth IRAs and consumption of tax deferred income in retirement, it is difficult to see the case for extension of favorable treatment in bankruptcy to them. First, contributions to a Roth IRA are not deductible from income,<sup>308</sup> unlike contributions to qualified pension arrangements, and to deductible IRAs. Therefore, there is little, on the front end, to distinguish Roth IRA contributions from normal savings accounts which are, of course, available to satisfy creditors' claims under both federal and state laws.

Perhaps as importantly, taxpayers may withdraw their contributions from a Roth IRA at any time after five years without penalty, similar to a normal savings account; only amounts attributable to earnings on those contributions are subject to penalties for premature distributions similar to those applicable to regular

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304. *See id.* § 72(t)(2)(F).

305. *See id.* § 72(t)(2)(E), (F).

306. Roth IRAs were enacted as part of the Taxpayer Relief Act of 1997, P.L. No. 105-34, § 302(a), 111 Stat. 788, 825-28, which added new § 408A to the I.R.C.

307. *See* H.R. CONF. REP. NO. 105-794 § 203 (1998). New Hampshire appears to be the first state to explicitly protect Roth IRAs. *See infra* Appendix A.

308. *See* I.R.C. § 408A(c) (West Supp. 1998).

IRAs, described above.<sup>309</sup> As a result, the approach taken in the 1998 bankruptcy reform legislation provides protection for accounts that, except for the favorable tax treatment given earnings on amounts held in the accounts, in every way resemble ordinary savings accounts. If the rationale for protecting amounts held in pension accounts is based in large part on their fidelity to spendthrift trusts, there seems to be no reason to extend that protection to Roth IRAs.

### *C. Distinguishing IRAs from Qualified Plans*

The statutory requirements for IRAs, with the exception of the prohibited transaction disqualification provisions, generally center on the language of the trust instrument. This approach is similar to the language first used in the I.R.C. to establish requirements for qualified pension plans—for example, in § 401(a)(2) of the I.R.C., the trust instrument must prohibit the use of trust assets for any purpose other than for the exclusive benefit of the employees participating in the plan.<sup>310</sup> Such language-based restrictions focus on the instrument and the moment of establishment of the trust or pension arrangement, with little attention to the operation of the trust in the period following adoption of the trust instrument. The burden of insuring compliance with the terms of the trust instrument necessarily falls on the trustee, which in the case of most IRAs is the financial institution sponsoring the account, but the statute provides no sanctions for noncompliance by the trustee.

In contrast, the core of the pension qualification requirements—nondiscrimination in benefits or contributions, vesting after a maximum period of years of service, etc.—do not rely on prescriptive trust language, but rather require substantive results in the course of the plan's operation. Moreover, the fiduciary duty requirements of ERISA, combined with the avenues for participant lawsuits against plan administrators and sponsors, provide a clear compliance mechanism for enforcement of ERISA requirements that are not connected to the tax qualification of the plan.

This difference in approach expresses the essential distinction between qualified pension plans and IRAs. The qualified plan requirements of the Code have been characterized as fundamentally paternalistic in that they require behavior from employees—essentially deferral of consumption until retirement—that individual employees might not choose to engage in if given the choice.<sup>311</sup> IRAs, on the other hand, are established, contributed to, and maintained almost solely at the discretion of the individual. The choice to immediately consume all or part of the amounts held in the IRA, rather than waiting for retirement, involves a monetary penalty but no disqualification for the trust. Moreover, the decision itself is unmediated by plan administrators or a qualified plan instrument that frequently simply forbids early distributions (other than in termination of employment cases) as a matter of policy and administrative

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309. *See id.* § 408A(d).

310. *Id.* § 401(a)(2).

311. *See generally* Deborah M. Weiss, *Paternalistic Pension Policy: Psychological Evidence and Economic Theory*, 58 U. CHI. L. REV. 1275 (1991).

convenience. This difference in approach gives rise to several specific areas of contrast between qualified plans and IRAs that are significant in determining the treatment of IRAs in bankruptcy.

### 1. No Coverage under ERISA

First, as pointed out by the Supreme Court in *Patterson*, IRAs are not governed by ERISA.<sup>312</sup> Under ERISA § 4(a), Title I of the Act applies to all “employee benefit plan[s].”<sup>313</sup> An employee benefit plan is defined under ERISA as either an employee welfare benefit plan or an employee pension benefit plan established or maintained by an employer or an employee organization.<sup>314</sup> Employee pension benefit plans are defined as plans maintained by an employer or employee organization to provide retirement income to employees, or to provide for deferral of income for employees up to or beyond the termination of their employment.<sup>315</sup> While there is no specific exclusion of IRAs from coverage under ERISA, as there is, for example, for church plans and governmental plans,<sup>316</sup> IRAs established by individuals do not provide benefits for employees and are not established by either an employer or employee association. As a result, at least this type of IRA is not covered by ERISA, including the provisions of Part 2 of Title I of ERISA prohibiting the assignment or alienation of pension plan benefits.<sup>317</sup>

The immediate consequence for purposes of the Bankruptcy Code is that the anti-alienation provision of ERISA § 206(d) does not extend to IRAs; therefore it does not constitute for IRAs a restraint on alienation that is applicable under nonbankruptcy law, as required by § 541(c)(2) of the Bankruptcy Code for exclusion of a trust from the bankruptcy estate under the federal statute.<sup>318</sup> As a result, IRAs can be protected from creditors in bankruptcy under state law exclusion or exemption statutes, or under the partial exemption provided by § 522(d)(10)(E) of the Bankruptcy Code, but are not exempted from the bankruptcy estate under § 541(c)(2) under *Patterson*.

### 2. Enforcement of IRA Rules—Disqualifying Events, Penalties Under the I.R.C., and Lack of Oversight

Once an IRA trust is established under a written instrument satisfying the foregoing requirements, it will not cease to be considered an IRA under the I.R.C. unless the individual who established the IRA does one of the following: engages in a prohibited transaction (as defined in I.R.C. § 4975), borrows from the IRA

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312. *Patterson v. Shumate*, 504 U.S. 753, 759-60 (1992).

313. 29 U.S.C. § 1003(a) (1994).

314. *See id.* § 1002(3).

315. *See id.* § 1002(2)(a)(i)-(ii).

316. *See id.* § 1003(b)(1)-(2).

317. *See* 29 U.S.C.A. § 1056(d)(1) (West Supp. 1998). This interpretation leaves open the possibility of coverage under ERISA for IRAs that are established for employees as part of an employer-provided pension plan, as in a SEP-IRA.

318. *See Patterson*, 504 U.S. at 762-63.

account, or uses the account as security for a loan.<sup>319</sup> Thus, the consequences of violating the IRA rules concerning the monetary limit on deposits, or the prohibition on placing property other than cash in an IRA account outside of a rollover from a qualified plan, are merely the imposition of monetary fines. The tax status of the account itself remains unaffected.

a. Tax Consequences of Excess or  
Nonqualifying Contributions

While, as stated above, the IRA trust agreement must prohibit acceptance of contributions in excess of \$2000 in any taxable year, and acceptance of contributions of property (other than rollovers), an IRA will not automatically be disqualified as a result of excess or property contributions. Under I.R.C. § 4973, an excise tax of 6% per year of the amount of excess contributions to an IRA is assessed until the excess amounts are withdrawn from the IRA.<sup>320</sup> This penalty generally is intended to serve as a substitute for treating the excess contributions like holdings in a normal account, generating earnings which would be taxable.<sup>321</sup>

In general, this excise tax can only be avoided by withdrawing the excess amounts from the IRA; at that point, the amounts are subject to the additional 10% early distribution penalty (if the taxpayer has not yet reached age fifty-nine-and-a-half)<sup>322</sup> and are treated as additional taxable income in the year of withdrawal, even if the amounts represent nondeductible contributions to the IRA out of income that has already been subject to income tax.<sup>323</sup> In addition, if any amounts were distributed to the taxpayer and not timely rolled over to an IRA, those amounts will be taxable income to the taxpayer in the year of distribution, even if they were later deposited in the IRA.

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319. See I.R.C. § 408(e)(2)-(3) (West Supp. 1998); *id.* § 4975. Property distributed to a participant, such as stock or other securities, is eligible for rollover treatment so long as the actual property distributed, or the proceeds of the sale of the property, is deposited into the IRA within the required 60-day time limit. See *id.* § 402(c)(1)(C) (1994) (for distributions after 1992); § 402(a)(5)(A)(iii), (a)(5)(C) (West Supp. 1992) (repealed 1993) (for distributions in 1992 and earlier). The mere registration of stock in the name of an IRA, without the actual transfer of the shares to the trustee of the IRA account, will not constitute a valid rollover; the physical transfer of shares is required for a valid completed rollover to an IRA. See Priv. Ltr. Rul. 88-04-014 (Oct. 27, 1987); *id.* 80-07-030 (Nov. 21, 1979); *id.* 79-28-075 (Apr. 13, 1979).

320. I.R.C. § 4973 (West Supp. 1998).

321. See *Benbow v. Commissioner*, 82 T.C. 941, 950 (1984).

322. See I.R.C. §§ 408(a); *id.* 72(t) (West Supp. 1998).

323. Corrective techniques are available for IRA owners who withdraw excess contributions, and any earnings on such contributions, before the due date of their tax returns for the tax year of the contribution. Such corrective withdrawals still result in a 10% penalty but the amounts withdrawn are treated as if they had never been contributed. See *id.* §§ 408(d)(4), 4973(b). This provision only applies to excess contributions for which no deduction from income was taken by the taxpayer. See *id.* § 408(d)(4)(B). If nonqualifying contributions that have not been declared as income by the taxpayer are made to an IRA, the taxpayer may be subject to prosecution for tax evasion or fraud. See *Arnold v. Commissioner*, 67 T.C.M. (CCH) 2351 (1994).

### b. Prohibited Transactions

Prohibited transactions generally encompass the types of transactions that could be considered self-dealing on the part of a trustee or beneficiary or, in the case of an IRA, the owner-settlor of the trust with respect to amounts held in the trust. Examples of prohibited transactions under the I.R.C. include sale or lease of any property between the IRA and the disqualified person, and borrowing money from the IRA.<sup>324</sup> The Department of Labor has also suggested that the use of funds in an IRA to purchase stock (through a stock option plan) in a company of which the owner of the IRA was a director and shareholder, might constitute a prohibited transaction under I.R.C. § 4975(c)(1)(D) or (E).<sup>325</sup> These two sections prohibit any direct or indirect use of plan assets by or for the benefit of a disqualified person or a fiduciary of the account.<sup>326</sup>

However, even though loans from an IRA to the account owner are a disqualifying event, it is possible that the use of an IRA account as *security* for a loan may not constitute a prohibited transaction under I.R.C. § 4975. While I.R.C. § 4975(c)(1)(D) states that a use by a disqualified person (the IRA owner, in this case) of the assets held by the plan (the IRA) is a prohibited transaction, I.R.C. § 408(e)(4) provides that amounts held in an IRA that are used as security for a loan will be considered to have been distributed to the IRA beneficiary.<sup>327</sup> This treatment would seem to override the prohibited transaction rule, since the constructive distribution called for under I.R.C. § 408(e)(4) would result in taxable income in that amount to the recipient, and would trigger a 10% penalty tax if the recipient had not yet reached age fifty-nine-and-a-half.<sup>328</sup> If the use of an IRA as security for a loan were not a prohibited transaction, the remainder of the IRA trust that was not pledged would presumably retain its exempt status.

If a prohibited transaction occurs, the account ceases to be an IRA. As a result, the earnings on the amounts held in the account cease to be tax exempt as of the first day of the year in which the transaction occurs, and the fair market value of the entire amount held in the account as of the first day of taxable year is included in the taxpayer's taxable income.<sup>329</sup> This penalty is comparable to the penalty of disqualification levied under the qualified plan structure of § 401(a) and its related requirements.<sup>330</sup> However, the circumstances under which the prohibited transaction rules might be violated with respect to an IRA are likely to occur infrequently and are easily avoided, so long as the IRA amounts are invested in publicly held stock or mutual funds or other common financial vehicles.

The enforcement mechanisms for qualified plans and for IRAs are thus starkly contrasted. The I.R.C. requirements for qualification of pension plans rely on the "atom bomb" of disqualification for enforcement of nondiscrimination and other

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324. See I.R.C. § 4975(c)(1).

325. See DOL Advisory Opinion 89-03A (Mar. 23, 1989).

326. See *id.*

327. I.R.C. §§ 4975(c)(1)(D); 408(e)(4).

328. See *id.* § 72 (t)(2)(A)(i).

329. See *id.* § 408(e)(2).

330. See discussion *supra* Part III.C.3.

rules. The result is an immediate and, if necessary, retroactive stripping of tax-exempt status from a pension trust itself, in addition to acceleration of taxable income for beneficiaries. Because the beneficiaries of the pension plan, the employees themselves, are most likely to suffer the consequences of disqualification, the penalty is rarely used by the IRS, and serves primarily as a threat to induce compliance with the qualification rules.

In contrast, the consequences of breaking most rules under § 408 of the I.R.C. invoke a much less extensive cost-benefit analysis for the potential wrongdoer with an IRA. For example, the physician who has committed Medicaid fraud and owes the state several hundred thousand dollars in damages and penalties might, in order to escape the judgment, contemplate depositing a few million dollars worth of stock in an IRA (a transaction that violates the I.R.C. requirements). She will clearly stand to gain more from that violation, achieving perhaps complete protection of the value of that stock from creditors, than she will lose in penalties if the IRS ever discovers the error, a long-shot given the low audit rate. At worst, her action has achieved at least a deferral of the day when creditors can tap the amounts placed in the IRA.

The result of treating IRAs as retirement accounts under state law in this situation is protection for a debtor who likely has more than enough assets to pay her debts without suffering much reduction in her standard of living in retirement. This protection is gained directly as a result of statutes intended to preserve retirement income for those who would be impoverished and require government assistance in old age without their retirement savings. It seems safe to say that this was an unintended result of both federal and state statutes.

#### *D. Confusion in the Courts*

The hybrid character of IRAs—tax-favored but not covered by ERISA, self-settled trusts benefitting a sole owner whose access to funds is nonetheless limited by penalties on premature withdrawals—has created substantial difficulties for courts continuing to struggle with their appropriate treatment in bankruptcy, and under state debtor-creditor law generally. Many courts have focused initially on whether IRAs can be excluded from the bankruptcy estate under § 541(c) of the Bankruptcy Code, because of either a restriction on alienation provided either by state laws protecting IRAs generally, or an anti-alienation provision contained in the IRA instrument itself.<sup>331</sup> Where the federal

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331. See *Meehan v. Wallace (In re Meehan)*, 102 F.3d 1209 (11th Cir. 1997).

We conclude that the § 541(c)(2) exclusion is not lost merely because the IRA document itself does not contain the restriction, it being contained instead in the Georgia statute. Our conclusion is supported by the plain meaning of the language of § 541(c)(2), which requires only that the restriction be "enforceable under applicable nonbankruptcy law." Nothing in the language of the statute suggests that the restriction must be contained both within a relevant nonbankruptcy statute and also within the trust instrument itself. Section 18-4-22(a) of the Official Code of Georgia Annotated clearly constitutes "applicable nonbankruptcy law." In order for the restriction in § 18-4-22(a) to be enforceable, nothing in Georgia law requires that the restriction be repeated in any IRA document. Common sense also

bankruptcy exemptions apply, courts have focused on whether IRAs are "retirement plans" covered by the partial exemption provided under § 522(d)(10) of the Bankruptcy Code.<sup>332</sup> Where the federal bankruptcy exemptions do not apply, in opt-out states, for example, courts must determine whether state statutes exempting "retirement accounts" in general apply to IRAs.<sup>333</sup>

supports our interpretation; a restriction is no less enforceable because it is located in the statute rather than in the document.

*Id.* at 1211-12 (footnotes omitted); *see also In re Yuhas*, 104 F.3d 612 (3d Cir. 1997).

The issue in this appeal is whether a New Jersey statute, N.J.S.A. § 25:2-1(b), that protects a qualified individual retirement account (IRA) from claims of creditors constitutes a "restriction on the transfer of a beneficial interest of the debtor in a trust" within the meaning of 11 U.S.C. § 541(c)(2) and thus results in the exclusion of the IRA from a bankruptcy estate. We hold that it does, and we therefore affirm the decision of the district court.

*Id.* at 613. *But see In re Snyder*, 206 B.R. 347 (Bankr. M.D. Pa. 1996).

I conclude that a statute exempting certain assets from execution is insufficient to exclude that asset from estate administration. If it were otherwise, all Pennsylvania exemptions would be excluded from administration regardless of a debtor's election under 11 U.S.C. § 522(b). To so hold would allow a debtor to elect the federal exemptions under 11 U.S.C. § 522(d) while resting assured that all property under its state law exemptions would be excluded from administration. The election of exemptions provided by 11 U.S.C. § 522(b) would be meaningless. This would lead to an absurd result and thus the statute cannot be so read.

*Id.* at 349 (each emphasis in original). *Accord In re Van Nostrand*, 183 B.R. 82 (Bankr. D.N.J. 1995).

The debtor, on the other hand, argues that N.J.S.A. § 25:2-1(b) provides the necessary restraint on alienation.

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The debtor's argument fails for two reasons. First, the IRA in question does not contain a restraint on alienation clause. . . .

Further, even if the transfer restriction may be applicable by statute only, the language of § 25:2-1(b) does not contain a restraint on alienation. The test for exclusion pursuant to 11 U.S.C. § 541(c)(2) is whether the debtor is precluded from transferring an interest in a trust, not whether the creditors may reach the trust assets.

*Id.* at 84-85.

332. *See In re Carmichael*, 100 F.3d 375, 378 (5th Cir. 1996) ("[F]or purposes of section 522(d)(10)(E), an IRA is a 'similar plan or contract.'").

333. *See In re Dubroff*, 119 F.3d 75 (2d Cir. 1997).

Section 282 of New York Debtor and Creditor Law specifies the permissible exemptions a debtor may claim under the Bankruptcy Code. This statute applies because New York has exercised the option available to states to replace the federal exemption statute with a state exemption statute.

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It is plain to us that subsection 2(e) of the [NYS statute] generally exempts stock bonus, pension, profit-sharing, and similar plans making payments on account of age. However, subprovisions (i)-(iii) within subsection 2(e) restrict the exemption by excluding plans with certain features: if (i) the plan was established by the debtor or an "insider," (ii) the plan makes payments "on account of age," and (iii) the plan does not qualify under § 408 of the I.R.C. Thus, as we read § 282, if the plan qualifies under § 408 of the I.R.C. and makes payments on



Even where a state law specifically cross-references § 408 of the I.R.C. in its exemptions of retirement accounts from the claims of creditors, courts must still settle a wide range of issues depending on the phrasing of the particular state statute in question. For example, courts have had to decide whether state statutes protecting IRAs might be viewed as preempted by ERISA,<sup>334</sup> whether state statutes providing only partial protection for IRAs should nonetheless protect all of a rollover contribution from a qualified plan trust that would have been excluded from the bankruptcy estate under § 541(c) of the Bankruptcy Code,<sup>335</sup> and whether debtors' current assets should include amounts eligible for distribution, but not yet actually distributed from, an IRA.<sup>336</sup> Underlying all of these issues, of course, is the continuing unanswered question of why tax-qualified status of IRAs should render them in any way especially worthy of protection from creditors' claims.

One influential recent decision in the Fifth Circuit, *Carmichael v. Osherow (In re Carmichael)*, in which the court determined that the debtor's IRA should be exempt from the claims of creditors because of its similarity to true retirement plans,<sup>337</sup> seems to encapsulate the trend of decisions dealing with IRAs. The court

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account of age, the plan is not excluded under subdivisions (i)-(iii) and the plan is exempt.

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An examination of § 522(d)(10)(E) of the Bankruptcy Code, the federal provision that applies in those states that have not opted out of the federal exemption scheme, confirms our holding because the federal provision is similar in all respects material to our inquiry to New York's § 282(2)(e).

*Id.* at 76-78 (citations omitted).

334. *See In re Schlein*, 8 F.3d 745, 753 (11th Cir. 1993) (holding that Florida state laws were not preempted by ERISA and were effective to exempt the Chapter 7 debtor's IRAs from the bankruptcy estate); *see also In re Green*, 178 B.R. 533, 537 (Bankr. M.D. Fla. 1995).

335. *See In re Barshak*, 106 F.3d 501, 504-05 (3d Cir. 1997) (holding that the language of the Pennsylvania statute protecting only limited amounts held in an IRA could not be interpreted to protect the entire amount of a rollover from a qualified plan); *see also In re Houck*, 181 B.R. 187 (E.D. Pa. 1995) (holding that the mere fact that amounts were rolled over into an IRA from a qualified plan does not provide protection to the amounts held in the IRA).

In the case at bar, Debtor's distributed interest in the Colebrook Farms ERISA-qualified plan was rolled over to an IRA. Under *Velis* and *Colville*, the distribution rendered the funds accessible to creditors, even if Debtor chose a rollover that could not be readily liquidated. In this case, the rollover to an IRA consisted of a deposit in a bank in the form of a savings account. In *Nationsbank of North Carolina v. Shumate*, the court of appeals held that ERISA's anti-alienation protection does not continue after actual distribution of the pension, even during the 60-day rollover period, when the pension funds are deposited into a bank account. The IRA in the matter before us is a bank account to which Debtor has immediate and unrestricted access, notwithstanding certain provisions in the documents that established the account, which will be addressed below. We find that the rollover does not afford the protection Debtor seeks.

*Id.* at 190 (citation omitted).

336. *See In re Solomon*, 67 F.3d 1128, 1133 (4th Cir. 1995) (holding that amounts held in an IRA belonging to a Chapter 13 debtor could not be considered available income prior to actual distribution).

337. 100 F.3d 375 (5th Cir. 1996).

in *In re Carmichael* specifically addressed and rejected the notion that the presence or absence of restrictions on ability to withdraw amounts in the trust should determine whether amounts held in an IRA are subject to the claims of the creditors.<sup>338</sup> The *Carmichael* court also rejected arguments that the lack of an anti-alienation provision in the IRA trust language should make it ineligible for protection under the Bankruptcy Code:

We reject out of hand the Trustee's argument that the absence of an anti-alienation provision in the IRA destroys its exemptibility. This argument is grounded first in the fact of control by the debtor. That the debtor has control over the IRA, penalty notwithstanding, does not destroy its exemptibility. Control is a concept applicable to the determination of whether an asset belongs to the estate, a determination that is made before the question of exemption is ever reached. Once the asset is included in the estate, the concept of control evanesces; control is simply irrelevant to the question of exemption. Indeed, other exempt assets, such as personal residences, remain in the debtor's control following a discharge.<sup>339</sup>

The court directly appealed to the fresh start purpose of the discharge in bankruptcy retirement policy as a rationale for protecting IRAs which had few of the characteristics of the kinds of pension trusts normally protected under the Bankruptcy Code:

Finally, exempting IRAs comports with the very policy furthered by exemptions—providing the honest debtor with a fresh start. More

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338. *See id.* at 378.

The plain language of the subject section [of the Bankruptcy Code] supports the conclusion that control by a debtor does not destroy exemptibility. True, to be exempt, the right to receive a payment under a "similar plan or contract" must be "on account of illness, disability, death, age, or length of service." Yet nowhere do the words "only" or "solely" appear. The language of the subject section does not express a requirement that the right to receive a payment under a "similar plan or contract" be conditioned "only" or "solely" or "exclusively" on one of the five listed events. None dispute that the list is exclusive and mandatory in that (1) the right to receive payment under a "similar plan or contract" must be triggered by at least one of the five events, and (2) the right to receive the payment cannot be either totally unfettered or not triggered by *inter alia* one of the five listed events.

An entirely separate question, however, is whether exemptibility is destroyed if, despite the right to receive the payment being triggered by one or more of the five listed events, such right can be triggered as well by some additional event, occurrence, or status that is not listed. Simply stated, the Trustee's argument is that the presence of such an additional factor somehow blocks or destroys exemptibility despite the presence of one of the five requisite events. We disagree: As long as the right to receive a payment under a plan or contract can be triggered by one or more of the five listed events, and is therefore exemptible, the fact that payments can also be triggered by some additional factor—or absence of some additional factor—cannot destroy exemptibility. Once one (or more) of the listed events is found to apply, it (or they) need not be the sole prerequisite to all rights to receive payment. Neither need the listed event (or events) block the right to receive payment under some other situation.

*Id.* at 378-79 (quoting 11 U.S.C. § 522(d)(10)(E) (1994)) (emphasis and parentheticals in original) (footnote omitted).

339. *Id.* at 378.

specifically, exempting IRAs furthers the policy behind the pension exemption—protecting a debtor's future income stream. And the Code even contains a safeguard to avoid potential abuse when it limits exemption to only such portion of the otherwise exemptible payments that the bankruptcy court deems necessary for the support of the debtor and any of his dependents.<sup>340</sup>

There are several problems with this reasoning, which has been cited approvingly in cases after *In re Carmichael*.<sup>341</sup> First, there is an inherent contradiction in applying the fresh start rationale to the case of retirement savings which are intended to support consumption, rather than additional earnings, in old age. Second, control over distributions from an IRA implies the debtor can use the asset for something other than consumption in retirement, particularly that control may allow acceleration of consumption in advance of old age, in contravention of the delay in consumption that is the sole reason for the exemption. The comparison to other exempt assets which the debtor still controls, such as the personal residence, is inapposite, since the homestead exemption is intended to support a particular kind of current consumption—that is, a place to live. Should the debtor rent the house out, the money received could still be seen as supporting current consumption including paying for a place to live. It is the enforced deferral of consumption that sets "retirement account" exemptions apart from other types of exemptions, and which should require enforceable limits on access before retirement before the debtor can protect such assets from creditors.

#### V. CONCLUSION

An examination of the permutations possible under the rubric of "retirement account" leads to the conclusion that at a minimum, IRAs, as they are currently structured and in particular as they have been altered and expanded to encompass non-retirement savings objectives in the most recent tax legislation, have too tenuous a connection to preservation of a necessary stream of income in retirement to deserve the degree of protection afforded qualified retirement plans under the *Patterson v. Shumate* standard. More broadly, few, if any, tax-qualified retirement arrangements can be justifiably protected from creditors in bankruptcy, regardless of the presence or absence of trust anti-alienation provisions that may provide a technical basis for exclusion from the bankruptcy estate.

Only traditional defined benefit pension plans, under which the employee performs receives an annuity payment in such a way as to virtually insure the pension's use for retirement support, fit at all comfortably into any consistent theory of bankruptcy protection for retirement assets. Even these plans, however, can provide retirement income far in excess of what most would consider "reasonable support." However, the conclusion we might reach once the current protections are stripped away—that only amounts projected to produce a poverty-level or just-above-poverty-level stream of income in retirement should be protected in bankruptcy regardless of the type of account in which those amounts are held—may be too distasteful to pursue. Such a conclusion implies a kind of

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340. *Id.* (footnote omitted). The court cited *In re Hickenbottom*, 143 B.R. 931, 933 (Bankr. W.D. Wash. 1992), in support of this proposition.

341. *See, e.g., In re Rawlinson*, 209 B.R. 501 (B.A.P. 9th Cir. 1997).

continuing means-testing in old age for those unlucky or improvident enough to have gone into bankruptcy at any point during their working lives.

It thus seems unlikely that the Supreme Court will reverse its decision in *Patterson* and abrogate to any substantial degree the protection currently granted qualified pension plans. It is also probable that some degree of protection will continue to be afforded to other "retirement accounts" not covered by ERISA. If we are determined to continue to provide protections to any such arrangements, therefore, changes to both state and federal law are required, to clarify current policies and make current protections consistent with the substantial changes recently enacted by Congress that may effectively have taken the "R" (for retirement) out of "IRA."

If limited measures designed to prevent only abusive cases in connections with IRAs are all that can be feasibly undertaken, two types of changes would help eliminate the most egregious problems. First, a model state statute revision would provide more consistent treatment of retirement accounts in all jurisdictions. Such a statute would protect only IRAs established and used to hold amounts distributed out of qualified retirement plans where the debtor was required to take a distribution and had no other qualified pension plan available to receive a rollover distribution. Second, limited changes to the Internal Revenue Code would expand the circumstances under which IRAs might lose their tax-favored status, in order to prevent the use of IRAs to shelter assets that may have been deposited in an IRA in violation of I.R.C. restrictions.

To be effective, these changes would probably require both significantly higher levels of IRS monitoring of IRAs than is currently being undertaken, and higher penalties placed on the financial institutions serving as IRA trustees who do not properly monitor IRA deposits. Nonetheless, if we wish to accord IRAs something of the status of qualified retirement plans protected under ERISA and the *Patterson v. Shumate* standard, we must perforce develop a regulatory scheme for IRAs that is closer to the qualified plan model. Ultimately, we may decide that this is too high a price to pay for consistency and predictability in the law. In which case, the lack of connection between a reasonable level of retirement income and IRAs of any description should render at least those accounts ineligible for the protections afforded qualified pension plans even after productive labor has ended.

The larger question of using the tax and bankruptcy laws to protect the institution of retirement itself must also be revisited. As the nature of work itself changes in the next century, the assumption that most Americans can spend both the first twenty years and the last thirty or more years of their lives in non-income producing activity may need to be severely revised. The current trend, however, is not encouraging, as the convergence of pension, bankruptcy, and tax policy has produced a structure that protects the well-off, even in bankruptcy, at the expense of the less fortunate debtor who was unable to take advantage of tax incentives for retirement savings.

APPENDIX A. STATE LAW PROTECTION OF RETIREMENT  
ACCOUNTS FROM CREDITORS<sup>a</sup>

SECTION I. RETIREMENT ACCOUNT PROTECTION AGAINST  
CREDITORS

(Note: States that provide protection of retirement plans against creditors generally have an exception for alimony or child support payments. Fraudulent contributions are also not exempt.)

ALABAMA: does not specifically exempt retirement plans from creditors under the chapter of the Alabama Code entitled "Exemptions." *See* ALA. CODE §§ 6-10-1 to 6-10-26 (1993). However, a qualified trust may not be assigned or alienated, voluntarily or involuntarily; this may not be waived by a participant or beneficiary. *See id.* § 19-3-1(b)(1). Qualified trusts include those qualifying under I.R.C. §§ 401(a) and 7701(a)(37). *See id.* § 19-3-1(b)(5)(d), (b)(5)(d)(3).

ALASKA: exempts from claims of creditors, interests in or money payable from, individual retirement plans. *See* ALASKA STAT. § 09.38.017(a)(1), (a)(2) (Michie 1996). "Retirement plans" include plans qualifying under I.R.C. §§ 401(a) and 408. *See id.* § 09.38.017(e)(3).

ARIZONA: exempts from any and all creditors' claims, money payable from or any interest in, a retirement plan qualifying under I.R.C. §§ 401(a) or 408. *See* ARIZ. REV. STAT. ANN. § 33-1126(C) (West Supp. 1997).

ARKANSAS: exempts from attachment, execution, and seizure for the satisfaction of debts, payments from or interests in pension, profit-sharing, or similar plan or contract, including individual retirement annuities that qualify under the applicable I.R.C. provision. *See* ARK. CODE ANN. § 16-66-220(a) (Michie Supp. 1997). Contributions to an IRA in excess of amounts deductible under the I.R.C. are not exempt unless otherwise exempt by law. *See id.* § 16-66-220(b).

CALIFORNIA: exempts private retirement plans, including pension and profit-sharing plans, up to the maximum amount. *See* CAL. CIV. PROC. CODE §§ 703.010(a), 704.115(a)(3) (West 1998). Both the trust and the payments made to the plan participant are exempt. *See id.* § 704.115(b), (d).

COLORADO: exempts from attachment, execution, or garnishment a limited amount based on a debtor's disposable earnings. *See* COLO. REV. STAT. ANN. § 13-54-104(2)(a) (West Supp. 1998). Colorado amended § 13-54-104(1) in 1991. Pre-1991, the statute read in pertinent part as follows: "'Earnings' means

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a. This Appendix was prepared by Ellen Sueda, LL.M., Univ. of Florida, 1997.

compensation paid or payable for personal services, whether denominated as wages, salary, commission, bonus, *avails of any pension or retirement benefits, or deferred compensation plan*, avails of health, accident, or disability insurance, or otherwise." *Id.* § 13-54-104(1)(b) (West 1990) (emphasis added). The amendment removed the clause "avails of any pension or retirement benefits, or deferred compensation plan." *Id.* Although there is no case law interpreting the change, there is a strong implication that the Colorado legislature intended such a change to remove all private retirement plans from exemption.

CONNECTICUT: exempts from creditors interests in or amounts payable to debtors from a plan or a retirement plan qualified under I.R.C. §§ 401, 403, 404, or 409. *See* CONN. GEN. STAT. ANN. § 52-321a(a)(1) (West Supp. 1998). IRAs and IRA annuities qualified under I.R.C. § 408 are also exempt to the extent funded, including amounts from income, appreciation, and roll-overs. *See id.* § 52-321a(a)(2). The exemption is limited to contributions not exceeding the maximum annual limits set forth in I.R.C. § 219(b). *See id.* Contributions made to a trust, within 90 days of the filing of a creditor's claim in court, by a 1% or greater shareholder in the plan sponsor are not protected. *See id.* § 52-321a(c).

DELAWARE: does not exempt Keoghs, IRAs, or IRA annuities from creditors. *See* DEL. CODE ANN. tit. 10, §§ 4901-4914 (1975 & Supp. 1996).

DISTRICT OF COLUMBIA: exempts from distraint, attachment, levy, or seizure and sale on execution or decree of any court annuities or retirement payments up to a limited amount. *See* D.C. CODE ANN. § 15-503 (1995).

FLORIDA: exempts from attachment or garnishment process, any payments from or interests in retirement plans qualified under I.R.C. §§ 401(a) or 408. *See* FLA. STAT. ANN. § 222.21(2)(a) (West 1989).

GEORGIA: exempts from garnishment, funds in or benefits from, IRAs or IRA annuities as defined in I.R.C. § 408. *See* GA. CODE ANN. § 18-4-22(a) (1991). In addition, Georgia exempts from garnishment funds and benefits from a pension or retirement program as defined in 29 U.S.C. § 1002(2)(A) ("employee pension benefit plan" or "pension plan" as defined in ERISA). *See id.* There is no mention of Keoghs.

HAWAII: exempts from attachment, execution, and seizure, the right of a debtor to a retirement plan described in I.R.C. §§ 401(a) or 408. *See* HAW. REV. STAT. § 651-124 (1996). The exemption does not extend to contributions made to the plan within three years before the date the civil action was initiated against debtor. *See id.*

IDAHO: exempts from execution, attachment, garnishment, seizure, or other levy by or under any legal process, the rights to or benefits payable from, a plan or arrangement qualifying under I.R.C. §§ 401(a) or 408. *See* IDAHO CODE § 11-604A(3) (1998). In addition, Idaho exempts money or other assets payable under a retirement plan qualified under I.R.C. §§ 401(a) or 408 "from all claims of

judgment creditors of the beneficiary or participant arising out of negligent or otherwise wrongful act or omission of the beneficiary or participant resulting in monetary damages to the judgment creditor." *Id.* § 55-1011(1) (1994).

ILLINOIS: exempts from "judgment, attachment, execution, distress for rent, and seizure for the satisfaction of debts," the right to the assets held in or to receive, funds from pension and profit-sharing plans, Keoghs, IRAs, and IRA annuities qualifying under the applicable section of the I.R.C. *See* 735 ILL. COMP. STAT. 5/12-1006(a)-(b) (West 1992).

INDIANA: exempts interest that debtors have in a retirement plan from levy or execution or any other final process from a court, for a judgment founded upon an express or implied contract or a tort claim. *See* IND. CODE § 34-55-10-2(b)(6) (1998). Retirement plan includes Keoghs, IRAs, and IRA annuities "*intended in good faith*" to qualify under the I.R.C. *Id.* § 34-6-2-131 (emphasis added). Such interest is limited to contributions by or on behalf of the debtors of amounts not subject to federal income tax. *See id.* § 34-55-10-2(b)(6)(A). Earnings on contributions and roll-overs are also exempt. *See id.* § 34-55-10-2(b)(6)(B), (C).

IOWA: exempts from execution a portion of a payment under a pension, annuity, or similar plan or contract on account of illness, disability, death, age, or length of service, unless contributions were made within one year of filing bankruptcy, which contributions are above the normal and customary contributions under a plan or contract.<sup>b</sup> *See* IOWA CODE ANN. § 627.6(8)(e) (1998).

KANSAS: exempts from execution, attachment, or garnishment process, money or other assets payable from or interest in, a retirement plan qualifying under I.R.C. §§ 401(a) or 408. *See* KAN. STAT. ANN. § 60-2308 (1994).

KENTUCKY: exempts from execution, attachment, garnishment, distress, or fee-bill, the right to or interest in, IRAs, IRA annuities, and other retirement plans qualifying for the deferral of income under the I.R.C. *See* KY. REV. STAT. ANN. § 427.150(2)(f) (Michie 1992).

LOUISIANA: exempts from all liability for any debt, except alimony and child support, all proceeds of and payments under annuities, Keoghs, IRAs, and all other pension or profit-sharing plans qualifying under I.R.C. §§ 401(a) or 408 to the extent contributions are exempt from federal income taxes. *See* LA. REV. STAT. ANN. § 20:33(1) (West 1979 & Supp. 1998).

MAINE: exempts from attachment and execution the debtor's right to receive a payment or account under an IRA or similar plan if it qualifies under I.R.C.

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b. Provisions such as this will be subsequently indicated in this Appendix as "an exemption provision similar to the federal bankruptcy provision 11 U.S.C. § 522(d)(10) (1994)."

§ 408. *See* ME. REV. STAT. ANN. tit. 14, § 4422(13)(E), (13)(E)(3) (West 1997). Case law does not clarify whether a “similar plan” includes Keoghs. Section 4422 was amended in 1995 to expressly include IRAs as exempt; there was no similar amendment for Keoghs.

MARYLAND: exempts from execution any money or other assets payable to a participant or beneficiary from, or interest in, a retirement plan qualifying under I.R.C. §§ 401(a) or 408. *See* MD. CODE ANN., CTS. & JUD. PROC. § 11-504(h)(1) (1996). This exemption does not apply to creditors of the plan. *See id.* § 11-504(h)(2)(ii).

MASSACHUSETTS: exempts from attachment, execution, or other process to satisfy any debt or liability, the right or interest of the debtors in Keoghs, IRAs, and retirement plans maintained in accordance with ERISA. *See* MASS. ANN. LAWS. ch. 235, § 34A (Law. Co-op. Supp. 1998). However, such exemption does not extend to debts or liability to satisfy penalties or restitutions to victims resulting from convictions of a crime. *See id.* In addition, such exemptions do not cover sums deposited in the account that are in excess of 7% of the total income of the debtor within five years of the entry of judgment. *See id.*

MICHIGAN: exempts from levy and sale under any execution payments or distributions of amounts contributed to IRAs or IRA annuities as defined in I.R.C. § 408. *See* MICH. COMP. LAWS ANN. § 600.6023(1)(k) (West Supp. 1998). Contributions include earnings or benefits on those contributions or premiums. *See id.* § 600.6023(1)(k)(iii). Michigan’s exemption does not extend to amounts exceeding the amounts deductible under the I.R.C., including earnings or benefits stemming from such amounts. *See id.* This limitation does not extend to rollovers qualified under the I.R.C. *See id.*

Michigan also exempts from levy and sale under any execution rights or interests of debtors in a plan qualified under I.R.C. § 401. *See id.* § 600.6023(1)(l).

MINNESOTA: exempts from attachment, garnishment, or sale on any final process issued from any court, debtor’s right to receive or payments from a plan qualified under I.R.C. §§ 401(a) or 408; this exemption includes rollovers. *See* MINN. STAT. ANN. § 550.37(24)(1) (West Supp. 1998).

MISSISSIPPI: has an exemption provision similar to the federal bankruptcy statute 11 U.S.C. § 522(d)(10) (1994). *See* MISS. CODE ANN. § 85-3-1(b)(iii) (Supp. 1998); *see also In re McLeod*, 102 B.R. 60 (Bankr. S.D. Miss. 1989).

Section 85-3-1(b)(iii) before amended was as follows:

(1) There shall be exempt from seizure under execution or attachment:

(b)(iii) All property and pension trusts which are qualified under the Employee Retirement Income Security Act of 1974 (ERISA) (P.L. No.93406), including, but not limited to, self-employment retirement (Keogh) plans and individual retirement accounts (IRA). However, no contribution made to any such plan, account or trust shall be exempt if made less than one



(1) calendar year from the date of filing for bankruptcy, whether voluntary or involuntary, or less than one (1) calendar year from the date of service of any writ of execution, attachment or garnishment on the person having such plan, account or trust in his possession or under his control. MISS. CODE ANN. § 85-3-1(1)(b)(iii) (Supp. 1988) (effective July 1, 1987).

*Id.* at 62. Section 83-3-1 was later amended to conform to the federal bankruptcy statute in 11 U.S.C. 522(d)(10) (1994).

Mississippi expressly exempts debtor's Keoghs and IRAs for the satisfaction of a judgment or claim in favor of another state or political subdivision of another state for failure to pay income tax on benefits received from such plan. *See* MISS. CODE ANN. § 85-3-1(d) (1995).

MISSOURI: exempts from attachment and execution debtors' right to payment from or interest in retirement plans qualified under I.R.C. §§ 401(a), 403, 408 (IRAs and IRA annuities), and 409. *See* MO. ANN. STAT. § 513.430(10)(f) (West Supp. 1998).

MONTANA: does not exempt from execution any private retirement plans. *See* MONT. CODE ANN. §§ 25-13-601 to 25-13-614 (1997).

NEBRASKA: has an exemption provision similar to the federal bankruptcy statute, 11 U.S.C. § 522(d)(10) (1994). *See* NEB. REV. STAT. § 25-1563.01 (1995). The Nebraska Supreme Court found IRAs exempt from garnishment under § 25-1563.01 to the extent reasonably necessary for the support of the debtor and any dependents. *See* *Novak v. Novak*, 513 N.W.2d 303, 307 (Neb. 1994).

NEVADA: exempts from execution money held in an individual retirement arrangement conforming with I.R.C. § 408 (1994), and plans qualified under I.R.C. § 401 (1994). *See* NEV. REV. STAT. ANN. § 21.090(1)(q) (Michie 1998). The exempt amount is limited to \$500,000 present value. *See id.*

NEW HAMPSHIRE: exempts from attachment and execution any interest in a retirement plan or arrangement qualified for tax exemption purposes under present or future acts of Congress, subject to the Uniform Fraudulent Transfer Act. The protected arrangements include, among others, defined contribution plans and defined benefit plans "as defined under the Internal Revenue Code": IRAs, SEPs, Roth IRAs, and education IRAs. N.H. REV. STAT. ANN. § 511:2:XIX (Supp. 1998).

NEW JERSEY: exempts from claims of creditors qualifying trusts. *See* N.J. STAT. ANN. § 25:2-1 (West 1998). Qualifying trusts include a trust created or qualifying under I.R.C. §§ 401 and 408. *See id.* § 25:2-1(b).

NEW MEXICO: exempts from attachment, execution by a judgment creditor any interest in or proceeds from a pension or retirement fund. *See* N.M. STAT. ANN. §§ 42-10-1, 42-10-2 (Michie 1996).

NEW YORK: exempts from application to the satisfaction of a money judgment all property while held in trust for a judgment debtor, where the trust has been created by, or the fund held in trust by, a person other than the judgment debtor. *See* N.Y. C.P.L.R. § 5205(c) (McKinney 1998). Trusts qualified as IRAs under I.R.C. § 408, Keoghs qualified under I.R.C. § 401, or created from a rollover pursuant to I.R.C. §§ 402(a)(5), 403(a)(4), or 408(d)(3) are considered a trust created by a person other than the judgment debtor. *See id.*

NORTH CAROLINA: exempts from the claims of creditors IRAs and IRA annuities as described in I.R.C. § 408. *See* N.C. GEN. STAT. § 1C-1601(a)(9) (1995).

NORTH DAKOTA: exempts from all attachment or process, levy and sale upon execution, and any other final process issued from any court Keoghs, IRAs, and IRA annuities qualified under I.R.C. §§ 401 and 408. *See* N.D. CENT. CODE § 28-22-03.1 (Supp. 1997). The exemption is limited to a \$100,000 for each plan with an aggregate limit of \$200,000 for all pensions, policies, plans, and accounts or proceeds. *See id.* This limit does not apply to the extent this property is reasonably necessary for the support of the resident and that of that resident's dependents. *See id.*

OHIO: exempts "from execution, garnishment, attachment, or sale to satisfy a judgment or order" the debtor's right in "the assets held in, or to receive any payment under" pension or profit-sharing plans qualified under the I.R.C. and any Keoghs, IRAs, and IRA annuities "to the extent reasonably necessary for the support of the" debtor and the debtor's dependents. OHIO REV. CODE ANN. § 2329.66(A)(10)(b), (c) (Anderson Supp. 1997). The exemption for IRAs is limited to contributions to the extent not deposited to evade payment of debt. *See id.*

OKLAHOMA: exempts "from attachment or execution and every other species of forced sale for the payment of debts" any interest in pension and profit-sharing plans, Keoghs, IRAs, and IRA annuities qualified under the I.R.C., to the extent that contributions were not subject to federal income tax. OKLA. STAT. ANN. tit. 31, § 1(A)(20) (West Supp. 1998).

OREGON: exempts from execution and all other process interests in pension and profit-sharing plans, IRAs, and IRA annuities qualified under the I.R.C. *See* OR. REV. STAT. §§ 23.170(1)(d)(A), (B), 23.170(2) (Supp. 1998). Contributions that are exempt include: contributions not subject to income tax, a nondeductible contribution to the extent allowable under the I.R.C., contributions to an IRA to the extent the contribution is not subject to federal excise tax as an excess contribution, rollovers or transfers from one account to another, qualifying for federal tax deferred status, and any earnings from such contributions. *See id.* § 23.170(c).

PENNSYLVANIA: exempts from attachment or execution on a judgment, contributions, appreciation, and payments from an employer—provided that it is

not assignable, from self-employed retirement plans and from retirement plans provided by I.R.C. §§ 401(a), 403(a)(b), 408, and 409. *See* 42 PA. CONS. STAT. § 8124(b)(1)(ix) (Supp. 1998). The exemption does not extend to amounts contributed within one year before the filing for bankruptcy, and amounts contributed to the fund in excess of \$15,000 within a one-year period. *See id.* § 8124(b)(1)(ix)(A), (B).

**RHODE ISLAND:** exempts from attachment interest, payments, or distributions from retirement plans qualified under I.R.C. §§ 401 and 408. *See* R.I. GEN. LAWS § 9-26-4(11), (12) (1997). The exemption for IRAs and IRA annuities does not extend to earnings or benefits from contributions that exceed the deductible amount allowed under I.R.C. § 408. *See id.* § 9-26-4(11)(iii). The exemption also applies to rights or interests protected by ERISA. *See id.* § 9-26-4(12)(i).

**SOUTH CAROLINA:** exempts from attachment, levy, and sale the debtor's right to receive retirement benefits; the statutory provision is similar as those outlined in the Federal Bankruptcy Code, 11 U.S.C. § 522(d)(10)(E). *See* S.C. CODE ANN. § 15-41-30(10)(E) (Law. Co-op. Supp. 1997). Under South Carolina law, a debtor must have the present right to receive payments from the debtor's IRA in order for the IRA to be exempt. *See In re Eisan*, 181 B.R. 848, 852 (Bankr. S.C. 1995).

**SOUTH DAKOTA:** exempts from process, levy, or sale, benefits received from retirement plans. *See* S.D. CODIFIED LAWS § 43-45-2(7) (Michie 1997).

**TENNESSEE:** exempts from execution, attachment, or garnishment any funds payable to debtor or debtor's beneficiary, or any interest of debtor or debtor's beneficiary in a retirement plan qualified under I.R.C. §§ 401(a), 403(a), (b), and 408. *See* TENN. CODE ANN. § 26-2-104(b) (1980 & Supp. 1997). The exemption does not extend to claims of the state of Tennessee. *See id.* In addition, records concerning the plan are exempt from subpoena. *See id.*; *see also* § 26-2-111(1).

**TEXAS:** exempts from attachment, execution, and seizure for the satisfaction of debts, debtor's rights to assets held in or to receive payments from pension and profit-sharing plans, Keoghs, IRAs, and IRA annuities. TEX. PROP. CODE ANN. § 42.0021(a) (West Supp. 1999). This exemption is limited to plans qualifying under applicable provisions of the I.R.C. *See id.* Nontaxable rollover contributions are also exempt. *See id.* § 42.0021(b). In addition, the exemption does not extend to IRAs or IRA annuities that exceed amounts deductible under the federal tax laws. *See id.* Exemption does not include secured interests in a retirement plan. *See id.* § 42.0021(d).

**UTAH:** exempts from execution any money or assets payable to a debtor from or an interest in a retirement plan described in I.R.C. §§ 401(a), 403(a), (b), and 408. *See* UTAH CODE ANN. § 78-23-5(1)(a)(x) (Supp. 1998). However, IRAs are not exempt because they are not annuities or similar plans within the ambit of Utah Code § 78-23-6. *See In re Swenson*, 130 B.R. 99, 101 (Bankr. N.D. Utah 1991).

VERMONT: exempts from attachment and execution debtor's right to receive, to the extent reasonably necessary for the support of debtor and debtor's dependents, payments under a pension, annuity, profit-sharing, stock bonus, or similar plan. *See* VT. STAT. ANN. tit. 12, § 2740(19)(J) (Supp. 1998).

VIRGINIA: exempts from creditor process interest in a retirement plan qualifying under I.R.C. §§ 401 and 408. *See* VA. CODE ANN. § 34-34A, B (Michie 1996). The exemption does not apply to interest in the retirement plan that would provide an annual benefit in excess of \$17,500; plans will be aggregated, including the debtor's spouse's plan, for purposes of this section. *See id.* 34-34F. In addition, the debtor cannot exempt amounts contributed to a retirement plan during the fiscal year in which the debtor claims the exemption, and for two preceding fiscal years "other than amounts that were exempt from creditor process immediately prior to being contributed to the retirement plan." This limitation extends to earnings on contributions. *See id.* § 34-34D. The exemption does not apply to claims made by the Virginia government pursuant to Chapter 13 of Title 63.1 against the debtor. *See id.* § 34-34E.

WASHINGTON: exempts from execution, attachment, garnishment, or seizure by or under any legal process, the rights of a debtor to "a pension, annuity, or retirement allowance or disability allowance, death benefits," or rights accrued in any employee benefit plan. *See* WASH. REV. CODE ANN. § 6.15.020(3) (West Supp. 1999). An employee benefit plan includes those defined under I.R.C. §§ 401(a), 403(a), and 408. *See id.* § 6.15.020(4).

WEST VIRGINIA: has a general exemption statute which exempts from execution or other process personal property not exceeding \$1,000. *See* W. VA. CODE § 38-8-1 (1997). There is no specific exemption for pensions, Keoghs, IRA, or IRA annuities.

WISCONSIN: exempts from execution assets held or amount payable under a pension plan, Keogh, IRA, or IRA annuity. *See* WIS. STAT. § 815.18(j)1 (1994). In order to be exempt the plan must meet with one of the following requirements: comply with the I.R.C., or not be used for any purpose other than for the exclusive benefit of the debtor (Keoghs). If the plan is an owner-dominated plan, the exemption is limited to the extent reasonably necessary for the support of debtor and debtor's dependents. *See id.* § 815.18(j)2, (j)4.

WYOMING: exempts from execution, attachment, garnishment, or any other process issued by any court any retirement or annuity fund to the extent the amounts contributed were excluded or deducted as retirement funding under the I.R.C. *See* WYO. STAT. ANN. § 1-20-110(a) (Michie Supp. 1998); *see also In re Honeycutt*, 908 P.2d 976, 978 (WYO. 1995) (holding an IRA not established by an employer nor paid to that person as an employee is not exempt from execution, attachment, or other process).

SECTION II. RETIREMENT ACCOUNT PROTECTION IN  
BANKRUPTCY PROCEEDINGS

(Note: Most states require residency in the state before the debtor can claim an exemption under state laws.)

**ALABAMA:** is an opt-out state. *See* ALA. CODE § 6-10-11 (1975). Alabama exempts certain qualified trusts from the bankruptcy estate. *See id.* § 19-3-1(b)(1). Qualified trusts include Keoghs (I.R.C. § 401(a)), IRAs, and IRA annuities described in I.R.C. § 7701(a)(37). *See id.* § 19-3-1(b)(5)(d)-(5)(d)(3).

**ALASKA:** is not listed in *Colliers* as an opt-out state. However, Alaska statutes strongly imply that the state has opted out of the federal exemptions by limiting exemptions in bankruptcy to those provided by Alaska statutes. *See* ALASKA STAT. § 09.38.055 (Michie 1996). An exemption, pursuant to ALASKA STAT. § 09.38.017, for retirement plans qualifying under I.R.C. §§ 401(a) and 408 does not apply to contributions made within 120 days before the debtor files for bankruptcy. ALASKA STAT. § 09.38.017(b).

**ARIZONA:** is an opt-out state. *See* ARIZ. REV. STAT. ANN. § 33-1133(B) (West 1990). The bankruptcy exemption for retirement plans qualifying under I.R.C. §§ 401(a) and 408 does not apply to contributions made within 120 days before the debtor files for bankruptcy. *See id.* § 33-1126(c)(2). In addition, this exemption only applies to bankruptcy proceedings filed before July 1, 1987. *See id.* § 33-1126(c)(3).

**ARKANSAS:** is an opt-out state. *See* ARK. CODE ANN. § 16-66-217 (Michie 1995). Arkansas' exemptions from execution in bankruptcy are listed separately from exemptions from creditors which also apply to creditors in bankruptcy. *See* § 16-66-218(b)(17). Arkansas exempts from the bankruptcy estate all contributions to an IRA made one year before the filing of the petition in bankruptcy. *See id.* § 16-66-218(b)(16). The maximum exemption is \$20,000 for an individual or for a husband and wife combined. *See id.*

**CALIFORNIA:** is an opt-out state. *See* CAL. CIV. PROC. CODE § 703.130 (West 1987). Debtors who file for bankruptcy may choose to apply the exemptions provided by either: (1) The Code of Civil Procedure, Part 2 Civil Actions, Title 9 Enforcement of Judgments, Division 2 Enforcement of Money Judgments, Chapter 4 Exemptions ("Chapter 4"), or (2) CAL. CIV. PROC. CODE § 703.140(a). Chapter 4 allows an exemption for Keoghs, IRAs and IRA annuities. *See id.* § 704.115(a)(3). Section 703.140(b)(10)(E) has an exemption provision identical to the federal bankruptcy exemption statute, 11 U.S.C. § 522(d)(10).

**COLORADO:** is an opt-out state. *See* COLO. REV. STAT. ANN. § 13-54-107 (West 1997). Exemptions are limited to those provided by the statute. *See id.* The Tenth Circuit has held that IRAs were statutorily exempt from the bankruptcy estate, however, the statutory language that included IRA exemptions from the

bankruptcy estate has since then been repealed. *See In re Kulp*, 949 F.2d 1106 (10th Cir. 1991). The new statute reads as follows:

(1)(b)(I) "Earnings" means:

(A) Compensation paid or payable for personal services, whether denominated as wages, salary, commission, or bonus;

(B) Funds held in or payable from any health, accident, or disability insurance.

(II) For the purposes of writs of garnishment that are the result of a judgment taken for arrearages for child support or for child support debt, "earnings" also means:

....

(B) Any pension or retirement benefits or payments, including but not limited to those paid pursuant to article 64 of title 22, C.R.S., articles 51, 54, 54.5, 54.6, and 54.7 of title 24, C.R.S., and article 30 of title 31, C.R.S., and section 35-65-402(2), C.R.S. ....

COLO. REV. STAT. ANN. § 13-54-104(1)(b)(I) (West Supp. 1998).

Although there is no case law interpreting the new statute, the removal of the IRA language strongly implies that the Colorado legislature intended no protection of IRAs. *See id.* § 13-54-104(1)(b)(II)(B).

CONNECTICUT: is not an opt-out state, thus federal exemptions in bankruptcy apply.

DELAWARE: is an opt-out state. *See* DEL. CODE ANN. tit. 10, § 4914 (1996). IRAs are not exempt under Delaware law. *See id.* §§ 4901-4904

DISTRICT OF COLUMBIA: is not an opt-out state, thus federal exemptions in bankruptcy apply.

FLORIDA: is an opt-out state. *See* FLA. STAT. ANN. § 222.201 (West 1989). Florida allows the federal exemption in addition to the federal exemptions in bankruptcy under 11 U.S.C. § 522(d). *See id.* Florida exempts retirement plans under I.R.C. §§ 401(a) and 408 from the bankruptcy estate. *See id.* § 222.21.

GEORGIA: is an opt-out state. *See* GA. CODE ANN. § 44-13-100(b) (1991). Georgia sets forth a list of bankruptcy exemptions which include payments from and interests in pension or profit-sharing funds and IRAs, to the extent necessary for support. The language is essentially the same as the federal exemption in 11 U.S.C. § 522(d)(10). *See id.* § 44-13-100(a)(2)(F), (a)(2.1)(D).

HAWAII: is not an opt-out state, thus federal exemptions in bankruptcy apply. However, under 11 U.S.C. § 522(b), Hawaii has chosen to apply its pension exemption statute to bankruptcy actions. *See* HAW. REV. STAT. § 651-124 (1996). Hawaii exempts from attachment, execution, and seizure, the right of a debtor to a retirement plan described in I.R.C. §§ 401(a) and 408. *See id.* The exemption

does not extend to contributions made to the plan within three years before the date the debtor files for bankruptcy. *See id.*

**IDAHO:** is an opt-out state. *See* IDAHO CODE § 11-609 (1990). Idaho only allows the debtors to exempt from the bankruptcy estate property specified under the laws of the state. *See id.* Assets held in and payments from plans qualified under I.R.C. §§ 401(a) and 408 would be exempt from the bankruptcy estate. *See id.* § 11-604A(3).

**ILLINOIS:** is an opt-out state. *See* 735 ILL. COMP. STAT. 5/12-1201 (West 1992). Illinois residents are prohibited from using the federal exemptions. *See id.* Illinois exempts pension and profit-sharing plans, Keoghs, IRAs, and IRA annuities qualifying under the I.R.C. from the bankruptcy estate of a debtor. *See id.* § 5/12-1006(d).

**INDIANA:** is an opt-out state. *See* IND. CODE § 34-55-10-1 (1998). A debtor is not allowed to use the federal exemptions and may exempt only the property specified by Indiana law. *See id.* Pension plans generally are exempt under Indiana law. *See id.* § 34-55-10-2(b)(6).

**IOWA:** is an opt-out state. *See* IOWA CODE § 627.10 (Supp. 1998).

**KANSAS:** is an opt-out state. *See* KAN. STAT. ANN. § 60-2312(a) (1994). Kansas allows exemptions for retirement plans that qualify under I.R.C. §§ 401(a) or 408. *See id.* § 60-2308(b). In addition to exemptions provided by state statute, Kansas also allows exemptions listed under 11 U.S.C. § 522(d)(10). *See id.* § 60-2312(b).

**KENTUCKY:** is an opt-out state. *See* KY. REV. STAT. ANN. § 427.170 (Michie 1996). A Kentucky debtor is not authorized to exempt property under federal law. *See id.* Kentucky exempts the right or interest in IRAs, IRA annuities, deferred compensation accounts, and other retirement plans qualifying for the deferral of income under the I.R.C. *See id.* § 427.150(2)(f). Kentucky only exempts contributions made more than 120 days before the debtor filed for bankruptcy. *See id.*

**LOUISIANA:** is an opt-out state. *See* LA. REV. STAT. ANN. § 13:3881(D)(1) (West Supp. 1999). A debtor may only exempt property under Louisiana law and federal law other than what is listed under 11 U.S.C. § 522(d). *See id.* § 13:3865(B). Pension and profit-sharing plans, Keoghs, IRAs, and IRA annuities qualifying under the I.R.C. are exempt from the bankruptcy estate. *See id.* § 20:33(1). The exemption does not apply to contributions made less than one calendar year from the date of filing the bankruptcy petition. *See id.*

**MAINE:** is an opt-out state. *See* ME. REV. STAT. ANN. tit. 14, § 4426 (West Supp. 1996). *See supra* Maine's description of exemptions in Section I of this Appendix.

MARYLAND: is an opt-out state. *See* MD. CODE ANN. CTS. & JUD. PROC. § 11-504(g) (1995). A debtor is not allowed to use the federal exemptions listed under 11 U.S.C. § 522(d). *See id.*; *see also supra* Maryland's description of exemptions in Section I of this Appendix.

MASSACHUSETTS: is not an opt-out state, thus federal exemptions in bankruptcy apply. However, Massachusetts statutes provide that exemptions for pension plans, Keoghs, and IRAs do not cover deposits into the account that are in excess of 7% of the total income of the debtor within five years of the declaration of bankruptcy. *See* MASS. ANN. LAWS ch. 235, § 34A (Law. Co-op. Supp. 1998).

MICHIGAN: is not an opt-out state, thus federal exemptions in bankruptcy apply. However, Michigan statutes provide that § 600.6023, which exempts retirement accounts, applies to federal bankruptcy exemptions as allowed by 11 U.S.C. § 522(b)(2). *See* MICH. STAT. ANN. § 600.6023(1)(k), (1)(l) (Law. Co-op. Supp. 1998).

MINNESOTA: is not an opt-out state, thus federal exemptions in bankruptcy apply. *See* MINN. STAT. ANN. § 550.37(24)(1) (West Supp. 1999).

MISSISSIPPI: is an opt-out state. *See* MISS. CODE ANN. § 85-3-2 (1991); *see also supra* Mississippi's description of exemptions in Section I of this Appendix.

MISSOURI: is an opt-out state. *See* MO. ANN. STAT. § 513.427 (West Supp. 1998). A debtor is not allowed to use the federal exemptions listed under 11 U.S.C. § 522(d). *See id.*; *see also supra* Missouri's description of exemptions in Section I of this Appendix.

MONTANA: is an opt-out state. *See* MONT. CODE ANN. § 31-2-106 (1997). Although Montana does not allow an exemption for private retirement plans from execution, Montana does provide an exemption from the bankruptcy estate the right to receive benefits from or interest in a private retirement plan. *See id.* § 31-2-106(3). The statute does not specifically mention exemption of plans qualifying under §§ 401(a), 408 or Keoghs, IRAs, or IRA annuities, but does provide that a plan that does not qualify under §§ 401(a) or 408 will not be exempt. *See id.* In addition, the statute excludes from exemptions contributions made within one year before the filing of the bankruptcy provision exceeding 15% of the debtors' gross income for that one-year period. *See id.*

NEBRASKA: is an opt-out state. NEB. REV. STAT. § 2515,105 (1995). Federal exemptions provided by 11 U.S.C. § 522(d) do not apply. *See id.*; *see also supra* Nebraska's description of exemptions in Section I of this Appendix.

NEVADA: is an opt-out state. *See* NEV. REV. STAT. ANN. § 21.090.3 (Michie 1998). Federal exemptions provided by 11 U.S.C. § 522(d) do not apply. *See id.*; *see also supra* Nevada's description of exemptions in Section I of this Appendix.



NEW HAMPSHIRE: may no longer be an opt-out state, in light of the repeal of N.H. REV. STAT. ANN. § 511:2-a as of January 1, 1999.

NEW JERSEY: is not an opt-out state, thus federal exemptions in bankruptcy apply.

NEW MEXICO: is not an opt-out state, thus federal exemptions in bankruptcy apply.

NEW YORK: is an opt-out state. *See* N.Y. DEBT. & CRED. LAW § 282 (McKinney 1990); *see also supra* New York's description of exemptions in Section I of this Appendix.

NORTH CAROLINA: is an opt-out state. *See* N.C. GEN. STAT. § 1C-1601(f) (1995). North Carolina limits bankruptcy exemptions to property listed in Article 16 of the North Carolina Statutes. *See id.* § 1C-1601(a). North Carolina exempts IRAs and IRA annuities as defined under I.R.C. § 408 from creditors. *See id.* § 1C-1601(a)(9).

NORTH DAKOTA: is an opt-out state. *See* N.D. CENT. CODE § 28-22-17 (1991). North Dakota allows only those exemptions provided by North Dakota law. *See id.*; *see also supra* North Dakota's description of exemptions in Section I of this Appendix.

OHIO: is an opt-out state. *See* OHIO REV. CODE ANN. § 2329.662 (Anderson 1995). Ohio does not allow debtors to exempt property under the Federal Bankruptcy Code. *See id.*; *see also supra* Ohio's description of exemptions in Section 1 of this Appendix.

OKLAHOMA: is an opt-out state. *See* OKLA. STAT. ANN. tit. 31, § 1(B) (West 1991). Oklahoma does not allow debtors to exempt property under the Federal Bankruptcy Code unless permitted by Oklahoma statute. *See id.*; *see also supra* Oklahoma's description of exemptions in Section I of this Appendix.

OREGON: is an opt-out state. *See* OR. REV. STAT. § 23.305 (1995). Oregon does not allow debtors to exempt property under the Federal Bankruptcy Code. *See id.*; *see also supra* Oregon's description of exemptions in Section I of this Appendix.

PENNSYLVANIA: is not an opt-out state, thus federal exemptions in bankruptcy apply. *See supra* Pennsylvania's description of exemptions in Section I of this Appendix.

RHODE ISLAND: is not an opt-out state, thus federal exemptions in bankruptcy apply. *See supra* Rhode Island's description of exemptions in Section I of this Appendix.

**SOUTH CAROLINA:** is an opt-out state. *See* S.C. CODE ANN. § 15-41-35 (Law. Co-op. Supp. 1997). South Carolina does not allow debtors to exempt property under the Federal Bankruptcy Code unless permitted by South Carolina law. *See id.*; *see also supra* South Carolina's description of exemptions in Section I of this Appendix.

**SOUTH DAKOTA:** is an opt-out state. *See* S.D. CODIFIED LAWS § 43-45-13 (Michie 1997). South Dakota does not allow debtors to exempt property under the Federal Bankruptcy Code. *See id.* South Dakota allows an exemption for retirement plans. *See id.* § 43-45-2(7).

**TENNESSEE:** is an opt-out state. *See* TENN. CODE ANN. § 26-2-112 (1980). Tennessee does not allow debtors to exempt property under the Federal Bankruptcy Code. *See id.* Tennessee allows an exemption for retirement plans qualifying under I.R.C. §§ 401(a) or 408. *See id.* § 26-2-104 (Supp. 1997).

**TEXAS:** is not an opt-out state, thus federal exemptions in bankruptcy apply.

**UTAH:** is an opt-out state. *See* UTAH CODE ANN. § 78-23-15 (1996). Utah does not allow debtors to exempt property under the Federal Bankruptcy Code. *See id.*; *see also supra* Utah's description of exemptions in Section I of this Appendix.

**VERMONT:** is not an opt-out state, thus federal exemptions in bankruptcy apply.

**VIRGINIA:** is an opt-out state. *See* VA. CODE ANN. § 34-3.1 (Michie 1996). Virginia does not allow debtors to exempt property under the Federal Bankruptcy Code unless permitted by Virginia law. *See id.* Virginia allows an exemption for retirement plans qualifying under I.R.C. §§ 401 or 408. *See id.* § 34-34(B); *see also supra* Virginia's description of exemptions in Section I of this Appendix.

**WASHINGTON:** is not an opt-out state, thus federal exemptions in bankruptcy apply. However, Washington has opted to extend its retirement provisions to Washington residents filing for bankruptcy under 11 U.S.C. § 522(b)(2). *See* WASH. REV. CODE ANN. § 6.15.020(1) (West 1995).

**WEST VIRGINIA:** is an opt-out state. *See* W. VA. CODE § 38-10-4 (1997). West Virginia does not allow debtors to exempt property under the Federal Bankruptcy Code. *See id.* West Virginia has a bankruptcy exemption statute which is separate from the general exemption statute. *See id.* The bankruptcy exemption for retirement plans is similar to 11 U.S.C. § 522(d)(10). *See id.* § 38-10-4(j).

**WISCONSIN:** is not an opt-out state, thus federal exemptions in bankruptcy apply.

**WYOMING:** is an opt-out state. *See* WYO. STAT. ANN. § 1-20-109 (Michie 1997). Wyoming does not allow debtors to exempt property under the Federal

Bankruptcy Code. *See id.*; *see also supra* Wyoming's description of exemptions in Section I of this Appendix.