Educational Materials

Thursday October 9, 2014 11:45 AM - 12:45 PM

Retirement Assets in Bankruptcy: Protecting, or Tarnishing, a Debtor's Assets in the Golden Years

Presented By

NCBJ | National Conference of Bankruptcy Judges

Retirement Assets in Bankruptcy
National Conference of Bankruptcy Judges
88th Annual Meeting
Chicago, IL
October 9, 2014
11:45 am – 12:45 pm

Speakers: Hon. Brian D. Lynch, Todd F. Maynes, Calvin Hwang

Electronic Materials

Hypothetical One

Diana Debtor opened four investment retirement accounts ("IRAs") at brokerage houses Alpha Investco, Bravo Retirement Corp., Charlie Wealth Management, and Delta Mutual. Over the period of five years, Diana put $100,000 in each of the four IRAs. When the IRA's were opened, Diana was instructed to complete a "Customer Relationship Agreement," whereby she granted a lien in her funded accounts (including the IRAs), to cover trading losses which could occur with her other accounts. Debbie signed the respective Agreements, and started saving for her future.

At all brokerage houses other than Alpha Investco – Bravo Retirement, Charlie Wealth Management, and Delta Mutual – Diana also opened margin-trading accounts, losses on which could initially be covered by the broker itself. Diana had the opportunity also to open such a margin-trading account at Alpha Investco, but opted not to.

In the Bravo Retirement margin-trading account, Diana actively traded and suffered losses, and the brokerage filed a U.C.C. lien on her IRA account. In the Charlie Wealth management margin-trading account, Diana actively traded, and won on all her trades. No lien arose or was filed on her IRA account. Finally, at Delta Mutual, Diana opened the margin-trading account, but never made a trade.

Diana ran into financial difficulty due to an unexpected flood which destroyed her home. When Diana filed Chapter 7 bankruptcy, she claimed exemptions as to each of the four IRA accounts. The Trustee objected, stating that in each case, by signing the Customer Relationship Agreement and perhaps additional actions, Diana had engaged in the "lending of money or other extension of credit between a [retirement] plan and a disqualified person" as prohibited by 26 U.S.C. § 4975(c)(1)(B).

<u>Question</u>: Is the Trustee correct as to all, some, or none of the IRAs?

Synopsis of Law Relevant

11 U.S.C. § 522 – Exemptions
§ 522(b)(3)(C): An individual may exempt retirement funds from property of the estate to the extent that those funds are in a fund or account that is exempt from taxation under Internal Revenue Code § 408 (dealing with IRAs).

26 U.S.C. § 4975(c)(1)(B) – Tax on Prohibited Transactions
The direct or indirect lending of money or other extension of credit between an IRA and its owner is a prohibited transaction on which tax is imposed.

<u>In re Willis</u>, 2010 WL 1408343 (S.D. Fla. April 6, 2010).

IRA funds were not exempt property where debtor engaged in prohibited transactions by borrowing from the IRA, causing IRA funds to lose their tax-exempt status.

IRS Announcement 2011-81, 2011-52 I.R.B. 1052
IRS will determine the tax consequences relating to an IRA without taking into account the consequences that might otherwise result from a prohibited transaction under Internal Revenue Code § 4975 resulting from an IRA owner's entering into any agreement to extend credit or provide a security interest in the IRA, provided that there has been no execution or other enforcement pursuant to the agreement against the assets of the IRA.

In re Daley, 717 F.3d 506 (6th Cir. 2013).
IRA funds did not lose their exempt status where the account owner signed an agreement pledging his IRA as security for any future debts to the broker but the owner never borrowed from the IRA and the broker never extended credit to the owner based on the existence of the IRA.

Janpol v. Commissioner, 101 T.C. 518 (1993).
Profit-sharing plan lost its tax-exempt status where plan participants guaranteed loans on behalf of the plan trust even though guarantees were conditioned on default by the trust and no such default occurred. The guarantee was held to be, in effect, a contract to make a loan to the trust that was prohibited whether or not the condition for liability had arisen.

Key Questions

At what point does the operation of a Customer Relationship Agreement amount to an extension of credit by a broker to Diana resulting in a prohibited transaction?

- Upon execution of the agreement?
- Once Diana opens a margin-trading account?
- Once Diana makes a trade in a margin-trading account?

Hypothetical Two

Five siblings, Justin, Jodi, Jim, Jack, and Jill, work together in a jewelry store. Justin is 54, Jodi is 58, Jim is 60, Jack is 64, and Jill is 71 and they each have $500,000 IRAs. One day the jewelry store they own is robbed, and the siblings are left with no inventory, but owing substantial amounts of money to the consignors who provided them with gemstones. The siblings each file Chapter 13 bankruptcy.

At the time of their petitions, Jim and Jill are actively receiving and plan to continue receiving distributions out of their IRAs for the foreseeable future; Jodi is not receiving distributions, but will do so when she turns 59 and 1/2 in 18 months. Jack has decided for the next five years not to receive distributions, although he would be entitled to receive them. Justin likewise is not receiving distributions. None of them attributes the IRA principal or monthly distributions (as applicable) as income for purposes of projected disposable income (PDI).

<u>Questions:</u>
1) Should IRA distributions count as income for PDI?
2) What if the IRA is claimed as exempt with no objection?
3) Should the IRA be included in liquidation analysis?
4) Is there a good faith challenge for any debtors allowed to exclude income from PDI?

Synopsis of Law Relevant

11 U.S.C. § 1306 – Property of the Estate

§ 1306(a): Property of the estate includes, in addition to the property specified in section 541 of this title--

(1): all property of the kind specified in such section that the debtor acquires after the commencement of the case but before the case is closed, dismissed, or converted to a case under Chap 7, 11 or 12 of this title, whichever occurs first; and

(2): earnings from services performed by the debtor after the commencement of the case but before the case is closed, dismissed, or converted…

11 U.S.C. § 101(10A) – Current Monthly Income

(A) means the average monthly income for all sources . . . .

(B) but excludes benefits received under the Social Security Act, payments to victims of war crimes . . .

<u>Hamilton v. Lanning</u>, 130 S. Ct. 2464 (2010)
When a bankruptcy court calculates a debtor's projected disposable income, the court may account for changes in the debtor's income or expenses that are known or virtually certain at the time of confirmation.

Baud v. Carroll, 634 F.3d 327 (6th Cir. 2011)
it is appropriate to calculate a debtor's projected disposable income using the inclusions and exclusions from disposable income set forth in the Code and the deductions permitted by the Code, supplemented as of the date of confirmation and adjusted to take into account changes during the applicable commitment period that are known or virtually certain at the time of confirmation.

In re Zahn, 391 B.R. 840 (B.A.P. 8th Cir. 2008)
Bankruptcy courts that have considered whether IRA distributions should be included in current monthly income have found that distributions from IRAs should be excluded because the money deposited into an IRA is received for use prior to the distribution from the IRA.

Rousey v. Jacoway, 125 S. Ct. 1561 (2005)
IRA exempt under 522(d)(10)(E) to extent necessary for the support of the debtor and any dependents of the debtor.

In re LeClair, 461 B.R. 86 (Bankr. Mass. 2011)
Contributions made in accordance with the terms … as described in IRC Section 408(k), and a contribution in cash may not exceed the amount permitted under IRC Sections 219(b) and 408(b).

Key Questions

- What distributions are being received now or will be received in the near future?
- Even if exempt, are IRA distributions excluded from the definition of income?
- Does the debtor have an independent duty to contribute all available funds to their plan?

Hypothetical Three

One day, three potential debtors come to bankruptcy attorney Randy Righteous, wanting to file bankruptcy soon: Henry Hog, Priscilla Pig, and Bart Boar. Each has $1 million in debt, $200,000 in assets, largely in cash, and each is presently being sued and garnished by creditors. Randy fills out a preliminary bankruptcy schedule for each debtor, and makes all the possible exemption claims.

At the end of each consultation, Randy discloses to each Debtor that they are eligible to file Chapter 7, but will each have $100,000 in nonexempt assets they will have to turn over to the Trustee, unless they themselves decide to engage in "prebankruptcy planning."

Henry goes out and converts $80,000 to an IRA, leaving $20,000 to turn over to the Trustee. Henry has a heart condition and wants to retire soon, but has insufficient savings to achieve this goal. Henry fully discloses his pre-bankruptcy planning to the Chapter 7 Trustee.

Priscilla converted $25,000 to an IRA, leaving $75,000 to turn over to the Trustee. Priscilla already has more than $1.5 million in retirement savings, and she just turned 50 years old. Priscilla fully discloses her pre-bankruptcy planning to the Chapter 7 Trustee.

Finally, Bart converted $45,000 to an IRA, leaving $55,000 to turn over to the Trustee. As opposed to listing the IRA on his Schedule B, Bart only mentions the $45,000 for the first time at his 341 meeting. At that time, however, he says that he does not remember what he did with the money or whether it is in the form of an IRA, although he promises to follow up with Trustee. Bart promptly amends his Schedules to disclose the IRA and claim the exemption.
Question: If the Trustee objects to each Debtor's IRA exemption, how will the Bankruptcy Court rule?

Synopsis of Law Relevant

In re Beaudin, 2010 WL 3748735 (Bankr. D. Colo 2010)
It is very difficult for practitioners to know under the tests articulated when to challenge an exemption on this ground and when to advise a client to take advantage or pre-bankruptcy planning.

In re Warren, 512 F.3d 1241 (10th Cir. 2008)
Courts are reluctant to recognize a conversion of nonexempt assets as fraudulent, without additional evidence, although it may suffice.

Norwest Bank Nebraska, N.A. v. Tveten, 848 F.2d 871 (8th Cir. 1988); Hanson v. First Nat'l Bank, 848 F.2d 866 (8th Cir. 1988)

Physician converting $700,000 nonexempt assets is evidence of fraudulent intent; Farmers converting $31,000 nonexempt assets is not evidence of fraudulent intent.

In re Sholdan, 217 F.3d 1006 (8th Cir. 2000); In re Beverly, 374 B.R. 221 (B.A.P. 9th Cir. 2007). Trustee may act to recapture assets transferred as § 548(a) fraudulent conveyance and the debtor may risk loss of discharge pursuant to § 727(a)(2).

Miguel v. Walsh, 447 F.2d 724 (C.D. Cal. 1971).
Trustee may use § 544 strong-arm power to avoid transfers pursuant to state law.

Law v. Siegel, 134 S. Ct. 1188 (2014)
Courts may not surcharge exemptions as federal law provides no authority for bankruptcy courts to deny an exemption on a ground not specified by the Code.

Key Questions

- What conduct of the debtor constitutes extrinsic evidence of fraud?
- Some factors determining fraud:
  -- Disclosure; Acted under ongoing or threat of lawsuit; Converting all available assets; Acted secretly to convert assets; Removed or concealed assets; Was insolvent at time of conversion; Converted shortly before or after borrowing funds for that purpose; Retained control of exempted property
  -- Other possible badges… proportion of assets, debtor's intent to use asset, misrepresentation, whether any nonexempt assets remain, whether asset was long-term holding suddenly converted, debtor's actions deviated from historical conduct, debtor received legal advice prior to conversion, proximity of time.
- How did each debtor source assets converted to IRA?
  -- What if withdrawn from an IRA and used for personal expenses prior to redeposit into a rollover IRA?

Hypothetical Four

Copper Pipes International ("CPI") is a manufacturer that administers an ERISA-qualified retirement plan for its employees. Facing financial duress, CPI's executives improperly failed to deposit with the IRS the tax withholdings of CPI's employees. CPI used the cash it failed to deposit to make its matching contributions to the ERISA-qualified plan. CPI later filed Chapter 7 bankruptcy and a Trustee was appointed. Post-petition, the IRS asserts a lien against the ERISA-qualified plan for the funds which should have been withheld to pay employee taxes.

<u>Questions</u>:

1. Does the automatic stay protect the plan from the IRS lien?
2. If there is a cause of action for the prepetition excess ERISA-qualified plan payments being fraudulent conveyances, may the Chapter 7 Trustee pursue the cause of action or does ERISA preclude it?
3. If the Chapter 7 Trustee assumes administration of the ERISA-qualified plan under 11 U.S.C. § 704(a)(11), does the Bankruptcy Court have jurisdiction over the Trustee's claim to compensation from plan assets?

Synopsis of Law Relevant

11 U.S.C. § 541 – Property of the Estate
§ 541(c)(1)(A): Except as provided in paragraph (2) of this subsection, an interest of the debtor in property becomes property of the estate . . . notwithstanding any provision in an agreement, transfer instrument, or applicable nonbankruptcy law that restricts or conditions transfer of such interest by the debtor.
§ 541(c)(2): A restriction on the transfer of a beneficial interest of the debtor in a trust that is enforceable under applicable nonbankruptcy law is enforceable in a case under Title 11.

<u>Patterson v. Shumate</u>, 504 U.S. 753 (1992)
The anti-alienation provision contained in an ERISA-qualified pension plan constitutes a restriction on transfer enforceable under applicable nonbankruptcy law such that a debtor's interest in such plan may be excluded from the property of the bankruptcy estate.

<u>Gross v. Commissioner</u>, 556 F. App'x 631 (9th Cir. 2014)
Liens on prepetition assets that are not included in the bankruptcy estate are not affected by the bankruptcy proceeding. Therefore, a debtor's Chapter 7 bankruptcy did not affect the IRS's lien on the debtor's ERISA plan which was not part of the bankruptcy estate and the IRS may levy the ERISA plan.

<u>Matter of Baker</u>, 114 F.3d 636 (7th Cir. 1997)

Anti-alienation provision applies to shield debtor's interest in plan assets from inclusion in his bankruptcy estate even where debtor made improper loans of plan funds.

In re Harris, 188 B.R. 444 (Bankr. M.D. Fla. 1995)
Debtor's interest in profit-sharing plan was not excluded from his estate where he failed to manage plan assets in compliance with ERISA and the Internal Revenue Code.

In re Vaughan Co., Realtors, 493 B.R. 597 (Bankr. D.N.M. 2013)
ERISA § 502, which limits who may bring a civil action against an ERISA-qualified plan, does not apply to prevent a Trustee from pursuing a fraudulent conveyance claim where such claim is brought under the Bankruptcy Code and the Uniform Fraudulent Transfer Act rather than ERISA.

U.S. Dept. of Labor v. Kirschenbaum, 508 B.R. 257 (E.D.N.Y. 2014)
The Bankruptcy Court lacks core jurisdiction over a Trustee's obligations as administrator of an employee benefit plan which are created by ERISA and exist outside of the bankruptcy.
The Bankruptcy Court lacks non-core jurisdiction to order that the fees and expenses of a plan administrator and his professionals be paid out of plan assets where the administrator is already authorized to compensate himself and other professionals out of the plan assets under both ERISA and documents governing the plan and paying expenses out of plan assets would have no conceivable effect on the bankruptcy estate.

Key Questions

- Is the plan part of the bankruptcy estate?
- Does the failure to administer a plan in compliance with ERISA and the Internal Revenue Code cause plan assets to become property of the bankruptcy estate?
- Under what authority is a claim being brought against the plan?
- Does the authorization of the Trustee to conduct the activities for which a claim is being brought arise out of the Bankruptcy Code?
- Do the Trustee's activities affect the bankruptcy estate?

What About My Retirement?

Tara Twomey
National Consumer Bankruptcy Rights Center
www.ncbrc.org
July 2014

Retirement savings for most Americans are woefully inadequate, but does a fresh start include the ability to keep retirement savings and make retirement contributions? Is social security really off the table for unsecured creditors? In most cases, the answer to these questions is 'yes.' After the 2005 amendments to the Bankruptcy Code, debtors will be able to exclude retirement benefits from the estate or exempt them. Social security benefits are unavailable to secured creditors. Distributions from retirement accounts are generally not considered projected disposable income in chapter 13, but payments from defined benefit plans may be treated differently. The one area showing deep splits among the courts is the debtor's ability to make voluntary retirement contributions during chapter 13.

Retirement Savings Crisis

I. Americans are living longer

Americans who reached age 65 in 2011 are projected to live, on average, another 21 years to age 86

II. Americans are not saving enough for retirement

- A. Three Strategies for Retirement Savings
    1. Save during retirement years
        - a. Shift from pensions (defined benefit plans) to defined contributions plans
        - b. 2012 study of 2.2 million employees at large companies showed only 15% were positioned to meet their needs if they retirement at 65. Aon Hewitt, The Real Deal: 2012 Retirement Income Adequacy at Large Companies
        - c. Results for U.S. population would be worse
        - d. Study estimates workers need 11x their annual income at 65 to retire with an 85% replacement
        - e. Average savings represented only 5.3x
        - f. Research by the Employment Benefit Research Institute shows that 66% of workers surveyed had less than $50,000 saved for retirement (excludes equity in primary residence or defined benefit plans)
    2. Spend less in retirement
        - a. Household 50+ carried an average credit card balance of $8,278 in 2012—more than household under 50 ($6,258) (DEMOS)
        - b. Average total debt held by seniors increased 83% between 2001 and 2010 to $5,000 (EBRI).

b. Inflation over the last five years for food and medical care is outpacing inflation across the board. This may have a disproportionate impact on seniors.

3. Delay the age of retirement

Retirement Savings in Bankruptcy

I. The Gold Standard – Subject to ERISA

A. Purpose behind the Employment Retirement Income Security Act (ERISA) is to make certain that if a worker has been promised a defined pension benefit upon retirement—and if he has fulfilled whatever conditions are required to obtain a vested benefit—he actually will receive it. *Patterson v. Shumate*, 504 U.S. 753, 765 (1992)

B. 11 U.S.C. § 541(a). Estate created upon filing of the petition. Property of the estate is broadly construed and includes all legal or equitable interests in property whether tangible or intangible, real or personal. Some property specifically excluded from the estate.

1. Section 541(c)(2) excludes property that is subject to a "restriction on the transfer of a beneficial interest of the debtor in a trust that is enforceable under applicable nonbankruptcy law."
2. In *Patterson v. Shumate*, 504 U.S. 753 (1992), the Supreme Court held that the anti-alienation provision in "ERISA-qualified" pension plans was a restriction on transfer enforceable under "applicable non-bankruptcy law."
3. In practice
   a. Debtor should still disclose asset on schedule. *See Daniels v. Agin*, 736 F.3d 70 (holding debtor must disclose assets even if he believes they are unavailable to the estate).
   b. Automatic stay may not be applicable to funds in plans subject to ERISA. Section 362(b)(2)(B) provides that the filing of a petition does not operate as a stay "of the collection of a domestic support obligation from property that is not property of the estate." *See In re Bowen*, 2010 WL 1855871 (Bankr. E.D.N.C. May 7, 2010) (automatic stay did not bar ex-wife from enforcing qualified domestic relations order).

C. Is the plan "subject to ERISA"?

1. Employee benefit plan established by an employer engaged in interstate commerce (with limited exceptions)
2. "Each pension plan shall provide that benefits provided under the plan may not be assigned or alienated…" 29 U.S.C. § 1056(d)(1).

D. Must the ERISA trust be entitled to favorable tax treatment under IRC § 401? *See In re Sewell*, 180 F.3d 707 (5th Cir. 1999) (ERISA plan not required to be tax qualified); *Matter of Baker*, 114 F.3d 636 (7th Cir. 1997); *In re Handel*, 301 B.R. 421 (Bankr. S.D.N.Y. 2003) (if plan's restriction on alienation is enforceable under ERISA, it need not be tax-qualified to be excluded from estate under 541(c)(2)).

E. Was plan operated in violation of ERISA? Courts have split on whether there is an equitable exception to ERISA's anti-alienation provision. *Compare Matter of Baker*, 114 F.3d 636 (7th Cir. 1997) (plan remained subject to ERISA despite debtor's violations of ERISA fiduciary duties in his capacity as plan trustee) *and In re Handel*, 301 B.R. 421 (Bankr. S.D.N.Y. 2003) with *In re Harris*, 188 B.R. 444 (Bankr. M.D. Fla. 1995) and *In re Lane*, 149 B.R. 760, 765-66 (Bankr. E.D.N.Y. 1993). *See also In re Guidry*, 493 U.S. 365 (1990) (refusing to impose equitable limitation on ERISA anti-alienation provision).

F. Tricky areas
   1. Qualified Domestic Relation Orders (QDROs) – An alternate payee under a QDRO is considered an ERISA plan beneficiary. *See* 29 U.S.C. § 1056(d)(3)(J); *Nelson v. Ramette*, 322 F.3d 541 (8th Cir. 2003). But BEWARE of property interests that arise after the filing of a complaint/petition for divorce, but before a divorce decree or QDRO is issued. *Compare Ostrader v. Lalchandani*, 279 B.R. 880 (B.A.P. 1st Cir. 2002) (interest in ERISA plan not property of the estate where bankruptcy filed after divorce decree but before QDRO entered), *In re West*, 507 B.R. 252 (Bankr. N.D. Ill. 2014) (defective QDRO did not deprive debtor of ability to exempt interest in ex-spouse's pension plan), *and In re Remia*, 503 B.R. 6 (Bankr. D. Mass. 2013) (divroce judgment gave debtor interest in funds that could be exempted even in absence of QDRO) *with In re Burgeson*, 504 B.R. 800 (Bankr. W.D. Pa. 2014) (in the absence of QDRO, debtor was not a beneficiary of ex-spouse's pension plan, but had only an equitable claim under state law and that claim was property of the estate).

   2. Employee/owners – *Yates v. Hendon,* 541 U.S. 1 (2004) (sole shareholder and president of professional corporation could qualify as "participant" in ERISA pension plan sponsored by corporation as long as plan covered one or more employees other than himself and his wife). *See* 29 C.F.R. § 2510.3-3(c)(1) (corporation's sole owner is not an "employee" for purposes of ERISA).

   3. Stock option plans – *In re Segovia*, 404 B.R. 896 (Bankr. N.D. Cal. 2009) (Long Term Inventive Compensation Plan including stock options not subject to ERISA); *Maguire v. Medtronic, Inc*., 2010 WL 744561 (Bankr. W.D. Pa. Feb. 26, 2010) (employer stock option plan that vested immediately not subject to ERISA)

II. Plans not subject to ERISA

A. Excluded from the estate? Does it meet the 541(c)(2) test? Is there a trust subject to a "restriction on the transfer of a beneficial interest of the debtor in a trust that is enforceable under applicable nonbankruptcy law"? *See In re Laher*, 496 F.3d 279 (3d. Cir. 2007) (403(b) deferred annuity plan constituted trust under state law and restricted beneficiary's ability to transfer interest in account); *Rhiel v. OhioHealth Corp. (In re Hunter*), 380 B.R. 753 (Bankr. S.D. Ohio 2008) (same).

B. Are the retirement funds exempt? The purpose of exemption law is to allow debtors to keep those items of property deemed essential to daily life. In the bankruptcy context, exemptions serve the overriding purpose of helping the debtor to obtain a fresh start by maintaining essential property necessary to build a new life. *See* H.R. Rep. No. 95-595, at 117 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6078 (purpose of this scheme is to provide "adequate exemptions and other protections to ensure that bankruptcy will provide a fresh start."); *Rousey v. Jacoway*, 544 U.S. 320, 322, 325 (2005). Section 522 of the Bankruptcy Code permits debtors to exempt certain property from the bankruptcy estate pursuant to the federal exemptions, listed in 11 U.S.C. § 522(d), or the applicable state exemptions.

1. 2005 Amendments - retirement fund exemptions

    a. Most retirement accounts will be exempt under the 2005 amendments to the Code. Amendments codified and extended *Rousey v. Jacoway*, 125 S. Ct. 1561 (2005) (exempting IRA under section 522(d)(10)(E) to the extent necessary for the support of the debtor and any dependents of the debtor).

    b. Section 522(b)(3)(C) applicable in opt-out states; section 522(d)(12) available under federal exemption scheme: "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."

        i. Is the fund or account exempt from taxation?

        • *In re Miller*, 500 B.R. 578 (B.A.P. 8th Cir. 2013) (individual retirement annuity funded by a direct rollover from another tax-qualified IRA was tax-exempt under IRC § 408(b) and therefore exemptible in bankruptcy under 522(b)(3)(C)).

        ii. Whether operation of plan or account renders it unqualified?

        An IRA loses its tax-exempt status if the owner "engages in any transaction prohibited by section 4975" of the tax code. I.R.C. § 408(e)(2)(A).

• *Daley v. Mostoller* (*In re Daley*), 717 F.3d 506 (6th Cir. 2013) (agreement granting lien on all accounts, including IRA, did not cause IRA to lose tax exempt status); *see also* IRS Announcement 2011-81, 2011-52 I.R.B. 1052 (mere existence of a "cross-collateralization agreement," as the IRS calls it, does not by itself disqualify an IRA from exempt status).
• *In re Plunk*, 481 F.3d 302 (5th Cir. 2007) (court could consider disqualifying event—payment of personal bills from plan assets—occurring after IRS last determination)
• *In re Willis*, 2010 WL 1408343 (S.D. Fla. April 6, 2010), *aff'd* 424 Fed. Appx. 880 (11th Cir. April 21, 2011) (IRA funds not exempt because debtor engaged in prohibited transactions causing assets to lose tax-exempt status).

iii. Are inherited IRAs exempt?
• *Rameker v. Clark*, 134 S. Ct. 2242 (2014).

c. Section 522(b)(4)
i. Subsection (a): presumption in favor of exemption if fund has a favorable determination from the IRS.

• IRS letter going to form, not operation, of plan does not create presumption. *In re Bauman*, 2014 WL 816407 (Bankr. N.D. Ill. Mar. 4, 2014).

ii. Subsection (b): if no favor determination debtor must show: no adverse determination, retirement fund is in substantial compliance with IRC requirements OR not in compliance but debtor not materially responsible for non-compliance

iii. Direct transfers and distributions

d. Caps on exemptions
1. For most retirement funds there is no exemption limit
2. Traditional IRAs and Roth IRA's exemptions are limited to $1,245,475 as of April 1, 2013. (This amount is subject to adjustment every 3 years.). 11 U.S.C. § 522(n).

2. Other exemptions?
a. Section 522(d)(10)(E) and *Rousey*
i. Old exemption remains in the Code

ii. Still applicable to plans providing payments based on a statutory trigger other than retirement (illness, disability, death or length of service)

3. Retirement plans that are neither tax-qualified nor subject to ERISA.

b. State exemptions

i. Tex. Prop. Code Ann. § 42.0021(a)

ii. Mich. Com. L. Ann. § 600.5451(j), (k), (l).

iii. Illinois, 735 ICLS 5/12-1006

iv. Minn. Ann. Stat. § 550.37, subd. 24.

C. Fraudulent Transfer?

In re Thomas, 2012 WL 2792348 (Bankr. D. Idaho 2012) (conversion of non-exempt insurance policy to exempt IRA not fraudulent)

In re Beaudin, 2010 WL 3748735 (Bankr. D. Colo. Sept. 21, 2010) (IRA opened on the eve of bankruptcy with funds from non-exempt tax refund not made with actual intent to defraud creditors)

Retirement Contributions in Bankruptcy

A. Statutory Provision

Section 541(b)(7): Property of the estate does not include:

(7) any amount—

(A) withheld by an employer from the wages of employees for payment as contributions—

(i) to—

(I) an employee benefit plan that is subject to title I of the Employee Retirement Income Security Act of 1974 or under an employee benefit plan which is a governmental plan under section 414(d) of the Internal Revenue Code of 1986;

(II) a deferred compensation plan under section 457 of the Internal Revenue Code of 1986; or

(III) a tax-deferred annuity under section 403(b) of the Internal Revenue Code of 1986;

except that such amount under this subparagraph shall not constitute disposable income as defined in section 1325 (b)(2); or

(ii) to a health insurance plan regulated by State law whether or not subject to such title; or

(B) received by an employer from employees for payment as contributions—

(i) to—

(I) an employee benefit plan that is subject to title I of the Employee Retirement Income Security Act of 1974 or under an employee benefit plan which is a governmental plan under section 414(d) of the Internal Revenue Code of 1986;

(II) a deferred compensation plan under section 457 of the Internal Revenue Code of 1986; or

(III) a tax-deferred annuity under section 403(b) of the Internal Revenue Code of 1986;

except that such amount under this subparagraph shall not constitute disposable income, as defined in section 1325 (b)(2); or

(ii) to a health insurance plan regulated by State law whether or not subject to such title;

B. Three Views

1. Chapter 13 debtors not allowed to make voluntary post-petition retirement contributions in any amount. *In re Seafort*, 669 F.3d 662 (6th Cir. 2012); *In re Parks*, 475 B.R. 703 (B.A.P. 9th Cir. 2012).
2. Chapter 13 debtor permitted to make contributions in any amount so long as not exceeding limits established by plan; 541(b)(7) unequivocally removes voluntary retirement contributions from the projected disposable income calculation. *In re Hall*, 2013 WL 6234613 (Bankr. N.D. Ill. Oct. 22, 2013); *In re Drapeau*, 485 B.R. 29 (Bankr. D. Mass. 2013).
3. Permits "continued" contributions to retirement accounts. *In re Seafort*, 437 B.R. 204 (B.A.P. 6th Cir. 2010), *aff'd on other grounds*, 669 F.3d 662 (6th Cir. 2012); *In re Jensen*, 496 B.R. 615 (Bankr. D. Utah 2013).

Retirement Loan Repayment as Projected Disposable Income

A. Statutory Provision - 1322(f) – any amounts required to repay loan from retirement fund account does not constitute disposable income.

B. Deduct amount in full or prorate over the plan? *Compare In re Haley*, 354 B.R 340 (Bankr. D.N.H. 2006) (deduction allowed in ful) and In re Wiggs, 2006 WL 2246432 (Bankr. N.D. Ill. 2006) (same) *with In re Kofford*, 2012 WL 6042861 (Bankr. D.Utah Dec. 4, 2012)(requiring debtor to prorate loan payments over the plan, but also misconstruing *In re Lasowski*, 575 F.3d 815 (8th Cir. 2009), which required a step up plan, not proration).

Retirement Account Distributions as Projected Disposable Income

A. Statutory Provision – 11 U.S.C § 101(10A)
The term "current monthly income"—
(A) means the average monthly income from all sources that the debtor receives (or in a joint case the debtor and the debtor's spouse receive) without regard to whether such

income is taxable income, derived during the 6-month period ending on—
(i) the last day of the calendar month immediately preceding the date of the commencement of the case if the debtor files the schedule of current income required by section 521 (a)(1)(B)(ii); …

B. Retirement Distributions are generally not PDI
- Conversion of pre-petition assets from one form to another, even to cash, does not produce income.
  - *In re Zahn*, 391 B.R. 840, 845 (B.A.P. 8th 2008) (IRA distributions taken by non-debtor spouse not treated as disposable income and treated similarly to withdrawals from savings accounts).
  - *See also Simon v. Zittel*, 2008 WL 750346 (Bankr. S.D. Ill. Mar. 19, 2008) (holding that 401K distributions taken within the six months prior to filing Chapter 13 did not constitute "income from all sources" within the meaning of the § 101(10A)); *In re Breeding*, 366 B.R. 21, 25 (Bankr. E.D. Ark. 2007) (liquidation of two certificates of deposits did not produce income); *but see In re DeThample*, 390 B.R. 716, 726 (Bankr. D. Kan. 2008) (holding that a pre-petition distribution from a debtor's 401(k) is included in a CMI, but may be disregarded when determining debtor's projected disposable income).

- Pension plan distributions (even those with contributory elements) may be treated differently
  - *In re Coverstone*, 461 B.R. 629, 634 (Bankr. D. Idaho 2011) (voluntary contributions were but one factor of a "complex algorithm" and that the majority of the contributory pension income he was receiving at present was, ultimately, provided by his employer, and therefore, considered disposable income).

Social Security Benefits

A. Background
1. 58 million American received approx. $816b in Social Security benefits in 2013; average retirement benefits - $1269; approximately 35% of Americans over 65 rely completely on Social Security.
2. Are Social Security benefits property of the estate? 42 U.S.C. § 407 – "None of the moneys paid…under this subchapter shall be subject to…the operation of any bankruptcy or insolvency law." Are social security benefits property of the estate? *In re Carpenter*, 614 F.3d 930 (8th Cir. 2010) (holding anti-assignment provision in Social Security Act barred the inclusion of past and future social security benefits in the bankruptcy estate).

B. Social Security Not Projected Disposable Income
1. Disposable income test: Trustee or holder of an allowed unsecured claim may object to confirmation if the debtor does not propose to pay to unsecured creditors all of his or her projected disposable income to be received during the applicable commitment period. 11 U.S.C. § 1325(b). Section 1325(b)(2) defines disposable

income as "current monthly income received by the debtor . . . less amounts reasonably necessary to be expended." In turn, "current monthly income" is defined as "the average monthly income from all sources that the debtor receives . . . derived during the 6-month period" prior to filing the bankruptcy petition. 11 U.S.C. § 101(10A)(A)(i).

2. *Baud v. Carroll*, 634 F.3d 327 (6th Cir. 2011). Chapter 13 trustee acknowledged that social security is not included in disposable income under section 101(10A)(B), but nevertheless argued that it should be included in the calculation of "projected disposable income" under section 1325(b) because it was a known change in the debtor's income. The Sixth Circuit disagreed finding that the trustee's interpretation would essentially read the social security exclusion out of the Code. The court also dispensed with the trustee's attempt to align the case with *Hamilton v. Lanning*, 130 S. Ct. 2464 (2010), stating that the definition of disposable income could not be ignored simply because there is a disparity between the amount calculated using that definition and the debtor's monthly net income as shown on Schedule J.
3. *Mort Ranta v. Gorman*, 721 F.3d 241 (4th Cir. 2013); *Beaulieu v. Ragos*, 700 F.3d 220 (5th Cir. 2012) (stating that it makes little sense to circumvent the social security exclusion by allowing such benefits to be considered projected disposable income); *Cranmer v. Anderson*, 463 B.R. 548 (10th Cir. 2011) (rejected the chapter 13 trustee's attempts to characterize the receipt of social security benefits as one of those "unusual" circumstances that justified departure from the statutory formula).

C. A Question of Bad Faith

1. Good faith test requires that "the plan [be] proposed in good faith and not by any means forbidden by law." 11 U.S.C. § 1325(a)(3). The good faith standard provides a check on actions that abuse the bankruptcy system.
2. Courts have generally rejected attempts to reframe disposable income objections as good faith objections.
3. *Welsh v. Drummond*, 711 F.3d 1120 (9th Cir. 2013). The trustee argued that the debtor's failure to contribute social security income to increase plan payments was an indicia of "egregious" behavior sufficient to find bad faith. The court disagreed and found that reconsidering debtors' contribution of social security income to their plan payments would render the ability to pay test in section 1325(b) meaningless. The court also found that section 101(10A) and 42 U.S.C. § 407 were each more specific than section 1325(a)(3) with respect to social security. Citing cannons of statutory construction that disfavor statutory interpretations that render other statutory language superfluous and that require specific statute to control over general statutes addressing the same subject, the court held that failure to contribute social security benefits to plan payments did not by itself constitute bad faith.
4. *In re Thompson*, 493 B.R. 140 (B.A.P. 8th 2010) (exclusion of social security income from plan payments, standing alone, could not prevent debtors from establishing good faith); *Mort Ranta v. Gorman*, 721 F.3d 241, 253 n.15 (4th Cir.

2013); *In re Melander*, 506 B.R. 855 (Bankr. D. Minn. 2014) (chapter 13 debtors control the amount of social security benefits that are contributed to plan).

D. Feasibility
   1. Section 1325(a)(6) requires that the "debtor will be able to make all payments under the plan and to comply with the plan." If the plan does not meet this standard, often called the feasibility test, confirmation may be denied. Under this test, the budget figures must show sufficient income or other financial resources to enable the debtor to make the payment proposed. A plan is considered feasible if the debtor's net monthly income, as reflected on Schedule J, is equal to or greater than the debtor's proposed plan payment.
   2. *Mort Ranta v. Gorman*, 721 F.3d 241 (4th Cir. 2013). Trustee argued that if social security was not considered projected disposable income then it could not be used in determining the feasibility of the plan. The court found that nothing in the Code supports the bankruptcy court's holding that if social security income is not part of disposable income, it cannot be used to support feasibility. To the contrary, the court cited a string of cases, legislative history, and treatises in support of its finding that social security income has historically been used to support feasibility. "We therefore hold, in agreement with the Sixth Circuit, that 'a debtor with zero or negative projected disposable income may propose a confirmable plan by making available income that falls outside of the definition of disposable income—such as . . . benefits under the Social Security Act—to make payments under the plan.'" (*citing Baud*, 634 F.3d at 352 n.19).