UNITED STATES BANKRUPTCY COURT
FOR THE SOUTHERN DISTRICT OF IOWA

In the Matter of	:	**Case No. 93-2401-CH**
	:	**Chapter 7**
JOHN L. HENSS,	:	
	:	
Debtor.	:	

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ORDER--OBJECTIONS TO CLAIMS OF EXEMPTION

On May 2, 1994, hearing was held on objections to claims of exemption filed by creditor G. Dean Garland (Garland) and the trustee, Anita L. Shodeen. Debtor, John L. Henss (Henss) was represented by his attorney Gary R. Hassel. Garland, was represented by his attorneys Robert B. Hansen and Fred Beaver. The Chapter 7 Trustee, Anita L. Shodeen, appeared pro se. Upon conclusion of the hearing, the court took this matter under advisement upon a briefing deadline. Briefs have been filed by the parties and the matter is now considered fully submitted.

This is a core proceeding pursuant to 28 U.S.C. § 157(b)(2)(B). The court, upon review of the briefs, pleadings, arguments, and evidence, now enters its findings of fact and conclusions of law pursuant to Fed.R.Bankr.P. 7052.

EVIDENTIARY OBJECTION

During the presentation of the two objections to exemption at the hearing, it was agreed by the court and the parties that it would be expedient to handle the issues simultaneously and for Debtor's case to be presented in conjunction with the main case in order to minimize the time involved. Therefore, when Garland and Trustee rested their cases, Debtor also determined that all information in need of presentation to the court had been made by direct evidence or in cross examination and rested without putting on a direct case in chief. Thereafter, Trustee offered Exhibit U as a rebuttal exhibit. Exhibit U is a copy of a federal court order in the case of Lynn Martin, Secretary of the United States Department of Labor v. Feilen, et al., Civil Action No. 4-88-CV-80103 (United States District Court, Southern District of Iowa).

At the hearing, Debtor agreed that there was no objection relative to foundation or authenticity of the exhibit. However, the court allowed Debtor time to file an objection on other grounds to Exhibit U. Debtor has filed an objection to Exhibit U on the grounds that because there was no case in chief presented by Debtor, it is inappropriate to present rebuttal evidence to a main case that has not been separately presented to the court. Additionally, Debtor objects to the relevance of the exhibit and argues that it is prejudicial.

Trustee contends that Exhibit U is proper rebuttal evidence as the proceeding was structured to minimize the time involved in presenting all evidence and arguments to the court. Trustee argues that she did not waive her ability to present evidence in rebuttal. Trustee maintains that the testimony of Debtor through direct and cross examination made it clear that Debtor was responsible for directing the activities of the trust and the pension plan. She argues that Exhibit U goes directly to the credibility of Debtor and his ability to engage in such activities based upon an order of the United States District Court, Southern District of Iowa, enjoining him from serving as a fiduciary or service provider to any employee benefit plan subject to ERISA, subject to a very narrow exception.

The court finds that Debtor's case was presented in conjunction with the main case as a means to meet the goal of judicial economy pursuant to Fed.R.Evid. 611.

Additionally, the court finds that Trustee did not waive her ability to present evidence in rebuttal to that which was presented during the case in chief. The exhibit is relevant and properly addresses issues raised by Debtor's counsel as it goes to the credibility of Debtor and Debtor's ability to engage in activities related to a trust. Furthermore, the court finds that the court order designated as "a consent order" and signed by Debtor does not constitute surprise. Finally, the court finds that the exhibit would not serve to prejudice the finder of fact in this case. Accordingly, the court finds that Debtor's objection is overruled and Trustee's rebuttal Exhibit U is admitted into evidence.

FINDINGS OF FACT

I. Homestead Exemption

1. The house which is the subject of this dispute was built on land which was deeded to John and Ruth Henss by Edward and Mary Ann Goehring on June 1, 1977. This real estate is locally known as 1120 South 45th Court, West Des Moines, IA 50265, and legally described as follows:

> Lot 8 in WESTERNWOODS , an Official Plat, now
> included in and forming a part of the City of
> West Des Moines, Polk County, Iowa.

2. On January 27, 1978, John and Ruth Henss disclaimed all right, title and interest in the Henss Property, stating that the previous warranty deed was in error "for the reason that Oden and Henss, P.C. was the intended and correct grantee and that a correction warranty deed has been executed and is being filed concurrently herewith to correct said error." This corrected warranty deed from the Goehrings to Oden and Henss,

P.C. was executed on January 31, 1978. Oden and Henss, P.C. amended its articles of incorporation on March 22, 1978 to change its corporate name to John L. Henss, C.P.A., P.C.

3. In 1983, a house was built on the Henss Property. On October 1, 1983, a real estate contract was signed by John and Ruth Henss in which they agreed to purchase the Henss Property. John and Ruth Henss agreed to pay a total of $235,000.00. The seller was listed as John L. Henss, C.P.A., P.C ("P.C.").

4. In March of 1983, Henss personally guaranteed the performance of Capital Resources Corporation in the purchase of Marshall Packing Co.

5. On November 18, 1983, John and Ruth Henss executed a quit claim deed wherein they quit claimed any interest in the Henss Property to John L. Henss, C.P.A., P.C. On that same date, the P.C. gave a mortgage and note in the amount of $138,900.00 to Brenton Mortgages, Inc. This mortgage was secured by the Henss Property.

6. Brenton Mortgages, Inc. assigned the mortgage to Continental Western Life Insurance Company on November 18, 1983.

7. On August 31, 1984, John L. Henss, C.P.A., P.C. gave a mortgage on the Henss Property to Brenton National Bank of Des Moines in the amount of $900,000.00.

8. On November 1, 1984, John L. Henss, C.P.A., P.C. executed a Tenant Agreement With Option to Purchase with Henry F. Lee and Ruth Lee. Such lease was assigned to Brenton National Bank on December 14, 1984. The tenant agreement covered the Henss Property now in dispute.

9. On May 13, 1985, John L. Henss, C.P.A., P.C. gave a mortgage on the Henss Property to West Des Moines State Bank in the amount of $100,000.00.

10. On March 3, 1987, the Iowa District Court in Marshall County entered a judgment against Henss in favor of Garland on Henss's personal guarantee of Capital Resources Corporation.

11. On July 10, 1987, Brenton National Bank assigned the mortgage dated August 31, 1984 to M. I. Hoffmann.

12. On October 1, 1988, John and Ruth Henss entered into an agreement with John L. Henss, C.P.A., P.C. in which Henss agreed to assume all obligations of the mortgage owing to Brenton Mortgages, Inc. in the principal amount $136,153.10. In return, John L. Henss, C.P.A., P.C. agreed to discharge and forgive any obligations due from Henss related to the installment contract for purchase of the Henss Property in the amount of $113,563.24. This agreement was not recorded until July 8, 1992.

13. On March 24, 1989, an order was entered against Henss in favor of Garland in the Iowa District Court creating a constructive trust over proceeds of income from Henss' professional practice since the personal guarantee of the Capital Resources Corporation contract in March of 1984.

14. On October 24, 1990, John L. Henss, C.P.A., P.C. renegotiated a mortgage and note with Continental Life Insurance Company.

15. On October 2, 1991, M. I. Hoffmann assigned the mortgage to Oden, Henss and Thielking. Oden, Henss and Thielking then assigned the mortgage to Lyle Middleton on November 5, 1991.

16. The mortgage payments on the Henss Property were paid by John L. Henss, C.P.A., P.C. from April 1984 until June 1994.

17. On September 22, 1993, Henss filed a Petition for Bankruptcy Relief under Chapter 7 of the U.S. Bankruptcy Code.

18. Subsequently and in a timely manner, G. Dean Garland and Secured Beef, Ltd. filed an objection to Debtor's claim of homestead exemption.

19. On April 7, 1994, attorney David L. Wetsch executed a title opinion on the property at issue. The title opinion states as follows:

> I find marketable title of record in fee simple and free from material objections, except as are hereinafter mentioned, to be in: John L. Henss, C.P.A., P.C., grantee named under a quit claim deed dated November 18, 1983, . . . and also by virtue of a warranty deed dated January 27, 1978.

20. The title opinion also lists several exceptions among which is exception No. 8 wherein the opinion notes a real estate contract dated October 1, 1983, between John L. Henss, C.P.A. and Ruth K. Henss as buyers. The opinions notes as follows:

> According to the terms and conditions of the agreement (dated October 1, 1988) and by the execution of the same, the real estate contract referenced in this paragraph was fulfilled by John L. Henss and Ruth K. Henss, husband and wife, assuming the real estate mortgage instrument referenced in paragraph 4 above. However, a deed in fulfillment of this real estate contract has not been given by the contract seller. Accordingly, to clear title to the property under examination, I require a duly executed deed from John L. Henss, C.P.A., P.C. to John L. Henss and Ruth K. Henss.

II. ESOP

1. Debtor claims an exemption in an interest he holds in an employees' stock ownership plan ("ESOP") created by John L. Henss, C.P.A., P.C.

2. The ESOP was established by John L. Henss, C.P.A., P.C., on October 1, 1973. It was amended on October 1, 1989.

3. The purpose as stated by the plan in § 1 is "to create a uniform retirement plan covering all qualifying employees of the company." The plan further provides:

> The plan is administered by the employer on an annual basis ending each September 30, the accounting date. All employer contributions are paid to the trustee, and together with all income receipts are held by the trustee in the trust and administered for the exclusive benefit of participants and their beneficiaries, pursuant to the plan and a trust agreement which is part of the plan. This plan is intended to be an employees' stock ownership plan as defined in Internal Revenue Code, § 4975(e).

4. The ESOP provides in § 7 as follows:

> The trustee shall use all available cash, as directed by the administrator, to buy qualifying employer securities from any available sources, including, but not limited to, purchases on the open market or newly insured securities. It is understood that the plan will be invested primarily in qualifying employer securities.

5. Section 8 of the ESOP provides for loans to the trust and states as follows:

> The plan may borrow money for any lawful purpose, provided the proceeds of the exempt loans are used within a reasonable time after receipt only for any or all of the following purposes:
>
> (a) to acquire company stock;
>
> (b) to repay such loan;
>
> (c) to repay a prior exempt loan.
>
> All loans to the trust which are made are guaranteed by a disqualified person must satisfy all requirements applicable to exempt loans including but not limited to the following:
>
> (a) the loan must be at a reasonable rate of interest;

(b) any collateral pledged to the creditor by the plan shall consist only of the company stock purchased with the borrowed funds;

(c) under the terms of the loan, the creditor shall have no recourse against the plan except with respect to such collateral;

(d) the loan must be for a specific term and may not be payable at the demand of any person, except in the case of default.

. . .

All qualifying employer securities purchased with the proceeds of exempt loans shall be held in a suspense account and released in accordance with the provisions of reg. 54.4975-7(b)(8) and (15). As the loan is repaid there shall be a release from encumbrance which is proportionate to the debt reduction (i.e. the amount released is equal to the amount of securities times the fraction; the numerator of which is the current payment of principal and interest and the denominator the numerator plus the sum of future years payments of principal and interest.). The number of future years under the loan must be definitely determinable.

6. Section 12 of the ESOP provides as follows:

if your participation ends by retirement under the plan or debt, your plan benefit will be all of the final balance in your account. You will be treated as having retired under the plan if your participation ends for any of the following reasons:

a) normal retirement--The accounting date coinciding with or next following your 65th birthday.

(b) deferred retirement--Any accounting date after your normal retirement date.

(c) early retirement--Any accounting date after your have completed six years of service.

(d) disability retirement--If the administrator determines on the basis of a doctor’s certificate that you have become totally and

> permanently disabled and unable to work as a regular full-time employee of the employer . . .

7. Section 16 of the ESOP provides for plan benefits distribution as follows:

> Distribution of your plan benefit will be made in cash. The trustee will make such distribution only on instructions from the administrator. Distribution will be made to you if living, and if not, the proceeds distributed to your designated beneficiary.

8. Paragraph 17 of the ESOP provides for alienation of benefits:

> During your participation, you are not entitled to any payment, withdrawals or distribution under the plan, nor may your interest in the plan either as a participant or after your participation is ended, and that of your designated beneficiary, be assigned either by voluntary or involuntary assignment or operation of law. However, after your service is ended, the administrator, in its discretion, may direct the trustee to advance to you if living, or if not, to your designated beneficiary, an immediate partial distribution not to exceed one-half of your plan benefit as then estimated by the administrator.

9. Section 23 of the ESOP provides as follows:

> This plan is designated, designed and intended to qualify under § 401(a) of the Internal Revenue Code so that (i) the employer contributions are currently deductible, (ii) all income of the trust is exempt from tax, and (iii) you will not be taxed on your benefit on the plan until you receive distribution of the plan benefit. Notwithstanding any other provision of the plan, and particularly the preceding sentence, the board of directors reserves the right:
>
> (a) at any time to amend the plan in any way necessary to obtain an initial determination from the Internal Revenue Service that the plan qualifies under § 401(a) . . .

10. The administrator for the plan is listed as J. L. Henss, C.P.A., P.C. The definition section of the ESOP provides that the designated beneficiary is defined as follows:

> "the participant's surviving spouse or if there is no surviving spouse or the spouse consents to any person or persons named by the participant to receive the participant's share of the distribution if the participant is not living on the distribution date. Any such consent by a spouse must be in writing, must acknowledge the effect of such election and must be witnessed by a plan representative by a notary public.

A participant is defined as "any employee of the employer who has met the eligibility and participation requirements of the plan."

11. The trustee of the plan is designated as Steven K. Thielking.

12. On September 22, 1986, the Internal Revenue Service issued a determination letter that the ESOP at that time had been determined to have been qualified under the Internal Revenue Code. The letter stated that "based upon the information supplied, we have made a favorable determination on your application identified above . . . continued qualification of the plan will depend upon its effect in operation under the present form . . . this determination is subject to your adoption of the proposed amendments submitted in your or your representative's letter dated 09/04/86."

13. A summary annual report for the ESOP was filed on September 30, 1991. The report provided that a total of five persons were participants in or beneficiaries of the plan at the end of the plan year. Plan assets were valued at $55,675.25 as of September 30, 1991, compared to $128,230.37 as of the beginning of the plan year.

14. The summary annual report for the ESOP filed on September 30, 1992, reported that the value of plan assets was $35,922.68 as of September 30, 1992, compared to $55,675.25 as of the beginning of the plan year. The report provided that a total of five persons were participants in or beneficiaries of the plan.

15. Debtor received a distribution from the ESOP in 1991 in the amount of $40,000.00. He also received a distribution from the ESOP in 1992 in the amount of $40,000.00. Debtor received a distribution in the amount of $25,000.00 in 1993. The income of the P.C. was paid to Debtor or his wife in the form of ESOP distributions. The P.C. would cash advance to Debtor's wife and record a receivable due from Debtor. The P.C. then declared a dividend to the ESOP and deducted this amount. The ESOP made a distribution of the dividends to Debtor or his wife and the distribution was immediately signed by Debtor to the P.C. The P.C. then offset this amount against the debt owed by Debtor or his wife to the P.C.

16. Dividends have been allocated to each participant in the plan in each of the four years the dividends were paid. However, Debtor is the only participant in the ESOP to actually receive a distribution from the plan with respect to such dividends. The distribution received by Debtor in each of the four years equaled the total amount of the dividend paid to the ESOP. After the ESOP made this distribution to Debtor it contained only stock in the P.C. The dividends allocated to the other participants consisted of stock.

17. Debtor has received $160,000.00 of cash distribution since 1988. The other participants received stock allocations of about $11,000.00. This stock is now worth about $5,000.00.

18. The only shareholder in the P.C. is the ESOP. Debtor is the administrator and fiduciary to the ESOP. The trustees for the ESOP have made no decisions. Debtor controls approximately 75% of the stock in the P.C. through his ESOP interest and functions as president and sole director.

19. Debtor is an active employee of the P.C. and is not retired. However, he receives no income from the P.C.

20. No significant retirement benefits have been accumulated in the ESOP for other participants and no material contributions have been made to the ESOP by the P.C. for over 10 years.

21. The P.C. had no employee other than Debtor until 1993. Participants other than Debtor have been included in the plan since 1986. No other employers other than the P.C. have adopted the plan.

22. The primary asset of the ESOP is stock in the P.C. which is formed under the professional corporation provisions of the Iowa Code. None of the participants other than Debtor are licensed C.P.A.s.

23. The ESOP borrowed $125,000.00 in 1986 to acquire stock in the P.C. The original loan was made directly to the ESOP with a term of five years. Nothing in the agreement prevents the lender from accelerating the loan in the event of default. The most recent loan renewal is payable on demand. The ESOP has made only one interest payment in the seven year period in which the loan existed. This payment, reducing the principal balance, was made in July 1993 for $85,000.00. The P.C. has made interest payments on the ESOP loan on an ongoing basis.

24. No suspense account was ever established for the shares acquired with the ESOP loan and no annual allocation of shares acquired with the loan proceeds has occurred.

25. The present ESOP document has never been approved by the Internal Revenue Service.

26. Debtor received an allocation of $4,000.00 to his ESOP account in 1990. Debtor received no salary in that year.

DISCUSSION

I. Homestead Exemption

Debtor argues that his homestead was built in 1983 and has been continuously occupied by Debtor from that time until the present. He argues that the judgment claim of Garland did not arise until 1987 and thus does not constitute a pre-acquisition debt. Furthermore, Debtor argues that the debt upon which the judgment is based arose in March of 1984 after the property was purchased and the house was built and occupied. Debtor argues that he is a contract purchaser from John L. Henss, C.P.A., P.C. or alternatively, that he is the titleholder to the property and is, therefore, entitled to a homestead exemption in the property.

Garland objects to Debtor's claim of homestead exemption arguing that legal title currently resides in John L. Henss, C.P.A., P.C. Moreover, Garland argues that Debtor's claim to equitable title in the property is defeated by the fact that John L. Henss, C.P.A., P.C. has made every payment for that real estate and Debtor is currently indebted to John L. Henss, C.P.A., P.C. in an amount considerably in excess of the total of the mortgage payments made to date. Garland also argues that his claim precedes any homestead rights that may have been acquired by Debtor and the homestead is, therefore, nonexempt from the prior debt. Alternatively, Garland argues that Debtor is not entitled to a homestead exemption on that portion of the Henss Property against which debt was retired by use of funds subject to the Garland's constructive trust.

Iowa Code § 561.16 provides, as relevant herein, that:

> The homestead of every person is exempt from judicial sale where there is no special declaration of statute to the contrary. Persons who reside together as a single household unit are entitled to claim in the aggregate only one homestead to be exempt from judicial sale. A single person may claim only one homestead to be exempt from judicial sale.

Iowa Code § 561.1 defines homestead in relevant part as follows:

> The homestead must embrace the house used as a home by the owner, and, if the owner has two or more houses used, the owner may select which the owner will retain.

However, Iowa Code § 561.21(1) provides that a homestead may be sold to satisfy debts which qualify as follows:

> Those contracted prior to its acquisition, but then only to satisfy a deficiency remaining after exhausting the other property of the debtor, liable to execution.

In this case, Debtor does not have title to the property. The title opinion clearly states that title to the Henss Property lies with John L. Henss, C.P.A., P.C. Debtor has not produced any evidence to this court which would rebut this finding. However, the title opinion also states that the ownership interest of the P.C. is subject to a real estate contract with Debtor which was fulfilled by Debtor.

Debtor argues that he has an interest in the Henss Property by virtue of this October 1, 1983 purchase agreement in which he and his wife agreed to purchase the Henss Property on contract from John L. Henss, C.P.A., P.C. The evidence produced by

Garland reveals that on November 18, 1983, after the execution of the purchase contract, Henss quit claimed any interest in the property to the P.C.

Furthermore, all mortgage payments were made by the P.C. Although, Debtor has testified that he reimbursed the P.C. for the payments at year end, Debtor has failed to produce any corroborating evidence that would support his statements that the mortgage payments were repaid. In fact, the evidence produced by Garland reveals that a debt is owed by Debtor to John L. Henss, C.P.A., P.C. in an amount considerably in excess of the total of the mortgage payments.

Based on the court's assessment of Debtor's credibility, the evidence presented and the failure to rebut such evidence, the court finds that the weight of the evidence persuades this court that, prior to October 1, 1988, Debtor had no legal nor equitable interest in the property. Therefore, until October 1, 1988, when John L. Henss, C.P.A., P.C. forgave obligations by Henss under the real estate contract, there is no evidence that an equitable or legal right to support a homestead exemption existed.

Assuming that Debtor acquired a right to a homestead exemption in the Henss property on October 1, 1988, the judgment entered in favor of Garland was prior in time to the right to a homestead exemption. Garland's claim originates from Debtor's personal guaranty of the Capital Resources contract in March of 1984. Garland received a judgment in state court against Debtor on March 3, 1987. Therefore, the debt arose prior to any homestead rights and the Henss Property is not exempt as to Garland's claim pursuant to Iowa Code § 562.21. The court need not reach Garland's alternate argument concerning the constructive trust.

II. ESOP

Garland and Trustee object to Debtor's claim of exemption in an interest in an ESOP created by John L. Henss C.P.A., P.C. Garland and Trustee argue that Debtor's interest in the ESOP is not excludable from property of his bankruptcy estate under the anti-alienation provisions of the Employee Retirement Income Security Act (ERISA). Secondly, Garland and Trustee argue that the ESOP interest is not excludable under the Iowa Spendthrift clause. Thirdly, Garland and Trustee contend that the interest in the ESOP is not exempt pursuant to Iowa Code § 627.6(8)(e).

A. Property of the Estate

11 U.S.C. § 541(a) provides in relevant part:

> The commencement of a case under § 301, 302, or 303 of this title creates an estate. Such estate is comprised of all the following property, wherever located and by whomever held:
>
> > (1) Except as provided in subsections (b) and (c)(2) of this section, all legal or equitable interests of the debtor and property as of the commencement of the case . . .

Section 541(c)(1) provides generally that restrictions on the transfer of property will not prevent such property interest from being included in property of the estate. However, § 541(c)(2) provides an exception wherein:

> A restriction on the transfer of beneficial interest of the debtor in a trust that is enforceable under applicable nonbankruptcy law is enforceable in a case under this title.

1. ERISA

The U.S. Supreme Court recently held that the anti-alienation requirement under ERISA constitutes a restriction on transfer which is enforceable under applicable "non-bankruptcy law." Patterson v. Shumate, 112 S.Ct. 2242 (1992). Pursuant to the holding in Shumate, benefits which constitute "ERISA qualified plans" are excluded from a debtor's bankruptcy estate pursuant to 11 U.S.C. § 541(c)(2). Id. at 2247. The term "ERISA qualified" plan is not defined in the Shumate opinion. Moreover, neither ERISA nor the Internal Revenue Code used the term. Therefore, the court must look at interpretations of case law to determine what constitutes an "ERISA qualified" plan.

Prior to the Shumate case, the Tenth Circuit found that a plan must meet the "tax qualification" requirements of the Internal Revenue Code in order to be excluded from the bankruptcy estate as a "ERISA qualified" plan. In re Harline, 950 F.2d 669 (10th Cir. 1991).

A leading post-Shumate case approved the Harline approach related to tax qualification and additionally held that a "ERISA qualified plan" must be subject to ERISA and contain an anti-alienation provision which is enforceable. In re Hall, 151 B.R. 412, 419 (Bankr. W.D. Mich. 1993). Other cases which have considered the issue have adopted the three-prong test set forth in Hall. See In re Nolan, 175 B.R. 214, 217 (Bankr.N.D. Ohio 1994); In re Orkin, 170 B.R. 751, 753 (Bankr.D.Mass 1994); In re Foy, 164 B.R. 595, 597 (Bankr.S.D.Ohio 1994). But see In re Hanes, 162 B.R. 733, 740 (Bankr.E.D.Va. 1994) (holding that an ERISA qualified plan must be subject to ERISA and contain an anti-alienation provision, but need not be tax qualified.)

In accordance with the case law in this area, the court finds that an ESOP must satisfy the following three-prong test in order to be considered an excludable "ERISA qualified" plan:

(1) The ESOP must satisfy tax qualification requirements under the Internal Revenue Code;
(2) The ESOP must be subject to ERISA; and
(3) The ESOP must contain an enforceable anti-alienation provision.

The court notes that Debtor conceded in his brief that the ESOP is not subject to ERISA arguing that tax qualification is the only relevant consideration. Therefore, technically, this concession means that the ESOP interest has already failed the test of an "ERISA qualified" plan. However, the court shall address the argument on its merits despite Debtor's concession in written brief.

a. Tax Qualification

The operation of a plan as well as the plan provisions must meet the requirements for qualification. Myron v. U.S., 550 F.2d 1145 (9th Cir. 1977). IRC § 401(a) prescribes the requirements which must be met for qualification of a trust forming part of a pension, profit-sharing, or stock bonus plan. Treas. Reg. § 1.401-1(a). Furthermore, for purposes of the post-ERISA regulations, a "qualified plan" for tax purposes is defined as a "plan which satisfies the requirements of § 401(a). Treas. Reg. § 1.401-0(b)(1). Treas. Reg. §§ 1.401 through 1.401-14 reflect the provisions of § 401 prior to ERISA amendments while §§ 1.401-14 and preceding § 1.402(a)-1 reflect the provisions of section 401 after amendment. Treas. Reg. § 1.401-0(a). While, Debtor argues that the treasury regulations adopted prior to ERISA are invalid and inapplicable, this court is satisfied that such regulations were not revoked and are still enforced by the IRS. See e.g. Gross Distributing Co. v. C.I.R., 710 F.2d 249, 250 (6th Cir. 1983) and Sol Walker & Co. v. U.S., 636 F.2d 298, 302 (Ct. Cl. 1980).

A plan must be operated for the "exclusive benefit" of employees. I.R.C. § 401(a). Treas. Reg. 1.401-1(b)(3) provides:

> If the plan is so designed as to amount to a subterfuge for distribution of profits to shareholders it will not qualify as a plan for the exclusive benefit of employees even if other employees who are not shareholders are also included in the plan.

Debtor testified that he has been an active employee and is not retired. Debtor uses the ESOP to pay personal expenses in his capacity as president and sole director of the P.C. and as plan fiduciary of the ESOP. Debtor testified that the income of the P.C. is paid to him or to his wife in the form of ESOP distributions. The P.C. pays personal expenses for Debtor and records a receivable due from Debtor. The P.C. then declares a dividend to the ESOP and deducts this amount. The ESOP makes a distribution of the dividend to Debtor or his wife and the distribution is immediately assigned by Debtor to the P.C. The P.C. then offsets this amount against the debt owed by Debtor. The characterization of the given transaction is not determined until after year end, long after the economic event has occurred.

Additionally, dividends have been allocated to each participant in the plan in each of the four years in which dividends were paid. However, Debtor is the only participant in the ESOP to actually receive cash distribution from the plan with respect to such dividends. The dividends received by Debtor are a significant portion of the total earnings realized by the P.C. since 1987. Therefore, based on a careful consideration of all of the evidence presented and this court's opinion of Debtor's credibility, the court finds that the plan is designed as to serve as a subterfuge for distribution of profits to Debtor and is not a plan for the exclusive benefit of the employees.

Another aspect of the exclusive benefits rule is that a qualified plan must not discriminate in favor of highly compensated employees with respect to contributions and benefits. IRS § 401(a)(4). Treas. Reg. § 1.401-1(b)(3) provides in relevant part:

> The plan must benefit employees in general, although it need not provide benefits for all employees. Among the employees to be benefited may be persons who are officers or shareholders. However, a plan is not for the exclusive benefit of employees in general if it discriminates either in eligibility requirements, contributions, or benefits in favor of those employees who are officers, shareholders, persons whose principal duties consist in supervising the work of other employees, or the highly compensated employees.

An optional form of benefit offered exclusively to a highly compensated employee will automatically fail these tests and disqualify the plan. IRC § 410(b)(1).

Debtor falls within the classification of a highly compensated employee pursuant to IRC § 414(q)(5). Debtor receives an immediate cash distribution of dividends while others receive stock allocations. This dividend policy also results in the retention of dividends for some participants and the distribution of dividends to Debtor by an immediate payment method. Debtor receives full cash value for his dividend while the value to other participants is dependent upon the value of underlying stock. Although, Debtor argues that he is the only employee eligible to receive benefits, the plan document requires that all dividends be paid in cash to all participants. Accordingly, the court finds that the cash method of payment to Debtor represents a prohibited discrimination. Additionally, this method of payment violates the minimum coverage requirements because a highly compensated employee receives benefits which no other participant receives. I.R.C. § 410(b).

A plan cannot include individuals who are not employees of the employer without losing its status as a "qualified plan." Professional and Executive Leasing, Inc. v. C.I.R., 89 T.C. 225 (1987), aff'd, 862 F.2d 751 (9th Cir.1988). However, an employer which satisfies certain requirements may include the employees of another entity in a plan if certain rules are satisfied. I.R.C. § 413(c). A basic rule is that the plan must be maintained and adopted by all employers who have employees participating in the plan. Participants other than Debtor have been included in the plan since 1986. There is no evidence that anyone other than the P.C. adopted the plan.

The primary purpose of the ESOP must be to provide retirement benefits to the employees of the sponsoring employer. Treas. Reg. 1.401-1(b)(1). Preretirement and death benefits of the plan must be incidental to the retirement benefits provided to participants. In this case, Debtor has received pre-retirement distributions exceeding $160,000.00 since 1987, even though he is not retired and continues to be an employee of the P.C. The distributions to Debtor have materially exceeded the assets in the ESOP and the ESOP has few assets from which to pay retirement benefits.

A qualification requirement for ESOP is the inclusion of an election allowing participants to receive shares in kind upon retirement or termination. I.R.C. § 401(a)(23) and I.R.C. § 409(h). In this case, the document includes a provision which only entitles a participant to receive cash upon his/her retirement or severance from employment. No option is given to the participant to acquire shares in kind. Debtor argues that the ESOP falls within an exception where an ownership of a corporation shares are limited to employees of the corporation by law or under the articles or bylaws of the corporation. I.R.C. § 409(h). However, Iowa law does not prevent an individual who is not an employee of the P.C. from owning shares in the P.C. if the individuals is otherwise licensed to practice the relevant profession under Iowa Code § 496(c)(10). Similarly, the articles and bylaws of the P.C. contain no restriction to the effect that only employees of the P.C. can own a share in the P.C.

Garland and Trustee argue that the ESOP fails to satisfy requirements imposed specifically on employee stock ownership plans. The ESOP borrowed $125, 000 in 1986 to acquire stock in the P.C. The purpose of a loan of this kind must be to benefit plan participants. Treas. Reg. § 54.4975-7(b)14. The term of a loan must be specified and cannot be payable on demand and payments may not be accelerated upon default. Treas. Reg. § 54.4975-7(b)(8)(ii). Additionally, the only assets of the ESOP which may be pledged are the shares required with the loan. The lender must have no recourse to assets held by the ESOP except to the shares acquired with the loan proceeds. Shares must be released as collateral when payments are made with respect to the loan. Treas. Reg. § 54.4975-7-(b)(5) and 7(b)(8). Moreover, the treasury regulations require an ESOP to establish a separate suspense account for shares acquired with an ESOP loan. Reg. 54.4975-11(c). Substantial and recurring contributions must be made to the ESOP for the purpose of paying down the ESOP loan and releasing encumbrances. Treas. Reg. §§ 1.401-1(b)(2) and 54-4975-(7)(b)(8)iii.

Debtor argues that no property of the ESOP was given as security for the loan. In contrast, Garland and the Trustee maintain that each of the loan documents create a blanket security interest in all property held by the ESOP. The loan documents grant a security interest in "all other personal property of the Borrower of every kind and description which is now or hereafter comes into the possession of the Lender for any reason . . ." The court finds that there is a condition precedent to any security interest in the Lender. There has been no evidence that the Lender came into possession of any of the ESOP assets. Therefore, the court holds that the loan documents did not give an improper security interest in ESOP property. Accordingly, the ESOP need not release security interests.

However, the court finds that Debtor has engaged in prohibited transactions concerning the loan. The original loan was made directly to the ESOP in 1986 to acquire stock in the P.C. The loan was for five years. Nothing in the agreement prevents the lender from accelerating the loan in the event of default. Additionally, the court finds that the most recent loan renewal provides that the loan is payable on demand which is prohibited. Moreover, the ESOP has failed to make substantial and recurring payments on the loan as the ESOP has made only one interest payment in the seven-year period. Lastly, there is no evidence that a suspense account was ever established or that annual allocation of shares has occurred.

In accordance with the above discussion, the court finds that the ESOP does not meet the requirements for tax qualification.

b. Subject to ERISA

The second element of the test requires the plan be covered by ERISA and satisfy certain ERISA requirements to constitute an "ERISA qualified" plan. In re Hall, 151 B.R. at 420. ERISA applies " to any employee benefit plan if it is established or maintained . . . by an employer engaged in commerce or in any industry or activity affecting commerce." 29 U.S.C. § 1003(a)(1). Furthermore, 29 U.S.C. § 1002(2)(A) provides in relevant part:

> [T]he terms "employee pension benefit plan" and "pension plan" mean any plan . . . which was heretofore or is hereafter established or maintained by an employer . . . to the extent that by its express terms or as a result of surrounding circumstances such plan, . . . (i)provides retirement income to employees, or (ii) results in deferral of income by employees for periods extending to the termination of covered employment or beyond . . .

29 U.S.C. § 1103(c)(1) requires that "the assets of the plan shall never inure to the benefit of any employer and shall be held for the exclusive purpose of providing benefits to participants . . ." Moreover, the Secretary of Labor has narrowed the definition of "employee benefit plan" under ERISA as follows:

> (b) Plans without employees. For purposes of title I of the Act and this chapter, the term "employee benefit plan" shall not include any plan . . . under which no employees are participants covered under the plan . . . .

29 .C.F.R. § 2510.3-3.

The court has found in the above discussion that the ESOP fails to satisfy the exclusive benefits rule in a tax context. The court finds that for the same reasons, the ESOP fails the exclusive benefits rule of ERISA, as well. Debtor and his wife have received large cash distributions from the ESOP to the exclusion of the other participants. Debtor has not retired from his work at the P.C. The ESOP is merely a subterfuge designed to funnel proceeds of the P.C. to Debtor for expenses. The ESOP is not held for the exclusive purpose of providing benefits to participants, nor is it used to provide retirement income or deferred income extending to termination of coverage and beyond. The court notes that Debtor concedes in his written brief that the ESOP is not subject to ERISA. Debtor states "Garland has gone to great lengths to demonstrate that the plan in question is not subject to ERISA. As indicated above, we do not disagree with that position." This court agrees that subject ESOP does not comply with the provisions of ERISA.

c. Enforceable Anti-Alienation Provision

Garland and Trustee argue that the anti-alienation provision provided in the ESOP plan is unenforceable by a beneficiary who has breached his fiduciary duty to the plan. At least one court has held that an anti-alienation provision in a plan which is "ERISA qualified" is not enforceable by a participant who violates the fiduciary standards of ERISA. Coar v. Kazimir, 990 F.2d 1413 (3rd Cir. 1993). In Coar, the Third Circuit held that a beneficiary who violated his fiduciary duty could not enforce the anti-alienation provision against other beneficiaries of the plan and that the plan could, therefore, set off amounts owed by the Debtor out of his plan benefits.

In this case, Debtor made advances to his wife and paid personal expenses through the P.C. Debtor subsequently treated these amounts as dividends to the ESOP. Debtor, in his fiduciary capacity, assigned these dividends to the P.C. Debtor exercised complete control over the assets of the ESOP. He maintained records of the plan, made all the decisions, and controlled how the dividends were distributed. Debtor's dividend policy benefited himself to the detriment of other plan participants and is a form of self-dealing prohibited under ERISA fiduciary standards. 29 U.S.C. § 1106(b)(1). This action also violates the exclusive benefit rule imposed on fiduciaries and the prudent-person standard under ERISA. 29 U.S.C. § 1104(a)(1)(a) and (b). Debtor's failure to carry out plan provisions involving dividends also violates his duty to strictly comply with provisions and plan documents. 29 U.S.C. § 1104(a)(2)(D). Furthermore, Debtor intentionally ignored a Department of Labor order preventing him from acting as an ESOP fiduciary in an ERISA trust.

However, the court finds that this case is distinguishable from the Coar case wherein the court found that the anti-alienation provision was unenforceable against the other beneficiaries and the plan itself. Garland and Trustee ask this court to find that the anti-alienation provision is unenforceable against third parties. The court finds that this is inconsistent with ERISA law and with the Coar holding itself. Accordingly, the court finds that the anti-alienation provision is enforceable. However, the ESOP still fails to meet the first two tests of tax qualification and ERISA qualification and is not excludable from property of the estate pursuant to § 541(c)(2).

2. Iowa Spendthrift Trust Law

Traditional spendthrift trusts may be also be excludable under § 541(c)(2) if the trust has the necessary characteristics of a spendthrift trust under the applicable state law. In re Swanson, 873 F.2d 1121, 1123 (8th Cir. 1989). Iowa law generally recognizes the validity of spendthrift trusts. Matter of Lingle, 119 B.R. 672, 675 (Bankr. S.D. Iowa

1990). However, spendthrift trust provisions do not apply if the beneficiary is the settlor of the trust or otherwise exercises dominion and control over trust funds. In re Swanson, 873 F.2d at 1124.

While, the court again notes that Debtor himself argued in his written brief that Iowa law is preempted by federal ERISA, the court having found that the ESOP is not "ERISA qualified" shall consider the Iowa law on its merits.

In this case, Debtor exercises control over the P.C. as president and sole director. Debtor pays personal expenses out of the P.C. and routinely advances money to his wife. He controls how the P.C. will distribute profits and owns a substantial portion of the shares in the P.C. through the ESOP. Debtor is the alter ego of the P.C. and is accordingly the settlor of the trust and his ESOP interest therein is not protected under the spendthrift trust rules.

Furthermore, Debtor exercises much control over trust assets and other transactions. He determines when dividends and contributions are made and has the ability to distribute plan assets. The degree of control Debtor exercises over the ESOP in the instant case is inconsistent with the policies behind spendthrift trust rules. Therefore, the court finds that the ESOP cannot be considered a spendthrift trust under Iowa law. Accordingly, the court finds that the ESOP is not excluded from the bankruptcy estate pursuant to § 541(c)(2) and is property of Debtor's estate pursuant to § 541(a).

B. Exemption under Iowa Code § 627.6 (8)(e)

Because Debtor's interest in the ESOP has been found to be property of the estate, the court now must determine if Debtor may properly exempt such interest. 11 U.S.C. § 522(b) allows Debtor to exempt certain assets under state exemption laws where the state opts out of the federal exemption provisions. Iowa has opted out of the federal exemption provisions. Iowa Code § 627.10. Under Iowa law, exemption statutes are to be liberally construed in favor of the debtor. Frudden Lumber Co. v. Clifton, 183 N.W. 2d 201, 203 (Iowa 1971). However, the court should not "depart substantially from the express language of the exemption statute or extend the legislative grant." Matter of Knight, 75 B.R. 838, 839 (Bankr. S.D. Iowa 1987) (citations omitted).

Iowa Code § 627.6(8)(e) provides that a debtor may hold exempt from execution the following:

> A payment or a portion of a payment under a pension annuity, or similar plan or contract on account of illness, disability, death, age, or length of service. . . .

To qualify as an exemption under this provision a plan or contract similar to pension plans annuities include:

> (1) A formal plan established for the benefit of the debtor usually is a part of a relationship of an employer or employer organization;
> (2) The benefits of the plan or fund are "akin to future earnings" of the debtor and intended as retirement or deferred income to provide future support of the debtor;
> (3) Access and control of the plan or fund must be in the hands of someone other than the debtor with strong limitations on withdrawal and distribution expressed in the formal plan or fund for the purpose of providing retirement and deferred income;
> (4) Payment under the plan or contract is to be on account of illness, disability, death, age, or length of service.

See Matter of Pettit, 55 B.R. 394, 398 (Bankr. S.D. Iowa 1985), aff'd, 57 B.R. 362 (S.D. Iowa 1985). Assuming arguendo that Debtor could satisfy the first two elements, the court finds that the last two elements are clearly not met in this case. Debtor, as stated throughout this opinion, has extensive control and access over the plan. Therefore, Debtor may not exempt his interest pursuant to Iowa Code § 627.6(8)(e). See In re Huebner, 141 B.R. 405, 407 (Bankr. N.D. Iowa), aff'd, 986 F.2d 1222 (8th Cir. 1993).

Similarly, Debtor has failed to satisfy the "on account of" standard. First, the "on account of" language had been interpreted to require that plan payments be based on some "triggering" event such as retirement, death, or specified length of service. Huebner, 141 B.R. at 407; See also In re Kemp, Case No. 94-1763-CH (Bankr. S.D. Iowa May 1, 1995) (Judge Hill's Decision # 280). The dividends paid to Debtor at date constitute a large portion of the benefits under the plan and were not paid on account of a triggering event such as retirement, death or specified length of service as Debtor is not retired and continues to be employed at the P.C. Secondly, Debtor's access and control over the payments persuades this court that any funds received would not be "on account of" one of the triggering events, but instead "on account of" Debtor's decision. See Huebner, 986 F.2d at 1225. Accordingly, the court finds that Debtor may not exempt his ESOP interest pursuant to Iowa Code § 627.6(8)(e).

ORDER

IT IS THEREFORE ORDERED that G. Dean Garland's objection to claim of homestead exemption is sustained and Debtor may not claim as exempt the house and real estate located at 1120 South 45th Court, West Des Moines, IA 50265, and legally described as:

> Lot 8 in WESTERNWOODS, an Official Plat, now included in
> and forming a part of the City of West Des Moines, Polk County, Iowa.

IT IS FURTHER ORDERED that the objections to Debtor's claim of exemption in the John L. Henss CPA, PC, Employee Stock Ownership Trust by the trustee, Anita L. Shodeen, and G. Dean Garland are sustained and Debtor may not claim his interest in said ESOP as exempt.

Dated this ________ day of ______________, 1995.

____
RUSSELL J. HILL, CHIEF JUDGE
UNITED STATES BANKRUPTCY COURT

UNITED STATES BANKRUPTCY COURT
FOR THE SOUTHERN DISTRICT OF IOWA

In the Matter of	:	**Case No. 93-2401-CH**
	:	**Chapter 7**
JOHN L. HENSS,	:	
	:	
Debtor.	:	

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ORDER--MOTION FOR RECONSIDERATION OR CLARIFICATION OF ORDER ENTERED SEPTEMBER 11, 1995

On September 11, 1995, this court entered an order sustaining creditor, G. Dean Garland's objection to claim of homestead exemption. The court found that Debtor may not claim as exempt the house and real estate located at 1120 S. 45th Court, West Des Moines, Iowa 50265. The court also sustained the objections to Debtor's claim of exemption in the John L. Henss, CPA, P.C., Employees Stock Ownership Trust.

On September 22, 1995, Debtor moved for reconsideration and clarification of the order. Debtor argues that the portion of the court's ruling dealing with the denial of homestead exemptions was based upon incorrect findings in that the court stated that the personal guarantee of Henss to Garland occurred in March of 1983. Debtor points out that the evidence supports a finding that the guarantee was not made until March of 1984. The court has reviewed its order entered on September 11, 1995. The court finds that an error was made in the findings of fact under the portion of the ruling dealing with the denial of homestead exemption. Specifically, on page 4, item 4, the court misstated the date of the personal guarantee of Henss to Garland. That date should have been stated as March of 1984. However, the court finds that this error does not affect the decision of the court. It is clear that in the substantive discussion section of the opinion the court correctly stated the personal guarantee date as March of 1984. Specifically, on page 15 the court stated "Garland's claim originates from Debtor's personal guarantee of the Capital Resources contract in March of 1984." Garland received a judgment in state court against Debtor on March 3, 1987. Therefore, the debt arose prior to any homestead rights and the Henss property is not exempt as to Garland's claim pursuant to Iowa Code § 562.2(1).

Debtor also argues that the court should have considered the extent to which the homestead should have been exempt by virtue of its acquisition in part from the proceeds of Debtor's prior homestead which was sold in 1983. Debtor requests the court to clarify its ruling, taking into account Iowa Code § 561.20.

Iowa Code § 561.20 provides as follows:

> Where there has been a change in the limits of the homestead, or a new homestead has been acquired with the proceeds of the old, the new homestead, to the extent in value of the old, is exempt from execution in all cases where the old or former one would have been.

The court finds that Debtor produced no evidence of a prior homestead nor any evidence that the property at issue was purchased in part from proceeds of a prior homestead. In fact, the evidence reflects that the debtor testified only that the property was purchased in 1983 on an installment contract. Therefore, the court finds that Debtor has failed to prove any right to homestead exemption pursuant to Iowa Code § 561.20.

IT IS THEREFORE ORDERED that the findings of fact portion of the order sustaining exemptions filed on September 11, 1995, shall be changed to reflect that the personal guarantee of Henss to Garland occurred in March of 1984.

IT IS FURTHER ORDERED that this change does not affect the decision of the court as the court clearly considered the correct date of March of 1984 in the discussion section of the order.

IT IS FURTHER ORDERED that Debtor has failed to prove any rights to homestead exemption pursuant to § 561.20.

Dated this ________ day of November, 1995.

____
RUSSELL J. HILL, CHIEF JUDGE
UNITED STATES BANKRUPTCY COURT