UNITED STATES BANKRUPTCY COURT
DISTRICT OF SOUTH DAKOTA
Central Division

In re:	)	Bankr. No. 00-30094
	)	
JOHN DAVID MCGRUDER	)	Chapter 7
Soc. Sec. No. 503-92-9638	)	
	)	
and	)	
	)	DECISION RE: OBJECTION TO
MARLENE JOYCE MCGRUDER	)	CLAIMED EXEMPTIONS IN
Soc. Sec. No. 503-72-1373	)	CERTAIN ANNUITY PAYMENTS
	)	
Debtors.	)	

The matter before the Court is the objection to Debtors' claimed exemption of certain annuity payments filed by Trustee John S. Lovald and Debtors' response. This is a core proceeding under 28 U.S.C. § 157(b)(2). This Decision and subsequent Order shall constitute the Court's findings and conclusions under Fed.Rs.Bankr.P. 7052 and 9014. As set forth below, the Court concludes that the objection must be sustained.

I.

John D. and Marlene J. McGruder ("Debtors") filed a Chapter 7 petition on October 16, 2000. They claimed exempt under S.D.C.L. §§ 43-45-4 and 58-12-4 and 11 U.S.C. § 541(c) an asset described as "Life Ins. Company of Virginia - Personal Injury Settlement - present value of payments over 12 years." They valued the asset at $11,000 and claimed it all exempt. In their Statement of Financial Affairs, Debtors also disclosed that in the past two years they had received $10,000 from "Life Ins. Co. of Virginia - Annuity."

The case trustee, John S. Lovald, timely filed an objection to

37

this claimed exemption. He argued that Debtor John McGruder's full interest in the personal injury settlement could not be declared exempt as an annuity. He stated:

> If the settlement is treated as an annuity, subject to the South Dakota annuity exemption provided in SDCL 58-12-8, the following would be applicable:
>
> From the installment of $20,000.00 due on November 1, 2003, $15,000.00 would be exempt and $5,000.00 would be non-exempt. Of the payment due on November 1, 2008, $15,000.00 would be exempt and $20,000.00 would be non-exempt. Of the payment due on November 2, 2013, $15,000.00 would be exempt and $35,000 would be non-exempt.
>
> Further, Trustee objects to Debtors' contention that these settlement proceeds would not be considered property of the Estate.

Debtors timely responded to Trustee Lovald's objection. They again argued that their valuation of the annuity resulted in a value that falls within the statutory allowance.

Following some discovery, the parties submitted the matter to the Court on stipulated issues, stipulated facts, and briefs. The parties also stipulated to the admission of some exhibits: the RELEASE AND SETTLEMENT AGREEMENT and the single premium deferred annuity policy under which Debtor John McGruder is the annuitant; an assignment of the annuity; and a "net present value" calculation by Debtors' Certified Public Account. As to the latter, Trustee Lovald stipulated to its foundation, but did not agree to be bound by the CPA's analysis.

In their stipulated facts, the parties disclosed that the

subject annuity provided for five payments. In 1993, $10,000 was paid out. Another $10,000 was paid in 1998. The remaining payments scheduled to be received are $20,000 in 2003, $35,000 in 2008, and $50,000 in 2013.

The parties agreed there were two issues: whether the annuity was excluded from property of the bankruptcy estate under § 541(c)(2) and, if not excluded, the extent the payments may be exempted under state law. Within the § 541(c)(2) discussion, Debtors also addressed whether creation of the annuity was an attempt to defraud creditors. Trustee Lovald has not raised that issue, so it is not considered further herein.

In an exhibit-letter to Debtors, Debtors' Certified Public Accountant stated:

> I calculated the net present value of the [three remaining payments] using the United States Department of Treasury Applicable Federal Rate for calculation of an annuity effective January 1, 2001. This rate is 6.8% and the net present value of the payment stream ... is $59,016.67.
>
> If a monthly payment stream is desired until date of death, life expectancy must be considered. I used the Internal Revenue Service's mortality table and found the life expectancy of a male age 39 is 74 and a woman 36 to be 78. The monthly payment stream must then reach to the latest date of death. In this case, 42 years from the first monthly payment. I calculated the monthly payment amount by using the net present value of $59,016.67 invested at 6.8% to be paid out equally in 504 (42 years times 12 months) payments. The monthly payment is $355.01 for 503 months with a final payment of $341.27.

In their brief, Debtors argued that the annuity is not

property of the estate under the exclusion provided by 11 U.S.C. § 541(c)(2) because the annuity contained anti-alienation restrictions that placed the annuity outside the reach of creditors under South Dakota law. As to the extent of an exemption under state law, Debtors stated:

> The exception to total exemption under SDCL 58-12-6 of the benefits from an annuity as set forth in SDCL 58-12-8 do not apply to [Debtor John] McGruder's annuity. SDCL 58-12-8 applies only to annuities where benefits are presently due and payable. A limit of $250.00 per month is imposed on benefits presently due and payable. There is no limit placed on benefits that are not yet due and payable. SDCL 58-12-8 does not apply to benefits which will become payable at some point in the future. State law only allows an annuity with future payments to be challenged based on SDCL 58-12-7.

In his brief, Trustee Lovald conceded that Debtor John McGruder's annuity falls under the provisions of S.D.C.L. ch. 58-12. Contrary to Debtors, however, Trustee Lovald argued that the entire stream of payments is subject to the statute and that the state code provisions limit a debtor to an exemption of benefits at $250 per month. He also argued that Debtors are limited to $250 per month, not $250 per month for each of them. Based on his application of the statute and the payment schedule for post-petition payments, Trustee Lovald calculated that the bankruptcy estate should retain $83.33 for the 60 month period between November 1, 2003 and November 1, 2008; $333.33 per month for the 60 month period between November 1, 2008 and November 1, 2013; and

$583.33 for the period November 1, 2013 forward. He stated there is nothing in the state exemption statutes that would indicate that the value of the annuity should be reduced to present value.

Alternatively, Trustee Lovald noted that even under Debtors' calculation method -- that the annuity is worth $355.01 per month over Debtor John McGruder's projected life -- the bankruptcy estate is entitled to retain $105 per month for the life of the annuity.

In his reply brief, Trustee Lovald reiterated that state law protects Debtor John McGruder's annuity from creditors only to the extent of $250 per month, thus leaving the balance as part of the bankruptcy estate. He also argued that state law clearly intends a simple mathematical calculation to arrive at the protected and non protected portion of the annuity: divide the total amount of the annuity by the number of months in the contract.

II.

Property of a bankruptcy estate includes "all legal or equitable interests of the debtor in property as of the commencement of the case." 11 U.S.C. § 541(a)(1). The scope of the statute is very broad. *Whetzal v. Alderson*, 32 F.3d 1302, 1303 (8th Cir. 1994).

Excluded from the bankruptcy estate is a debtor's beneficial interest in a trust to the extent that nonbankruptcy law restricts the transfer of that interest. 11 U.S.C. § 541(c)(2). *Whetzal*, 32 F.3d at 1303 (citing *Patterson v. Shumate*, 504 U.S. 753, 760-62

(1992)). "Applicable nonbankruptcy law" includes both state spendthrift trust laws as well as the Employee Retirement Income Security Act (ERISA) provisions under federal law. *Shumate*, 504 U.S. at 758-59; *In re Green*, 967 F.2d 1216 (8th Cir. 1992). The debtor bears the burden of showing that certain property is excluded from the bankruptcy estate under § 541(c)(2). *In re Gilroy*, 235 B.R. 512, 515 (Bankr. D. Mass. 1999).

From property of the bankruptcy estate, a debtor may also remove or "exempt" certain property. 11 U.S.C. § 522(b). This exempt property is not liquidated by the case trustee to pay creditors. 11 U.S.C. §§ 522(b) and 522(c). In the District of South Dakota, the bankruptcy court looks to state law to define what property the debtor may declare exempt. 11 U.S.C. 522(b)(2)(A) and S.D.C.L. § 43-45-13.

A debtor's entitlement to an exemption is determined on the day he files his bankruptcy petition. *See Armstrong v. Peterson (In re Peterson)*, 897 F.2d 935 (8th Cir. 1990)(debtor's post-petition death did not result in reversion of exempt property to estate); *Armstrong v. Harris (In re Harris)*, 886 F.2d 1011 (8th Cir. 1989)(cites therein); and *In re Myers*, 17 B.R. 339, 340 (Bankr. D.S.D. 1982). The value of exempt property, unless an exemption in the proceeds of a homestead in some states, also is determined on the date of the petition. *In re Sherbahn*, 170 B.R.

137, 140 (Bankr. N.D. Ind. 1994)(amount of exemption is controlled by value the debtor ascribes to it in the schedules); *In re Dore*, 124 B.R. 94, 96 (Bankr. S.D. Cal. 1991)(value of exempt property is determined at the time of filing).

As acknowledged by Trustee Lovald, South Dakota law protects from creditors a certain portion of a debtor's beneficial interest in an annuity. Chapter 58-12 governs. Section 58-12-5 defines an annuity under Chapter 58-12 as

> any obligation to pay certain sums at stated times, during life or lives, or for a specified term or terms, issued for a valuable consideration, regardless of whether or not such sums are payable to one or more persons, jointly or otherwise but does not include payments under life insurance contracts at stated times during life or lives, or for a specified term or terms.

The annuity protection statute of Chapter 58-12 provides:

> The benefits, rights, privileges and options which under any annuity contract heretofore or hereafter issued are due or prospectively due the annuitant, shall not be subject to execution nor shall the annuitant be compelled to exercise any such rights, powers, or options, nor shall creditors be allowed to interfere with or terminate the contract, except as provided by §§ 58-12-7 to 58-12-9, inclusive.

S.D.C.L. § 58-12-6. This statute incorporates important limitations set forth in §§ 58-12-7, 58-12-8, and 58-12-9.

Section 58-12-7 precludes protection of the annuity from creditors if the annuity was purchased with the intent to defraud creditors. That issue has not been raised in this case.

Section 58-12-8 limits the amount of an annuity that may be

protected from creditors. It provides:

> The total exemption under § 58-12-6 of benefits presently due and payable to any annuitant periodically or at stated times under all annuity contracts under which he is an annuitant, shall not at any time exceed two hundred and fifty dollars per month for the length of time represented by such installments, and such periodic payments in excess of two hundred and fifty dollars per month shall be subject to levy in the manner provided by law and the rules of court.

Section 58-12-9 implements § 58-12-8. It provides that a court may order the debtor to pay to judgment creditors any portion of an annuity payment that is not protected by § 57-12-8. However, before doing so, § 58-12-9 also directs the court to give "due regard for the reasonable requirements of the judgment debtor and his [dependents], as well as any payments required to be made by the annuitant to other creditors under prior court orders."

The protection is not limited to the annuitant. Section 58-12-10 states that an assignee's or beneficiary's interest in periodic payments under an annuity contract is protected in the same manner as the annuitant's interest if the annuity so provides.

South Dakota law also restricts a creditor's ability to access a debtor' beneficial interest in express trusts. S.D.C.L. ch. 55-1. Specifically, § 55-7-17 provides that a spendthrift trust declaration in a trust "is sufficient to restrain the voluntary or involuntary alienation of the interest by the beneficiary to the maximum extent permitted by law." Section 55-1-19 further provides that "[i]f the trustor is also a beneficiary of the trust," then

any spendthrift trust provision "does not prevent the trustor's creditors from satisfying claims from the trustor's interest in the trust estate."

III.

A. DEBTORS' ANNUITY IS NOT EXCLUDED FROM THE BANKRUPTCY ESTATE.

As noted above, South Dakota law protects from creditors a debtor's beneficial interest in a spendthrift trust, as well as in an annuity. If the debtor is not the settlor of the spendthrift trust, S.D.C.L. § 55-1-19, his entire interest is protected "to the maximum extent permitted by law."[1] If the debtor's beneficial interest is in an annuity, the debtor may protect his interest in the annuity up to a value of $250 per month for the term of the annuity. S.D.C.L. § 58-12-8. Since these protections are not identical, it is important to ascertain whether Debtors' interest is in a trust or an annuity. The parties assumed it was an annuity. Based upon the definition of an annuity at S.D.C.L. § 58-12-5 and the present record, there is nothing that leads the Court to alter that assumption.

Whether Debtor's annuity is *excluded* from the estate under § 541(c)(2) or *exempted* from the estate under state law will yield the same result, but the issue is addressed for the sake of a clearer record. Resolution of the issue, interestingly enough,

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[1] This phrase is not further defined within S.D.C.L. ch. 55-1.

focuses on a sometimes overlooked aspect of § 541(c)(2).

Section § 541(c)(2) expressly states that the exclusion from property of the bankruptcy estate applies only to a debtor's beneficial interest in a "trust." Section 541 does not define "trust." Moreover, the focus in *Shumate* was not on the "trust" requirement, but on whether the phrase "nonbankruptcy law" in § 541(c)(2) encompasses both state spendthrift trust laws and federal ERISA laws; the Court held that the phrase incorporated both. *Shumate*, 504 U.S. at 759. Since *Shumate*, however, several courts have discussed what qualifies as a "trust" under § 541(c)(2).

Recently, in *In re Barnes*, ___ B.R. ___, 2001 WL 815360, slip op. (Bankr. E.D. Mich. 2001), the court tackled the issue when it had to decide whether two different types of annuities were excluded as trusts under § 541(c)(2). The court reviewed the holdings of other courts and noted their varying conclusions. Some courts had found that the *Shumate* decision had effectively removed the trust requirement from § 541(c)(2), at least as to ERISA qualified plans. *Barnes*, slip op. at 4-7 (cites therein). Other courts concluded that the trust requirement perseveres, at least in a non-ERISA context. *Barnes,* slip op. at 7-9 (cites therein). Yet in another line of cases, the courts said that a "trust" under § 541(c)(2) broadly encompasses employer-created and employer-

controlled retirements plans that are analogous to a spendthrift trust. *Id.* at 9-11 (cites therein). *See Whetzal*, 32 F.3d at 1303-05 (the debtor's retirement funds in the federal Civil Service Retirement System were excluded from the estate under § 541(c)(2) in the same manner as ERISA funds).

However this annuity may be characterized under the above-cited case law, it is not a trust. Debtors' annuity is not ERISA qualified, nor an employer-created and controlled plan. *Compare In re Fink,* 153 B.R. 883, 885 (Bankr. D. Neb. 1993)(the debtor's annuity from a teachers' retirement fund was excluded from the estate under § 541(c)(2) because, *inter alia,* the contract was administered by a fiduciary); *Skiba v. Kelvington (In re Kelvington)*, 146 B.R. 358, 359-60 (Bankr. W.D. Pa. 1992)(the debtor's annuity from a teachers' retirement fund qualified under ERISA and was excluded under § 541(c)(2)). The annuity lacks the traditional indicia of a trust: there was no intention to create a trust; there is no identifiable trust *res;* and the RELEASE AND SETTLEMENT AGREEMENT and the annuity are both contracts that created for Debtor John McGruder a present right to receive future payments. *In re Walters*, 172 B.R. 283, 286 (Bankr. W.D. Mo. 1994); *In re Simon*, 170 B.R. 999, 1001-02 (Bankr. S.D. Ill. 1994); *see Pineo v. Fulton (In re Fulton)*, 240 B.R. 854 (Bankr. W.D. Pa. 1999)(retirement annuity not excluded under § 541(c)(2) as a

trust); *In re Myers*, 2000 B.R. 155, 157-58 (Bankr. N.D. Ohio 1996)(structured settlement lacked indicia of a trust); *In re Wiley*, 184 B.R. 759, 764-65 (Bankr. N.D. Iowa 1995); *contra In re Schuster*, 256 B.R. 701, 703 (Bankr. D.N.J. 2000)(annuity purchased by the debtor from an insurance company was a trust under § 541(c)(2)). Further, the annuity, created with funds Debtor John McGruder received from a personal injury settlement, was essentially self-settled and thus could not qualify as a protected spendthrift trust under state law. S.D.C.L. § 55-1-19; *see Vucurevich v. Stragalas (In re Stragalas)*, 208 B.R. 693, 695 (Bankr. D. Az. 1997); *In re Robbins*, 211 B.R. 2, 3-4 (Bankr. D. Conn. 1997)(cites therein); *Myers*, 200 B.R. at 157-58; *Simon*, 170 B.R. at 1002. Consequently, since this annuity does not qualify as a trust, Debtors' interest in the annuity may not be excluded from the bankruptcy estate under 11 U.S.C. § 541(c)(2).

B. DEBTORS MAY EXEMPT A PORTION OF THE ANNUITY.

Though Debtors' interest in the annuity is not excludable under § 541(c)(2) of the Bankruptcy Code, a portion of it is still exemptible under § 522(b) of the Bankruptcy Code and ch. 58-12 of the state code. The tougher question is how much. There is little reported case law interpreting ch. 58-12. Fortunately, the statutes are fairly straightforward.

The subject annuity meets the definition supplied by

§ 58-12-5. Debtor Marlene McGruder also qualifies as a protected beneficiary under § 58-12-10 since her rights to payments under the RELEASE AND SETTLEMENT and the annuity contract do not appear to be transferable or subject to commutation.

The final question is how much of the annuity may be declared exempt. Section 58-12-8 clearly recognizes Debtors' present right to receive future payments and provides that the "total" of these periodic or at-stated-times payments "shall not at any time exceed payment at the rate of two hundred and fifty dollars per month for the length of time represented by such installments[.]" As indicated on the Application for Structured Annuity, which is incorporated in the annuity contract, the payment schedule sets forth several dates certain; the payments are not for a stated life. On October 16, 2000, the date on which Debtors declared their exemption, Debtors had a present right to three future payments, which became property of the estate: $20,000 on November 1, 2003; $35,000 on November 1, 2008; and $50,000 on November 1, 2013. Thus, the total of the payments that are property of the estate are $105,000. There is no merit to Debtors' argument that no installments were due and payable on the petition date.

The "length of time represented by such installments" is from the date the exemption was made, October 16, 2000, to November 2,

2013, when the last payment is made, for a total of 157 months. Under the maximum exemption allowance of $250 per month established by § 58-12-8, Debtors may thus exempt $39,250. The balance of $65,750 remains estate property.

Debtors have urged the Court to reduce the total to be paid to its present value and also to calculate the allowed monthly payments over Debtors' life span. A present value reduction, however, is not contemplated by § 58-12-8. Further, the length of time for payments under the annuity is for the stated dates, and is clearly not based on the life of either Debtor.

Trustee Lovald's calculation of the maximum allowance under § 58-12-8 was based on each of the remaining payments being spread over a 60-month period, the length of time between the installments. However, the statute refers to a "total exemption," as well as to the "the length of time represented by such installment*s* [plural]." Accordingly, the Court concludes that it must total both the payments due and payable on the petition date and the time periods over which those installments are paid, beginning with the date of the petition, to calculate a hypothetical monthly payment from which the exempt $250 portion is subtracted. This method provides more uniformity in the application of § 58-12-8 looking from the petition date forward, regardless of when the post-petition payments are scheduled to be

made, the amount of each installment, or the length of time between installments.

One final calculation may yet be made regarding the total amount of the annuity payments that Debtors may declare exempt. Section 58-12-9 contemplates that before the Court orders the excess annuity to be applied to debts, it must give "due regard for the reasonable requirements of [Debtors' and their dependents], as well as any payments required to be made by [Debtors] to other creditors under prior court orders." If Debtors believe that a larger monthly exemption is needed to meet their and their dependents' necessary living expenses, they may within ten days request that an evidentiary hearing be scheduled. Otherwise, Trustee Lovald may supply an appropriate order sustaining his objection.

Dated this 14 day of August, 2001.

BY THE COURT:

Irvin N. Hoyt
Bankruptcy Judge

I hereby certify that a copy of this document was mailed, hand delivered, or faxed this date to the parties on the attached service list.

AUG 14 2001

Charles L. Nail Jr., Clerk
U.S. Bankruptcy Court, District of South Dakota
By

ATTEST:
Charles L. Nail, Jr., Clerk
By: Deputy Clerk

UNITED STATES BANKRUPTCY COURT
SEAL

NOTICE OF ENTRY
Under F.R.Bankr.P. 9022(a)
Entered

AUG 14 2001

Charles L. Nail, Jr., Clerk
U.S. Bankruptcy Court
District of South Dakota

Case: 00-30094 Form id: 122 Ntc Date: 08/14/2001 Off: 3 Page : 1
Total notices mailed: 6

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Debtor	McGruder, Marlene Joyce 211 Lincoln Avenue, #674, Highmore, SD 57345
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Trustee	Lovald, John S. PO Box 66, Pierre, SD 57501
Aty	Gering, Bruce J. Office of the U.S. Trustee, #502, 230 South Phillips Avenue, Sioux Falls, SD 57104-6321
Aty	Sword, James G. PO Box 8250, Rapid City, SD 57709-8250