

Retirement, Annuity and Life Insurance Benefit Planning Creditors' Rights to Retirement, Annuity, and Life Insurance Benefits

“New York law recognizes the right of individuals to arrange their affairs so as to limit their liability to creditors,”

In re Heller Trust, 613 N.Y.S.2d 809, at 810 (Sur. Ct., N.Y. Co. 1994)

Competing Equitable Principles that Often Create Debtor-Creditor Issues:

Debtors should fully pay all their debts.

Retirement, Annuity and Life Insurance Benefits should be protected from creditor claims.

A Dearth of New York State Decisions in this Area

Four Paradigms:

- ◆ State Laws
- ◆ Federal Laws Other than ERISA and Bankruptcy
- ◆ ERISA
- ◆ Bankruptcy Law

Conclusions

Retirement benefits are protected against the creditors of a plan participant or beneficiary other than:

- ◆ individual's spouse
- ◆ former spouse
- ◆ current creditors
- ◆ victims of crimes committed by the individual
- ◆ governments

Annuity benefits are protected against the individual's creditors if (a) the individual is the purchaser of the annuity or (b) the individual is the beneficiary of the purchaser, other than:

- ◆ individual's spouse
- ◆ former spouse
- ◆ current creditors
- ◆ victims of crimes committed by the individual
- ◆ governments

Life insurance benefits are protected against the insured's creditors, other than:

- ◆ the insured's spouse
- ◆ former spouse
- ◆ current creditors
- ◆ victims of crimes committed by the individual
- ◆ governments

Recurring Issue: Does Protection Extend to Benefits After their Distribution?

Creditors' Rights versus Spendthrift trusts

- ◆ A trust is a spendthrift trust to the extent its property may not be assigned.
- ◆ Some spendthrift trusts provide for automatic payments such as the attainment of age 40.
- ◆ A spendthrift trust may, but need not, provide that distributions are at the discretion of one or more of the trust trustees.
- ◆ Spendthrift provisions of a self-settled trust do not protect the trust creator
- ◆ To the extent a trust is protected by a spendthrift provision, a beneficiary's creditor may not reach the beneficiary's interest until the distribution is made by the trustee.
- ◆ This pre-distribution protection is far more limited than the post-distribution protections that are often available under debtor-creditor statutes.

Protections of Private Retirement Benefits

N.Y. C. P. L. R. § 5205(c).

Personal property exempt from Application to the satisfaction of money judgments

There is an exemption for a debtor's interest in and payment made to the debtor from an

- ◆ Individual Retirement Account (Roth and Traditional IRAs)
- ◆ Retirement Plan sponsored by a private entity funded by a trust that qualifies under Code Section 401(a)
- ◆ Section 457 Plan sponsored by a government or a tax-exempt entity

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- ◆ Section 457 Plan sponsored by a government or a tax-exempt entity
- ◆ Ninety Percent of a debtor's payments for personal services rendered within sixty days before, and at any time after, an income execution is delivered except such part as a court determines to be unnecessary for the reasonable requirements of the judgment debtor and his dependents

Protections of State Government Retirement Benefits

N.Y. EDUC. § 524. Exemption from taxation and execution

- ◆ There is an exemption for a debtor's interest in and benefit payments made by the New York State Teachers Retirement System.
- ◆ The statute does not explicitly address the treatment of payments received from the government retirement plan.
 - ◆ *In re Estate of King*, 196 Misc. 2d 250, 764 N.Y.S. 2d 519 (Sur. Ct. Broome Co. 2003) (holding that commercial lender may not enforce judgment against distributed teacher benefits)
 - ◆ *Cf. Anthis v Copland*, 270 P.3d 574, 173 Wn.2d 752 (Wash. 2012) (holding that similar Washington law does not protect distributed public pension benefits against the enforcement of a wrongful death judgement).

There is often an issue of whether there is implicit protection of distributed retirement, annuity, or life insurance benefits. Thus, it is important to know how distinguished courts have resolved this issue. The New York Court of Appeals considered whether a tort judgment creditor could enforce the debt against workers compensation payments received by the responsible party under a statute with provisions similar to the one protecting teacher's retirement benefits.

When Do Statutes Provide Post-Distribution Creditor Protection?

Workers' Compensation Law § 33 Assignments; exemptions [1913]

Compensation or benefits due under this chapter shall not be assigned, released or commuted except as provided by this chapter [there seem to be no such exceptions], and shall be exempt from all claims of creditors and from levy, execution and attachment or other remedy for recovery or collection of a debt . . .

Observation:

Law does not explicitly address the treatment of workers compensation benefits that have been distributed.

Post-Distribution Creditor Protection Available

By concession the moneys due under the award would have been exempt from the pursuit of creditors before they reached the judgment debtor. The argument is, however, that they became subject to seizure the instant they were paid. If this is so, the exemption is next to futile. . . .The exemption must have a meaning consistent with the policy behind it. Few words are so plain that the context or the occasion is without capacity to enlarge or narrow their extension. The thought behind the phrase proclaims itself misread when the outcome of the reading is injustice or absurdity.

Surace v. Danna, 161 N.E. 315, at 315-16 (N.Y. 1928) (Court Opinion, J. Benjamin Cardozo)

Post-Distribution Creditor Protection Available

No property is exempt from execution unless some statute makes it so, and the burden is upon the person claiming exemption to bring his property within some statutory exception . . . The compensation and benefits which are exempt are only those which are "due." The statute does not deal with those which have been paid. . . .

The purpose of section 33 impresses me as directing a mode of procedure by which the State or the employer may be enabled to get rid of compensation, which is due and payable, simply by paying it over to the person to whom it has been awarded or to whom it is payable under the statute.

Id. at 317-18 (Dissenting Opinion, J. John Francis O'Brien)

Judge O'Brien was a NY Court of Appeals Judge from 1927 until 1939

O'Brien v. Tremaine, 285 N.Y. 233 (New York Ct. Appeals 1941).

EQUITABLE EXCEPTIONS TO NEW YORK DEBTOR PROTECTION

- ◆ Statutory Family Support Obligations Override Debtor Protections - N.Y. C. P. L. R. § 5441
- ◆ Domestic Relations Law Overrides Debtor Protections - N.Y. Dom. Rel. § 236 -B
- ◆ Fraudulent Conveyance Law Overrides Debtor Protections - N.Y. C. P. L. R. § 5205 & N.Y. Dr. & Cr. L. § 273
- ◆ Criminal Law **Limited** Override of Debtor Protections - N.Y. EXEC § 632-a: Restitution
- ◆ NY State Tax Law **Does Not** Override Debtor Protections

**Protections for a Beneficiary
of Retirement, Annuity, and Life Insurance Benefits
from Debtors of the Benefit Creators Rather than the Beneficiary's Creditors**

N.Y. E. P.T.L. § 13-3.2(a). Rights of beneficiaries of pension, retirement, death benefit, stock bonus and profit-sharing plans, systems or trusts and of beneficiaries of annuities and supplemental insurance contracts

Beneficiaries of retirement, annuity and life insurance benefits may not be deprived of benefits by claims of creditors of the creator of the benefit unless:

- ◆ the contributed funds were part of a fraudulent transfer
- ◆ the claim is for estate taxes
- ◆ is based upon an elective share claim

Observations:

This EPTL Section does not address the ability of creditors of the beneficiary to enforce their claims other than the NYS Department of Taxation and Finance Taxation which may enforce its claims for estate taxes against the beneficiary. In contrast, CPLR 5205 limits the ability of beneficiary's creditors to enforce judgments against survivor benefits.

II. Federal Non-Bankruptcy Debtor-Creditor Laws Governing Retirement, Annuity and Life Insurance Benefits

Protections of Federal Government Retirement Benefits

5 U.S.C. § 8346. Exemption from legal process; recovery of payments [Civil Service Retirement]

- ◆ There is an exemption for a debtor's interest in and benefit payments by a federal retirement plan.
- ◆ The statute does not explicitly address the treatment of payments received from a government retirement plan.

In re Anderson, 410 B.R. 289 (Bankr. W.D. Mo. 2009) (holding that, as with N.Y. EDUC. L. § 524, distributed benefits are not subject to execution and arguing that this finding is consistent with the most recent case-law.)

Protections of Federal Government Retirement Benefits

42 U.S.C. § 407. Assignment; amendment of section. [Social Security Act § 207]

(a) The right of any person to any future payment under this title [42 U.S.C. §§ 401 et seq.] shall not be transferable or assignable, at law or in equity, and **none of the moneys paid or payable or rights existing under this title** [42 U.S.C. §§ 401 et seq.] **shall be subject to execution, levy, attachment, garnishment, or other legal process**, or to the operation of any bankruptcy or insolvency law.

(b) **No other provision of law**, enacted before, on, or after the date of the enactment of this section [enacted April 20, 1983], **may be construed to limit**, supersede, or otherwise modify the provisions of this section except to the extent that it does so by **express reference to this section**.

Observations:

- ◆ There is an explicit exemption for a debtor's interest in and benefit payments by Social Security.
- ◆ There is an explicit exemption for a debtor's payments received from the Social Security Administration

Protections of Federal Government Life Insurance Benefits

5 U.S.C. § 8705. [Federal Employees Group Life] Death claims; order of precedence; escheat

- ◆ The statute requires the federal government to pay the life insurance benefit to the person designated by the federal employee unless there is a domestic relations order to the contrary.
- ◆ The statute permits the assignment of life insurance benefits.

Observations:

- ◆ State creditor claims, other than those that are part of specified domestic relations orders, may not be enforced against a debtor's interest in and benefit payments from federal insurance.
- ◆ However, federal creditor claims may be offset against a debtor's federal insurance benefit payments.

EQUITABLE EXCEPTIONS TO FEDERAL DEBTOR PROTECTIONS OTHER THAN THOSE OF ERISA AND BANKRUPTCY LAW

- ◆ Statutory Family Support Obligations Override Debtor Protections - 42 U.S.C. § 659.
- ◆ Domestic Relations Law Overrides Debtor Protections - 42 U.S.C. § 659 & Non-Support Obligation statutes applying to specific federal protections
- ◆ Fraudulent Conveyance Law **Does Not** Override Debtor Protections
- ◆ Criminal Law Fines and Restitution Override Debtor Protections - 18 U.S.C. § 3613 & 18 U.S.C. §§ 3663A-3664.
- ◆ Internal Revenue Code Overrides Debtor Protections - Code §§ 6331-6334.

III. ERISA non-Bankruptcy Debtor-Creditor Law

ERISA PURPOSE COVERAGE

The Employee Retirement Income Security Act of 1974, as amended (“ERISA”) governs welfare plans and pension plans other than those of governments, churches, or those limited to owner-employees. ERISA was enacted because existing federal and state law, including the tax-qualification rules, did not adequately protect employee benefit plan participants and beneficiaries. Thus, Title I of the Act, the focus of this material is entitled, “Protection of Employee Benefit Rights,” and provides the most protection for retirement benefits as suggested by words in the title of the statute.

ERISA COVERAGE

ERISA pension plans either provide retirement income or defer employee income until the or after the date of the termination of employment. There are three types of ERISA pension plans:

- ◆ Unfunded Plans primarily for executives - Top-Hat Plans for executives
- ◆ Small Business plans with almost universal coverage funded with IRAs- SIMPLE plans and Simplified Employee Pension plans.
- ◆ The vast majority of pension plans, such as 401(k) plans or defined benefit plans, that cover a private entity's employees.

An ERISA pension plan need not be tax-qualified.

However, tax-qualified pension plans sponsored by private entities that are not church plans or limited to owner-employees are ERISA pension plans.

ERISA PREEMPTION

ERISA preempts any state law that "may now or hereafter relate to any [ERISA] employee benefit plan," other than those explicitly or implicitly excluded.

Although there are numerous U.S. Supreme Court decisions addressing ERISA preemption, there is considerable uncertainty about the interaction between ERISA and the federal and state Debtor-Creditor laws.

ERISA Provisions Relevant to Benefit Creditor Protections

ERISA Benefit Rights

ERISA § 502(a)(1)(B). [Civil enforcement for all ERISA plans]

(a) Persons empowered to bring a civil action. A civil action may be brought--
(1) by a participant or beneficiary--

(B) to recover benefits due to him under the terms of his plan, to enforce his rights under the terms of the plan, or to clarify his rights to future benefits under the terms of the plan

Observations:

- ◆ Unlike the tax-qualification sections, this ERISA section gives participants and beneficiaries the right to enforce their benefit rights.
- ◆ The ERISA language is very similar to the federal group life insurance statutory language. That language prevents the state from compelling the federal government to defer to a garnishment order other than a specified domestic relations order.

ERISA Provisions Relevant to Benefit Creditor Protections

ERISA Fiduciary Requirements

ERISA § 404. Fiduciary Duties [For Most ERISA plans Other than Top-Hat Plans].

ERISA fiduciaries must discharge their duties in accord with the plan documents that are consistent with ERISA.

Observations:

- ◆ This section governs ERISA plans other than Top-Hat Plans.
- ◆ This section does not provide plan participants or beneficiaries with an enforceable right to plan benefits.
- ◆ There is a distinction between plan documents and plan terms. The latter must be consistent with ERISA, but the former need not be.

ERISA Provisions Relevant to Benefit Creditor Protections

ERISA Spousal Benefit Requirements

ERISA § 205. Requirement of joint and survivor annuity and preretirement survivor annuity

Pension plans other than Top-Hat Plans, SEPs, and SIMPLE Plans must provide survivor benefits to the spouses of married plan participants. Moreover, such benefits may only be waived with the consent of the participant's spouse, if any. Thus, such plans, which are the vast majority of ERISA pension plans, shall hereinafter be called **Spousal Survivor Benefit Plans**.

The sponsors of pension plans, other than Spousal Survivor Benefit Plans, such as Top-Hat Plans, may choose whether to provide surviving spouse benefits. Similarly, the sponsors of ERISA life insurance plans need not provide any spousal survivor benefits, but may choose to do so.

ERISA Provisions Relevant to Benefit Creditor Protections

ERISA Spousal Benefit Requirements

ERISA § 206(d). Assignment or alienation of [Spousal Survivor Benefit] plan benefits.

(1) Each pension plan shall provide that **benefits provided under the plan may not be assigned or alienated.**

Observations:

This prohibition, often called the Alienation Prohibition, is limited to Spousal Survivor Benefit Plans. It does not apply to

- ◆ Top-Hat Plans
- ◆ SEP or SIMPLE Plans
- ◆ Life Insurance Plans

Federal and State-Law Garnishment of ERISA Plan payments

Benefit Payments by Spousal Survivor Benefit Plans May Not Be Garnished

Guidry v. Sheet Metal Workers National Pension Fund, 493 U.S. 365 (1990) (holding that ERISA does not permit a union to use the other relief provisions of a federal statute to obtain restitution from a union official who embezzled union funds by compelling a Spousal Survivor Benefit Plan co-sponsored by the union to pay the official's plan benefits to the union). The Court declared that:

As a general matter, courts should be loath to announce equitable exceptions to legislative requirements or prohibitions that are unqualified by the statutory text. The creation of such exceptions, in our view, would be especially problematic in the context of an antigarnishment provision . . . The impracticability of defining such a standard reinforces our conclusion that the identification of any exception should be left to Congress. Id. at 376-77

Observations:

- ◆ A federal law may not implicitly override the Alienation Prohibition that protects the benefits from Spousal Survivor Benefit Plans.
- ◆ *A fortiori*, a state law may not override the Alienation Prohibition that protects the benefits from Spousal Survivor Benefit Plans.

Federal and State-Law Garnishment of ERISA Plan Payments Issue (1)

Benefit Payments from ERISA Plan Other than Spousal Survivor Benefit Plans May Be Garnished

Mackey v. Lanier Collection Agency & Serv., Inc., 486 U.S. 825 (1988) (holding that ERISA permits state law garnishments of ERISA benefit payments because the plan, a vacation plan, was not a Spousal Survivor Benefit Plan). Court relied on (1) the fact that the Alienation Prohibition only applies to Spousal Survivor Benefit Plans, and (2) the presumption that ERISA is not concerned with who is entitled to receive a benefit payment from an ERISA plan.

Observations:

- ◆ This implies that ERISA permits state law garnishments of payments from
 - ◆ Top-Hat Plans
 - ◆ SEP or SIMPLE Plans
 - ◆ Life Insurance Plans
- ◆ Later Supreme Court decisions cast considerable doubt on the viability of *Mackey* because of the critical importance they ascribe to the right of an ERISA plan participant or beneficiary to receive a benefit payment from an ERISA plan.

Federal and State-Law Garnishment of ERISA Plan Payments Issue (2)

The *Guidry* Supreme Court did not consider whether ERISA protects benefits that have been distributed by a Spousal Survivor Benefit Plan. However, almost all the Circuits that have considered the matter, including the Second Circuit, have treated Spousal Survivor Benefit Plans as spendthrift trusts in which creditor protection ceases after the plan makes a benefit payment. Thus, the courts allow creditors may compel the recipient of the retirement benefit to pay the benefit amount to the creditor under this analysis.

Such spendthrift treatment of pension benefits is problematic under New York law for

- ◆ participants and beneficiaries of ERISA Plans that are tax-qualified but not funded with trusts
- ◆ participants and beneficiaries of ERISA Plans that are not tax-qualified
- ◆ Obligations that are not subject to debtor-creditor protections.

**How May a Spousal Survivor Benefit Plan who receives a benefit from
a Spousal Survivor Benefit the Plan Seek
to Persuade a Court that Creditors May Not
Wrest Those payments from the Participant or Beneficiary**

The participant may observe that the spendthrift trust treatment is contrary to the treatment of

- ◆ federal pension benefits,
- ◆ New York government pension benefits, and
- ◆ the treatment of private pension benefits under N.Y. C. P. L. R. § 5205.

Clients may then rely upon the Cardozo analysis of the purpose of ERISA, which is even more clearly the protection of plan participants and beneficiaries. This analysis has been repeatedly applied by the Supreme Court in post-*Guidry* decisions without citing Cardozo, although in a widely cited footnote the Supreme Court expressed agnosticism about the extent to which ERISA protects distributed benefits from ERISA Spousal Survivor Benefit Plans. *Kennedy v. Plan Adm'r of the Du Pont Sav. and Inv. Plan*, 555 U.S. 285, n.10 at 300 (2009).

**The Post-Guidry Supreme Court Decisions Suggest that Creditors May Not
Wrest benefit payments received by a Spousal Survivor Benefit Plan
participant or beneficiary from the Plan**

Boggs v. Boggs, 520 U.S. 833 (1997) (holding that ERISA prevents Louisiana state community property law from being used to wrest a distributed benefit from a designated beneficiary). The Court therein stated:

The axis around which ERISA's protections revolve is [sic] the concepts of participant and beneficiary. . . . It does not matter that respondents have sought to enforce their [benefit] rights only after the retirement benefits have been distributed since their asserted rights are based on the theory that they had an interest in the undistributed pension plan benefits. Their state-law claims are pre-empted. The judgment of the Fifth Circuit is Reversed. Id. at 854

Observation:

This is the Cardozo approach in which the Court asks what is the statutory purpose of the ERISA entitlement provision.

**The Post-Guidry Supreme Court Decisions Suggest that Creditors May Not
Wrest benefit payments received by a Spousal Survivor Benefit Plan
participant or beneficiary from the Plan**

Egelhoff v. Egelhoff, 532 U.S. 141 (2001) (holding that ERISA prevents Washington state revocation upon divorce statutes from being used to wrest benefit from a designated beneficiary). The Court therein referred the “core ERISA concern” of paying benefits in accord with the plan documents. *Id.* at 147.

Observation:

This is again the Cardozo approach in which the Court asks what is the statutory purpose of the ERISA fiduciary responsibility provision, although the beneficiary was relying on the benefit entitlement provision to obtain her benefits.

The Most Recent Post-Guidry Supreme Court Decision Suggest that Creditors May Not Wrest benefit payments received by a Spousal Survivor Benefit Plan participant or beneficiary from the Plan

The Court in *Hillman v. Maretta*, 569 U.S. ___, 133 S.Ct. 1943, 2013 U.S. LEXIS 4167 (June 3, 2013) asked why there was a federal requirement that FEGLIA (federal employee insurance) death benefits be paid to the employee's duly designated beneficiary.

The Court concluded that the purpose was to assure that the duly designated beneficiary would obtain and keep the proceeds rather than merely to "advance administrative convenience by establishing a clear rule to dictate where the Government should direct insurance proceeds."

Thus, the Court found that FEGLIA preempted a state revocation upon a divorce statute that permitted the FEGLIA benefits to be wrested from the beneficiary.

A fortiori because the primary purpose of ERISA is to protect ERISA plan participants and beneficiaries, benefits they receive from an ERISA plan continue to receive ERISA protection.

Observation:

The Court fully embraced the Cardozo approach which is based on an analysis of the statutory purpose of the federal benefit entitlement provision. The Court, however, did not cite Cardozo.

EQUITABLE EXCEPTIONS TO ERISA DEBTOR PROTECTIONS

- ◆ Statutory Family Support Obligations Override Debtor Protections - ERISA 206(d)(3).
- ◆ Domestic Relations Law Overrides Debtor Protections -ERISA 206(d)(3).
- ◆ Fraudulent Conveyance Law **Does Not** Override Debtor Protections
- ◆ Criminal Law Fines and Restitution Override Debtor Protections - ERISA 514(b)(4) and 18 U.S.C. § 3613 & 18 U.S.C. §§ 3663A-3664.
- ◆ Internal Revenue Code Overrides Debtor Protections - Code §§ 6331-6334.

IV. Bankruptcy

Fundamental Bankruptcy Principles

The debtor's bankruptcy estate generally includes all the legal or equitable interests of the debtor in property as of the commencement of the case other than those items excluded.

There are three kinds of property of a debtor seeking bankruptcy protection, *i.e.*, the discharge and/or restructuring of outstanding debts:

- ◆ Property excluded from the bankruptcy estate is generally disregarded in the bankruptcy.
- ◆ Exempt property is part of the bankrupt estate but does not generally have to be used to pay debts. A debtor may choose whether to use the federal or state bankruptcy exemptions if the relevant state, like New York, permits a choice.
- ◆ Non-exempt property generally has to be used to pay debts.

Fundamental Bankruptcy Principles

Individual debtors generally may file under either Chapter 7 or Chapter 13 of the Bankruptcy Code:

- ◆ In a Chapter 7 bankruptcy the debtor's non-exempt assets, if there are any that are not worthless, are used by a bankruptcy trustee to pay the debts that are dischargeable in such a bankruptcy. There is no payment plan.
- ◆ In a Chapter 13 bankruptcy, there is no trustee, but the debtor must enter into a good faith payment plan. Under such a plan the debtor may use the debtor's projected disposable income to pay off some of the debtor's non-dischargeable debt, reinstate a home mortgage or car loan, and may retain some of the exempt property.

Eligibility for Different Bankruptcy Chapters

A debtor may only use Chapter 7 if

(1) the debtor's "current monthly income" for the six months period ending on the last day of the month prior to the filing is below the median income of a family the same size as the debtor's family;

and if not, if

(2) the debtor's projected "disposable income," which uses the "current monthly income" as a starting point, is below a specified level.

Income Eligibility for Chapter 7 Filing

11 U.S.C. § 101. Definitions

The term "current monthly income"– means the average monthly income from all sources that the debtor receives (or in a joint case the debtor and the debtor's spouse receive) without regard to whether such income is taxable income, derived during the 6-month measuring period but excludes benefits received under the Social Security Act.

Observation:

The current monthly income includes all retirement, annuity and life insurance income other than social security benefits.

Good Faith Requirement for Chapter 13 Filing

11 U.S.C. § 1325. Confirmation of [Chapter 13] plan

(a) Except as provided in subsection (b), the court shall confirm a plan for payments from the debtor's disposable income if--

(3) the plan has been proposed in good faith and not by any means forbidden by law; . . .

Observation:

The good faith requirement gives the bankruptcy court considerable discretion and may lead to the inclusion of social security payments in the payment plan.

Retirement, Annuity, and Life Insurance Benefit Bankruptcy Exclusions

11 U.S.C. § 541. Property of the [bankruptcy] estate.

(c) (1) Except as provided in paragraph (2) of this subsection, an interest of the debtor in property becomes property of the [bankruptcy] estate . . .

(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.

Observation:

The relevant restriction on a transfer is one that prevents a debtor from enforcing a claim against the property interest.

1. Bankruptcy Exclusion for Spendthrift Trust Benefits

- ◆ A debtor's beneficial interests in a spendthrift trust, *i.e.*, if the interests may not be assigned, is excluded from the debtor's bankruptcy estate, if the trust is not self-settled in New York.
- ◆ Thus, life insurance policies and non-qualified annuity policies, which are assets of a spendthrift trust, would be excluded from the debtor's bankruptcy estate if the trust is not self-settled.
- ◆ If a spendthrift trust is named as the beneficiary of a retirement plan or IRA, the beneficiary could exclude the interest from his bankruptcy estate, if any, because the interest would not have been self-settled.

2. Bankruptcy Exclusion for ERISA Plan Benefits

Patterson v. Shumate, 504 U.S. 753 (1992) (holding that because the alienation prohibition for Spousal Survivor Benefit Plans is enforceable under applicable non-bankruptcy law, the benefits from a trusteed Spousal Survivor Benefit Plans are excluded from a bankruptcy estate).

Issues:

- ◆ If a creditor may not wrest a benefit distributed from a Spousal Survivor Benefit Plan to a participant or beneficiary as a result of the trust's alienation prohibition, is the distributed benefit excluded from such a debtor's bankruptcy estate?
- ◆ If a creditor may not compel an ERISA plan under the terms of the plan to pay the benefit to the creditor, are the undistributed benefits excluded from the debtor's bankruptcy estate, if the plan is not funded with a trust, but with an annuity contract?

3. Bankruptcy Exclusion for New York Government Plan Benefits

New York State and local pension plans are funded with trusts that customarily prohibit the assignment of benefits as described above. Thus, they should be excluded under the same analysis as benefits in Spousal Survivor Benefit Plans.

Issues:

- ◆ If a creditor may not wrest a benefit distributed from a government to a participant or beneficiary as a result of the trust's assignment prohibition, is the distributed benefit excluded from such a debtor's bankruptcy estate?
- ◆ Government plans are often funded with annuity contracts, such as 403(b) plans. May such plans be considered trustee plans, and, if not, are they eligible for the bankruptcy exclusion?

4. Bankruptcy Exclusion for Benefits from IRAs or Tax-Qualified Pension Plans Funded with Trusts

There is a division of authority about whether a debtor's interest in IRAs and pension plans that are protected from creditor claims under state laws, rather than under the trust terms, such as N.Y. C.P.L.R. § 5205 are thereby excluded from the debtor's bankruptcy estate pursuant to 11 U.S.C. § 541(c)(2).

Cf. Orr v. Yuhas (In re Orr), 104 F.3d 612 (3rd Cir. 1997) Cert. Den'd. 1997 U.S. LEXIS 3890 (June 23, 1997) (holding in an opinion written by future Supreme Court Justice Samuel Alito that there is an exclusion);

and

Lowenschuss v. Selnick (In re Lowenschuss), 171 F.3d 673 (9th Cir. 1999) Cert. Den'd. 1999 U.S. LEXIS 5886 (October 4, 1999) (holding that there is no exclusion).

5. Bankruptcy Exclusion for Social Security Benefits

Social security benefits are not interests in a trust.

Thus, a debtor may not exclude social security benefits from his or her bankruptcy estate on the basis of being interests in a spendthrift trust.

Rather they are excluded on the basis of 42 U.S.C. §§ 407(a) and (b).

Those sections prohibit the operation of any bankruptcy or insolvency law on social security benefits unless the bankruptcy law explicitly overrides such prohibition.

There is no such bankruptcy override.

6. Bankruptcy Exclusion for Federal Pension Benefits

Federal pension plans, are not funded with trusts, which is why federal debts may be offset against federal payments of such benefits.

Thus, they may not be subject to the spendthrift trust exclusion.

However, the terms of most federal retirement plans prohibit the assignment of benefits “except as otherwise may be provided by Federal laws”

Courts have accepted the idea of an exclusion based on this approach.

Issue:

If a creditor may not obtain a FEGLIA (federal employee insurance) benefit from the federal government, is the undistributed benefit excluded from the debtor’s bankrupt estate under similar reasoning?

**Eligibility of Retirement, Life Insurance and Annuity Benefits
for Federal Bankruptcy Exemptions Associated with State Exemption Election**

11 U.S.C. § 522. Exemptions.

- (b)(3) [Federal Exemptions Added to State Exemptions] Property listed in this paragraph is . . .
- (A) . . . any property that is exempt under Federal law [such as social security or federal pension benefits], other than subsection (d) of this section, . . .
- (C) **retirement funds to the extent that those** funds are in a fund or account that is exempt from taxation under section 401[?], 403[?], 408, 408A, 414[?], 457[?], or 501(a) of the Internal Revenue Code of 1986 [2005]

Observations:

- ◆ The added federal exemptions presuppose that social security and federal benefits are part of the bankruptcy estate.
- ◆ The above retirement benefit exemption is limited to undistributed benefits from tax-qualified plans.

Eligibility of Retirement, Life Insurance and Annuity Benefits for Federal Bankruptcy Exemptions Associated with Federal Exemption Election

11 U.S.C. § 522 (d) (11) The debtor's right to receive, or property that is traceable to—

(C) a payment under a life insurance contract that insured the life of an individual of whom the debtor was a dependent on the date of such individual's death, to the extent reasonably necessary for the support of the debtor and any dependent of the debtor;

(12) Retirement funds to the extent that those funds are in a fund or account that is exempt from taxation under section 401[?], 403[?], 408, 408A, 414[?], 457[?], or 501(a) of the Internal Revenue Code of 1986 [26 U.S.C. § 401, 403, 408, 408A, 414, 457, or 501(a)].

Observations:

- ◆ The federal exemptions protect life insurance proceeds both before and after their distribution but only to the extent they meet a reasonable needs requirement.
- ◆ In contrast, the retirement benefit exemption, which is identical to the one in the added federal exemption, is limited to undistributed benefits from tax-qualified plans.

Eligibility of Retirement, Life Insurance and Annuity Benefits for Federal Bankruptcy Exemptions Associated with Federal Exemption Election

11 U.S.C. § 522 (d)(10) The debtor's right to receive--

(A) a social security benefit, unemployment compensation, or a local public assistance benefit; . . .

(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 reasonably necessary for the support of the debtor and any dependent of the debtor, . . .

. . .

Observations:

- ◆ The federal exemptions do not seem to protect distributed social security benefits or retirement benefits.
- ◆ Undistributed retirement benefits are not protected if available simply because of termination of employment but beneficiary payments are protected.
- ◆ Undistributed retirement benefits are only protected if they are reasonably necessary, in which case they would have to be distributed and thus not protected. *Cf. In re Donaghy*, 11 B.R. 677 (Bankr. S.D. N. Y. 1981) (distributed benefits protected) and *In re Cesare*, 170 B.R. 37 (Bankr. D. Conn. 1994) (distributed benefits are not protected).

A recent Supreme Court Bankruptcy Decision

In *Clark v. Rameker*, 573 U. S. ____ (2014)(slip opinion No. 13–299, June 12, 2014), the Supreme Court held that IRA beneficiaries are not entitled to a bankruptcy exemption for a debtor because the court declared that the plan beneficiary's plan benefits are not payable because of the beneficiary's retirement. However, the same is true of the IRA creator's benefits.

Issues:

May a beneficiary of a tax-qualified plan that is not an ERISA plan, such as an owner-employee plan, use the bankruptcy exemption?

May a beneficiary who is a surviving spouse use the bankruptcy exemption? If so, does the survivor need to do something to qualify for the exemption?

What effect does the decision have on a person electing to use the New York State exemptions?

Bankruptcy Treatment of Retirement, Life Insurance and Annuity Benefits Under New York State Bankruptcy Exemptions

N.Y. DEBT & CRED. § 282. Permissible [Estate] exemptions in bankruptcy.

The New York State bankruptcy exemptions include the N.Y. C. P. L. R. § 5205 exemptions and the life insurance and annuity exemptions under non-bankruptcy law.

Thus, debtors may apply the NYS creditor protections for retirement, annuity, and life insurance benefits in bankruptcy.

Bankruptcy Treatment of Retirement, Life Insurance and Annuity Benefits Under New York State Bankruptcy Exemptions

N.Y. DEBT & CRED. § 282. 2 (iii) Permissible [Estate] exemptions in bankruptcy (iii) the following property: . . .

The New York State bankruptcy exemptions include a retirement plan benefit exemption similar to the federal exemptions with two major differences:

- ◆ The exemption applies to the debtor's right to receive or the debtor's interest retirement plan benefit payment
- ◆ retirement plan benefit payments need not meet a reasonable needs test

Observation:

Unlike the N.Y. C. P. L. R. § 5205 protections for retirement plan benefits this does not protect all plan payments. Payments because of the termination of employment, *i.e.*, retirement are not covered. Beneficiary payments are again covered.

Conclusions:

There is a consensus that

- ◆ retirement benefits should be protected against the claims of creditors except when equity requires a different result.
- ◆ life insurance and annuity benefits creditor protections generally curb the debtors of the creator of such benefits, but usually not the creditors of the beneficiaries.

There are five basic equitable exceptions, although the extent is often unclear:

- ◆ statutory family support obligations
- ◆ domestic relations law obligations
- ◆ obligations that may not be avoided with fraudulent transfers
- ◆ criminal law obligations
- ◆ non-criminal government obligations, particularly tax liabilities.

The major federalism question is the extent to which federally governed retirement, annuity, and life insurance benefits are subject to the claims of state-law creditors before and after their distribution by the federally governed plans. This is the case within and without bankruptcy.