

**UNITED STATES BANKRUPTCY COURT
For the Southern District of Iowa**

In re:	:	Case No. 00-3328-DH
MICHAEL G. MASTERSON,	:	
	:	
	:	Chapter 7
Debtor.	:	
	:	

ORDER— OBJECTIONS TO EXEMPTION AND OBJECTIONS THERETO

On January 18, 2001, a telephonic hearing was held on Creditor, Sanchez and Hook, and Trustee’s Objections to Exemption and Debtor’s Objections Thereto. Attorney Thomas J. Yeggy represented Sanchez and Hook (hereinafter Creditor). Attorney Dale G. Haake represented Trustee, A. Fred Berger. Attorney Steven E. Balk represented Debtor. At the conclusion of the hearing, the court took the matter under advisement on a briefing schedule. Post-hearing briefs have been received, and the court now considers the matter fully submitted.

The court has jurisdiction of these matters pursuant to 28 U.S. C. § 157(b)(1) and § 1334 and order of the United States District Court for the Southern District of Iowa pursuant to 28 U.S.C. § 157(a). This is a core proceeding pursuant to 28 U.S.C. § 157(b)(2)(B). Upon review of the pleadings, stipulation of facts, evidence, and arguments of counsel, the court now enters its findings and conclusions pursuant to Fed. R. Bankr. P. 7052.

FINDINGS OF FACT

1. On September 8, 2000, Michael G. Masterson (hereinafter Debtor) filed a petition for relief under Chapter 7 of Title 11, the Bankruptcy Code.
2. On Schedule B, Personal Property, Debtor scheduled a Roth IRA (Individual Retirement Account) valued at \$22,794.00.
3. On Schedule C, Property Claimed as Exempt, Debtor scheduled the Roth IRA as exempt under Iowa Code § 627.6(8)(e). Debtor subsequently amended his schedules on November 22, 2000. The amendment did not change the exemption entry for the Roth IRA.
4. Debtor opened the Roth IRA with the Edward Jones Company on April 27, 1999. Debtor transferred \$6,283.85 from a Roth IRA at Norwest to the Edward Jones account. He made a similar transfer of \$2,074.36 from Dewitt Bank and Trust on May 26. On June 1, he contributed \$2,000.00 to the account for the 1999 tax year.
5. On February 14, 2000, Debtor took a distribution of \$18,174.00 from the Edward Jones Roth IRA.
6. On April 13, 2000, Debtor deposited \$20,174.00 into the Edward Jones Roth IRA account. Debtor identified \$2,000.00 of this amount as a contribution for the 2000 tax year and \$18,174.00 as replacement for earlier distribution.

DISCUSSION

This matter comes before the court on Trustee's Objection to Exemption and Creditor's Objection to Exemption. They ask the court to disallow Debtor's claim of

exemption in the Roth IRA. They argue, that under the Iowa Code Debtor, may only legally contribute and exempt \$2,000.00 for the tax year 2000. The attempted “repayment” of \$18,174.00 constitutes a contribution in excess of the allowable amount and therefore, is nonexempt property of the bankruptcy estate. For the following reasons, the court agrees with Trustee and Creditor, and Debtor’s claim of exemption will be partially disallowed.

The filing of a bankruptcy petition creates an estate comprised of all "legal and equitable interests of the debtor in property...." 11 U.S.C. § 541(a)(1). From this estate, a debtor may exempt certain property. 11 U.S.C. § 522(b). Section 522(b)(1) permits the states to "opt out" of the federal exemption scheme and requires the debtor to use the exemptions provided by state law. Once a state opts out, “its debtors are limited to the exemptions provided by state law.” Owen v. Owen, 500 U.S. 305, 308 (1991). Iowa has chosen to opt out of the federal exemptions. Iowa Code § 627.10. Therefore, Iowa law determines the scope of the exemptions.

A party in interest may object to a debtor’s claim of exemption. Fed. R. Bankr. P. 4003(b). The burden is on the objecting party to prove that the exemption is not properly claimed.

At the outset, the court notes that Debtor claimed the Roth IRA exempt under Iowa Code § 627.6(8)(e). In resistance to Trustee’s objection, Debtor relied on § 627.6(8)(e). Debtor amended his schedules on November 22, 2000, and again claimed exemption under the same statute. Hearing was held on January 18, 2000, and Debtor offered arguments for exemption under § 627.6(8)(e).

This court has consistently held that a debtor may not exempt an interest in an individual retirement account under § 627.6(8)(e). In re Griffieon, slip op. 97-3649-CH at 4 (Bankr. S.D. Iowa June 23, 1998). Debtor does not offer any special circumstances which would merit divergence from the general rule. See In re Caslavka, 179 B.R. 141 (Bankr. N.D. Iowa 1995)(IRA fully funded by rollover from ERISA qualified plan exempt). Consequently, the court finds that Debtor's Roth IRA is not exempt under § 627.6(8)(e).

Debtor apparently concedes that his Roth IRA is not exempt under (8)(e). In his post-hearing brief, he abandons the arguments made in the pleadings and at the hearing, and for the first time argues that the IRA is not property of the bankruptcy estate. Neither Trustee nor Creditor objected to Debtor's raising the issue post-hearing, and both responded to his arguments in their respective briefs. Therefore, the court will conclude that they have waived any objections and consider the issue as before the court.

Currently, there is a split in the circuits on the issue of whether an IRA is property of the bankruptcy estate based on an exemption statute. The actual issue might be better stated as whether the restriction on transfer must be included in the pension plan provisions creating the trust. The Third Circuit in Orr v. Yuhas (In re Yuhas), 104 F.3rd 612 (3rd Cir. 1997) held that a New Jersey statute, N.J.S.A. § 25:2-1(b), exempting from creditors' claims any property held in a qualifying trust and any distributions made from a qualifying trust constituted a restriction on transfer that was enforceable under nonbankruptcy law. The court concluded that, under 11 U.S.C. § 541(c)(2), the statute restriction was enforceable in bankruptcy; therefore, the IRA was not property of the

bankruptcy estate. Id. Likewise, the Eleventh Circuit reached a similar result in Meehan v. Wallace (In re Meehan), 102 F.3d 1209 (11th Cir. 1997). There, the court held that Georgia statute, O.C.G.A. § 18-4-22(a) imposed a restriction on transfer by garnishment. Id. at 1211. The debtor's interest in the IRA was excluded from the bankruptcy estate. Id. at 1214.

In Lowenschuss v. Selnick (In re Lowenschuss), 171 F.3d 673, 683 (9th Cir. 1999), the Ninth Circuit court acknowledged that it was creating a split in the circuits when it reached the opposite conclusion. In that case, the court determined that a pension plan that did not qualify under ERISA was property of the bankruptcy estate. It held that in order for a debtor's beneficial interest in a pension plan to be excluded from the estate, the plan must contain a transfer restriction and that transfer restriction must be enforceable under state or federal law. Id. at 680-682. In considering Pennsylvania law, the Ninth Circuit ruled that section 8124(b) of the Pennsylvania Consolidated Statutes did not suffice because it was an exemption statute and did not allow the debtor to enforce the pension plan's transfer restriction as required by Patterson v. Shumate, 504 U.S. 753 (1992). In re Lowenschuss, 171 F.3d at 682.

Additionally, at least one bankruptcy court in Michigan has held that the restriction on transfer must be contained in the language of the trust. In re Zott, 225 B.R. 160, 164 (Bankr. E.D. Mich. 1998). The court held that the restriction on execution on plan funds contained in Mich. Comp. Laws Ann. § 600.6023(1)(k) pertained to a debtor's choice of exemptions in bankruptcy and was not relevant for purposes of § 541(c)(2). Id. at 163.

The Eighth Circuit has not addressed the precise issue before this court, however, the Eleventh Circuit cites Whetzal v. Alderson, 32 F.3d 1302 (8th Cir. 1994) as support for its position. In re Meehan, 102 F.3d at 1213. In that case, the bankruptcy court determined that the debtor's right to take a lump sum payment from his Civil Service Retirement System pension plan was property of the bankruptcy estate. The United States District Court for South Dakota affirmed, "stating that because the debtor had 'the unfettered right to the assets of this pension fund' the trustee could exercise the option to receive the debtor's benefits in one lump sum." Id. at 1303. The Eight Circuit reversed holding that the civil service plan was covered by a restriction on transfer similar to that required by ERISA. Id. The court recognized that 5 U.S.C. § 8346(a) provided that civil service retirement benefits were not assignable or subject to levy, attachment, or other legal process except as otherwise provided by federal laws. Id. The court relied on Patterson v. Shumate in determining that the option to withdraw lump sum benefits from the civil service retirement account did not make the benefits property of the bankruptcy estate. Id. at 1303-1305.

The Eleventh Circuit cited Whetzal v. Alderson in support of its analysis that the transfer restriction may be provided by a statute rather than the pension plan. In re Meehan, 102 F.3d at 121. The court stated that nothing in the Eighth Circuit opinion or 5 U.S.C. § 8346(a) indicates that a plan document exists. Id.

The bankruptcy court in Zott distinguished Whetzal v. Alderson. That court found the Eleventh Circuit's interpretation of Whetzal v. Alderson misplaced because an IRA is a private retirement plan and not a pension covered by the Civil Service

Retirement Act. In re Zott, 225 B.R. at 165. Under the statutory provisions, the Act was the retirement plan document. Id. at 166. Further, under 5 U.S.C. § 8346(a) the anti-alienation provision is enforceable on debtors and creditors alike. Id.

While this court is inclined to agree with the § 541(c)(2) analysis of In re Zott, the court need not decide the issue at this time because such a determination will have relatively little bearing on the outcome in this case.

First, the court notes that the issue more often arises in those jurisdictions where debtors may choose either state exemptions or the federal exemptions listed in the Bankruptcy Code. In those instances, debtors attempt to avail themselves of both the federal exemptions and a state exemption for IRAs. As stated above, Iowa has opted out of the federal exemptions, and debtor must use the exemptions provided by Iowa law.

Debtor argues that the Roth IRA is not property of the bankruptcy estate because Iowa Code § 627.6(8)(f)(3) provides a restriction on the transfer of his interest to creditors. He maintains that the entire corpus of the account is excluded from the estate. The court disagrees.

Section 541(c)(2) provides:

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

Pursuant to this section, the “Bankruptcy Code merely allows a transfer restriction that is enforceable outside of bankruptcy to be enforced within bankruptcy.” In re Lowenschuss, 171 F.3d at 681. Section 627.6(8)(f)(3) became effective on May 17, 1999 as part of House file 660. It provides in relevant part:

f. Contributions and assets, including the accumulated earnings and market increases in value, in any of the plans or contracts as follows:

* * *

(3) For simplified employee pension plans, self-employed pension plans, Keogh plans (also known as H.R. 10 plans), individual retirement accounts, Roth individual retirement accounts, savings incentive matched plans for employees, salary reduction simplified employee pension plans (also known as SARSEPs), and similar plans for retirement investments authorized in the future under federal law, the exemption for contributions shall not exceed, for each tax year of contributions, the actual amount of the contribution or two thousand dollars, whichever is less. The exemption for accumulated earnings and market increases in value of plans under this subparagraph shall be limited to an amount determined by multiplying all the accumulated earnings and market increases in value by a fraction, the numerator of which is the total amount of exempt contributions as determined by this subparagraph, and the denominator of which is the total of exempt and nonexempt contributions to the plan.

For purposes of this paragraph "f", "market increases in value" shall include, but shall not be limited to, dividends, stock splits, interest, and appreciation.

"Contributions" means contributions by the debtor and by the debtor's employer.

By its plain language, § 627.6(8)(f)(3) limits the exemption amount of a Roth IRA to the actual contribution amount not to exceed \$2,000.00 for each tax year of contributions and the accumulated earning and market increases on the exempt amount. Therefore, even under Debtor's position, while the properly exemptible contributions and increases on that amount would not be property of the bankruptcy estate, any contributions and increases attributable to that amount would be property of the estate and turned over to the Trustee.

The final result is the same if the court rejects Debtor's position and determines that the Roth IRA is property of the bankruptcy estate. In that instance, Debtor may utilize § 627.6(8)(f)(3) to exempt his actual contributions up to \$2,000.00 for each tax year along with the increases derived from that amount. Any excess contributions and the increases attributable to that amount remains property of the estate and subject to

distribution among the creditors. Regardless, of whether the amount of the Roth IRA preserved for the Debtor is excluded for the estate in the first instant or exempted out of the estate in the second, the final result under Iowa law is the same.

In this case, the court finds that on the date of the petition Debtor claimed a beneficial interest in a Roth IRA valued at \$22,794.00. Debtor opened the account in 1999 with Edward Jones Company. He offered no evidence as to the initial amount or the source of the funds. In 1999, Debtor transferred funds from two other Roth IRA accounts totaling \$8,358.21 into this account and deposited \$2,000.00 for the 1999 tax year. On February 14, 2000, Debtor took a distribution of \$18,174.00 from the Roth IRA account. He offered no evidence as to a remaining balance or, if any, the source of those funds. On April 13, 2000, Debtor deposited \$20,174.00 into the Roth account.

Under the Tax Code, a distribution from a Roth IRA is treated as made first from the contributions made to the account. 26 U.S.C. § 408A(d)(4)(B)(i). The court finds this method to be appropriate for determining the exemption amount provided under § 627.6(8)(f)(3). Consequently, the court finds that Debtor's \$18,174.00 distribution necessarily included the 1999 contribution and the transfers from the other Roth IRAs. Because Debtor offered no evidence of the account balance after the distribution or evidence of the source of any remaining balance, the court finds that no accumulated earnings or market increases remained in the account for purposes of § 627.6(8)(f)(3). The court further finds that \$2,000.00 of the \$20,174.00 deposited on April 13, 2000, constitute an exempt contribution under § 627.6(8)(f)(3), and the remaining amount is a nonexempt contribution.

Section § 627.6(8)(f)(3) directs the court to calculate a fraction, the numerator of which is the total exempt contributions, and the denominator of which is the total exempt and nonexempt contributions. In this case, the numerator is 2000, and the denominator is 20174, the fraction being 2000/20174. The accumulated earnings and market increases fraction should then be multiplied by this fraction. However, as stated earlier, Debtor supplied no evidence of earnings, market increases, or balances. While it is arguable that the \$2,620.00 represents earnings and increases, there is no evidence before the court to substantiate that position. It is just as reasonable to assume the amount represents a contribution in excess of the exempt amount. The court finds that \$0 represents the accumulated earnings and market increases and accordingly no additional exemption is available under the statute.

Under either of the above methods, Debtor would be entitled to a \$2,000.00 exemption for the Roth IRA. As the court noted previously, Debtor did not claim the exemption provided by § 627.6(8)(f)(3), and the court denied the exemption under § 627.6(8)(e). However, the court recognizes that (f)(3) is a new addition to the Iowa Code first appearing in the bound volumes in the 2001 edition. Further, Creditor and Trustee agree that under the new section, Debtor would be entitled to a \$2,000.00 exemption for the 2000 tax year contribution, and in brief essentially argue that Debtor should be limited to that amount. Therefore, equity suggests that Debtor should be allowed to amend his schedules to claim the exemption provided in § 627.6(8)(f)(3), and the court will so order. The remainder of the Roth IRA shall be turned over to Trustee for administration.

Finally, the court notes that Trustee suggests that Debtor may be liable for payment of funds pursuant to 11 U.S.C. §§ 544, 545, 547, or 548. Each of these Code sections cross-references Fed. R. Bankr. P. 7001(1) and are properly brought as adversary proceedings with all the accompanying procedural safeguards. The court expresses no opinion as to actions under the above sections or any other action Trustee may take. Trustee is free to pursue the course he deems appropriate.

ORDER

IT IS ACCORDINGLY ORDERED as follows:

1. Creditor's Objection to Exemption claimed under Iowa Code § 627.6(8)(e) is SUSTAINED.
2. Trustee's Objection to Exemption claimed under Iowa Code § 627.6(8)(e) is SUSTAINED.
3. Debtor shall amend his schedules to claim \$2,000.00 in the Edward Jones Company Roth IRA exempt under Iowa Code § 627.6(8)(f)(3).
4. Excepting the exempted \$2,000.00, Debtor shall turn over the remainder of the Edward Jones Company Roth IRA to the Chapter 7 Trustee.

RUSSELL J. HILL, CHIEF JUDGE
U.S. BANKRUPTCY COURT