



UNC  
SCHOOL OF LAW

NORTH CAROLINA LAW REVIEW

---

Volume 64 | Number 1

Article 7

---

11-1-1985

# Pension and Bankruptcy Laws: A Clash of Social Policies

Laurence B. Wohl

Follow this and additional works at: <http://scholarship.law.unc.edu/nclr>



Part of the [Law Commons](#)

---

## Recommended Citation

Laurence B. Wohl, *Pension and Bankruptcy Laws: A Clash of Social Policies*, 64 N.C. L. REV. 3 (1985).

Available at: <http://scholarship.law.unc.edu/nclr/vol64/iss1/7>

This Article is brought to you for free and open access by Carolina Law Scholarship Repository. It has been accepted for inclusion in North Carolina Law Review by an authorized administrator of Carolina Law Scholarship Repository. For more information, please contact [law\\_repository@unc.edu](mailto:law_repository@unc.edu).

# PENSION AND BANKRUPTCY LAWS: A CLASH OF SOCIAL POLICIES

LAURENCE B. WOHL†

I.	INTRODUCTION .....	4
II.	BANKRUPTCY LAW—A BRIEF REVIEW .....	6
	A. <i>Bankruptcy Act of 1898</i> .....	6
	B. <i>Bankruptcy Reform Act of 1978</i> .....	11
III.	SPENDTHRIFT TRUSTS .....	12
	A. <i>Brief Explanation of ERISA Plans</i> .....	13
	B. <i>ERISA Plans as Spendthrift Trusts</i> .....	14
	1. Keogh Plans and Individual Retirement Accounts .....	16
	2. Corporate Plans .....	18
	3. Effect of Impediments to Exercise of Control .....	20
	C. <i>Assignment and Alienation in Non-Spendthrift Trusts</i> .....	22
IV.	EXEMPTIONS .....	24
V.	RELATIONSHIP OF BANKRUPTCY LAW TO PENSION LAW .....	28
	A. <i>Purpose of ERISA</i> .....	28
	B. <i>Appropriate Law Regulating Pension Arrangements</i> .....	30
VI.	PROPOSAL FOR JUDICIAL RECONCILIATION OF BANKRUPTCY AND ERISA POLICY .....	31
VII.	CONCLUSION .....	36

*The dual purposes of the United States Bankruptcy Code are the financial rehabilitation of debtors and the satisfaction, to the fullest extent possible, of creditors' claims. The policy evinced by the Employee Retirement Income Security Act of 1974 (ERISA) is the encouragement and protection of accumulated savings for retirement years. Interesting crosscurrents attend the meeting of the policies behind these two statutory schemes. Pension assets of a debtor in bankruptcy are not given the protections contemplated by ERISA if they are attached by creditors. Conversely, maximum satisfaction of creditors' claims is not achieved if the debtors' pension assets are not subject to attachment. In resolving the conflict between ERISA and Bankruptcy Code policies, courts have typically favored the Code. Professor Wohl examines this conflict and concludes that ERISA and Bankruptcy Code principles can be judicially and legislatively harmonized without violating the purposes of either. The harmony results from recognition that ERISA pension arrangements have a two-part nature: they are both retirement schemes and tax*

---

† Associate Dean and Assistant Professor of Law, University of Dayton School of Law. B.S. 1969, University of California at Berkeley; J.D. 1972, University of California at Davis.

*deferred savings accounts. According to Professor Wohl, that part of an ERISA arrangement representing a retirement scheme should be exempt from the debtor's bankruptcy estate, and that part of the arrangement representing the tax deferred savings should become property of the estate. This resolution leaves intact both ERISA's assurance of ample retirement funds and the Bankruptcy Code's promise of maximum repayment of creditors consistent with a debtor's "fresh start."*

## I. INTRODUCTION

An individual seeking protection under the bankruptcy laws<sup>1</sup> generally is attempting to obtain either relief from debts or a court supervised plan to pay existing debts in an orderly fashion.<sup>2</sup> A debtor seeking immediate liquidation of debts will proceed under Chapter 7 of the Bankruptcy Code, which requires that the debtor's existing assets be turned over to creditors in payment of as much of the debtor's liabilities as such assets can liquidate. In turn the debtor is relieved of any further liability to pay remaining prebankruptcy debts.<sup>3</sup> A debtor seeking a court supervised plan for the payment of some or all debts will pursue the protection granted under either Chapter 11 or Chapter 13 of the Bankruptcy Code, both of which anticipate payment of existing debts in accordance with a schedule reasonably matching the debtor's actual cash flow.<sup>4</sup>

---

1. The federal bankruptcy laws have gone through a series of incarnations. The Bankruptcy Act of 1898, ch. 541, 30 Stat. 544, was substantially revised by the Chandler Act of 1938, ch. 575, 52 Stat. 840, and then repealed by the Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549 (effective Oct. 1, 1979). The 1978 Act was amended by the Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, 98 Stat. 333. Following common usage, this Article will refer to the Bankruptcy Act of 1898 and the Chandler Act of 1938 as the Bankruptcy Act and to the Bankruptcy Reform Act of 1978 and the Bankruptcy Amendments and Federal Judgeship Act of 1984 as the Bankruptcy Code.

2. For a review of the reasons individuals declare bankruptcy, see D. STANLEY & M. GIRTH, *BANKRUPTCY: PROBLEM, PROCESS, REFORM* (1971). Although recognizing that bad debt management is an important factor in many personal bankruptcies, these authors suggest that a significant portion of personal bankruptcies is caused by forces beyond the control of the debtor.

A report by the United States Comptroller General prepared for the House of Representatives in 1983 indicated that the reasons for declaring bankruptcy in both Chapter 7 and Chapter 13 proceedings were increases in cost of living (67% of Chapter 7 respondents and 72% of Chapter 13 respondents), unemployment (36% of Chapter 7 respondents and 34% of Chapter 13 respondents), and unusual medical bills (36% of Chapter 7 and Chapter 13 respondents). *COMPTROLLER GENERAL OF THE UNITED STATES, REPORT TO THE CHAIRMAN, HOUSE COMMITTEE ON THE JUDICIARY, BANKRUPTCY REFORM ACT OF 1978—A BEFORE AND AFTER LOOK 15-16* (July 20, 1983).

In another study, four reasons were most frequently cited as the causes of bankruptcy: medical bills (43%), too much credit purchasing (44%), rises in the cost of living (45%), and creditor collection attempts (29%). Two other reasons, cited by 28% of the respondents to this study, were marital problems and easy access to credit. A. SULLIVAN, *CONSUMER BANKRUPTCY STUDY, PERSONAL BANKRUPTCY: CAUSES, COSTS AND BENEFITS, CREDIT RESEARCH CENTER 35* (Krannert Graduate School of Management, Purdue University Monograph No. 24, 1982).

3. 11 U.S.C. §§ 701-766 (1982). The debtor must cooperate with the trustee in liquidating property of the estate. *Id.* § 521. See also R. AARON, *BANKRUPTCY LAW FUNDAMENTALS*, 1-9 to 1-24 (1984) (overview of Chapter 7 bankruptcy).

4. For an excellent general review of Chapter 13 procedures, see W. DRAKE & J. MORRIS, *CHAPTER 13 PRACTICE AND PROCEDURE* (1984).

Neither Chapter 11 reorganizations nor Chapter 13 proceedings will be discussed in this Article. The theoretical and policy considerations underlying these bankruptcy alternatives are substantially different from those underlying Chapter 7. As a practical matter the issues raised in this Article are not serious problems under either Chapter 11 or Chapter 13 circumstances because

This Article will address the question whether pension assets<sup>5</sup> vested in a debtor who is not currently receiving benefit payments under the pension are property that must be turned over to creditors in a Chapter 7 bankruptcy. Determining whether a debtor's pension assets are available to creditors in a bankruptcy requires more than a straightforward analysis of the federal bankruptcy statute and its case law amplification. The apparently conflicting policies of the federal bankruptcy laws and the Employee Retirement Income Security Act of 1974 (ERISA)<sup>6</sup> must also be examined. Conflicts arise because ERISA policy encourages the accumulation of savings for retirement and the protection of accumulated retirement benefits,<sup>7</sup> whereas the bankruptcy laws are motivated by the dual purposes of allowing the debtor a new financial beginning and permitting creditors to recoup from the debtor's existing assets as much of the monies owed them as is possible.<sup>8</sup> The sanctity and protection of retirement benefits cannot be maintained if those benefits can be attached by creditors. Conversely, the maximum amount of a debtor's assets is not made available to creditors if a substantial portion of those assets is in a retirement account that is unavailable to creditors.<sup>9</sup> Analyzing the issues raised by this conflict, this Article reviews the distinction between exemptions<sup>10</sup> and exclusions<sup>11</sup> as they affect pension benefits in a bankruptcy estate. The Article further discusses whether the pension laws tolerate creditor access to pension benefits in a Chapter 7 proceeding, and if they do tolerate such access, whether the laws impose different treatment of those benefits based upon their being subject to exemption or exclusion.<sup>12</sup> Finally, the Article, accepting that at least some pension benefits should be available to creditors, proposes an analytical method that: (1) determines how much of a debtor's pension benefits should be protected from creditors, (2) produces

---

neither chapter requires liquidation of the debtor's assets as does Chapter 7. Rather, Chapters 11 and 13 are concerned with debt payments made from a debtor's cash flow.

5. As used in this Article, the terms "pension" and "pension arrangement" include retirement benefits accrued under corporate and self-employed pension and profit-sharing plans, individual retirement accounts and annuities, and any other deferred compensation plan for which tax deferral on contributions is permitted under I.R.C. §§ 401, 501 (1985).

6. Pub. L. No. 93-406, 88 Stat. 829 (1974). The Employee Retirement Income Security Act of 1974 is the "short title" (presumably so defined by Congress with tongue firmly in cheek) of the Pension Reform Act of 1974. This Act substantially revised the Internal Revenue Code, added §§ 1001-1461 to Title 29 of the United States Code, and deleted the Welfare and Pension Plans Disclosure Act, Pub. L. No. 85-836, 72 Stat. 997 (repealed effective Jan. 1, 1975, and previously codified at 29 U.S.C. §§ 301-309). Throughout this Article the Pension Reform Act of 1974, as amended from time to time, shall be referred to as ERISA.

7. See *infra* text accompanying notes 143-53. The most important purpose of ERISA is to ensure that benefits earned by a participant are protected from appropriation by a plan's sponsor, 29 U.S.C. §§ 1106, 1112 (1985); I.R.C. § 4975 (1985), and from the sponsor's imprudent investment of the plan's assets. 29 U.S.C. §§ 1102-04 (1985); I.R.C. § 4975 (1985).

8. See *Burlingham v. Crouse*, 228 U.S. 459, 473 (1913) ("It is the twofold purpose of the Bankruptcy Act to convert the estate of the bankrupt into cash and distribute it among creditors and then to give the bankrupt a fresh start with such exemptions and rights as the statute left untouched.").

9. The most substantial asset of some debtors is their vested interest in a pension plan. Pension benefits represent highly liquid assets that are actively sought by creditors even when debtors have other substantial assets.

10. 11 U.S.C. § 522 (1982).

11. *Id.* § 541.

12. See *infra* notes 72-105 & 120-139 and accompanying text.

the same result whether exemption or exclusion theory is used, and (3) allows adherence to the purposes of both pension and bankruptcy laws.<sup>13</sup>

## II. BANKRUPTCY LAW—A BRIEF REVIEW

### A. *Bankruptcy Act of 1898*

The Bankruptcy Act of 1898, as from time to time amended,<sup>14</sup> governed bankruptcy matters prior to October 1, 1979.<sup>15</sup> One of its significant purposes was to "protect debtors and their families from pauperism and to facilitate [their] rehabilitation."<sup>16</sup> One approach adopted under the statutory framework to accomplish this goal was to exempt certain property of a debtor from attachment by creditors<sup>17</sup> even though such property was property of the debtor's estate.<sup>18</sup> Another approach was to exclude from the debtor's estate altogether property whose title was deemed too tenuous or the need for which too overwhelming to subject it to creditors' claims.<sup>19</sup> Consequently, the question of what constituted property available to a debtor's creditors became a primary focus of many bankruptcy proceedings.<sup>20</sup>

Questions of what property in the debtor's estate should be exempt were easily resolved by statutory specification.<sup>21</sup> The definition of what became property of a debtor's bankruptcy estate, however, was not based on a specific list of

13. See *infra* notes 162-72 (Section VI).

14. See *supra* note 1.

15. October 1, 1979, was the effective date of the Bankruptcy Reform Act of 1978. See *supra* note 1.

16. Plumb, *The Recommendations of the Commission of the Bankruptcy Laws—Exempt and Immune Property*, 61 VA. L. REV. 1, 4 (1975).

17. Formerly debtors were allowed only those exemptions permitted by the debtor's state of domicile. Bankruptcy Act of 1898, ch. 541, § 24, 30 Stat. 544, 553, *repealed by* Bankruptcy Act of 1978, Pub. L. No. 95-598, § 401, 92 Stat. 2549, 2682; Act of June 22, 1938, ch. 575, § 69, 52 Stat. 840, 879 (later codified at 11 U.S.C. § 110), *repealed by* Bankruptcy Act of 1978, Pub. L. No. 95-598, § 401, 92 Stat. 2549, 2682. The current bankruptcy laws provide a federal exemption scheme, 11 U.S.C. § 522(d) (1982), but continue to allow a debtor to elect his or her domiciliary state's exemptions in lieu of those specified under the federal statute. *Id.* § 522(b)(1).

18. Property of the bankruptcy estate is property in which the debtor has an interest at the time a bankruptcy petition is filed and which, subject to exemptions, may be applied toward satisfaction of prebankruptcy debts. See 11 U.S.C. § 541(a)(1) (1982); *infra* note 49. There is at least a theoretical distinction between exemptions and exclusions. If property is excluded from the bankruptcy estate it is outside the ambit of control of the bankruptcy laws. If property is included in the estate but is exempt from creditor attachment, it is under the control of the bankruptcy laws but is not available for satisfaction of prebankruptcy debts. The bankruptcy laws prior to October 1, 1979, were highly dependent upon the exclusion concept, whereas the laws after that date are more exemption oriented. For an example of the impact of this distinction, see *Nunnally v. Nunnally* (*In re Nunnally*), 506 F.2d 1024 (5th Cir. 1975), discussed *infra* note 37.

19. Bankruptcy Act of 1898, ch. 541, § 70, 30 Stat. 544, 565, *repealed by* Bankruptcy Act of 1978, Pub. L. No. 95-598, § 401, 92 Stat. 2549, 2682.

20. See, e.g., *Kokoszka v. Belford*, 417 U.S. 642 (1974); *Lines v. Frederick*, 400 U.S. 18 (1970); *Segal v. Rochelle*, 382 U.S. 375 (1966); *Mason v. Eastman Kodak Co.* (*In re Parker*), 473 F. Supp. 746 (W.D.N.Y. 1979); *Firestone v. Metropolitan Life Ins. Co.* (*In re Di Piazza*), 29 Bankr. 916, 918 (Bankr. N.D. Ill. 1983); *In re Mace*, 4 Bankr. Ct. Dec. (CRR) 94, 96-97 (Bankr. D. Or. 1978).

21. Bankruptcy Act of 1898, ch. 541, § 24, 30 Stat. 544, 553, *repealed by* Bankruptcy Act of 1978, Pub. L. No. 95-598, § 401, 92 Stat. 2549, 2682; Act of June 22, 1938, ch. 575, § 69, 52 Stat. 840, 879 (later codified at 11 U.S.C. § 110), *repealed by* Bankruptcy Act of 1978, Pub. L. No. 95-598, § 401, 92 Stat. 2549, 2682.

items but rather on judicial interpretation of the purposes of the bankruptcy laws.<sup>22</sup> One purpose of the Bankruptcy Act was to provide assets from which the debtor's creditors could be paid the amounts due them. However, one need not go much beyond basic common-law contract concepts to fulfill that goal. In addition to the policy of making creditors whole, there was another, conflicting social policy at work.<sup>23</sup> It was deemed essential to permit the debtor once again to become a productive citizen free from the burdens of past profligacy or bad fortune.<sup>24</sup>

To maintain the balance of conflicting social policies reflected in the Bankruptcy Act, the courts were required to weigh the relative necessity of each piece of a debtor's property to pay creditors' claims against the significance of the property to a debtor's ability to live without public assistance. The resolution of this question frequently hinged upon a determination whether the assets in question were more appropriately connected to activities of the debtor that caused bankruptcy or to the debtor's postbankruptcy survival. The test became one of measuring whether each asset in question was "sufficiently rooted in the pre-bankruptcy past and so little entangled with the [debtor's] ability to make an unencumbered fresh start that it should be regarded as 'property' under [Bankruptcy Act section] 70a(5)."<sup>25</sup>

In *Segal v. Rochelle*<sup>26</sup> the United States Supreme Court had to determine whether tax refunds resulting from operating loss carrybacks<sup>27</sup> were sufficiently

---

22. Courts recognized early that the state law exemptions—the only applicable exemptions under the Bankruptcy Act—were inappropriately harsh. The courts, therefore, sought additional exemptions based on a debtor's reasonable expectations of what would be available to him or her for the provision of future basic needs. For a discussion of this judicial creation of a federal "exemption," see Lee, *Leading Case Commentary: Lines v. Frederick*, 45 AM. BANKR. L.J. 115 (1971).

23. See *Segal v. Rochelle*, 382 U.S. 375 (1966), in which the United States Supreme Court, recognizing the conflicting policies, stated:

The main thrust of § 70a(5) is to secure for creditors everything of value the bankrupt may possess in alienable or leviable form when he files his petition. To this end the term "property" has been construed most generously and an interest is not outside its reach because it is novel or contingent or because enjoyment must be postponed. However, limitations on the term do grow out of other purposes of the [Bankruptcy] Act; one purpose which is highly prominent and is relevant in this case is to leave the bankrupt free after the date of his petition to accumulate new wealth in the future.

*Id.* at 379 (citations omitted).

24. In *Local Loan Co. v. Hunt*, 292 U.S. 234 (1934), the United States Supreme Court refused to allow the postbankruptcy garnishment of a debtor's wages, which had been pledged as security for a prebankruptcy loan. The Court stated:

The power of the individual to earn a living for himself and those dependent upon him is in the nature of a personal liberty quite as much as, if not more than, it is a property right. To preserve its free exercise is of the utmost importance, not only because it is a fundamental private necessity, but because it is a matter of great public concern. . . . The new opportunity in life and the clear field for future effort, which it is the purpose of the bankruptcy act to afford the emancipated debtor, would be of little value to the wage earner if he were obliged to face the necessity of devoting the whole or considerable portion of his earnings for an indefinite time in the future to the payment of indebtedness incurred prior to his bankruptcy.

*Id.* at 245.

25. *Segal v. Rochelle*, 382 U.S. 375, 380 (1966).

26. 382 U.S. 375 (1966).

27. Under I.R.C. § 62 (1985) a taxpayer is permitted to deduct expenses incurred in the taxpayer's trade or business or other activity entered into for profit during a taxable year to the extent of

rooted in the prebankruptcy past to be properly treated as property of the bankruptcy estate. Based upon the fact that the refund, although determined and received in *Segal* after the bankruptcy proceeding began, was really the return of money derived from the operation of the business that caused the bankruptcy, the Court decided that refunds derived from operating loss carrybacks were property of the estate. Thus, the refund was deemed sufficiently rooted in the past to be more properly considered property of the estate than an asset needed for a fresh start.<sup>28</sup> The Court apparently concluded that the refund was more reasonably considered a part of the cause of the bankruptcy than a part of the debtor's postbankruptcy right to accumulate wealth for the future.

The same factors considered in determining the includability of tax refunds under the old Act received judicial attention in determining whether or not pension benefits were property of the bankruptcy estate.<sup>29</sup> Pension benefits are connected to past wages in much the same way tax refunds are related to past business operations. These benefits are derived from contributions made to a pension plan by the debtor's employer as deferred compensation, by the debtor out of wages paid to him or her, or by the debtor out of self-employment income. Yet, unlike tax refunds that result from errors in calculation or unintended business reversals, pension benefits are accumulated intentionally for the specific purpose of providing a retiree with essential income during retirement.

Dealing with assets similar to pensions because of the method of their accumulation, the United States Supreme Court in *Lines v. Frederick*<sup>30</sup> determined that accrued but unpaid vacation pay held by the debtor's employer was not property of the bankruptcy estate. The Court premised this conclusion on the fact that accrued vacation pay was intended to provide the debtor and the debtor's family sufficient assets to meet their needs during the annual period when the employer was shut down or upon the debtor's termination of employment. Thus, the pay was akin to future wages. The Court posited:

---

the taxpayer's gross income for that taxable year. In the event that a taxpayer's expenses for any such year exceed his or her income for that same period, I.R.C. § 172 (1985) permits them to be used to offset net income in the three taxable years immediately preceding the year of loss—*i.e.*, "carried back"—and in certain tax years following the year of loss.

28. Both the United States Court of Appeals for the First Circuit in *Fournier v. Rosenblum*, 318 F.2d 525 (1st Cir. 1963), and the United States Court of Appeals for the Third Circuit in *In re Sussman*, 289 F.2d 76 (3d Cir. 1961), had held that income tax refunds resulting from operating loss carrybacks were not property of the estate. These courts had reasoned that because such refunds depended on an operating loss in the current year, and because the extent of the loss could not be determined until the close of the debtor's taxable year, a date subsequent to the filing for bankruptcy, the refunds were not property of the estate at the time of the bankruptcy filing. Indeed, the "property" did not come into existence until after the filing of the petition in bankruptcy.

The Supreme Court took an opposing view in *Segal*. It agreed that § 70a(5) of the Bankruptcy Act allowed the bankruptcy trustee to acquire only the property owned by the debtor as of the date the bankruptcy petition was filed. The tax refund, however, represented property in existence prior to the bankruptcy, even though the value of such property could not be calculated until some later time. *Segal*, 382 U.S. at 379-80.

29. As one court noted, "Under Section 70a of the Bankruptcy Act, pension plan funds were viewed as a wage substitute for some future period and, therefore, were not included within the property of the estate." *Barr v. Hinshaw (In re Hinshaw)*, 23 Bankr. 233, 234 (Bankr. D. Kan. 1982) (citations omitted).

30. 400 U.S. 18 (1970).

Since [such vacation pay] is a part of their wages, [it] is "a specialized type of property presenting distinct problems in our economic system." Where the minimal requirements for the economic survival of the debtor are at stake, legislatures have recognized that protection that might be unnecessary or unwise for other kinds of property may be required.<sup>31</sup>

The Court decided that to include these funds as property of the bankruptcy estate would violate the policy of allowing a debtor a fresh start. Thus, the Court excluded from property of the estate funds serving a purpose similar to pension funds—substitute wages. To include these funds would have deprived the debtor of the bankruptcy laws' promise of a "new opportunity in life and [a] . . . clear field for future effort, unhampered by the pressure and discouragement of preexisting debt."<sup>32</sup>

Despite its decision in *Lines* the Supreme Court has made clear that not everything having its origin in wages, if merely set aside, will be deemed a wage substitute. In *Kokoszka v. Belford*<sup>33</sup> the Supreme Court determined that overwithheld income taxes refunded after the commencement of bankruptcy proceedings were property of the bankruptcy estate. The Court's conclusion was based on the distinction between funds related to wages that were merely saved and wages set aside specifically to take the place of wages in the future. This distinction, although not specifically made by the Court, was really one between savings for items other than necessities and the accumulation of assets essential for basic necessities and support on retirement or disability.<sup>34</sup> The Court clearly found that an item rooted in wages would be excluded from property of the bankruptcy estate only if it were "designed to function as a wage substitute at some future period and, during that future period, [were intended] to 'support the basic requirements of . . . [a debtor's life].'"<sup>35</sup>

The wage substitute line of reasoning found its way directly into determinations involving pension arrangements. In deciding that pension benefits did not pass to the trustee in bankruptcy if such benefits were maintained by the debtor's employer in tax qualified pension and profit sharing plans,<sup>36</sup> the United States Court of Appeals for the Fifth Circuit reasoned that such benefits were to be regarded as future wages necessary to provide the debtor with the basic requirements of life.<sup>37</sup> However, the bankruptcy courts were, and continue to be, less

---

31. *Id.* at 20 (quoting *Sniadach v. Family Fin. Corp.*, 395 U.S. 337, 340 (1969)); see also *Tennessee Valley Auth. v. Kinzer*, 142 F.2d 833 (6th Cir. 1944) (vacation pay that is not accessible until a vacation is taken is similar to future wages).

32. *Local Loan Co. v. Hunt*, 292 U.S. 234, 244 (1934).

33. 417 U.S. 642 (1974).

34. For all practical purposes total disability and retirement are synonymous. Almost all pension arrangements provide that a participant will be permitted to take distribution of vested benefits upon disability. This arrangement is permitted by *Treas. Reg. § 1.401-1(b)(1)(f)* (1963).

35. *Kokoszka*, 417 U.S. at 648 (quoting *Lines v. Frederick*, 400 U.S. 18, 20 (1970)); see also *Segal*, 382 U.S. at 379 ("future wages of the bankrupt do not constitute 'property' at the time of bankruptcy").

36. For an explanation of the term "tax qualified," see *infra* note 66 and accompanying text.

37. See *Turpin v. Wente (In re Turpin)*, 644 F.2d 472 (5th Cir. 1981). *Turpin*, although decided subsequent to the effective date of the new Bankruptcy Code, was decided under the old Bankruptcy Act. Because the court did not say whether the debtor was a stockholder of the professional



willing to accept the wage substitute argument in the case of Keogh plans<sup>38</sup> and individual retirement accounts (IRAs).<sup>39</sup>

The courts, in evaluating IRA and Keogh plans, did not deny the future wage substitute aspects of these pension vehicles.<sup>40</sup> Rather, the courts were convinced that the ability of the debtor to gain access to plan assets after debts had been discharged in bankruptcy but before retirement removed these cases from the wage substitute analysis and required that such funds be viewed as currently accessible to the debtor.<sup>41</sup>

The courts attempted to establish certain objective standards to deal with the distinction between assets excluded from the bankruptcy estate because of their necessity for the debtor's fresh start and those includable because of their accessibility to the debtor. Some of the standards that were established were

corporation that maintained the retirement plans, it is not clear how this factor may have affected the decision. In other cases a debtor's control of distributions from the plan has resulted in plan assets being included in the bankruptcy estate. See *infra* notes 72-105 and accompanying text.

In *Nunnally v. Nunnally* (*In re Nunnally*), 506 F.2d 1024 (5th Cir. 1975), an earlier case decided by the same court but not involving debtor control of the plan's sponsor, a wife who lent monies to the marital community during the marriage was awarded monies representing the loan when the parties divorced. She was given a lien against the husband's Navy retirement benefits as security. Thereafter, the husband declared bankruptcy and sought to exclude his pension benefits from his bankruptcy estate so that his ex-wife would be denied assets from which her loan could be repaid. The court held that the pension benefits were not to be included in the bankruptcy estate because they were a wage substitute, but found that repayment of the "loan" was alimony and thus not a dischargeable debt under Texas law.

38. A Keogh plan is a retirement plan that is similar to a corporate pension or profit sharing plan, but is maintained by a sole proprietorship or partnership. Keogh plans are authorized under ERISA and are tax exempt under I.R.C. §§ 401, 501 (1985). A penalty tax is imposed upon a participant in a Keogh plan who withdraws certain monies therefrom before attaining age 59 1/2 if the participant owns more than five percent of the sponsor of the subject Keogh plan. See *id.* § 72(m)(5).

39. An individual retirement account is a retirement plan that can be maintained by an individual, whether employed or self-employed. Contributions to an IRA are tax deductible to the individual who maintains the IRA under I.R.C. § 408 (1985). Any amounts withdrawn from an IRA prior to the attainment of age 59 1/2, death, or disability are subject to a 10% penalty tax. *Id.* § 408(f).

40. See *In re Mendenhall*, 4 Bankr. 127 (Bankr. D. Or. 1980) (Keogh account is a contingent future interest); *In re Mace*, 4 Bankr. Ct. Dec. (CRR) 94, 96 (Bankr. D. Or. 1978) (purpose of IRA is to "put funds away for future use").

41. After reviewing cases involving tax loss carrybacks, income tax withholding, vacation pay plans, and government retirement plans, the court in *In re Mace*, 4 Bankr. Ct. Dec. (CRR) 94 (Bankr. D. Or. 1978), decided to include the debtor's IRA as property of the estate:

While the ostensible purpose of establishing an IRA is to put funds away for future use when the depositor is retired and in need of a substitute for wages, this Court is convinced that to treat an IRA as a substitute for future wages would be incorrect. In each of the foregoing cases [analyzed by the court] where the asset was determined to be a substitute for future wages, the bankrupt *had only limited control over the fund* so that there was a substantial certainty that the funds would be used at a time when a wage substitute was necessary.

*Id.* at 96-97 (emphasis added).

Two years later the same bankruptcy court reached a similar conclusion in *In re Mendenhall*, 4 Bankr. 127 (Bankr. D. Or. 1980), which involved a Keogh plan rather than an IRA. The court's statement in that case that "[t]he Keogh plan in the case at bar provides for withdrawal of contributed funds at any time . . ." *id.* at 129, however, is confusing because such a provision would have resulted in denial of the plan's tax exempt status. See I.R.C. § 401 (1985). The court might have believed, as it did in *Mace*, that the relatively small withdrawal penalty imposed by the Internal Revenue Code or by the plan itself was insufficient to make the plan anything more than a savings account.

based on whether payments were to be made "during a time when the pensioner may well have no or few other sources of income,"<sup>42</sup> whether payments were intended to substitute for wages during times when the employee was laid off,<sup>43</sup> whether the debtor had the right to withdraw money from a pension fund prior to retirement,<sup>44</sup> and whether the funds from which payments were made were based upon hours worked.<sup>45</sup>

## B. *Bankruptcy Reform Act of 1978*

The primary focus of the Bankruptcy Code enacted in 1978<sup>46</sup> is not on the question of includability of property in the debtor's estate but rather on the statutory exemptions from creditor access provided for property that is part of the estate.<sup>47</sup> However, much of the same reasoning that was applied to the issue of includability under the former laws is applied under the new laws to the question of exemption.<sup>48</sup>

The current bankruptcy code provides that the estate of a debtor consists, essentially, of every kind of interest in property possessed by the debtor prior to bankruptcy;<sup>49</sup> the term "property" is to be given its widest and most expansive

42. *Nunnally v. Nunnally* (*In re Nunnally*), 506 F.2d 1024, 1026 (1975).

43. *Electrical Workers v. IBEW-NECA Holiday Trust Fund*, 583 S.W.2d 154 (Mo. 1979). In this nonbankruptcy case, an employees' credit union attempted to garnish benefits under a vacation trust fund. The employer made periodic payments into the fund to provide benefits during the employee's holidays when the employee probably would not otherwise receive compensation. These funds were subject to garnishment because the payments were clearly intended to be wage substitutes.

44. See *In re Mendenhall*, 4 Bankr. 127 (Bankr. D. Or. 1980); *In re Mace*, 4 Bankr. Ct. Dec. (CRR) 94 (Bankr. D. Or. 1978).

45. *Electrical Workers v. IBEW-NECA Holiday Trust Fund*, 583 S.W.2d 154 (Mo. 1979).

46. For a description of the legislative history of the Act, see *supra* note 1.

47. In a thorough review of the then-proposed bankruptcy act, which later became the Bankruptcy Reform Act of 1978, see *supra* note 1, Plumb stated that "[t]he . . . Commission [on the Bankruptcy Laws of the United States] would eliminate transferability, levibility, and contingency as tests of whether property of the debtor would pass to the estate. The question of pension rights, therefore, would be dealt with strictly as a matter of exemption." Plumb, *supra* note 16, at 57.

48. The same analysis that applied to the Bankruptcy Act's notion of includability is appropriate in an analysis of exemption under the Bankruptcy Code because the fresh start concept was, in reality, a common law addition to the list of exemptions permitted under the Bankruptcy Act.

49. 11 U.S.C. § 541 (1982). This section, entitled "Property of the Estate," reads in part:

(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:

(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.

. . . .

(c)(1) Except as provided in paragraph (2) of this subsection, an interest of the debtor in property becomes property of the estate under subsection (a)(1), (a)(2), or (a)(5) of this section notwithstanding any provision . . .

(A) that restricts or conditions transfer of such interest by the debtor; or

(B) that is conditioned on the insolvency or financial condition of the debtor, on the commencement of a case under this title, or on the appointment of or the taking possession by a trustee in a case under this title or a custodian, and that effects or gives an option to effect a forfeiture, modification, or termination of the debtor's interest in property.

(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 this title.

meaning.<sup>50</sup> Thus, even arguably contingent claims such as a debtor's potential tax refunds<sup>51</sup> have been held to be property of the estate under the Bankruptcy Code.<sup>52</sup> Generally, the Code relies on a specific set of exemptions designed to give the debtor a fresh start to ameliorate the harsh effects of this all-inclusive definition.<sup>53</sup> However, the Code's definition of property is slightly relaxed by the statutory exclusion therefrom of interests in spendthrift trusts and similar arrangements.<sup>54</sup>

### III. SPENDTHRIFT TRUSTS

From the rather expansive language of the statute and the equal breadth accorded such language by the courts, there should be little question of the inclusion in the bankruptcy estate of a debtor's interest in a pension, profit sharing, or other kind of retirement arrangement.<sup>55</sup> However, because Bankruptcy Code section 541(c)(2) excludes from the bankruptcy estate the debtor's interest in a trust that has restrictions on transfer enforceable under nonbankruptcy

---

50. See *In re Clark*, 18 Bankr. 824, 826 (Bankr. E.D. Tenn. 1982). "The scope of [Bankruptcy Code § 541] is broad. It includes all kinds of property, including tangible or intangible property, causes of action, and all other forms of property formerly specified in § 70(a) of the Bankruptcy Act." *Id.*; see also *Firestone v. Metropolitan Life Ins. Co. (In re Di Piazza)*, 29 Bankr. 916, 918 (Bankr. N.D. Ill. 1983) ("[T]he Code broadens what is included in the bankruptcy estate by eliminating Act concepts of leviability, transferability, vested title and fresh start."); *Joelson v. Tiffin Sav. Bank (In re Everhart)* 11 Bankr. 770, 774 (Bankr. N.D. Ohio 1981) ("Section 541 expressly includes in the estate all the property of the debtor, even that needed for a fresh start.")

51. *In re DeVoe*, 5 Bankr. 618 (Bankr. S.D. Ohio 1980). In *DeVoe*, even though the bankruptcy filing preceded the end of the debtor's tax year, the court included in the bankruptcy estate the debtor's purely contingent interest in a potential tax refund for that year.

52. One court has stated that "[t]he [Bankruptcy] Code broadens what is included in the bankruptcy estate by eliminating Act concepts of leviability, transferability, vested title and fresh start policies . . . . Though state law will define the debtor's legal and equitable interests, the issue of what is property of the estate is a federal issue." *Clotfelter v. CIBA-GEIGY Corp. (In re Threewitt)* 20 Bankr. 434 (Bankr. D. Kan.), *rev'd*, 24 Bankr. 927 (D. Kan. 1982) (on reversal, court held employer's contributions to pension fund were not included in bankruptcy estate). Under the Bankruptcy Act "a bankrupt's beneficial interest in a trust was not part of the estate if the interest could not be transferred or levied upon under state law." *Samore v. Graham (In re Graham)*, 726 F.2d 1268, 1271 (8th Cir. 1984).

During its deliberations over the Bankruptcy Code, Congress indicated that the definition of property under § 541(a)(1) "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." S. REP. NO. 989, 95th Cong., 2d Sess. 82 (1978); H.R. REP. NO. 595, 95th Cong., 1st Sess. 368 (1977).

53. As one commentator stated:

There was general agreement among the critics of the 1898 Act that straight bankruptcy failed to give debtors a "fresh start," or a new beginning . . . .

. . . .

The Code, therefore, provides for the first time a federal exemption which the debtor may elect in preference to his state exemption, unless a state forecloses this option . . . .

Goetz, *Consumer Bankruptcies: Should Ability-To-Pay Condition Bankruptcy Relief?*, 27 N.Y.L. SCH. L. REV. 705, 712-13 (1982).

54. 11 U.S.C. § 541(c)(2) (1982) provides: "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 this title."

55. As will be discussed in this Article, even if pension trusts are property of the estate the assets of such trusts may qualify for federal or state exemptions. See *infra* notes 120-39 and accompanying text (Section IV).

law,<sup>56</sup> there is a question whether pension trusts are excludable. Section 541(c)(2)'s language describes, without actually labelling, a spendthrift trust; therefore, the more specific issue in excludability is whether a pension arrangement may be characterized as a spendthrift trust or as a trust similar enough to a spendthrift trust to be excluded under section 541(c)(2).<sup>57</sup>

### A. Brief Explanation of ERISA Plans

To understand the problem created by the language of Bankruptcy Code section 541(c)(2) as it relates to retirement arrangements, it is first necessary to have a basic understanding of how such arrangements are established and maintained. There are numerous types of retirement plans, including profit sharing, pension, and thrift plans. All of these plans have different characteristics relating to whether the employer, the employee, or both make contributions;<sup>58</sup> who assumes the risk of investment loss;<sup>59</sup> and the amount of the benefits ultimately to be paid to a plan participant. Despite these differences, however, all retirement plans have beneficial tax consequences if maintained in a trust or invested in some form of retirement annuity that meets the requirements of the Internal

---

56. 11 U.S.C. § 541(c)(2) (1982); see *supra* note 49 (text of § 541). Regarding a nonpension trust, the United States Bankruptcy Court for the Western District of Kentucky has stated:

Where property is held in trust for the debtor, the estate created under Section 541 succeeds to any interest of the debtor in the trust estate or fund, except as noted in Section 541(c)(2) [of the Bankruptcy Code] . . . .

Thus, property of the estate will include the debtor's beneficial interest in the trust estate unless there is a valid restriction on the transfer of that interest which would be enforceable under nonbankruptcy law.

*Avery Fed. Sav. & Loan Ass'n v. Klayer (In re Klayer)* 20 Bankr. 270, 272 (Bankr. W.D. Ky. 1981). Under this analysis a pension trust would not be considered property of the bankruptcy estate if it were deemed a trust that under nonbankruptcy law has sufficient restrictions inhibiting the debtor-beneficiary's ability to assign or transfer pension benefits.

57. See *infra* notes 63-92 and accompanying text.

58. I.R.C. § 401 (1985) sets forth requirements for tax-qualified pension, profit-sharing, and stock bonus plans. I.R.C. § 412 (1985) establishes the minimum amounts that can be contributed annually by employees and employers to corporate or Keogh pension and profit sharing plans, and I.R.C. § 415 (1985) establishes maximum amounts. An employer may deduct annual contributions to a retirement plan in accordance with limitations set forth at I.R.C. § 404 (1985). I.R.C. § 408 (1985) authorizes establishment of IRAs under which employees maintain retirement plans independent of any plan maintained by their employers, and I.R.C. §§ 219, 408 (1985) generally limit to \$2,000 annually the amount that can be contributed to an IRA.

59. In defined contribution plans the plan participants bear the risk of investment loss. Both money purchase pension plans and profit sharing plans are defined contribution plans. Profit sharing plans are plans to which employers make contributions of a discretionary amount of their profits, and money purchase pension plans are plans to which employers make contributions equal to a fixed percentage of participants' compensation. Both provide that a participant will receive benefits on retirement, or other appropriate date, equal to his or her share of the aggregate employer contributions, together with any income earned by such contributions from the date of contribution to the date of withdrawal. If the plan has been well invested the participant will receive a large distribution of assets, but if the contributions have been poorly invested, the participant will receive a smaller distribution of assets. In the most extreme case of investments gone sour a participant will receive no distribution of assets.

Unlike a defined contribution plan, a defined benefit plan virtually guarantees its participants specific benefits on retirement. The employer bears the risk of investment gain or loss in the defined benefit form of retirement arrangement because if there are insufficient assets in the plan to make the promised payout, the employer will have to make extra contributions. If the plan investments should fare better than expected, the employer will be able to reduce the amount of contributions it otherwise would have been required to make.

Revenue Code.<sup>60</sup>

Retirement plans are established by a number of different individuals and entities. Often the party establishing the plan and the plan's participants are closely related; the company sponsoring the plan might have only one employee who is also the company's sole stockholder, or a few highly paid employees who are also the company's majority stockholders. An example of this type of employer-employee situation is a professional medical corporation of which the doctor-employees of the corporation are its sole stockholders. The control over such a corporation's pension plan and the pension's assets by the stockholder-employees is obvious. Individuals establish, maintain, and have substantial control over their own IRAs. The individual who owns the IRA is also solely responsible for making contributions to the plan. These contributions generally are based on the individual's annual compensation, but are unrelated to any specific employment.<sup>61</sup> Plans are also established by employers who are unrelated to their employees other than in the respective employer-employee capacity. These plans frequently deny control over investment or withdrawal of plan assets to any beneficiary.

Each of these plans creates different problems of analysis in the determination whether a beneficiary's benefits are available to creditors in bankruptcy. Differing relationships among the employee, the employer, and the plan lead to different degrees of control over plan assets by a beneficiary. The issue of control is central to the courts' view of whether benefits to be paid by the plan qualify for exclusion under section 541(c)(2) and thus of the availability of such assets to creditors.<sup>62</sup>

### B. ERISA Plans as Spendthrift Trusts

Spendthrift trusts "provide for a right in a beneficiary to future income or principal of the trust, but also [provide] that his right to receive these payments in the future shall not be transferable by him or liable to be taken for the payment of his debts."<sup>63</sup> The degree of enforceability of the spendthrift provision of a trust varies from state to state.<sup>64</sup> The difficulties in defining trusts related to

60. I.R.C. § 501 (1985) exempts from taxation pension arrangement trusts that meet the requirements of I.R.C. § 401 (1985). Only contributions to trusts qualifying under I.R.C. §§ 401, 501 (1985) and certain custodial accounts and insurance contracts are deductible under I.R.C. § 219 (1985) or I.R.C. § 404 (1985). See *infra* text accompanying notes 66-70 for a discussion of the requirement that pension arrangement assets be held in trust.

61. I.R.C. § 219 (1985) allows an individual a tax deduction for limited contributions to a plan that meets the requirements of I.R.C. § 408 (1985). IRAs must be trusts or custodial accounts, which may have banks, savings and loan associations, trust companies, or other entities that meet certain stringent requirements as trustees. See *id.* §§ 408(a)(2), 408(n), 581; see also Treas. Reg. §§ 1.401-12 (1968) (requirements for Keogh plans); *id.* § 1.408-2 (1980) (general rules governing IRAs).

62. See *infra* notes 93-105 and accompanying text.

63. G.G. BOGERT & G.T. BOGERT, HANDBOOK OF THE LAW OF TRUSTS 147 (5th ed. 1973).

64. Professor Scott has noted:

[I]n many states a restraint on the alienation of the right of a beneficiary to receive the income under a trust created by a person other than the beneficiary himself is valid although there is no statute that so provides. On the other hand, in a few states it has been held that spendthrift trusts are against public policy. In such states the trust is valid but

retirement arrangements as spendthrift or spendthrift-like trusts, however, do not appear to be due to the multiplicity of jurisdictions passing on the question; rather, the difficulties arise because of the difficulty of fitting a retirement trust within the traditional definition of a spendthrift trust.

Trusts related to retirement arrangements are not traditional spendthrift trusts primarily because they are not established for the purposes generally associated with such trusts. Spendthrift trusts are normally established by a person who is concerned about the beneficiary's well being for the purpose of protecting the beneficiary from his or her own improvidence.<sup>65</sup> Unlike traditional spendthrift trusts, retirement related trusts normally are established by the individual who is the plan's beneficiary, a corporation wholly or substantially owned by the plan's beneficiary, or an employer otherwise unrelated to the beneficiary but who maintains a retirement plan as part of its employees' compensation package.

Pension agreements often contain anti-alienation provisions, which resemble the spendthrift provisions of spendthrift trusts. To be "tax qualified,"<sup>66</sup> the assets of a pension arrangement must be maintained in a trust that meets the strict and multitudinous requirements of the Internal Revenue Code (I.R.C.).<sup>67</sup> The requirement causing the greatest concern to the bankruptcy courts is that the trust contain an anti-alienation provision. Section 401(a)(13) provides:

A trust shall not constitute a qualified trust under this section unless the plan of which such trust is a part provides that benefits provided under the plan may not be assigned or alienated. For purposes of the preceding sentence, there shall not be taken into account any voluntary and revocable assignment of not to exceed 10 percent of any benefit payment made by any participant who is receiving benefits under the plan unless the assignment or alienation is made for purposes of defraying plan administration costs.<sup>68</sup>

If a retirement plan does not contain this "spendthrift" language it will not be tax qualified, and consequently the employer will not be permitted a deduction

---

the attempt to restrain alienation by the beneficiary of his interest and to restrain his creditors from reaching it is invalid.

2 A. SCOTT, *THE LAW OF TRUSTS* 1139-41 (3d ed. 1967).

65. Professor Scott has described the relationship of a beneficiary to a spendthrift trust as follows:

Trusts in which the interest of a beneficiary cannot be assigned by him or reached by his creditors have come to be known as "spendthrift trusts." The term is not altogether felicitous, since it is quite immaterial whether or not the beneficiary is in fact a spendthrift. The term does, however, connote the general idea that the purpose of the settlor in creating such a trust is to protect the beneficiary against his own folly or inefficiency or misfortune. It is useful, at any rate, as a short phrase indicating that the interest of the beneficiary is subject to a restraint on alienation, whether the restraint is imposed by the terms of the trust or by statute.

*Id.* at 1131.

66. I.R.C. § 401(a) (1985) defines a qualified trust as one that meets certain statutory requirements. I.R.C. § 404 (1985) requires that for employer contributions to a pension trust to be tax deductible they must be made to a trust that is qualified under I.R.C. § 501(a) (1935). Section 501(a) requires that in order for a trust to be exempt from tax it must be qualified under I.R.C. § 401(a) (1985).

67. For the primary requirements, see I.R.C. §§ 401(a), 410, 411 (1985).

68. *Id.* § 401(a)(13). Similar language is found at 29 U.S.C. § 1056(d)(2) (1982).

for its contributions.<sup>69</sup> Distributions in violation of the dictates of the provision presumably can lead to loss of the tax exempt status of the retirement arrangement and the trust related to it.<sup>70</sup>

The language of I.R.C. section 401(a)(13) looks strikingly like language describing a traditional spendthrift trust. The significance of the similarity for purposes of the bankruptcy law is that Bankruptcy Code section 541(c)(2) excludes from property of the bankruptcy estate the debtor's interest in a trust from which an anticipatory assignment of an interest is restricted.<sup>71</sup>

The courts have had two problems in dealing with Bankruptcy Code section 541(c)(2) as it relates to tax exempt retirement arrangements. The first problem is determining whether the statutory language is intended to include restrictive trusts other than traditional spendthrift trusts. The second problem is whether the trusts related to pension, profit-sharing, and similar retirement arrangements are indeed spendthrift trusts.

### 1. Keogh Plans and Individual Retirement Accounts

Analyzing the appropriateness of applying section 541(c)(2)'s exclusion for spendthrift trusts to assets of or benefits to be paid from retirement trusts, the courts have focused on the type of plan involved and on the degree of control exercised by the debtor over the operation of and the distribution of assets from the plan. An IRA is established by the individual who is its beneficiary,<sup>72</sup> and Keogh plans are established by sole proprietorships or partnerships whose owners are also plan beneficiaries.<sup>73</sup> The debtor has substantial control in both Keogh plans and IRAs because the establishment of the Keogh plan or IRA and its continued maintenance is fully within the debtor's discretion. The debtor also has complete control over whether to maintain, terminate, or contribute to an IRA in any year<sup>74</sup> and substantially complete control over maintenance of, termination of, or contributions to a Keogh plan.<sup>75</sup> This control is a major factor

---

69. I.R.C. § 401(a)(13) (1985).

70. The IRS has taken the position that assignment to a debtor's creditor of pension benefits, even in compliance with a court order, is cause for the disqualification of a retirement arrangement that had been or otherwise would continue to be qualified as tax exempt. See PLR #8131020, I.R.S. LTR. RUL. REP. (CCH) #8131020 (May 5, 1981); *contra*, Rev. Rul. 80-27, 1980-1 C.B. 85 (assignments of pension benefits in accordance with court ordered support payments held not to disqualify a plan). The conflict between court ordered assignment and the I.R.C. restrictions on transfer has recently been resolved in cases concerning marital dissolution by legislation discussed *infra* at note 119, but it is still an open question in nonmarital dissolution cases.

71. See *supra* note 49 for language of § 541(c)(2).

72. See *supra* note 61.

73. I.R.C. § 401(d) (1985), in conjunction with the definitions in I.R.C. § 401(c) (1985), allows for the establishment of tax exempt Keogh plans and related trusts by self-employed individuals and partners and generally treats such self-employed individuals and partners as employees for purposes of contributions to the plan and plan administration. Unlike IRAs, see *supra* note 61, there are no statutory restrictions on who or what can be a trustee of a retirement trust maintained by a Keogh retirement plan. Keogh plans, like plans maintained by corporations, can be trustee by individuals, including the owner or partner of the company sponsoring the plan.

74. There are no statutory or regulatory requirements that contributions be made annually to an IRA. Although there is no minimum contribution requirement, there is a maximum permitted annual IRA contribution of \$2,000. See I.R.C. § 219(b)(1), (c)(2) (1985).

75. Contributions to a Keogh profit sharing plan are within the full discretion of the employer

in courts' determinations that these pension arrangement trusts are not excluded under Bankruptcy Code section 541(c)(2).<sup>76</sup>

The United States Court of Appeals for the Fifth Circuit decided in *Goff v. Taylor (In re Goff)*<sup>77</sup> that Keogh plan trusts do not constitute traditional spendthrift trusts and thus are not excluded from the bankruptcy estate by Bankruptcy Code section 541(c)(2), despite the trusts' inclusion of the anti-alienation provision required by ERISA. The court examined the meaning of section 541(c)(2)'s phrase "enforceable under applicable nonbankruptcy law" and concluded that the language was intended to exclude from a debtor's estate only traditional spendthrift trusts as recognized by the relevant state law.<sup>78</sup> The court's statutory interpretation is supported by legislative history, which suggests that Congress intended to exclude as property of a debtor's estate only assets of trusts cognizable as traditional spendthrift trusts under state law and did not intend an exclusion for trusts that only take on the appearance of spendthrift trusts.<sup>79</sup> Although not stated in *Goff*, lurking in the background of the court's decision is the debtor's right under the provisions of the plan to with-

---

sponsoring the plan. The IRS has imposed an administrative rule, which also applies to corporation sponsored retirement plans, that if there are not at least nominal contributions annually to such a plan it will be deemed to have terminated. Treas. Reg. § 1.411(d)-2(d) (1977) provides:

A complete discontinuance of contributions under the plan is contrasted with a suspension of contributions under the plan which is merely a temporary cessation of contributions by the employer. A complete discontinuance of contributions may occur although some amounts are contributed by the employer under the plan if such amounts are not substantial enough to reflect the intent on the part of the employer to continue to maintain the plan.

Congress has established maximum annual contributions. I.R.C. §§ 404, 415 (1985). Within broad limits the sole proprietor or partner has full discretion as to the amount of contributions. There is also discretion as to the amount of contributions for money purchase and defined benefit pension Keogh plans, but the amount of contributions is fixed by formulae in the plan document. However, the plan sponsor retains the right to amend this type of plan at any time. Such an amendment could be for purposes of reducing contribution levels, although the IRS will not tolerate too frequent changes to the contribution level.

76. *E.g.*, *Goff v. Taylor (In re Goff)*, 706 F.2d 574 (5th Cir. 1983) (control by debtor over Keogh plan); *In re Mace*, 4 Bankr. Ct. Dec. (CRR) 94 (Bankr. D. Or. 1978) (control by debtor over IRA assets).

77. 706 F.2d 574 (5th Cir. 1983).

78. *Id.* at 580. The *Goff* court found "that Congress did not evidence an intent, by reference to 'applicable nonbankruptcy law' to include an ERISA plan exemption. Rather, [it found] that Congress intended to exclude only trust funds in the nature of 'spendthrift trusts' from the property of the estate." *Id.* (quoting 11 U.S.C. § 541(c)(2) (1982)).

79. See H.R. REP. NO. 595, 95th Cong., 2d Sess. 176, reprinted in 1978 U.S. CODE CONG. & AD. NEWS 5963, 6136 ("The bill also continues over the exclusion from property of the estate of the debtor's interest in a spendthrift trust to the extent the trust is protected from creditors under applicable State law.").

Congress rejected a more narrow exception for spendthrift trusts than the exception that finally became Bankruptcy Code § 541(c)(2). The Commission on the Bankruptcy Laws suggested that spendthrift trusts be excepted from property of the estate only to the extent necessary for the reasonable support of the debtor and his or her dependents. H.R. DOC. NO. 137, 93d Cong., 1st Sess., pt. I, at 197-98 (1973), reprinted in COLLIER ON BANKRUPTCY App. 2, I-1, 197-98 (15th ed. 1979). The Commission on the Bankruptcy Laws was established by Congress to assist in revising the federal bankruptcy laws. It is interesting to note that the Commission's proposal was not breaking new ground in the inviolacy of spendthrift trusts, for numerous states have recognized the sanctity of such trusts only to a limited degree. See generally 2 A. SCOTT, *supra* note 64, § 151 (discusses conflict among states regarding validity and effect of spendthrift provisions in trusts).



draw funds prior to retirement or death with relative impunity.<sup>80</sup> The scope of the *Goff* decision, however, is limited. First, the court adhered to a strict interpretation of what constitutes a spendthrift trust because it believed that Congress did not intend to increase the ambit of the generally accepted definition of that term. Second, the court was dealing with a beneficiary who was also the trust's settlor, an arrangement under which spendthrift provisions have not been recognized,<sup>81</sup> and which the United States Court of Appeals for the Fifth Circuit, two years before *Goff*,<sup>82</sup> had decided would not be permitted for Keogh plans.<sup>83</sup>

Although there appear to be no cases dealing with the spendthrift nature of IRA trust provisions,<sup>84</sup> because an IRA is so similar to a Keogh arrangement, courts should treat them in a similar fashion. If a Keogh plan is not an excludable spendthrift trust, then it would be hard to find grounds to exclude an IRA.

## 2. Corporate Plans

Distinguishable from the Keogh plan and IRA cases are cases involving plans maintained by corporations for the benefit of their employees. These plans take many forms but in any form are distinguishable from IRA and Keogh plans in that they are established and maintained by an entity other than the beneficiary. Thus, the argument that the assets of an IRA or Keogh plan are includable in a debtor's estate because the settlor cannot be the beneficiary of a spendthrift trust or because a beneficiary has too much control over the trust for it to be deemed a spendthrift trust, is more problematic in the corporate plan setting.

In *Samore v. Graham (In re Graham)*<sup>85</sup> the debtor was sole director of a

80. The version of I.R.C. § 72(m)(5) (1985) in effect when *Goff* was decided imposed, in addition to any income taxes otherwise payable by a taxpayer, a tax of 10% of the amounts withdrawn from a Keogh plan by an owner-employee prior to that individual's retirement, death, or other termination of the plan. The section has been amended by the Tax Equity and Fiscal Responsibility Act of 1982, Pub. L. No. 97-248, § 237(d)(1)(A)-(d)(1)(C), (d)(2), (d)(3), 96 Stat. 324, 511-12 (1982), and the Tax Reform Act of 1984, Pub. L. No. 98-369, § 521(d), 98 Stat. 494, 868 (1984), which have narrowed slightly the group upon which such penalties are imposed.

81. See 2 A. SCOTT, *supra* note 64, at 1190.

Even in jurisdictions in which spendthrift trusts are permitted, the settlor cannot create a spendthrift trust for his own benefit. If the owner of property transfers it in trust to pay the income to himself for life or for a period of years, and provides that his interest under the trust shall not be assignable by him and that his creditors shall not be permitted to reach it, nevertheless he can effectively assign his interest and his creditors can reach it.

*Id.*

82. See *Judson v. Witlin (In re Witlin)*, 640 F.2d 661, 663 (5th Cir. 1981) (court noted the "strong public policy . . . prevent[ing] any person from placing his property in what amounts to a revocable trust for his own benefit which would be exempt from the claims of his creditors").

83. See also *In re Clark*, 18 Bankr. 824 (Bankr. E.D. Tenn. 1982) (Keogh plan not exempt under Bankruptcy Code when spendthrift trust was created for the settlor's own benefit).

84. In *In re Howerton*, 21 Bankr. 621 (Bankr. N.D. Tex. 1982), an IRA held in the form of an annuity as permitted under I.R.C. § 408(b) (1985) was found to be an asset of the debtor's estate primarily because it was not technically held in trust. The court in *Howerton*, answering the question whether an IRA was exempt under a state exemption statute, stated that "[IRAs] are basically tax deferral [sic] plans over which the Debtors exercise a great deal of control. They may withdraw the cash value of the annuity subject to a tax assessment at any time and there is no guarantee the funds will be retained until retirement." *Id.* at 623.

85. 726 F.2d 1268 (8th Cir. 1984).

corporation that maintained a profit sharing plan of which he was the trustee. It is not clear whether the debtor was the sole shareholder of the corporation, although it appears that he was. Contributions to the plan were completely within the discretion of the corporation and therefore of its controlling shareholder.<sup>86</sup> The court's conclusion that Bankruptcy Code section 541(c)(2) encompasses only traditional spendthrift trusts, not profit sharing or pension trusts, was based on strict statutory analysis. Control by the debtor of the profit sharing trust essentially merged the interests of the plan trust and its beneficiary, however, and probably was a motivating reason for the decision.

Even cases in which it is reasonably clear that the debtor is not in control of the plan trust or the corporation sponsoring the plan can raise the issue whether a pension arrangement trust constitutes a spendthrift or spendthrift-like trust. In one instance a court refused to recognize a spendthrift trust when the debtor had the right to withdraw his contributions from a plan to which both he and his employer contributed, even though such withdrawal would cause the debtor to forfeit deferred retirement benefits.<sup>87</sup> Another court refused to find a similar plan's trust to be a spendthrift-like trust because to the extent the debtor made voluntary contributions to the plan he was a settlor for whom spendthrift provisions would not apply under any circumstances.<sup>88</sup>

An alternative view of excludability was presented in *Clotfelter v. CIBA-GEIGY Corp. (In re Threewitt)*,<sup>89</sup> in which the debtor was a participant in an ERISA plan sponsored by his employer. Under the plan the employer partially matched plan contributions made by an employee. Reasoning that the assets of the plan attributable to the debtor's contributions were not property of his bankruptcy estate, the court stated:

Since Congress did not choose to use the term "spendthrift trust" . . . [in section 541(c)(2)] there is no reason to suppose that when the term appears in the legislative history it should be taken as a term of art; it is more reasonable to suppose that the term should be given its ordinary, more general meaning as "inclusive of all trusts which bar creditors from reaching a beneficiary's interest."<sup>90</sup>

---

86. *Id.* at 1269. Like Keogh plans, corporate plans face no minimum contribution requirements. However, the IRS requires at least minimal annual contributions for the plan to retain its tax exempt status. Treas. Reg. § 1.411(d)-2(d) (1977). See *supra* note 75 for the language of the regulation.

87. *Firestone v. Metropolitan Life Ins. Co. (In re Di Piazza)*, 29 Bankr. 916, 922 (Bankr. N.D. Ill. 1983) ("[t]he crucial factor is the debtor's unqualified right of withdrawal. [Because of this right of withdrawal,] the profit sharing plan is not a traditional spendthrift trust.")

88. *In re Wilson*, 3 Bankr. Ct. Dec. (CRR) 844, 845 (Bankr. N.D. Tex. 1977). *Wilson* was decided under the Bankruptcy Act. Although the concept of property that was includable in the estate was somewhat different under the Bankruptcy Act than under present law, the court's reasoning in *Wilson* is still relevant: "It is well settled that a spendthrift provision does not protect property from creditors where the grantor established the trust for his own benefit with his own property." *Id.* For a discussion of the definition of property under the Bankruptcy Act, see *supra* text accompanying notes 22-45.

89. 24 Bankr. 927 (D. Kan. 1982).

90. *Id.* at 929; accord *In re Pruitt*, 30 Bankr. 330 (Bankr. D. Colo. 1983). In *Pruitt* the court bolstered its argument by stating that "[w]hen a statute is clear on its face there is no need to resort to legislative history." *Id.* at 331.

The court concluded that if ERISA anti-alienation language is enforceable against general creditors, then it is enforceable against trustees in bankruptcy who attempt to bring retirement plan assets into the bankruptcy estate. Although the court's reasoning did not reflect apparent congressional intent,<sup>91</sup> the court was attentive to the conflict between the bankruptcy law policy of paying creditors and the ERISA policy of protecting pension assets for retirement and resolved the conflict in favor of protecting pension assets.<sup>92</sup>

### 3. Effect of Impediments to Exercise of Control

The degree of a debtor's control over the disposition of pension assets, especially the ability to withdraw the assets prior to retirement, often has been the persuasive factor in courts' unwillingness both to exclude the pension from the estate and to exempt the pension from creditor collection.<sup>93</sup> Pre-retirement access to and control of pension benefits lead to the characterization of funds as tax deferred savings accounts rather than as wage substitutes.<sup>94</sup> An impediment to the exercise of control that causes the debtor undue hardship, however, may lead a court to allow exclusion of the pension assets from the estate.<sup>95</sup>

One court found sufficient hardship in a corporation sponsored profit sharing plan that permitted an early distribution of benefits only upon a showing of financial need caused by a serious medical or casualty emergency.<sup>96</sup> Even in that case the court indicated that if access to the funds might cause their dissipation prior to retirement or severe emergency, the funds would be included in the bankruptcy estate.<sup>97</sup> Another case, decided under the old Act, concerned a pension plan that permitted voluntary withdrawal of vested benefits at any time. However, an employee making such a withdrawal could not participate in the plan for one year after the withdrawal and faced the potential forfeiture of his

91. See *infra* notes 112 & 114-19 and accompanying text.

92. *Threewitt*, 24 Bankr. at 929.

93. See *Goff v. Taylor (In re Goff)*, 706 F.2d 574, 588-89 (5th Cir. 1983) (inclusion of Keogh plan assets under new Bankruptcy Code); *Mason v. Eastman Kodak Co. (In re Parker)*, 473 F. Supp. 746 (W.D.N.Y. 1979) (IRA funds not exempt when bankrupt retains substantial control over the funds); *In re Howerton*, 21 Bankr. 621 (Bankr. N.D. Tex. 1982) (IRA not exempt under state exemption scheme); *In re Talbert*, 15 Bankr. 536 (Bankr. W.D. La. 1981) (pension assets are not exempt from creditor collection under state exemption for pensions); *Eisenberg v. Baviello (In re Baviello)*, 12 Bankr. 412 (Bankr. E.D.N.Y. 1981) (pension assets become property of the estate under old Act); *In re Mace*, 4 Bankr. Ct. Dec. (CRR) 94 (Bankr. D. Or. 1978) (ERISA pension fund exempt when fund is a spendthrift trust beyond the reach of employee or employee's creditors).

94. See *In re Talbert*, 15 Bankr. 536, 537 (Bankr. W.D. La. 1981) (applying a state exemption for pensions, court noted that even though pension arrangements are granted as benefits, these arrangements are nevertheless nothing more than savings accounts).

95. *Mason v. Eastman Kodak Co. (In re Parker)*, 473 F. Supp. 746 (W.D.N.Y. 1979).

96. *Id.* at 751 (debtor permitted to borrow from the plan subject to substantial restrictions, including repayment within three years and termination of plan participation).

97. *Id.* The court in *Eisenberg v. Baviello (In re Baviello)*, 12 Bankr. 412, 415 (Bankr. E.D.N.Y. 1981), explaining *In re Parker*, 473 F. Supp. 746 (W.D.N.Y. 1979), stated:

Finding that these limitations on the bankrupt's control effectively precluded use of the fund for any purpose other than the future support of the bankrupt and his dependents, the Court [in *Parker*] concluded that the fund was intertwined with the bankrupt's ability to make an unencumbered fresh start and that it should be preserved for his benefit rather than the estate's.

nonvested interest. These penalties were not considered to impose sufficient hardship either to justify exclusion of the pension trust from the estate or to permit an exemption.<sup>98</sup>

Cases dealing with the control aspect of Keogh plans and IRAs rather than corporation sponsored pension plans have been resolved much more easily because the only limitation on the ability to withdraw funds is a penalty of additional taxes.<sup>99</sup> Courts consider such an insignificant limitation as tantamount to granting the debtor complete control of the pension funds<sup>100</sup> and unfettered access to the funds for current use.<sup>101</sup>

The withdrawal right is a significant issue because courts are concerned that if plan assets are excluded from the bankruptcy estate or exempt from creditor access the debtor will wait for bankruptcy court discharge of debts and then withdraw pension funds for current use.<sup>102</sup> If pension assets are too readily available to the debtor, they are the same as any other assets accumulated for current use.<sup>103</sup>

The conclusion that debtor control over and access to pension assets should be the determinative factor in deciding whether to exclude such assets from the debtor's estate, while reasonably convincing from the perspective of the Bankruptcy Code, is less persuasive when viewed against the backdrop of ERISA

---

98. *In re Wilson*, 3 Bankr. Ct. Dec. (CRR) 844 (N.D. Tex. 1977) (court focused primarily on the withdrawal rights of the debtor, not on the fact that early withdrawal of some plan benefits might cause a forfeiture of company contributions).

99. I.R.C. § 72(m) (1985) provides for imposition of a tax in addition to a taxpayer's normal income tax in any year in which a pre-age 59 1/2 or pre-death distribution is taken from a Keogh or corporate pension plan by one who is a five percent owner of the company sponsoring the pension plan. The amount of this tax equals 10% of benefits distributed and included in the distributee's adjusted gross income under any other provision of the I.R.C. The same treatment is provided for early distributions from an IRA. *Id.* § 408(f).

100. *See Goff*, 706 F.2d at 588; *Judson v. Witlin (In re Witlin)*, 640 F.2d 661 (5th Cir. 1981).

101. *E.g.*, *Eisenberg v. Baviello (In re Baviello)*, 12 Bankr. 412 (Bankr. E.D.N.Y. 1981); *see also In re Mace*, 4 Bankr. Ct. Dec. (CRR) 94, 95-96 (Bankr. D. Or. 1978) (court refused IRAs the dignity of being considered pensions, stating that "there has been no establishment of a pension system for IRAs but merely an amendment of the Internal Revenue Code to provide certain tax benefits for a disadvantaged group to encourage retirement savings"). The *Mace* court incorrectly construed the purpose of the massive revisions to the pension laws made by ERISA. This court, like others, was so concerned that funds were currently available to a debtor that it ignored the purposes for allowing the funds to be accumulated. Once blinded to the latter concern, courts do not attempt to reconcile the purposes of ERISA and the Bankruptcy Code.

The same failure to reconcile ERISA and bankruptcy policies applies to benefits in a corporate plan over which the employee has the right of unrestricted withdrawal. *See Firestone v. Metropolitan Life Ins. Co. (In re Di Piazza)*, 29 Bankr. 916, 921-22 (Bankr. N.D. Ill. 1983) (even when plan is maintained by a corporation that debtor does not control, assets of pension plan derived from employee's own contributions that can be withdrawn at will are assets of estate).

102. *See Goff*, 706 F.2d at 588 ("Debtors could shelter funds in Keogh plans immediately before declaring bankruptcy . . . and immediately after discharge of all debts withdraw such funds for their own benefit."); *Bass v. Shackelford (In re Shackelford)*, 27 Bankr. 372, 373 (Bankr. W.D. Va. 1983) ("If exempt, I.R.A.'s could easily be misused by debtors attempting to keep money from creditors until it could be otherwise diverted."); *Hovis v. Lowe (In re Lowe)*, 25 Bankr. 86, 88 (Bankr. D.S.C. 1982) (debtor not entitled to shelter funds pending bankruptcy declaration); *see also* 11 U.S.C.A. § 727 (West 1979 & Supp. 1985) (restrictions on discharge); *cf. Mason v. Eastman Kodak Co. (In re Parker)*, 473 F. Supp. 746, 751 (W.D.N.Y. 1979) (debtor's pension assets are not assets of the estate even though the right of early withdrawal existed only upon a showing of hardship).

103. *See, e.g.*, *Hovis v. Wright (In re Wright)*, 39 Bankr. 623 (D.S.C. 1983), *aff'd*, 751 F.2d 714 (4th Cir. 1985); *In re Mace*, 4 Bankr. Ct. Dec. (CRR) 94, 97 (Bankr. D. Or. 1978).

policy. Attempting to reconcile ERISA's policy encouraging accumulation of assets for use upon retirement with the needs of a debtor's creditors in bankruptcy, some courts have found that distributions to creditors from the debtor's retirement plan have been legislatively sanctioned by the Bankruptcy Code, even though the distributions are technically in violation of ERISA's anti-alienation provisions.<sup>104</sup> Other courts, viewing ERISA as an impediment to be overcome but not seriously considered, allow the Bankruptcy Code primacy over ERISA<sup>105</sup> because ERISA does not prohibit early withdrawals of benefits from a plan; it merely imposes a penalty for such withdrawals.

### C. *Assignment and Alienation in Non-Spendthrift Trusts*

The issue whether pension assets are assignable, alienable,<sup>106</sup> or otherwise within the debtor's unfettered control is also relevant to the determination whether pension assets not excluded from the debtor's estate by section 541 may nonetheless be exempted from creditor attachment by Bankruptcy Code section 522(b).<sup>107</sup> Section 522(b) permits a debtor to exempt from creditor attachment certain property that is part of the bankruptcy estate under section 541 by electing the federal scheme of exemption in section 522(d) or the exemption of the debtor's state of domicile.<sup>108</sup> If the debtor elects the state exemption system, in addition to the property exempted by such state law, he or she also is permitted to exempt any other property of the bankruptcy estate for which there is an exemption under any federal nonbankruptcy law.<sup>109</sup>

The courts have addressed the question whether the I.R.C. section 401(a)(13) prohibition of assignment or alienation of pension benefits, even if insufficient to constitute a spendthrift trust, is an impediment to access imposed by "other federal law" within the meaning of Bankruptcy Code section 522(b)(2)(A). The key to resolving this question is whether ERISA's anti-assignment and anti-alienation provisions are sufficient to prevent the debtor from having access to the assets of the subject pension trust.

On its face, the broad language of Bankruptcy Code section 522(b)(2)(A) includes any federal law that contains specific anti-alienation provisions. Congressional intent, however, appears to be less expansive. In both Senate and House of Representatives reports<sup>110</sup> accompanying the Bankruptcy Reform Act

104. See, e.g., *Firestone v. Metropolitan Life Ins. Co.* (*In re Di Piazza*), 29 Bankr. 916, 923 (Bankr. N.D. Ill. 1983).

105. See, e.g., *Hovis v. Lowe* (*In re Lowe*), 25 Bankr. 86, 89 (Bankr. D.S.C. 1982); *In re Talbert*, 15 Bankr. 536, 538 (Bankr. W.D. La. 1981); *Eisenberg v. Baviello* (*In re Baviello*), 12 Bankr. 412, 417 (Bankr. E.D.N.Y. 1981); *In re Mace*, 4 Bankr. Ct. Dec. (CRR) 94, 95 (Bankr. D. Or. 1978).

106. See *supra* text accompanying note 68 for the relevant portion of the text of I.R.C. § 401(a)(13) (1985). Nearly identical language is found at 29 U.S.C. § 1056(d)(2) (1982).

107. See *supra* note 18 for a discussion of the difference between exemptions and exclusions.

108. 11 U.S.C. § 522(b) (1982).

109. *Id.* § 522(b)(2)(A). See *infra* note 120 for the language of the statute indicating what property a debtor may exempt.

110. S. REP. NO. 989, 95th Cong., 2d Sess. 1, reprinted in 1978 U.S. CODE CONG. & AD. NEWS 5787-5962; H.R. REP. NO. 595, 95th Cong., 2d Sess. 1, reprinted in 1978 U.S. CODE CONG. & AD. NEWS 5963-6435.

of 1978,<sup>111</sup> a number of federal laws were listed as examples of laws that Congress contemplated as having anti-alienation provisions that would remove the assets from the purview of the Bankruptcy Code.<sup>112</sup> Courts have held that "[w]hile the . . . list was not meant to be exclusive . . . the failure of Congress to include ERISA plan benefits [is] probative of Congressional intent that ERISA was not a 'Federal law' upon which a [section] 522(b)(2)(A) exemption could be based."<sup>113</sup>

The federal laws listed in the congressional reports as providing exemptions under Bankruptcy Code section 522(b)(2)(a) have in common the fact that the benefits they affect are expressly made not subject to execution, levy, attachment or garnishment.<sup>114</sup> ERISA has no such provision; it merely provides that ERISA plan benefits cannot be alienated or assigned.<sup>115</sup> In light of this distinction in language and the specification in the congressional history, some courts insist that the exemption of Bankruptcy Code section 522(b)(2)(A) does not include ERISA.<sup>116</sup>

An opposing viewpoint has been taken by at least one bankruptcy court.<sup>117</sup> This opposing viewpoint characterized the laws comprising the list of statutes set forth in the congressional history as enforcing "nothing more than prohibitions against assignment and alienation"<sup>118</sup> no matter what words actually are used in imposing the restriction. This court, recognizing the tension between ERISA and bankruptcy policies, looked for support to cases dealing with garnishment, on the theory that "[t]o allow a creditor to garnish these plans would undermine the protection that Congress intended to give to the plan beneficiaries."<sup>119</sup>

111. See *supra* note 1 for a description of the legislative history of the Act.

112. The Senate report set forth the following list:

Foreign Service Retirement and Disability payments, 22 U.S.C. 1104; Social security payments, 42 U.S.C. 407; Injury or death compensation payments from war risk hazards, 42 U.S.C. 1717; Wages of fishermen, seamen, and apprentices, 46 U.S.C. 601; Civil service retirement benefits, 5 U.S.C. 729, 2265; Longshoremen's and Harbor Workers' Compensation Act death and disability benefits, 33 U.S.C. 916; Railroad Retirement Act annuities and pensions, 45 U.S.C. 228(L); Veterans benefits, 45 U.S.C. 352(E); Special pensions paid to winners of the Congressional Medal of Honor, 38 U.S.C. 3101; and Federal homestead lands on debts contracted before issuance of the patent, 43 U.S.C. 175.

S. REP. NO. 989, *supra* note 110, at 5861; see also H.R. REP. NO. 595, *supra* note 110, at 6316 (identical list).

113. *Samore v. Graham (In re Graham)*, 726 F.2d 1268, 1274 (8th Cir. 1984), *aff'g* 24 Bankr. 305 (Bankr. N.D. Iowa 1982). In *Graham* the United States Court of Appeals for the Eighth Circuit affirmed a Bankruptcy Court conclusion that Congress specifically had precluded creditor access to Civil Service retirement benefits but had merely provided an anti-alienation provision in ERISA. See also *Goff v. Taylor (In re Goff)*, 706 F.2d 574, 583-84 (5th Cir. 1983) (court, in dicta, used list quoted *supra* note 112 to substantiate an argument that because Congress did not include ERISA in that list for purposes of Bankruptcy Code § 522, it could not have intended to exclude ERISA plan benefits from the estate under Bankruptcy Code § 541).

114. See, e.g., *Samore v. Graham (In re Graham)*, 24 Bankr. 305, 312 (Bankr. N.D. Iowa 1982), *aff'd*, 726 F.2d 1268 (8th Cir. 1984).

115. See I.R.C. § 401(a)(13) (1985); 29 U.S.C. § 1056(d)(2) (1982).

116. E.g., *Judson v. Witlin (In re Witlin)*, 640 F.2d 661 (5th Cir. 1981).

117. *Barr v. Hinshaw (In re Hinshaw)*, 23 Bankr. 233 (Bankr. D. Kan. 1982).

118. *Id.* at 235.

119. *Id.* at 236. The issue whether to allow garnishment of pension assets most often has arisen in the context of marital dissolution. The cases frequently have involved situations in which either a

## IV. EXEMPTIONS

In addition to exemptions recognized by the Bankruptcy Code but also authorized by nonbankruptcy federal law, the Bankruptcy Code itself provides exemptions from creditors' claims for certain property necessary for a debtors' fresh start.<sup>120</sup> The debtor may choose between two sets of exemptions—federal

---

spouse has attempted to garnish a former spouse's pension distributions in order to collect court ordered support or the court, as part of its divorce decree, has attempted to have the pension make support payments to the spouse.

In the past courts sought to protect the plan participant's family by finding that the anti-alienation provision was meant to protect the family as well as the participant. In *Hisquierdo v. Hisquierdo*, 439 U.S. 572 (1979), the Court recognized the need to protect a participant's family but was required to hold that a pension was not subject to garnishment by a former spouse because the pension was regulated under the Railroad Retirement Act of 1974 (45 U.S.C. §§ 231-231(t) (1982)). The Railroad Retirement Act was amended in 1983 to provide that at least some of the benefits thereunder could be treated, within judicial discretion, as community property or distributed in accordance with an appropriate judicial decree of divorce. Railroad Retirement Solvency Act of 1983, Pub. L. No. 98-76, § 419(a), 97 Stat. 411 (amending 45 U.S.C. § 231(m) (1982) by the addition of subsection (b)(1)).

Generally the courts carved out, even in nonbankruptcy situations, an exception to the ERISA anti-alienation rules on the ground that it is a significantly greater social goal to have spouses take care of their families than to have spouses provide for their own retirement. *See, e.g.*, *General Motors Corp. v. Buha*, 623 F.2d 455, 459-60 (6th Cir. 1980); *Cartledge v. Miller*, 457 F. Supp. 1146, 1154-55 (S.D.N.Y. 1978). Given the former language of ERISA that it superseded state law, 29 U.S.C. § 1144 (1982 & Supp. I 1983) (amended 1984), and that benefits could not be assigned or alienated, I.R.C. § 401(a)(13) (1982 & Supp. I 1983) (amended 1984), courts were left with the choice of putting a pension beneficiary's dependents on the street with no support or implying an exception either to ERISA's anti-alienation provision or to ERISA's supersession provision. *See American Tel. & Tel. v. Merry*, 592 F.2d 118 (2d Cir. 1979) (court implied exception to ERISA's preemption of state law provision for family support payments).

The court-made exception to ERISA recently has been substantially affirmed by the Retirement Equity Act of 1984, Pub. L. No. 98-397, § 204(a), (b), 98 Stat. 1426 (1984). This legislation amended ERISA by allowing a state's domestic relations law to permit use of one's pension benefits to pay spousal and child support, thus overriding the ERISA prohibition against assignment or alienation of pension benefits. *See also Schlaefel v. Schlaefel*, 112 F.2d 177 (D.C. Cir. 1940) (permitting divorced wife's recovery from former husband's disability pension plan); *Stone v. Stone*, 450 F. Supp. 919 (N.D. Cal. 1978) (permitting spousal recovery from employee benefit plan), *aff'd*, 632 F.2d 740 (9th Cir. 1980), *cert. denied*, 453 U.S. 922 (1981).

120. "The [Bankruptcy] Code . . . provides a list of exemptions and allows the debtor to take advantage of more liberal state exemptions. The federal alternative exempts property of the debtor which is generally recognized as necessary for ordinary life, and a so-called 'grubstake' exemption—that is, a dollar amount also considered necessary to aid in the support of the debtor." 3 COLLIER ON BANKRUPTCY ¶ 522.02 (L. King 15th ed. 1985).

The exemption provision of Bankruptcy Code § 522 reads in part:

(b) Notwithstanding section 541 of this title, an individual debtor may exempt from property of the estate either—

(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 at the place in which the debtor's domicile has been located for the 180 days immediately preceding the date of the filing of the petition . . .

.....

(d) The following property may be exempted under subsection (b)(1) of this section:

.....

(10) The debtor's right to receive—

.....

(E) 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

exemptions in section 522(d) and exemptions provided by the law of the debtor's state of domicile. Thirty-five states, however, have opted out of the federal exemption system,<sup>121</sup> and require their citizens to comply with the state's schedule of exemptions.

If the debtor elects the federal exemption scheme, pension assets are subject to exemption under Bankruptcy Code section 522(d)(10)(E).<sup>122</sup> This section permits exemption of "[t]he debtor's right to receive . . . a payment under a . . . [pension arrangement to the extent] reasonably necessary for the support of the debtor and any dependent of the debtor."<sup>123</sup> All other questions relating to this section are secondary to the ultimate dictate of the policy of exemptions—providing a "fresh start." A fresh start is most important to one who is in financial need, a circumstance that can safely be assumed if an individual is in bankruptcy.<sup>124</sup> The meaning of "fresh start" in the context of section 522(d)(10)(E) depends on courts' willingness to find that a debtor's future needs can be met only by current pension assets.

The exemption is not intended to insure the debtor and the debtor's family against any future contingency that could inflict further financial harm or discomfort.<sup>125</sup> The exemption is intended to assure the debtor "that assets to which he may become entitled in the future will be acquired free of any prebankruptcy obligations."<sup>126</sup> Courts have attempted to establish criteria for the purpose of setting out benchmarks against which the parameters of the "reasonably necessary" standard of section 522(d)(10)(E) can be set.<sup>127</sup> The primary criterion is that the amount exempted, together with the debtor's presumed earnings until retirement, must be sufficient to allow the debtor to sustain basic needs upon retirement<sup>128</sup> and be available to meet those needs.<sup>129</sup>

Some courts have determined that because the debtor has no right to cur-

---

reasonably necessary for the support of the debtor and any dependent of the debtor, unless . . . [exception stated].

11 U.S.C. § 522 (1982). The exception applies if the plan was established by an insider, the payment is due to age or length of service, and the plan does not qualify as tax exempt under I.R.C. § 401(a) (1985). 11 U.S.C. § 522(d)(10)(E)(i)-(iii) (1982); see also H.R. REP. NO. 595, 95th Cong., 2d Sess. 360, reprinted in 1978 U.S. CODE CONG. & AD. NEWS 5787, 6316 (listing federal plans under which debtor might exempt).

121. COLLIER BANKRUPTCY EXEMPTION GUIDE 1 & n.6 (L. King ed. 1984).

122. See *supra* note 120 for the language of the statute.

123. 11 U.S.C. § 522(d)(10)(E) (1982).

124. The same may not be the case in corporate bankruptcies in which the petition in bankruptcy is filed to avoid legal responsibilities. See, e.g., NLRB v. Bildisco & Bildisco, 104 S. Ct. 1188 (1984) (debtor-in-possession was permitted to avoid an executory collective bargaining agreement under a reorganization under Chapter 11 of the Bankruptcy Code). *Bildisco* essentially was overruled by the Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, § 541, 98 Stat. 333, 390-91 (1984), which added 11 U.S.C.A. § 1113 (West Supp. 1985).

125. See *In re Kochell*, 26 Bankr. 86 (Bankr. W.D. Wis. 1982), *aff'd*, 31 Bankr. 139 (W.D. Wis. 1983), *aff'd*, 732 F.2d 564 (7th Cir. 1984).

126. Turpin v. Wentz (*In re Turpin*), 644 F.2d 472, 475 (5th Cir. 1981).

127. In a compromise between the House version of the Bankruptcy Reform Act of 1978, which allowed an exemption for all pension plan assets vested in a debtor, and the Senate version, which would have left the exemptions entirely up to state discretion, the Act as finally adopted exempted only pensions to the extent "reasonably necessary." For an excellent summary of the legislative history of the Act, see Warren v. Taff (*In re Taff*), 10 Bankr. 101, 105-06 (Bankr. D. Conn. 1981).

128. *Id.* at 107; see also *In re Grant*, 40 Bankr. 612, 613-14 (Bankr. N.D. Tex. 1984) (basic needs



rent payments under a pension arrangement, the section 522(d)(10)(E) exemption is not available.<sup>130</sup> These courts apparently have concluded that the fresh start concept can only accommodate present need and cannot be reconciled with payments to be received in the distant future. They find it inappropriate to deem the "reasonably necessary" requirement of Bankruptcy Code section 522(d)(10)(E) met if the debtor is relatively young and gainfully employed.<sup>131</sup> These courts view the exemption as available only to "protect the fresh start of the debtor following bankruptcy, not to insure that no future misfortune could possibly lower the standard of living to which the debtor's dependents have become accustomed."<sup>132</sup>

Some courts view pension benefits as reasonably necessary to assure a fresh start, and thus inviolable, regardless of the length of time between a debtor's bankruptcy and retirement.<sup>133</sup> As one court noted:

[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 prebankruptcy 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 prebankruptcy contributions to a pension fund, are a substitute for future wages and thus pass to the bankrupt free of the claims of prebankruptcy creditors.<sup>134</sup>

---

not related to former lifestyle, but should take into account special needs of debtor). The court in *In re Miller*, 33 Bankr. 549 (Bankr. D. Minn. 1983) analyzed the criteria as follows:

[B]ecause of the small amount involved and because of the existence of . . . [the debtor's] pension plan and the right to social security and his age, he has no foreseeable future need to withdraw funds from the profit sharing plan. Thus I find that none of the debtor's profit sharing plan is reasonably necessary for the support of the debtor.

*Id.* at 551.

129. *Walker v. Treadwell (In re Treadwell)*, 699 F.2d 1050, 1053 (11th Cir. 1983) (social security payments, although essential to "insure [that] the needy have the necessary resources for continuing basic care and maintenance. . . . [are not to be exempt when] the statutory objective of preserving essential resources for the debtor could not have been effectuated" by exempting them).

130. See, e.g., *In re Werner*, 31 Bankr. 418, 422 (Bankr. D. Minn. 1983); *In re Kochell*, 26 Bankr. 86, 87 (Bankr. W.D. Wis. 1982), *aff'd*, 31 Bankr. 139 (W.D. Wis. 1983), *aff'd*, 732 F.2d 564 (7th Cir. 1984); *In re Clark*, 18 Bankr. 824, 828 (Bankr. E.D. Tenn. 1982).

131. See, e.g., *In re Werner*, 31 Bankr. 418 (Bankr. D. Minn. 1983) (48 year-old school teacher debtor actively engaged in profession and continuing to make contributions to state sponsored pension plan); *In re Kochell*, 26 Bankr. 86 (Bankr. W.D. Wis. 1982) (44 year-old debtor earning \$1500 per month in excess of his needs at the time of the bankruptcy petition), *aff'd*, 31 Bankr. 139 (W.D. Wis. 1983), *aff'd*, 732 F.2d 564 (7th Cir. 1984); *In re Clark*, 18 Bankr. 824, 825 (Bankr. E.D. Tenn. 1982) (debtor practicing medicine at time of bankruptcy filing).

132. *In re Kochell*, 26 Bankr. 86, 87 (Bankr. W.D. Wis. 1982), *aff'd* 31 Bankr. 139 (W.D. Wis. 1983), *aff'd*, 732 F.2d 564 (7th Cir. 1984). "The exemption of future payments . . . demonstrates a concern for the debtor's long-term security which is absent from the statute." *Clark v. O'Neill (In re Clark)*, 711 F.2d 21, 23 (3d Cir. 1983).

133. See, e.g., *Turpin v. Wentz (In re Turpin)*, 644 F.2d 472, 474 (5th Cir. 1981); see also *supra* notes 124-26 and accompanying text (purpose of exemptions is to ensure the debtor a "fresh start").

134. *Turpin v. Wentz (In re Turpin)*, 644 F.2d 472, 475 (5th Cir. 1981) (decided under the Bankruptcy Act).

Of course when the debtor is older and receiving or soon to qualify to receive distributions from a retirement arrangement, it is not difficult to determine whether such funds are "reasonably necessary" for the debtor's maintenance and support.<sup>135</sup> However, when the debtor is young and employable, particularly if employed in a profession in which high earnings are anticipated, courts are less willing to find pension funds that will become available in the distant future "reasonably necessary for the support of the debtor." This conclusion is particularly accurate when the assets are maintained in an IRA, a Keogh plan, or a plan maintained by a corporation in which the debtor owns all or a majority of the stock. In these circumstances courts have shown reluctance to ignore the debtor's easy access to the funds for acquiring nonnecessities once the bankruptcy proceedings are completed.<sup>136</sup> This concern is predominant, even though the language of section 522(d)(10)(E) exempting "the debtor's right to receive"<sup>137</sup> a pension anticipates future payments. When the date of retirement is too far in the future, courts are unwilling to exempt pension assets from collection for the same reason that pension assets were included in the bankruptcy estate under pre-1978 bankruptcy law—the debtor's control of and easy access to the assets.<sup>138</sup> In addition, courts have the equitable concern that to protect those who have pensions while not protecting those who place money in traditional savings or other accounts for future use is unfair.<sup>139</sup>

Perhaps the solution to the dilemma the courts face in resolving the issue of what is reasonably necessary for support lies not entirely with the bankruptcy laws, and perhaps this possibility explains the discomfort the courts display in

---

135. See, e.g., *Firestone v. Metropolitan Life Ins. Co. (In re Di Piazza)*, 29 Bankr. 916 (Bankr. N.D. Ill. 1983) (remanded for further fact finding as to whether low income, 56 year-old debtor had sufficient financial need to qualify for Illinois exemption similar to the exemption in Bankruptcy Code § 522(d)(10)(E)); see also *In re Donaghy*, 11 Bankr. 677 (Bankr. S.D.N.Y. 1981). In *Donaghy* the debtors were a 62 year-old husband in ill health and his 64 year-old wife who had cancer. They were required by their pension plan to take immediately a lump sum distribution of benefits accrued or to delay taking any benefits for three years, at which time they would receive monthly benefits. The debtors took the lump sum distribution, apparently out of need and concern that they would not be alive in three years to receive monthly benefits. The lump sum distribution was placed in a bank account prior to the debtors' filing a bankruptcy petition. Although the money was no longer in a pension plan under colorable protection of Bankruptcy Code § 522(d)(10)(E), the court applied the exemption because to do otherwise would "[elevate] form over substance. . . . This sum is intended to function as a wage substitute at some future period and . . . the lump sum pension payment is reasonably necessary for their present and future support during their declining years." *Id.* at 680. This decision appears to be the most expansive interpretation of the § 522(d)(10)(E) exemption, but the decision may well be limited by the extreme facts of the case.

136. See *supra* text accompanying notes 93-105.

137. 11 U.S.C. § 522(d)(10)(E) (1982).

138. Analysis of whether a pension fund constitutes a wage substitute is based on the differentiation between accumulation of assets for current purchases and accumulation of funds for provision of basic needs in the future. It is clear that a debtor's lack of control over accumulated funds is the criterion on which many courts rely in excluding and exempting pension benefits because the inability of the debtor to use such assets currently ensures their availability as future wage substitutes.

139. As one commentator has stated:

[T]here is no reason to protect those whose employers have maintained a qualified pension or profit-sharing plan and those who were eligible and willing to make similar provision for themselves under "H.R. 10," while denying such protection to those who were eligible for neither or who chose to provide for their old age by other means.

Plumb, *supra* note 16, at 95.

dealing with this matter. The policy motivations for Bankruptcy Code sections 522(d)(10)(E) and 541 are best understood when evaluated in conjunction with the purposes of the law with which they keep colliding, ERISA. Both the issue whether a pension plan trust is deemed a spendthrift trust and the question whether its assets are "reasonably necessary" for a debtor's support are best determined by considering the purposes for which Congress encourages the maintenance of retirement arrangements.

## V. RELATIONSHIP OF BANKRUPTCY LAW TO PENSION LAW

That Congress considers the provision of pension benefits an important social goal is clear from the legislation developed to promote the use of and protect the benefits under retirement arrangements. ERISA<sup>140</sup> was developed as a response to a perceived need to regulate what was becoming, at the time the legislation was being considered, one of the largest pools of investment assets in the United States.

### A. Purpose of ERISA

Through passage of ERISA Congress sought to assure that participants in existing plans knew what they were supposed to receive and then actually received the anticipated benefits.<sup>141</sup> Congress also sought through ERISA to provide benefits for a wider group of citizens<sup>142</sup> and to assist retirees in maintaining at least a minimal standard of living<sup>143</sup> by securing greater benefits for retirees than would be available under Social Security.<sup>144</sup> Congress' intent is evident from the statements of legislators immediately preceding the vote adopting ERISA. Senator Jacob Javits of New York, one of ERISA's primary sponsors, stated that "the pension reform bill is the greatest development in the life of the American worker since social security. For the first time in our history most

140. Pub. L. No. 93-406, 88 Stat. 829 (1974).

141. ERISA, Pub. L. No. 93-406, § 2, 88 Stat. 829, 832-33 (1974).

142. *Id.* § 202, 88 Stat. at 853-54 (codified at 29 U.S.C. § 1052 (1982 & Supp. I 1983)); see also *Leaders of Senate Labor Panel Pledge to Press Pension Reform Measure This Year*, N.Y. Times, Feb. 28, 1972, at 19, col. 2. I.R.C. § 410 (1985) is a similar provision. To implement congressional policy to allow as many people to participate in pension arrangements as possible, § 410 provides that in order for a pension arrangement to be given tax exempt treatment, it must allow almost all employees who have attained a minimum age to participate. *Cf. id.* § 401(a)(3) (as in effect in 1974) (referring to the minimum participation standards in § 410 as prerequisites for a qualified trust); Treas. Reg. 1.401-3 (1974) (pre-ERISA tax provisions relating to tax preferred pension plans).

143. See *Ebbing Resources: Social Security System Is on Its Way to Going Broke, Analysts Warn*, Wall St. J., Feb. 27, 1975, at 1, col. 6. (eastern ed.); *The Forces Reshaping Social Security*, BUS. WK., July 15, 1972, at 54; *Pension Increase Weighed By Panel*, N.Y. Times, Mar. 24, 1972, at 11, col. 1.

144. Congressman Smith stated at 120 CONG. REC. 29,210 (1974):

There is a great need for private pension plans, deferred income plans, and other plans which receive tax benefits as an encouragement to providing supplemental retirement income.

Realistically, social security by itself is not likely to be sufficient to provide enough for retirement income and the supplemental plans are very important.

Senator Beall commented that "[t]he bill seeks to protect the retirement benefits of the more than 36 million Americans who are covered by private pension plans and to encourage Americans not presently covered to provide for their own retirement through the granting of tax incentives." *Id.* at 29,961.

workers will be able truly to retire at retirement age and to live decently on their social security, and private pensions."<sup>145</sup> Senator Javits envisioned the pension reform bill as a vehicle by which citizens could be assured of decent living conditions on retirement.<sup>146</sup> Congressman Biaggi believed that ERISA "has one underlying theme. It is a piece of legislation designed to protect and expand the rights of all workers to a pension. It sets no geographic, social or economic stipulations, but instead seeks to cover the gamut of working people under its provisions."<sup>147</sup>

Congress chose to accomplish these social goals by conferring tax benefits on those who save for retirement.<sup>148</sup> Congress frequently has looked to the tax code to encourage preferred social behavior either by forgiving or by deferring taxes.<sup>149</sup> The use of tax incentives to promote behavior is time honored<sup>150</sup> and shows no less a congressional intent to induce the availability of a non-tax bene-

145. *Id.* at 29,933. Further on in his statement, Senator Javits detailed some case histories of workers who were denied benefits due to minor violations of extraordinarily strict vesting and participation requirements routinely made part of pension plans prior to the enactment of ERISA. This was one abuse against which ERISA was aimed. *Id.* at 29,934.

146. Senator Javits stated:

[T]his legislation will make better pension plans and undeniably, better pension plans will make a significant contribution to the economic security of large numbers of older people who need a much more realistic level of living in retirement. Even a substantially liberalized Social Security could not do the job private pensions can do.

Right now—even with recent substantial increases in its benefits—social security is just barely enough to support people, even at poverty levels. Nor do people save or invest enough money over a lifetime. The result is they cannot really cope with soaring food costs or any other forms of inflation.

*Id.* at 29,943.

147. *Id.* at 29,193.

148. Individual taxpayers are not required to include in their current year taxable income amounts that are contributed by their employers to a tax qualified pension arrangement. *See* I.R.C. §§ 61, 402 (1985). They receive a tax deduction for amounts they contribute to Keogh plans. *Id.* § 219. These amounts are, however, includable in the taxable income of the taxpayer when distributions are made out of the plan. *Id.* §§ 72, 402, 408. If the taxpayer is in a lower tax bracket or if the distributed benefits are taxed at a lower rate at the time of benefit distribution than at the time the contributions were made, the taxpayer has avoided taxes on the amount contributed to the extent of the difference. In addition, the taxpayer benefits by deferring taxation until retirement.

149. For example, as an inducement to taxpayers to increase their investment in capital assets, Congress passed, as part of the Economic Recovery Tax Act of 1981, Pub. L. No. 97-34, 95 Stat. 172, a new method of determining the amount of an asset's cost that a taxpayer could deduct in any one year. The new method accelerated considerably over what would have been available under the prior method of depreciation the amount of early year annual deductions. *Cf.* I.R.C. §§ 167, 168 (1958) (setting forth general guidelines for depreciation and accelerated cost recovery). Congress' stated reason for the change was to resurrect a tax incentive that had lost its luster due to inflation. The hope was that this new incentive would encourage taxpayers to replace old equipment and structures, thus stimulating the economy. *See* STAFF OF THE JOINT COMM. ON TAXATION, 97TH CONG., 1ST SESS., GENERAL EXPLANATION OF THE ECONOMIC RECOVERY TAX ACT OF 1981, at 18-19 (Comm. Print 1981).

150. Congressman Al Ullman stated that "under this legislation, the favorable tax treatment that has been so instrumental in encouraging the growth of nondiscriminatory plans over more than three decades will continue." 120 CONG. REC. 29,198 (1974). The tax code is used as much to channel investment as to produce income for the government. As one commentator has stated:

Virtually all provisions [of the tax code] that shield some income from the full impact of . . . any tax . . . were put there . . . (1) to provide greater equity . . . [and/or] (2) to provide incentives to taxpayers to engage in or enlarge activities which are held to be desirable as a matter of public policy.

R. FREEMAN, TAX LOOPHOLES: THE LEGEND AND THE REALITY 3-4 (1973).

fit than if it had provided for the availability of such a benefit by direct legislation.<sup>151</sup> Thus, it is not surprising that Congress selected the tax incentive approach to induce employers to provide retirement arrangements for their employees and to induce employed and self-employed individuals to reduce a portion of their savings to specially designated retirement funds. Despite the clear congressional policy allowing citizens to accumulate assets for retirement, the courts, when dealing with bankruptcy, generally ignore that policy in favor of paying a debtor's creditors.<sup>152</sup>

### B. *Appropriate Law Regulating Pension Arrangements*

For purposes of bankruptcy law the election between state and federal exemption systems is precisely what Congress intended for assets in general.<sup>153</sup> However, when the election is applied to pension assets, ERISA policy is undercut. Under the federal exemption system, the courts have been reluctant to find that the exemption for pension assets applies. The courts express this reluctance by defining the "reasonably necessary" requirement of section 522(d)(10)(E) in very narrow terms.<sup>154</sup> All the states provide some degree of exemption for pension arrangements, but the state exemptions are not identical to each other or to the federal exemptions. Thus the extent to which one's pension benefits are exempt from creditors in a bankruptcy depends on the state in which bankruptcy is filed. The existence of these exemption alternatives works at cross purposes with the congressionally stated policy behind ERISA—to have all pension arrangements regulated by a single law.

ERISA provides that it supersedes all state law affecting or relating to employee benefit plans.<sup>155</sup> So important was this preemption doctrine to the overall fulfillment of congressional intention that one congressman pointed to the provision as "the crowning achievement of this legislation . . . [because it reserves] to Federal authority the sole power to regulate the field of employee

---

151. "Suggestions are constantly being made that many of our pressing social problems can be solved, or partially met, through the use of income tax incentives." S. SURREY, *PATHWAYS TO TAX REFORM* 126 (1973). Professor Surrey went on to explain in this important and highly influential work that socially desired behavior is induced by the government foregoing current revenue and the taxpayer reducing his or her current cash out-flow by receiving a tax (monetary) benefit. He dubbed this process one of "tax expenditure." Whether it is more likely that desired goals will be achieved through direct expenditures by government or through the more indirect "tax expenditure" method of conferring tax benefits is an interesting issue but one far beyond the scope of this Article.

152. *See* *Judson v. Witlin (In re Witlin)*, 640 F.2d 661 (5th Cir. 1981) (court denied bankruptcy exemption under a Keogh plan); *In re Mace*, 4 Bankr. Ct. Dec. (CRR) 94 (Bankr. D. Or. 1978); *National Bank of N. Am. v. International Bd. of Elec. Workers Local 3*, 69 A.D.2d 679, 419 N.Y.S.2d 127 (1979) (ERISA employee pension fund not exempt from judgment creditors).

153. *See supra* note 120.

154. *See supra* text accompanying notes 122-39.

155. 29 U.S.C. § 1144(a) (1982 & Supp. I 1983) provides for supersession of state law by ERISA, and § 1144(d) provides that ERISA does not "alter, modify, invalidate, impair, or supersede" any federal law relevant to this discussion. *See also* H.R. CONF. REP. 1280, 93d Cong., 2d Sess., reprinted in 1974 U.S. CODE CONG. & AD. NEWS 5038, 5162 (emphasizing that ERISA supersedes only state laws affecting employee benefit plans and is not designed to exempt individuals from any state law that regulates insurance, banking, or securities).

benefit plans."<sup>156</sup> Despite this strongly expressed intention of Congress that federal law regulate all matters relating to pensions, the courts deciding cases in bankruptcy have split on the question whether the bankruptcy law, including state exemption laws applied under Bankruptcy Code section 522(b)(2)(A), supersedes ERISA.

Some courts have decided that a debtor's interest in a pension plan is not kept from the bankruptcy estate by ERISA when the debtor has chosen a state exemption system and that system does not protect pension benefits.<sup>157</sup> In such circumstances those benefits are protected only if the pension trust is considered a spendthrift-like trust excluded from the estate under Bankruptcy Code section 541(c)(2)<sup>158</sup> or if ERISA is considered "other Federal law" under Bankruptcy Code section 522(b)(2)(A).<sup>159</sup> Thus, ERISA's preemption of state law is undermined by allowing the various states to make their own rules regarding the regulation of ERISA plan benefits and by allowing the debtor to select state rather than federal exemptions. ERISA was specifically intended to preclude this situation. If there is some overwhelming reason to read an exception into ERISA, such as an implied exception for a spouse to provide support for his or her family,<sup>160</sup> that exception can be tolerated. However, if there is no overwhelming and conflicting social or legislative policy, it is hard to look approvingly upon judicial erosion of stated legislative intent.<sup>161</sup>

## VI. PROPOSAL FOR JUDICIAL RECONCILIATION OF BANKRUPTCY AND ERISA POLICY

Currently, if a debtor selects, or is forced to use, a state exemption system that does not adequately protect pension assets from creditors, the debtor may attempt to exclude such assets from property of the bankruptcy estate under Bankruptcy Code section 541(c)(2). This approach, however, has been singularly unsuccessful because it requires courts to view pension trusts as spendthrift

156. 120 CONG. REC. 29,197 (1974) (statement by Rep. Dent). The Congressman went on to say:

With the preemption of the field, we round out the protection afforded participants by eliminating the threat of conflicting and inconsistent State and local regulation. . . .

The conferees . . . applied this principle in its broadest sense to foreclose any non-Federal regulation of employee benefit plans. Thus, the provisions of section . . . [1144 of Title 29 of the United States Code] would reach any rule, regulation, practice or decision of any State, subdivision thereof or any agency or instrumentality thereof . . . which would affect any employee benefit plan [other than those specifically not covered by ERISA].

*Id.*; see also *id.* at 29,933 (statement by Sen. Williams).

157. See, e.g., *Samore v. Graham (In re Graham)*, 726 F.2d 1268 (8th Cir. 1984); *Goff v. Taylor (In re Goff)*, 706 F.2d 574 (5th Cir. 1983).

158. See *supra* text accompanying notes 55-92.

159. See, e.g., *Samore v. Graham (In re Graham)*, 726 F.2d 1268 (8th Cir. 1984); *Goff v. Taylor (In re Goff)*, 706 F.2d 574 (5th Cir. 1983). See *supra* text accompanying notes 108-19 for a discussion of whether ERISA qualifies as "other federal law."

160. For a discussion of current judicial and legislative positions on the levability and garnishability of pension benefits to fulfill family support obligations, see *supra* note 119.

161. *Clotfelter v. CIBA-GEIGY Corp. (In re Threewitt)*, 20 Bankr. 434 (Bankr. D. Kan.), *rev'd*, 24 Bankr. 927 (D. Kan. 1982).

trusts, an approach courts generally have been unwilling to take.<sup>162</sup> The debtor also may attempt to have ERISA deemed "other federal law," thus exempting pension assets under Bankruptcy Code section 522(b)(2)(A). The success of this latter approach also is doubtful.<sup>163</sup>

If the debtor elects to use the federal system of exemption, then section 522(d)(10)(E)'s exemption for certain pension benefits applies. However, the availability of this section depends on whether the debtor can establish that the amounts exempted are, or will produce income that is, "reasonably necessary" for support.<sup>164</sup>

Despite the legislative vehicles extant, judicial protection of pension assets from creditors is unlikely, at least in part because of a lack of concern for ERISA policy in the context of bankruptcy. Furthermore, many courts interpret the bankruptcy laws as inferentially overruling ERISA. This judicial stance might be acceptable if the Bankruptcy Code were carrying out social policy clearly more important than that surrounding ERISA. In the absence of such a finding, however, courts should try to reconcile ERISA and the bankruptcy laws.

Resolution of the conflict between creditors' rights in bankruptcy to acquire debtors' assets and debtors' rights, both under bankruptcy law and under ERISA, to protect assets for future needs would best be attained by remedial legislation that specifically addresses the issues discussed in this Article. Nevertheless, absent such legislative initiative, the courts can reconcile the two areas of the law through a more realistic and less narrow interpretation of existing bankruptcy law. A reconciliation of pension and bankruptcy policy can be achieved by judicial recognition that pension trusts are modified spendthrift trusts and that pension policy demands that all citizens be permitted to protect, even against creditors, some assets for retirement.

To permit individuals to have assets available for living expenses on retirement is to recognize that society ultimately will be forced to pay for the care of a retiree who does not have sufficient personal assets to provide the necessary requirements of life. Society's overwhelming concern in this regard is manifested in its willingness to defer collection of taxes on the portion of a taxpayer's income that is saved in a pension trust until the taxpayer begins receiving pension distributions.

To resolve the conflict between bankruptcy and ERISA policies, the courts first must recognize that a retirement arrangement is composed of at least two parts; one part is a traditional pension and the other part is a tax deferred, but otherwise conventional, savings account.<sup>165</sup> One court, recognizing this distinc-

---

162. See *supra* text accompanying notes 55-92.

163. See *supra* text accompanying notes 108-19.

164. See *supra* text accompanying notes 122-39.

165. The use of the term "savings account" is admittedly an oversimplification. It is shorthand for the various methods by which an individual invests funds and thereby postpones current consumption in favor of future consumption of the "saved" assets. Acknowledgement of the two-part nature of retirement arrangements was recently noted:

The [Senate] Finance Committee . . . will look at vehicles such as tax code Section 401(k)

tion, suggested an equitable means to reconcile bankruptcy and ERISA policy: "[A]lthough the anti-alienation clause required under an ERISA plan may bar creditors from retirement benefits, it should not operate to bar creditors from the present benefits included in a plan but not part of the retirement plan."<sup>166</sup>

The proposal that follows accepts this two part characterization of ERISA qualified pension arrangements and suggests that to the extent the assets of any retirement arrangement attributable to the debtor are tax deferred investments they should not be exempted or excluded from the bankruptcy estate. To the extent the plan assets represent the accumulation of an amount necessary to provide for reasonable needs upon retirement, they should be either exempted or excluded from the debtor's estate. This approach permits the debtor to keep property necessary for retirement as intended by ERISA while at the same time permitting the debtor's creditors to have access to all the debtor's property not needed for a "fresh start," thus satisfying the primary tenet of the Bankruptcy Code. Furthermore, this approach carries out one of the primary objectives of ERISA, applying a consistent federal law to the regulation of ERISA pensions and pension benefits rather than one federal and fifty state laws.

The primary reason courts have been unwilling to treat pension trusts as spendthrift trusts excluded from property of the estate under Bankruptcy Code section 541(c)(2) is the concern that pension assets which the participant can reduce to possession are likely to be used by the debtor immediately after the termination of the bankruptcy proceeding. Thus, courts reason, it would be foolish to view these assets as retirement assets. Without this concern courts might be persuaded to exclude at least a portion of a debtor's pension assets from the bankruptcy estate or to exempt them from creditor attachment.

Under ERISA a debtor may well have substantial control, including the right of pre-retirement withdrawal, over the assets in a pension trust. However, that control and right of withdrawal is only permitted by ERISA; it is not required. There is no reason under ERISA that a pension plan, Keogh plan, or IRA could not restrict the debtor's rights to borrow, pledge, distribute, or otherwise use the funds of a retirement plan prior to retirement. If the bankruptcy courts were to require that in order to exclude pension assets from a bankruptcy estate or to exempt them from availability to creditors a pension trust be subject

---

plans and IRAs to see if they are being used for retirement savings or just for deferred tax savings. . . . [Senator Chafee noted] that the extent to which these programs are being used solely as retirement income sources is not clear.

*Packwood Wants No Tax on Benefits, But Sees Possible Limits on Social Security*, 12 PENS. REP. (BNA) No. 4, at 145 (Jan. 28, 1985).

166. *In re Berndt*, 34 Bankr. 515 (Bankr. N.D. Ind. 1983). *Berndt* dealt with the question whether the profit sharing plan maintained by Sears, Roebuck and Co. for its employees was a spendthrift trust under Bankruptcy Code § 541(c)(2). *Id.* at 516. Under the plan the debtor had the right to withdraw contributions, and it was those assets the trustee in bankruptcy sought to obtain. *Id.* This author disagrees with the court's apparent categorization of all assets over which the debtor has control as "present benefits" not part of what is otherwise a "spendthrift trust" and the remainder of the assets as "future benefits" excluded because they are part of a "spendthrift trust." Nonetheless, it is significant that at least one court has recognized that a retirement arrangement can have more than one purpose and that these different purposes may have to be dealt with differently under the Bankruptcy Code.



to these restrictions, the control obstacle to protecting these assets in bankruptcy would be eliminated.

A number of things should be considered in determining whether this approach is feasible. Under some circumstances debtors now are permitted to retain exempt property acquired on the eve of bankruptcy.<sup>167</sup> Thus, even if the courts allow for eve-of-bankruptcy amendments to pension arrangements to provide restrictions on asset accessibility, no harm will be done to existing bankruptcy policy. In addition, and perhaps of most importance, the bankruptcy courts already have the authority under Bankruptcy Code section 522(d)(10)(E) to exempt some pension benefits and assets despite the fact that they may be subject to substantial rights of withdrawal or control by the debtor. The essential assumption of section 522(d)(10)(E) is that assets which are "reasonably necessary for the support of the debtor" will be available to the debtor to make a fresh start. This assumption is made easily when assets are to be used immediately. If the debtor is not yet at retirement age, however, given the provisions of most retirement arrangements, there is no assurance that this underlying assumption will be fulfilled, and if it is not fulfilled the basis for the exemption is nonexistent. To grant the exemption a bankruptcy court must be assured that such exempted amounts will be available for the support purposes for which they are exempt. In this situation, it is not a perversion of congressional intent for the bankruptcy court to grant a Bankruptcy Code section 522(d)(10)(E) exemption on the condition that the debtor place the exempted or excluded assets in a pension trust from which no loans or distributions can be taken or from which no assets can be pledged, assigned or hypothecated in any manner by the debtor prior to retirement. This approach also might qualify the pension arrangement as a spendthrift-like trust excluded from the bankruptcy estate under Bankruptcy Code section 541(c)(2).

This arrangement would be particularly helpful to the young debtor for whom courts have been unwilling to preserve pension assets because they are deemed unnecessary for a fresh start.<sup>168</sup> This reluctance appears to be based upon the assumption that a young person will have sufficient time to reestablish retirement savings and thus needs no current retirement plan assets protected from creditors. The difficulty with this analysis is that there is no analytical basis, other than instinct, on which the courts have drawn the line between those too young to have such assets protected and those too old to permit assets to be available to creditors. Given that the courts tend to view the preservation of retirement assets as an all or nothing proposition, there is no room in currently expressed theory to provide for age gradations. It is true that the pension assets of one who is twenty-five years old will need less protection than will pension assets of one who is thirty-five, and pension assets belonging to a thirty-five year-old will need less protection than will those of one who is fifty. Nonetheless,

---

167. See generally Resnick, *Prudent Planning or Fraudulent Transfer? The Use of Nonexempt Assets to Purchase or Improve Exempt Property on the Eve of Bankruptcy*, 31 RUTGERS L. REV. 615 (1978) (State exemption laws may allow retention of exempt property acquired on the eve of bankruptcy if necessary for survival, financial rehabilitation, or familial support.).

168. See *supra* text accompanying notes 130-39.

each has need for protection. This problem, as well as the problem of determining what is the "pension" portion and what is the "savings" portion of a debtor's pension benefits can be solved by application of actuarial theory.

The amount of retirement assets that needs protection from creditors increases with the age of the debtor. The debtor always should be able to protect an amount at least actuarially equal to what is necessary to provide a reasonable retirement benefit. The protected amount should be that amount which, if left in a tax free trust until retirement age, would produce a reasonable retirement benefit. Alternatively, the protected amount should be the amount which, when added to contributions that the court can assume will be made by or for the debtor during the remainder of the debtor's working life, will produce the "reasonable retirement benefit."

By way of example, assume that a reasonable retirement benefit is \$750.00 per month in current dollars. There are two ways of assuring that this benefit will be available to the debtor upon retirement. One way is to place a single lump sum amount in a trust fund that, assuming actuarially determined trust growth, will be sufficient at the debtor's retirement age to produce the then equivalent of \$750.00 per month in benefits. The other, probably preferable, method of providing for sufficient assets upon retirement is to assume that the debtor will be gainfully employed from the present to the time retirement age is attained and that either the debtor or the debtor's employer will make contributions to a pension plan until the debtor's retirement. Because any assumed pension contributions are based on assumed earnings, the court will have to make some assumption as to the debtor's anticipated future income. These estimates can be made by extrapolating existing data on wage progressions in specific industries and professions. Once these estimates are made the court should permit the debtor to protect from creditors that amount of his or her current pension benefits which, when added to the assumed additional contributions and earnings thereon, will result in an accumulation of retirement assets sufficient to provide a "reasonable retirement benefit."

Even if the adoption of the above method does not create results substantially different from those attained on an ad hoc basis in existing cases, adopting a theoretical framework for decision-making based on objective standards will assure that treatment of all pension benefits is consistent, whether federal exclusions or state or federal exemptions are used. This approach allows the courts to carry out the intent of the bankruptcy laws without violating the policies of ERISA. At the same time, the courts would free themselves from the theoretical box they are backing themselves into—an all or nothing approach to pension benefit allocation under the bankruptcy law.

How much the "reasonable retirement amount" should be is difficult to say and is a question of economics and social policy beyond the scope of this Article. However, Congress has provided guidelines. Floor statements relating to the passage of ERISA indicate that Congress intended pension benefits to act as a

supplement to social security payments.<sup>169</sup> Social security payments provide only the very basic retirement needs; clearly Congress felt that more support was necessary.<sup>170</sup>

There is a long distance between the bare, basic necessity felt insufficient by Congress and the opulence that bankruptcy courts are unwilling to permit. The courts should allow protection for a portion of pension assets that will produce benefits at twice or three times the poverty line<sup>171</sup> or the estimated poverty line at the time the debtor will reach retirement age.<sup>172</sup>

## VII. CONCLUSION

The conflict between ERISA and the bankruptcy laws has not been addressed directly by legislation or adequately resolved by the judiciary. In general, courts have favored the policy considerations of the bankruptcy laws over those of ERISA rather than attempting to reconcile the apparently divergent goals of these two legislative constructs. However, this preference is unnecessary because these two areas of law can be judicially or legislatively harmonized to reflect the policies behind both without doing extensive harm to the basic purposes of either.

---

169. See *supra* notes 144-47 and accompanying text.

170. See *supra* note 146.

171. The term poverty line or poverty level "consists of a set of dollar thresholds which vary by family size and composition. The average poverty threshold for a family of four persons was \$9,862 in 1982[;] . . . the poverty thresholds are updated every year to reflect changes in the annual average Consumer Price Index." BUREAU OF THE CENSUS, U.S. DEPT. OF COMMERCE, PUB. NO. 144, SERIES P-60, CURRENT POPULATION REPORT, CHARACTERISTICS OF THE POPULATION BELOW THE POVERTY LEVEL: 1982, at 1 (March 1984). The poverty level in the year 1982 for a two person household at or over age 65 was \$5,831.

172. Assuming a poverty line that will be higher in future years as the result of inflation does not suggest that the pension benefit which the court protects would be commensurately larger. Actuarial determinations of the assumed future contributions to be added to the current benefit would be adjusted for the same inflation factor as is the poverty line. Consequently the amount of the current protected benefit should not be enlarged inordinately.