UNITED STATES BANKRUPTCY COURT
DISTRICT OF SOUTH DAKOTA
Central Division

In re:	)	Bankr. No. 97-30009
MARJORIE ALVINA SCHMIDT fka Marjorie A. Baus Soc. Sec. No. 504-58-6306	)	Chapter 7
Debtor.	)	
JOHN S. LOVALD, TRUSTEE	)	Adv. No. 97-3001
Plaintiff,	)	MEMORANDUM OF DECISION: COMPLAINT TO RECOVER ESTATE PROPERTY
-vs-	)	
MARJORIE ALVINA SCHMIDT	)	
Defendant.	)	

The matter before the Court is a complaint to recover estate property. This is a core proceeding under 28 U.S.C. § 157(b)(2). This Memorandum of Decision and subsequent Order and Declaratory Judgment shall constitute the Court's findings and conclusions under F.R.Bankr.P. 7052. As set forth below, the Court concludes that Debtor's four Individual Retirement Accounts with the Bank of Hoven are *not* excluded from the bankruptcy estate under 11 U.S.C. § 541(c)(2).

I.

Debtor filed a Chapter 7 petition on January 28, 1997. In her schedules, filed the same day, Debtor stated she had three Individual Retirement Accounts (IRAs) at the Bank of Hoven (Bank) with a total value of $31,559.64 (account nos. 13741, 12484, and 12363). She did not claim these accounts exempt.

15.

On February 27, 1997, Trustee John S. Lovald filed a complaint alleging Debtor had failed to turnover the IRA accounts at the Bank. By answer filed March 11, 1997, Debtor disclosed that she had a fourth IRA account at the Bank, no. 16017, that held $922.24. Debtor argued, however, that the four accounts were not part of the bankruptcy estate under 11 U.S.C. § 541.

A pre-trial conference was held April 1, 1997. The parties agreed to submit the matter on stipulated facts and briefs. In their stipulated facts, the parties acknowledged that the Bank is the custodian of the four IRA accounts and that each account is represented by a certificate of deposit. The total face value of the four certificates is $32,481.88. The certificate for account no. 12363 states that it is a "SEP-IRA ACCOUNT" and that the account matures on January 7, 1995. The certificate for account no. 12484 states that it is an "IRA ACCOUNT" and that the account matures on February 22, 1995. The certificate for account no. 13741 states that it is an "IRA ACCOUNT" and that the account matures on April 14, 1998. The certificate for account no. 16017 states that it is a " SEP/IRA ACCOUNT" and that the account matures on June 30, 1998.

Each certificate states that the funds are payable to the depositor upon surrender on or after the maturity date. Each certificate has an automatic renewal provision. Interest is to be paid semi-annually with the interest added back to the principal. For each, "[t]here is a substantial interest penalty required for early withdrawal." Each certificate also states that withdrawals

before maturity are subject to the Bank's consent. The two older certificates state, "If this time deposit account is in a properly established 'I.R.A.,' or 'Keogh' Plan, you may withdraw without penalty, all or part of the account upon disability or age 59 1/2." The two newer certificates state, "If this time deposit account is in a properly established 'I.R.A.', 'SEP' or 'Keogh' Plan, you may withdraw without penalty, all or part of the account upon disability or age 59 1/2." Each certificate states, "The above penalty will be effective until changed by Federal or State Bank Regulations or Statute." While a place was provided for Debtor to sign the "Penalty" portion of each certificate, none were signed. Finally, each certificate states, "This certificate, and any right hereunder, may not be transferred."

In his brief, Trustee Lovald argued that these four accounts are not excluded from the estate under any non bankruptcy law. He stated no state law existed when Debtor filed that would exclude the accounts. He further argued that these four accounts are not ERISA qualified and that there is nothing in the federal code that restricts the transfer of an IRA except that a plan trustee may not do so by way of set off pursuant to 26 U.S.C. § 408(a)(4). Finally, Trustee Lovald argued that the account certificates do not contain any spendthrift trust provisions that would result in the funds being excluded under the rationale of *Patterson v. Shumate*, 504 U.S. 753 (1992). In sum, the Trustee argued,

> In the absence of a nonbankruptcy transfer restriction, (which in this case is totally missing), there is nothing about these IRA accounts under current law, which would

> distinguish them in any manner from normal CD's, savings accounts, or the multitude of other assets which are subject to administration within the bankruptcy estate.

Debtor argued that § 408(a) of the Internal Revenue Code renders each IRA account a trust. Debtor says each account contains a restriction of transfer because each states, "This certificate, and any right hereunder, may not be transferred." Debtor further argues that her right to withdraw the money for her personal use, subject to a 10% tax penalty, is not sufficient to deprive her of the exclusion that § 541(c)(2) provides. Debtor cites to recent cases by the Courts of Appeals for the Third, Fifth, and Ninth Circuits and argued a similar result was reached in *Whetzal v. Alderson*, 32 F.3d 1302 (8th Cir. 1994).

II.

The issue presented is whether Debtor's four IRA accounts created under 26 U.S.C. § 408(a) are excluded from property of Debtor's bankruptcy estate under 11 U.S.C. § 541(c)(2).

Section 408(a) of the Internal Revenue Code, Title 26, defines an "individual retirement account" as a "trust created or organized in the United States for the exclusive benefit of an individual or his beneficiaries, but only if the written governing instrument creating the trust meets [certain requirements]." These requirements include a limit on the amount that a person may contribute annually to such an account, that the bank serves as the trustee and administers the trust consistent with § 408, that the funds are not invested in a life insurance contract, that the depositor's interest in the balance of the account is

nonforfeitable, that the assets are not improperly commingled, and that regulations proscribed by the Secretary of the Treasury are followed. An account that qualifies under § 408(a) receives favorable income tax treatment.

Under 11 U.S.C. § 541(c)(2), property is excluded from a bankruptcy estate if there is a "restriction on the transfer of a beneficial interest of the debtor in a trust that is enforceable under applicable nonbankruptcy law[.]" Either state law or nonbankruptcy federal law can supply the necessary enforceable restriction on transfer. *Patterson*, 112 S.Ct. at 2246-47; *Whetzal*, 32 F.3d at 1303-04.

Several courts have addressed the issue of whether an IRA is excluded from property of the estate pursuant to § 541(c)(2). All recent decisions that this Court found state that IRAs are not excluded from the estate unless state law provides the necessary enforcement on a restriction of transfer. In dicta, the Supreme Court in *Patterson* supported this conclusion and some Circuit Courts of Appeal have followed suit.

In *Patterson*, the Court distinguished between federal ERISA law and federal tax laws on IRAs and concluded that pension plans that qualify as IRAs "lack transfer restrictions enforceable under 'applicable nonbankruptcy law'" and thus "could not be excluded under § 541(c)(2)." *Patterson*, 112 S.Ct. at 2249. The Court also distinguished property that is excluded from a bankruptcy estate under § 541(c)(2) and property that may be declared exempt

under § 522(d)(10)(E), an exemption statute not applicable in this District. *Id.*

In *Orr v. Yuhas (In re Yuhas)*, 104 F.3d 612 (3rd Cir. 1997), the court stated § 541(c)(2) sets forth five requirements that an IRA must meet to be excluded from a bankruptcy estate: (1) the IRA must constitute a "trust" under § 541(c)(2); (2) the funds in the IRA must represent the debtor's "beneficial interest" in that trust; (3) the IRA must be qualified under § 408 of the Internal Revenue Code; (4) applicable state law must place a restriction on the transfer of the IRA funds; and (5) the state-law restriction must be enforceable under nonbankruptcy law. *Id.* at 614. The court concluded that state law, there a New Jersey statute, supplied the requisite restriction and so the debtor's IRA was not excluded from the bankruptcy estate. *Id.* at 614-15. The New Jersey statute exempted "qualifying" trusts from claims of creditors and the statute defined "qualifying" trusts to include IRA accounts created under 26 U.S.C. § 408. *Id.* at 613. The court in *Yuhas* did not find any federal nonbankruptcy law that would have excluded the IRA from the bankruptcy estate under § 541(c)(2).

In *Meehan v. Wallace (In re Meehan)*, 102 F.3d 1209 (11th Cir. 1997), the debtor had a § 408 qualified account. *Id.* at 1210. The court recognized that while the IRA document itself did not contain a transfer restriction, state law did, there a Georgia statute, because it protected the qualified funds from garnishment. *Id.* at

1212-13. Citing *Whetzal*, 32 F.3d at 1302-04, and *In re Conner*, 73 F.3d 258, 260 (9th Cir. 1996), the court further concluded that the debtor's ability to access the funds did not make the § 541(c)(2) exclusion inapplicable. As in *Yuhas*, the court in *Meehan* did not find any federal, non bankruptcy law that would exclude the IRAs from the bankruptcy estate. *See also In re Barshak*, 106 F.3d 501 (3rd Cir. 1997), and *Solomon v. Cosby (In re Solomon)*, 67 F.3d 1128 (4th Cir. 1995).

Several bankruptcy courts have also concluded that a fund qualified under § 408 does not contain any anti-alienation provision enforceable by federal non bankruptcy law and so the IRA remains property of the estate. *See In re Snyder*, 206 B.R. 347, 349 (Bankr. M.D. Pa. 1996)(citing, among others, *Velis v. Kardanis*, 949 F.2d 78, 82 (3rd Cir. 1991), *In re Van Nostrand*, 183 B.R. 82, 85 (Bankr. D.N.J. 1995), *Eisenberg v. Houck (In re Houck)*, 181 B.R. 187, 193-95 (Bankr. E.D. Pa. 1995), and *Bohm v. Brewer (In re Brewer)*, 154 B.R. 209, 212-13, (Bankr. W.D. Pa. 1993)).

III.

Debtor has not identified any state or nonbankruptcy federal law, which existed on the petition date, that enforces a restriction on the transfer of Debtor's interest in the four IRA accounts. Accordingly, these accounts were not excluded from the bankruptcy estate pursuant to § 541(c)(2). Standing alone, the sentence, "This certificate, and any right hereunder, may not be

transferred," does not provide the necessary transfer restriction because the transfer of the funds themselves is not restricted. The certificate represents only the terms of the deposit with the Bank.

Compare, for example, an ERISA-qualified plan, which must provide that the benefits under the plan may not be assigned or alienated pursuant to 29 U.S.C. 206(d)(1) and which is enforceable under 29 U.S.C. §§ 1132(a)(3) and (5). *Patterson*, 112 S.Ct. at 2247. Similarly, retirement benefits for federal employees have a restriction placed on them by 5 U.S.C. § 8346(a), which states the retirement funds are "not assignable, either in law or equity, . . . or subject to execution, levy, attachment, garnishment or other legal process[.]" *Whetzal*, 32 F.3d at 1302-04. And, for example, in *Yuhas*, 104 F.3d at 613, state law provided that property in an IRA under 26 U.S.C. § 408(d)and (e) "shall be exempt from all claims of creditors and shall be excluded from the estate in bankruptcy. . . ." Here, Debtor has not identified any anti-alienation or anti-assignment language under the IRA account agreements *that nonbankruptcy law enforces*. While recent state laws may provide such an enforceable restriction, *see* S.D.C.L. §§ 43-45-15 through 43-45-18 (effective July 1, 1997), those statutes did not exist on the petition date -- when Debtor's exemptions must be determined. *See Armstrong v. Peterson (In re Peterson)*, 897 F.2d 935, 938 (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, 1013 (8th Cir. 1989)(cites therein); *Martinson v. Michael (In re Michael)*, 185 B.R. 830, 837 (Bankr. D. Mont. 1995)(cites therein; court need not consider post petition occurrences in determining a debtor's right to a homestead exemption); *In re Johnson*, 184 B.R. 141, 145 (Bankr. D. Wyo. 1995); and *In re Myers*, 17 B.R. 339, 340 (Bankr. D.S.D. 1982).

Finally, the tax penalty for an early withdrawal is not a transfer restriction. *Brewer*, 154 B.R. at 212. A 'transfer' of property is defined as "every mode . . . of disposing of or parting with property or with an interest therein. . . ." 11 U.S.C. § 101(54). That Debtor may have to pay a tax penalty when funds are withdrawn from the IRAs does not constitute a restriction on the "mode of disposing" itself.

Trustee Lovald shall prepare a proposed order and declaratory judgment that states Debtor's four IRA accounts are property of the bankruptcy estate and that Debtor shall promptly turn over the funds therein to the Trustee.

Dated this 6 day of August, 1997.

BY THE COURT:

Irvin N. Hoyt
Chief Bankruptcy Judge

ATTEST:
Charles L. Nail, Jr., Clerk
By: Deputy Clerk
(SEAL)

UNITED STATES BANKRUPTCY COURT SEAL

CERTIFICATE OF SERVICE
I hereby certify that a copy of this document was mailed, hand delivered, or faxed this date to those creditors and other parties in interest identified on the attached service list.
Charles L. Nail, Jr., Clerk
U.S. Bankruptcy Court
District of South Dakota
By: AO
Date: 08-06-97

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Under F.R.Bankr.P. 9022(a)
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Case: 97-03001 Form id: 122 Ntc Date: 08/06/97 Off: 3 Page : 1
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