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PRESENT LAW AND ISSUES RELATING TO THE TREATMENT OF QUALIFIED PENSION PLANS IN PERSONAL BANKRUPTCY

PREPARED BY THE STAFF

OF THE

JOINT COMMITTEE ON TAXATION

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INTRODUCTION

This pamphlet,[1] prepared by the staff of the Joint Committee on Taxation, provides a discussion of present law and issues relating to the treatment of employee benefit plans in personal bankruptcy.

Part I of the pamphlet is a summary. Part II is an overview of present law and an analysis. Part III is a discussion of three possible options for resolving the apparent conflict between the Internal Revenue Code and the Bankruptcy Reform Act of 1978. Part IV is a description of H.R. 3804, the Personal Bankruptcy Pension Protection Act of 1991, introduced by Mr. Gibbons on November 19, 1991.

[1] This pamphlet may be cited as follows: Joint Committee on Taxation, *Present Law and Issues Relating to the Treatment of Qualified Pension Plans in Personal Bankruptcy* (JCS-16-91), November 27, 1991.

I. SUMMARY

Present-law rules relating to the treatment of pension plan assets in personal bankruptcy

When an individual who is a participant in a pension plan declares personal bankruptcy, the individual's creditors sometimes attempt to satisfy their claims by seeking assignment of the individual's pension benefits. Under the Internal Revenue Code, a pension plan is not tax qualified unless it provides that benefits under the plan may not be assigned or alienated. Nevertheless, a number of bankruptcy courts have ordered plan trustees to pay over benefits to the creditors of a bankrupt plan participant.

The Internal Revenue Service has stated that compliance by a pension plan trustee with such an order may result in automatic disqualification of the plan under the Internal Revenue Code. Compliance with the order also could constitute a breach of the plan trustee's fiduciary duty under title I of the Employee Retirement Income Security Act of 1974 (ERISA). However, failure to comply with the order could result in a finding of contempt by the bankruptcy court.

The problem stems from the inherent conflict between the competing policies of the Internal Revenue Code and ERISA on the one hand and the Bankruptcy Reform Act of 1978 (the bankruptcy code) on the other. An important policy of the Internal Revenue Code and title I of ERISA is to protect employee pension benefits against assignment or alienation to encourage and protect the accumulation of savings for retirement. A basic goal of the bankruptcy code is to preserve, to the fullest extent possible, creditors' rights in bankruptcy. Title I of ERISA generally preempts State laws that relate to employee benefit plans. However, ERISA does not preempt other Federal laws. None of ERISA, the Internal Revenue Code, or the bankruptcy code explicitly state that it has precedence over the other and, because each is Federal law, none automatically preempts another. Accordingly, when these statutes apply in a given situation, the courts have found it difficult to determine which has priority.

As a result, the status of an individual's pension benefits in bankruptcy varies significantly depending on where the case is filed. In most jurisdictions, plan assets are not automatically excluded from an individual's bankruptcy estate. Whether or not the assets are subject to the claims of the individual's creditors depends on applicable State law and the terms of the relevant plan. This is confusing for individuals and plan trustees. It also would appear to run directly afoul of the express intent of Congress in passing ERISA and its sweeping State law preemption provision: that pension plans subject to ERISA would be treated uniformly across the country, rather than be subjected to the vagaries of

State law. In jurisdictions that do not exempt pension assets from bankruptcy, plan trustees are presented with an impossible choice—to comply with a bankruptcy order and risk plan disqualification and fiduciary liability, or refuse the order and face possible contempt charges.

Possible options

There are a number of possible approaches to solving the problem. One approach would be to wait for the matter to be resolved by the Supreme Court. However, it could take some time before the Court agrees to decide the issue. A more direct approach would be to adopt legislation to provide explicitly that the antialienation provisions in ERISA and the Internal Revenue Code apply in bankruptcy. The statutes also could be amended to provide that the antialienation provisions do not apply in bankruptcy. In between these two extremes are a number of possible compromise solutions under which plan assets would be exempt from bankruptcy in some cases while in other cases they would not.

Summary of H.R. 3804

H.R. 3804, the Personal Bankruptcy Pension Protection Act of 1991, clarifies the treatment of qualified pension plan assets when an individual declares personal bankruptcy. Under the Act, benefits provided under pension plans that are qualified under the Internal Revenue Code generally are excluded from the bankruptcy estate, except in the case of fraud. Thus, benefits provided under qualified pension plans generally are not subject to the claims of a bankrupt individual's creditors.

II. PRESENT LAW AND ANALYSIS [2]

A. Statutory Overview

A plan of deferred compensation that meets the qualification standards of the Internal Revenue Code (a qualified plan) is accorded special tax treatment under present law. Employees do not include qualified plan benefits in gross income until the benefits are distributed even though the plan is funded and the benefits are nonforfeitable. The employer is entitled to a current deduction (within limits) for contributions to a qualified plan even though an employee's income inclusion is deferred.

The qualification standards of the Internal Revenue Code are designed to achieve various tax and retirement policy goals.[3] One of the qualification requirements is an antialienation provision which provides that "[a] trust shall not constitute a qualified trust under [the Internal Revenue Code] unless the plan of which such a trust is a part provides that benefits provided under the plan may not be assigned or alienated." (Code sec. 401(a)(13)).[4] This requirement generally applies to all qualified plans other than plans maintained by churches or State or local governments, although such plans may incorporate the rule into the documents governing the plan.

The Internal Revenue Code also provides tax-favored status for certain types of retirement savings arrangements other than qualified plans, such as individual retirement arrangements (IRAs), simplified employee pensions (SEPs), and tax-sheltered annuities (Code sec. 403(b)). These arrangements provide tax benefits similar to those of qualified plans in that individuals are not taxed on contributions or earnings until distributed from the IRA, SEP, or tax-sheltered annuity. However, there are significant differences between the tax rules applicable to such arrangements and qualified plans, and not all of the qualification rules apply. In particular, the antialienation rule does not apply, although some plans may include a similar provision.

Title I of the Employee Retirement Income Security Act of 1974 (ERISA) sets forth standards that apply to most pension plans maintained by nongovernmental employers. For purposes of ERISA, a pension plan generally is defined as any plan, whether tax-qualified or not, maintained by an employer or employee organization that provides retirement income or results in a deferral of

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[2] Note: References to "Code sec." refer to the Internal Revenue Code; other section references are specifically identified as either "ERISA sec.", "section of the bankruptcy code", or "section of the Bankruptcy Reform Act of 1978".

[3] For a detailed description of qualified plans see Joint Committee on Taxation, *Present-Law Tax Rules Relating to Qualified Pension Plans* (JCS-9-90), March 22, 1990.

[4] There are limited exceptions to this rule for (1) revocable assignments of no more than 10 percent of benefits in pay status, (2) the pledging of a participant's account as security for a loan to the participant if the loan meets certain requirements, and (3) assignment of benefits to an alternate payee pursuant to a qualified domestic relation order.

income by employees for periods extending to the termination of employment or beyond.

Among the requirements imposed under ERISA is an antialienation rule which requires that "[e]ach pension plan shall provide that benefits provided under the plan may not be assigned or alienated." (ERISA sec. 206(d)(11)). This requirement applies to most plans subject to ERISA, including most tax-qualified pension plans. However, the requirement does not apply to (1) unfunded nonqualified deferred compensation plans maintained for a select group of management or highly compensated employees (top hat plans), (2) plans maintained solely for the purpose of providing benefits in excess of the Internal Revenue Code's limits on benefits and contributions (excess benefit plans), (3) IRAs, (4) plans maintained by State or local governments, (5) church plans, (6) pension plans under which no employees are participants (e.g., certain Keogh plans under which only partners or a sole proprietor are participants), and (7) tax-sheltered annuities (Code sec. 403(b)) under which the only contributions are salary reduction contributions. A plan trustee that disregards ERISA's alienation provision violates his or her fiduciary duty to plan participants.

Bankruptcy proceedings are governed exclusively by Federal bankruptcy law. Section 541 of the Bankruptcy Reform Act of 1978 (the bankruptcy code) provides that the commencement of a case creates an estate, and that such estate generally is comprised of all of the debtor's legal and equitable interests. Excluded from the estate, however, are certain trust interests that are subject to a restriction on transfer enforceable under applicable nonbankruptcy law. An interest in a trust subject to such a restriction on transfer never becomes part of the estate and is not subject to the claims of creditors.

Property that is part of the bankruptcy estate may in some cases be shielded from creditors by means of one or more exemptions. Under section 522(b)(1) of the bankruptcy code, a debtor may avail himself or herself of the Federal exemptions in section 522(d) of the bankruptcy code, unless the State of the debtor's domicile has "opted out" of allowing Federal exemptions. If the State has opted out, or if the debtor chooses not to apply the Federal exemptions (in cases where the debtor has a choice), section 522(b)(2) of the bankruptcy code allows the debtor to use exemptions available under State law and Federal nonbankruptcy law.

The Internal Revenue Service has stated that compliance by a pension plan trustee with a court order to pay over benefits to the creditors of a bankrupt plan participant may result in automatic disqualification of the plan under the Internal Revenue Code.[5] Compliance with the order also could constitute a breach of the plan trustee's fiduciary duty to plan participants under ERISA. Failure to comply with the order, however, could result in a finding of contempt by the Bankruptcy Court. Thus, the trustee generally must comply with the order and risk tax disqualification and liability for breach of fiduciary duty under ERISA.

[5] See, e.g., PLR 9109051 (March 6, 1991).

B. Analysis

There are five legal theories that pension plan trustees have used to argue that plan assets are beyond the reach of a bankrupt participant's creditors. Two of the theories are based on the application of section 541 of the bankruptcy code, relating to the creation of the bankruptcy estate. The other three theories are based on section 522 of the bankruptcy code, relating to exemptions.

Exclusion from bankruptcy estate: section 541(c)(2) of the bankruptcy code

ERISA as applicable nonbankruptcy law

Section 541 of the bankruptcy code provides that the commencement of a case creates an estate, and that such estate generally includes all legal or equitable interests of the debtor in property. Read alone, this would include a participant's interest in a pension plan. However, section 541(c)(2) of the bankruptcy code provides a special rule for trusts:

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

In other words, a trust interest that is subject to a restriction on transfer enforceable under applicable nonbankruptcy law does not become part of the bankruptcy estate.

Pension plan trustees have argued that the anti- alienation provisions in the Internal Revenue Code and title I of ERISA constitute a restriction on transfer described in section 541(c)(2) of the bankruptcy code. Because of this, they argue, a plan participant's interest in a pension plan does not become part of the bankruptcy estate and plan assets are beyond the reach of creditors. This "plain meaning" interpretation of section 541(c)(2), they point out, is the only reading of the statute that avoids a conflict between the ERISA and Internal Revenue Code provisions and the bankruptcy code in all cases, and thus, under principles of statutory interpretation, should be the one adopted by the courts.

This argument has been successful at the Federal Court of Appeals level only in the 4th and 6th Circuits. All of the other Federal Appeals Courts that have considered the issue (including the 2nd, 5th, 8th, 9th, and 11th Circuits) have rejected it. The latter courts have held that the phrase "applicable nonbankruptcy law" in section 514(c)(2) of the bankruptcy code was intended by Congress to be a narrow reference to state spendthrift trust law and not a broad reference to all other laws, including other Federal laws, that prohibit alienation.[6] In most jurisdictions, therefore,

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[6] These courts point to legislative history indicating that section 514(c)(2) is intended to refer to State spendthrift trust law. However, a counter argument can be made that because there is no ambiguity on the face of the statute, no reason exists to refer to legislative history. See, e.g., *In re Moore*, 907 F.2d 1476, 1478–9 (4th Cir. 1990) ("An appeal to legislative history is inappropriate here because the language of section 514(c)(2) is clear."). Accord *Davis v. Michigan Department of Treasury*, 109 S.Ct. 1500, 1504 n.3 (1989) ("Legislative history is irrelevant to the interpretation of an unambiguous statute."). See also *Forbes v. Lucas*, 924 F.2d 597 (6th Cir. 1991) (plan assets are not included in the bankruptcy estate because ERISA's antialienation provision constitutes a restriction on transfer enforceable under applicable nonbankruptcy law), cert.

Continued

pension plan assets are not excluded from the bankruptcy estate solely because the Internal Revenue Code or title I of ERISA provides for restrictions on assignment and alienation.

Pension plan as spendthrift trust

Plan trustees have argued that even if the Internal Revenue Code or ERISA are not applicable nonbankruptcy law, plan assets are nonetheless excluded from the bankruptcy estate pursuant to section 541(c)(2) because the plan is a spendthrift trust under State law. While the Federal Court of Appeals for the 2nd Circuit has suggested that a pension plan can never meet the criteria for a spendthrift trust under applicable State law,[7] other Federal Circuit Courts have suggested that it may be possible to qualify.

Whether a pension plan qualifies as a spendthrift trust under State law, however, depends on the precise language of the plan and the applicable State law. For example, a hallmark of a spendthrift trust is the beneficiary's inability to readily obtain the funds. Withdrawal or borrowing rights in a pension plan could thus be fatal to a claim that the plan qualifies as a spendthrift trust. Moreover, in some jurisdictions it appears that the debtor's ability to obtain funds by terminating employment is sufficient to defeat a spendthrift trust claim.[8]

Some States, such as Ohio, do not even recognize the spendthrift trust concept, so the spendthrift trust exemption is of no use there.[9]

Exemptions: section 522 of the bankruptcy code

In general

If plan assets are considered to be part of the bankruptcy estate, plan trustees and participants may still be able to avoid the claims of creditors through application of one of the exemptions set forth in section 522 of the bankruptcy code. Section 522(b) of the bankruptcy code provides two alternative exemption schemes under which plan trustees and participants have argued that pension plan assets are exempt from the claims of creditors.

Federal exemptions

A debtor who elects to use the Federal exemption scheme may attempt to shield pension plan assets under one of the exemptions set forth in section 522(d) of the bankruptcy code. However, the exemptions listed in section 522(d) are only available to the debtor if the State in which the debtor files for bankruptcy has not "opted out" of allowing the Federal exemptions. Thirty-five States (including Florida, California, and New York) have passed statutes

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denied, 1991 US LEXIS 3170 (June 3, 1991). The Supreme Court's denial of certiorari in the *Forbes* case could be interpreted as tacit approval of the 6th Circuit's ruling in the case (although it is unlikely that courts outside of the 4th and 6th Circuits will read it this way).

Moreover, even if the legislative history is relevant in this situation, it arguably is inconclusive. The legislative history indicates that section 541(c)(2) is intended to refer to State spendthrift trusts. It does not, however, state that the provision applies *only* to spendthrift trusts. See *Moore*, 907 F.2d at 1479.

[7] See *Regan v. Ross*, 691 F.2d 81 (2nd Cir. 1982).

[8] See *In re Shuman*, 78 Bankr. Reptr. 254 (9th Cir. B.A.P. 1987).

[9] See *Sherrow v. Brookover*, 189 N.E.2d 90 (Ohio Sup. Ct. 1963).

making section 522(d) inapplicable. Therefore, in most cases, the Federal scheme is not available.

In States that have not opted out of section 522(d), the debtor may be able to rely on section 522(d)(10) of the bankruptcy code to exempt at least a portion of his or her pension assets. Under that section, payments under most pension plans are generally exempt to the extent reasonably necessary for the support of the debtor and any dependent of the debtor. The protected amount is what is needed to sustain basic needs but not necessarily to maintain the debtor in his or her past standard of living.[10] Often, then, it is not a complete exemption—only the part needed to sustain basic needs is shielded from creditors.

State exemptions

An alternative to the Federal exemption scheme is the State exemption scheme contained in section 522(b)(2) of the bankruptcy code. Section 522(b)(2)(A) exempts from bankruptcy any property that is exempt under State or local law or Federal nonbankruptcy law. Plan trustees have made two arguments under this provision.

In some cases, plan trustees have argued that pension plans are exempt under applicable State or local law. The courts have approached this argument in different ways. Many courts simply examine State law to see if there is a general exemption for pension plans. Most recent cases, however, say that there can be no State law exemption for pension plans because any such law relates to pension plans and is therefore preempted by ERISA.[11]

The second argument under section 522(b)(2)(A) of the bankruptcy code is that the antialienation rules in title I of ERISA and the Internal Revenue Code constitute Federal nonbankruptcy law exempting pension plans from the claims of creditors within the meaning of that section. Some plan trustees have argued this point successfully.[12] However, most courts have found that these rules are not the kind of Federal nonbankruptcy law contemplated by section 522 of the bankruptcy code. These courts have ruled that the antialienation provisions of the Internal Revenue Code and title I of ERISA are not the same type of Federal law exemptions as those cited in the legislative history of section 522(b)(2)(A) of the bankruptcy code, and that those provisions are therefore inapplicable.[13]

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[10] See *In re Grant*, 40 Bankr. Reptr. 612 (Bankr. W.D. Tex. 1984).

[11] See, e.g., *In re Komet*, 104 Bankr. Reptr. 799 (Bankr. D. Colo. 1989). Section 514(a) of ERISA provides that ERISA generally preempts any State law insofar that it relates to any employee benefit plan subject to regulation under ERISA.

[12] See, e.g., *In re Starkey*, 116 Bankr. Reptr. 259 (Bankr. D. Colo. 1990).

[13] See, e.g., *In re Gribben*, 84 Bankr. Reptr. 494 (S.D. Ohio 1988).

III. POSSIBLE OPTIONS

There are a number of possible approaches to resolving the perceived conflict between the ERISA and Internal Revenue Code antialienation provisions and the bankruptcy code. The following is a brief discussion of three possible options.

A. Await Resolution by the Courts

One approach would be to wait for the matter to be resolved in the courts. Because of the split among the Federal Appeals Courts on this issue, the controversy is ripe for Supreme Court review. However, it could take some time before the Court agrees to decide the issue. In fact, a request for certiorari in a case in which the proper resolution of the conflict between the Internal Revenue Code and title I of ERISA and the bankruptcy code was the issue was recently denied by the Court.[14]

Moreover, if the Supreme Court does agree to hear a case on the issue, the outcome might vary depending on the facts of the particular case heard. Consequently, a judicial solution to the problem may not produce a result that the Congress would consider appropriate as the generally applicable rule.

B. Provide that Antialienation Provisions Apply in Bankruptcy

A more direct approach to the problem would be to adopt legislation to clarify the treatment of qualified pension plan assets in personal bankruptcy.

Broad applicability

Section 541(c)(2) of the bankruptcy code could be amended to make it clear that antialienation provisions in plans qualified under ERISA or the Internal Revenue Code constitute "applicable nonbankruptcy law" within the meaning of that provision. Thus, assets in qualified pension plans that restrict alienation would not be includible in a participant's bankruptcy estate and would not be available to creditors.[15]

Another way to achieve a similar result would be to amend ERISA and the Internal Revenue Code to provide that the pension plan antialienation provisions apply in bankruptcy, notwithstanding anything to the contrary in the bankruptcy code. This would have the same general effect as the amendment to the bankruptcy

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[14] See *Forbes v. Lucas*, 924 F.2d 597 (6th Cir. 1991) (plan assets are not included in the bankruptcy estate because ERISA's antialienation provision constitutes a restriction on transfer enforceable under applicable nonbankruptcy law), cert. denied, 1991 US LEXIS 3170 (June 3, 1991).

[15] Some commentators argue that, to be consistent, loans made by qualified plans to participants may also have to be exempted from the bankruptcy estate. Thus, for example, loans would not be discharged and participants would not be prevented from continuing repayment of the loans through payroll withholding. However, it is not clear that loans from a qualified plan should be treated differently from other loans in bankruptcy.

code described above—the pension plan antialienation provisions under ERISA and the Internal Revenue Code would be given full effect in bankruptcy and plan assets would not be available to creditors.

To make the law absolutely clear on this issue, the Internal Revenue Code, ERISA, and the bankruptcy code each could be amended. This would ensure uniform treatment in all situations.

A forceful argument can be made that antialienation provisions in qualified pension plans apply in bankruptcy under present law so any amendment to state this explicitly—particularly if achieved by modifying section 541(c)(2) of the bankruptcy code—could be viewed as a mere clarification of present law. Moreover, excluding pension plan assets from bankruptcy would be consistent with the policies embodied in ERISA and the Internal Revenue Code: the exclusion would protect the legitimate expectations of participants and employers that amounts set aside in a pension plan will be available for retirement,[16] and pension plans subject to these restrictions would be treated uniformly across the country, rather than subject to regulation under differing State laws.

To prevent debtors from using pension plans improperly to shield assets to which creditors would otherwise have legitimate claims limited antiabuse rules could be adopted. For example, amounts contributed to a plan in the 12 months preceding bankruptcy could be subject to special scrutiny to ensure that excessive contributions were not made merely to avoid creditors' claims. Contributions made during this period could be denied exempt status to the extent they were significantly larger than contributions made in previous years, or excludable contributions could be capped at the applicable contribution or benefit limitations for qualified plans under the Internal Revenue Code.

Another way to prevent possible abuse would be to limit the pension plan bankruptcy exclusion in all cases to a specified dollar amount, such as the amount equal to the maximum level of benefits guaranteed by the Pension Benefit Guarantee Corporation (PBGC) under title IV of ERISA (whether or not the plan is subject to title IV).[17] Assets in excess of this amount would be left unprotected. This would result in plan assets being exempt in the vast majority of bankruptcy cases. However, debtors would not be able to shield unreasonably large pension accounts from their creditors.

Perhaps the easiest way to prevent abuse of the pension plan exclusion, though, would be to limit the exclusion to plans that are qualified under the Internal Revenue Code. Because contributions and benefits under qualified plans are subject to strict regulation under the Internal Revenue Code,[18] the potential for abusive use

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[16] The legislative history indicates that the Internal Revenue Code and ERISA title I antialienation provisions are designed to provide assurance that an "employee's accrued benefits are actually available for retirement purposes." See H. Rep. No. 807, 93rd Cong., 2nd Sess., reprinted in 1974 U.S. Code Cong. & Admin. News 4670, 4734.

[17] For 1991, the maximum amount guaranteed is $2,250 per month payable as a straight life annuity commencing at age 65.

[18] For example, contributions to a qualified plan on behalf of any participant are limited to no more than $30,000 in 1991 (Code sec. 415(c)). Nondiscrimination requirements (Code sec. 401(a)(4)) may also make it very difficult to significantly increase the amount of contributions made on behalf of any one participant in any particular year.

of these plans to avoid bankruptcy is limited. To discourage abusive transfers further, the pension plan exclusion could be deemed not to apply to the extent a bankruptcy court determined that contributions to a plan were made, or provisions of the plan were adopted, to hinder or defraud creditors. H.R. 3804, described in part IV of this pamphlet, adopts this approach.

Limited applicability

Alternatively, ERISA and the Internal Revenue Code could be amended to provide that the pension plan antialienation provisions apply in bankruptcy in some, but not all, circumstances. For example, the rule could be that the provisions would apply only in the case of certain types of plans, such as plans that do not include discretionary employee contributions, or to certain types of contributions, such as nonelective contributions or contributions not in excess of certain limits. Limitations on the application of the antialienation provisions also could be based on the degree of control the debtor has over the operation and administration of a plan.

This compromise approach would balance the competing policies of ERISA and the Internal Revenue Code and the bankruptcy code, providing that one or the other controlled depending on the situation of the particular debtor. In situations where the debtor has no control over the establishment or administration of the plan, or over the amount of plan contributions, denying access to assets in the plan should not be viewed as frustrating creditors' legitimate expectations. Plan benefits generally are not taken into account in credit extension decisions because they are not available as security. Thus, the antialienation provisions should apply.

On the other hand, where a participant retains control over a plan, the potential for abuse becomes more pronounced and bankruptcy code policies may be more compelling. A participant who can manipulate the amount of assets that can be placed in a pension plan could, if ERISA and the Internal Revenue Code antialienation provisions applied in all circumstances, shield assets that would otherwise be available to satisfy the legitimate claims of creditors. Thus, in this situation, the bankruptcy code policy of protecting creditors' rights may be the more pressing concern and the antialienation provisions arguably should give way.

While it is easy to depict examples in which the correct result seems clear, crafting a general rule to distinguish between situations in which ERISA or the bankruptcy code should prevail would be difficult. One approach would be to define what constitutes a "spendthrift trust" under Federal law, and use this as the determinant of whether plan assets are available in bankruptcy. The benefit of this approach is that it would mimic the approach taken by the majority of courts under present law, but plan trustees would no longer have to perform a State-by-State analysis of spendthrift law provisions with potentially differing results in each case. This would be consistent with the intent of Congress in passing ERISA and its sweeping State law preemption provision: that pension plans subject to ERISA would be treated uniformly across the country, rather than be subjected to the vagaries of State law.

Crafting statutory language to define what constitutes a Federal spendthrift trust for this purpose would be difficult, however. State spendthrift trust definitions generally provide for three things: (1 the debtor cannot be the person who has set up the trust (i.e., the trust is not self-settled); (2) the debtor must not be able to invade the corpus of the trust; and (3) the debtor cannot otherwise be in control of the trust. The extent to which these rules would be incorporated into Federal law, and the effect of the rules on pension plans, is unclear. For example, if a participant can receive a loan from his or her plan account, or if a participant can withdraw his or her pension plan assets upon termination of employment, does the participant have access to the assets? Should retirees, who are more likely to have immediate access to benefits, be entitled to less protection than active employees? Should participants in large-employer plans enjoy more protection in bankruptcy than participants in small-employer plans? This would typically be the case if the State law prohibition on "self-settled" trusts were incorporated into the Federal definition, because participants in the small-employer plan are more likely to control their employer than their large-employer counterparts.

C. Provide that the Bankruptcy Code Preempts the Internal Revenue Code and ERISA

Section 541(c)(2) of the bankruptcy code could be amended to explicitly provide that ERISA and the Internal Revenue Code are no "applicable nonbankruptcy law" within the meaning of that provision, and that notwithstanding anything to the contrary in ERISA or the Internal Revenue Code, pension plan assets could be included in a participant's bankruptcy estate. In addition, the Interna Revenue Code and ERISA could be amended to provide an exception from the antialienation requirements in the event a plan trustee is presented with a valid bankruptcy order.

This is present law in the majority of jurisdictions, but with the additional clarification that a plan would not be disqualified under the Internal Revenue Code if a plan trustee complied with a valid bankruptcy order. Thus, pension plan assets would continue to be includible in a participant's bankruptcy estate unless the plan qualified as a spendthrift trust under State law. Once in the estate assets could be shielded from creditors only if the bankrupt participant qualified for an exemption under the State or Federal exemption scheme.

This "solution" would further the bankruptcy code policy of enlarging the debtor's estate to enable creditors to satisfy their claims against bankrupt debtors, but only at the expense of ERISA and Internal Revenue Code retirement policy. Whether pension plan assets are subject to the claims of an individual's creditors would continue to depend on applicable State law and the terms of the relevant plan. As under present law, this would be confusing for individuals and plan trustees. It also would appear to run directly afoul of the express intent of Congress in passing ERISA and its sweeping State law preemption provision: that pension plans subject to ERISA would be treated uniformly across the country rather than be subjected to the vagaries of State law.

A more radical option would be to provide that pension plan assets always are included in the bankruptcy estate. This would avoid the State-by-State spendthrift law analysis that creates problems for plan trustees under the present-law majority approach. However, if plan assets could qualify for an exemption under the bankruptcy code exemption scheme, there would continue to be a lack of uniformity in the treatment of pension plans across the country. Removing the exemptions so that pension assets could never be exempt from the claims of creditors would be a result that would be very difficult to justify.

A more limited solution would be to strengthen the exemptions for pension plans under the State or Federal exemption schemes. For example, section 522(b)(2)(A) of the bankruptcy code could be amended to make it clear that ERISA and the Internal Revenue Code qualifies as Federal nonbankruptcy law for purposes of applying the State law exemption scheme. Alternatively, ERISA and the Internal Revenue Code could be amended to provide that State laws exempting pension plans from bankruptcy were not preempted. In either case, individuals who elected to use State law could exempt pension plan assets from the claims of creditors. One serious drawback of this approach is that plan trustees would still be forced to make State-by-State determinations, a result that ERISA sought to avoid.

IV. DESCRIPTION OF H.R. 3804

Explanation of Provisions

H.R. 3804, the Personal Bankruptcy Pension Protection Act of 1991, clarifies present law to provide explicitly that benefits under most qualified retirement plans are not part of the bankruptcy estate of a plan participant. Specifically, the bill provides that an individual's bankruptcy estate does not include benefits provided under a pension plan (Code sec. 401(a)), annuity plan (Code sec. 403(a)), or tax-sheltered annuity contract (Code sec. 403(b)) that is qualified under the Internal Revenue Code if the plan or contract provides that benefits may not be assigned or alienated other than as permitted under such Code. The exclusion applies whether or not the restriction on alienation is a required plan provision. Thus, benefits provided under tax-deferred annuity contracts and under qualified plans maintained by churches and State or local governments are eligible for the exclusion even though they are exempt from the general rule under the Code prohibiting assignment and alienation.

Consistent with general bankruptcy principles, assets that the bankruptcy court determines were transferred to a plan or contract to hinder or defraud creditors are not excluded from the bankruptcy estate under this rule. This exception applies only to assets attributable to contributions made during the 1-year period ending on the date the bankruptcy petition was filed. Contributions in excess of the applicable limits under section 415 or 402(g) of the Internal Revenue Code generally are presumed to be made to hinder or defraud creditors under this rule. Significant increases in the rate of contribution to a plan may also indicate intent to defraud creditors, particularly if the participant has control over the amount of contributions made to the plan. In either case, only the portion of the contributions determined to be fraudulent would be includible in the participant's bankruptcy estate.

The qualified plan exclusion also does not apply to any plan or contract that was, during the 1-year period ending on the date the bankruptcy petition was filed, amended to include an antialienation provision with the intent to hinder or defraud creditors. The exclusion also does not apply to plans or contacts adopted during such 1-year period if the plan or contract was adopted to hinder or defraud creditors.

The bill amends the Internal Revenue Code to provide that the pension plan antialienation requirement does not apply in cases in which a bankruptcy court has determined that an antialienation provision was adopted, or assets were transferred to a plan, to hinder or defraud the creditors of a bankrupt participant.

Effective Date

The provisions of the bill are effective for cases commencing after the date of enactment. No inference is intended to be created by the bill for cases commencing before the effective date.

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