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# From the Bankruptcy Courts

*Benjamin Weintraub* and Alan N. Resnick***

### *IN RE GOFF*—KEOGH PLANS AND IRAs AS PROPERTY OF THE BANKRUPTCY ESTATE

In an age when Keogh plans and individual retirement accounts (IRAs), which are qualified for favorable tax treatment under the Employee Retirement Income Security Act of 1974 (ERISA),[1] are becoming substantial assets in millions of families, it is not surprising that bankruptcy trustees and debtors are often battling over these funds in bankruptcy court. In fact, the volume of litigation over a debtor's right to keep an ERISA pension plan despite the filing of a liquidation petition appears to be increasing at a rapid rate and is likely to continue to increase in the future as these pension funds grow.

Although the bankruptcy estate consists of all of the debtor's legal or equitable interests in property as of the commencement of the case,[2] debtors have advanced several arguments to support the position that the debtor's interest in Keogh plans and IRAs may not be lost to the trustee. *In re Goff,*[3] a recent case decided by the U.S. Court of Appeals for the Fifth Circuit, addressed and disposed of such arguments and concluded that a consequence of a liquidation petition is that the unfortunate debtor may have to begin saving for retirement all over again.

The *Goff* case involved a joint petition for liquidation filed by debtor spouses who had self-employed retirement trusts (Keogh plans[4]) administered by City National Bank. The Keogh plans had more than $90,000 deposited in them, including a $2,878 contribu-

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[1] Pub. L. No. 93-406, 88 Stat. 898 (codified at 29 U.S.C. §§ 1001–1144, and in scattered sections of the Internal Revenue Code).

[2] 11 U.S.C. § 541(a).

[3] 706 F.2d 574 (5th Cir. 1983). For other cases dealing with the fate of ERISA pension plans in bankruptcy, see, e.g., *In re* Pruitt, 30 Bankr. 330 (D. Colo. 1983); *In re* Wood, 23 Bankr. 552 (E.D. Tenn. 1982); *In re* Rogers, 24 Bankr. 181 (Ariz. 1982).

[4] These plans were established pursuant to the Keogh-Smathers Act, Pub. L. No. 87-792, 76 Stat. 809 (1962).

tion made by the debtors only three days prior to the filing of the liquidation petition. The Goffs had the right under the Keogh trust agreement to withdraw funds prematurely (prior to retirement, death, or sale or termination of the business) subject only to a 10 percent tax penalty.

**The Debtors' Argument**

The debtors took the position that the Keogh plans were excluded from property of the estate by virtue of Section 541(c)(2) of the Bankruptcy Code, which 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."

This argument was based on an antialienation clause contained in the Keogh trust document which provides:

> Neither the assets nor the benefits provided hereunder shall be subject to alienation, anticipation, assignment, garnishment, attachment, execution or levy of any kind, and any attempt to cause such benefits to be so subjected shall not be recognized, except to such extent as may be required by law.[5]

The bankruptcy trustee must have been somewhat convinced by the debtors' argument because he presented an application to the bankruptcy court to accept only $2,000 in full settlement of the claims of the estate against the Keogh plans.[6] The creditors' committee filed its opposition to the trustee's application and the bankruptcy court denied the application. The bankruptcy judge held that the entire Keogh plans were considered property of the estate and that the exclusion under Section 541(c)(2) was not applicable.

On appeal, the Fifth Circuit began its analysis of the problem by comparing the concepts of property of the estate under the former Bankruptcy Act and under the Bankruptcy Code. Under Section 70(a)(5) of the former Act, assets became part of the estate only if a two-part test was met: (1) the property had to be either transferable or leviable in nature, and (2) the purposes of the Bankruptcy Act had to be served by inclusion of the property. On the second part of the test, the Supreme Court in *Segal v. Rochelle*[7] indicated that where property "is sufficiently rooted in pre-bankruptcy past and so little entangled with the bankrupt's ability to make an unencumbered fresh start . . . it should be regarded as 'property' [of the estate]."[8] On the other hand, the Bankruptcy

[5] Goff, 706 F.2d at 577.

[6] *Id.* at 577 n.7.

[7] 382 U.S. 375 (1966).

[8] *Id.* at 380.

Code's concept of "property of the estate" under Section 541(a) is much broader in scope, including "all legal or equitable interests" that the debtor had as of the date of bankruptcy. The old two-part test based on transferability or leviability, as well as on policy considerations, has no role under the Code. As noted by the court of appeals in a footnote: "While the existence of a 'legal or equitable interest' may turn upon state nonbankruptcy law, once it is determined that such an interest exists, it automatically becomes property of the estate under § 541 of the Code."[9]

There is no doubt that the debtors had a "legal or equitable interest" in the Keogh plans when the joint petition was filed. However, the debtors argued that Section 541(c)(2), set forth above, effectively excludes the plans from the estate. They contended that the antialienation clause in the trust agreements, which is required in ERISA pension plans to qualify for favored tax treatment,[10] is a restriction on the transfer of the debtors' beneficial interest in the trust which is protected by Section 541(c)(2).

### Court of Appeals Disagrees With Debtor

The court of appeals rejected the debtors' reliance on Section 541(c)(2) and affirmed the bankruptcy court's holding that the Keogh plans in question remain property of the estate. Section 541(c)(2) makes effective only those restrictions that are "enforceable under applicable nonbankruptcy law." However, the court carefully examined legislative history and held that Congress did not intend to include all ERISA plans in the exemption. "Rather, we find that Congress intended to exclude only trust funds in the nature of 'spendthrift trusts' from the property of the estate. . . . [I]t is clear in the immediate case that appellate's self-settled trust did not constitute a spendthrift trust entitled to exclusion under relevant state law."[11] The court concluded that the Keogh plans that were set up and controlled by the debtors would not be considered "spendthrift trusts" under Texas law which is applicable nonbankruptcy law in this case. "The general rule is well established that if a settlor creates a trust for his own benefit and inserts a 'spendthrift' clause, restraining alienation or assignment, it is void as far as creditors are concerned and they can reach

[9] Goff, 706 F.2d at 578 n.10.

[10] 26 U.S.C. § 401(a)(13) requires, in relevant part, that in order to be tax-qualified, a pension trust must provide that "benefits provided under the plan may not be assigned or alienated." See also 29 U.S.C. § 1056(d)(1).

[11] Goff, 706 F.2d at 580.

the settlor's interest in the trust."[12]

It is important to note that the court of appeals limited its holding only to self-settled Keogh plans and IRAs and did not extend it to other ERISA-qualified pension plans which would be treated as spendthrift trusts under applicable state law. In fact, the court recognized that employer-created pension trusts receiving ERISA tax treatment may be excluded from the estate under Section 541(c)(2).

> In analyzing the effectiveness in bankruptcy of spendthrift provisions in pension plans, the courts have generally concluded that those contained in employer-created plans were effective [while] similar provisions in self-settled plans were not. The latter conclusion is inescapable since, as discussed earlier, the traditional law of spendthrift trusts has rejected the notion of effective spendthrift provisions in self-settled trusts. As to the former, without passing upon the exact limits of plans which could properly be characterized "spendthrift trusts," the employer-created-and-controlled nature of those plans may well make them analogous to a spendthrift trust.[13]

The debtors in *Goff* argued that the above analysis results in disparate treatment of self-employed and employer-created pension trusts which violates ERISA's statutory intention to treat all retirement plans the same way. In addition, since a debtor may quit employment immediately following the bankruptcy case, thus terminating the pension trust and receiving the funds, "any bankruptcy distinction made on the basis of the revokable, self-settled nature of self-employed pension plans is arbitrary.[14] The court rejected these arguments, noting that if such a distinction in bankruptcy conflicts with the policy of ERISA, "bankruptcy law prevails."[15] The court also disagreed with the debtors' characterization that the degree of beneficiary control is the same for Keogh plans and employer-created plans. For Keogh beneficiaries, premature withdrawal results in a 10 percent tax penalty, whereas the employee must quit his or her job in order to obtain funds in the employer-created trust. "We cannot equate a 'tax penalty' with 'employment termination' as equal restraints upon withdrawal of pension funds."[16]

Moreover, the court did not rule out the possibility that, in an appropriate case, even a self-settled trust may be excluded from the estate under Section 541(c)(2) if certain restrictions were placed on the debtor's con-

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[12] *Id.* at 587.
[13] *Id.* at 589.
[14] *Id.* at 588.
[15] *Id.* at 589.
[16] *Id.*

trol and on premature withdrawal. In a footnote, the court stated:

> We leave open the question of whether an appropriate case might be presented in which the restrictions upon a settlor-beneficiary's control and withdrawal of funds in a self-settled trust would ever render effective a spendthrift clause under applicable state law. Consider, for example, a restriction that would condition premature withdrawal upon a self-employed individual's sale of his business or career change.[17]

## The "Federal Law" Exemption

Another argument commonly advanced for exempting ERISA pension plans from the reach of the trustee is based on Section 522(b)(2)(A) which provides that a debtor who selects the state exemption system under Section 522(b) may also exempt property pursuant to "federal law" other than Section 522(d). Although the Goffs did not claim an exemption for the Keogh plans under this other "federal law" exemption, which made Section 522(b)(2)(A) inapplicable in that case, the court of appeals nonetheless discussed the relevance of that section on self-settled pension plans.

The court examined the legislative history and found that Congress provided a nonexclusive list of illustrations of federal laws that create exemptions applicable under Section 522(b)(2)(A).[18] The list included such items as foreign service retirement and disability payments (22 U.S.C. § 1104), Social Security payments (42 U.S.C. § 407), civil service retirement benefits (5 U.S.C. § 729, 2265), etc. The court noted the conspicuous absence of ERISA from the illustrative list. The court also pointed out that ERISA does not require that all pension plan funds be exempt from a creditor's reach, but only requires that the plan contain an antialienation clause in order to qualify for certain tax advantages. "By contrast, the listed statutes which establish or guarantee certain benefits *directly preclude all* such benefits from alienation or assignment."[19] Referring to the illustrative list in the legislative history, the court indicated that ERISA was not merely overlooked by accident:

> Given the extensive and general reach of ERISA-qualified plans, it is highly improbable that Congress intended their inclusion without mention in the Section 522(b)(2)(A) exemption in the midst of a listing of significantly less comprehensive and less well known statutes. The often-stated admonition that it may be treacherous to attach great weight to congressional silence in interpreting its laws does not apply in this case in

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[17] *Id.* at 589 n.42.

[18] S. Rep. No. 989, 95th Cong., 2d Sess. 75 (1977); H.R. Rep. No. 595, 95th Cong., 2d Sess. 360 (1977).

[19] Goff, 706 F.2d at 585.

light of the comprehensive consideration of this issue which is revealed by this history.[20]

## Lessons to Be Learned

The court's conclusion that self-settled Keogh plans are neither excluded from the estate under Section 541(c)(2) nor exempt from federal law within the meaning of Section 522(b)(2)(A) means that the debtor will lose such funds to the trustee in the liquidation case unless the plan is exempt under a state exemption statute and the debtor elects the state exemption system. If the debtor elects the Section 522(d) federal exemption system in a state that did not "opt out" of that system,[21] Section 522(d)(10)(E) gives the debtor an exemption in the Keogh plan only "to the extent reasonably necessary for the support of the debtor and any dependent of the debtor." The factors considered by the court in determining the extent to which the plan is necessary for support include age, health, future earnings, and necessary expenditures.[22] It is unlikely, therefore, that a debtor who is not near retirement age and who is likely to have significant future earnings from which to save for retirement will be permitted an exemption for most funds in a Keogh or IRA trust.

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[20] *Id.*; cf. *In re* Hinshaw, 23 Bankr. 233 (Kan. 1982), which held that ERISA pension trusts are exempt under § 522 (b)(2)(A), and which found that ERISA was substantially similar to the types of statutes included on the illustrative list.

[21] See 11 U.S.C. § 522(b), which permits a state to enact legislation to prohibit its citizens from selecting the federal exemption system contained in § 522(d).

[22] See *In re* Kochell, 26 Bankr. 86 (W.D. Wis. 1982); *In re* Donaghy, 11 Bankr. 677 (S.D.N.Y. 1981).