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IN RE TEW:
QDRO Interest in Retirement Funds Exemption in Indiana

2005
A CLE Presentation

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The Debtor in In re Trace Lynn Tew, 03-19946-AJM-7, claimed an exemption in $5,000 in a mutual fund transferred to her by her former husband pursuant to a Qualified Domestic Relations Order ("QDRO") from the former husband's 401(k) plan. The Chapter 7 Trustee objected to the exemption. Judge Metz held that the $5,000 was not exempt in his decision, dated January 7, 2005.

The Debtor's former husband was a participant in an ERISA qualified 401(k) plan and made contributions to the plan. The Debtor made no contributions to the 401(k). As of the date of the divorce, former husband was a participant under the plan. The settlement agreement approved by the divorce court provided that the Debtor shall have exclusive legal title, free and clear of husband's claims, of $5,000 that was to be transferred to the Debtor from the 401(k) plan via a QDRO, which provided that the $5,000 was to be paid to the Debtor in a lump sum and was to be segregated in a separate account solely in her name. The $5,000 in the segregated account was to be invested in a mutual fund until such time as the Debtor requested payment or directed the investment of the $5,000 or otherwise. The QDRO also provided that the Debtor shall be paid the $5,000 in the form of a single lump sum payment or in any other form in which benefits could be paid under the 401(k) plan. The Debtor was responsible for all taxes attributable to the distribution. The QDRO was approved by the state court in September of 2003, and the Debtor filed her chapter 7 case in October of 2003. The Debtor was not a "participant" under the 401(k) plan but was considered an "Alternate Payee", under which the Debtor was entitled to immediate distribution of the $5,000 after they had been segregated and transferred pursuant to the QDRO. The Debtor, at any time, had the right to withdraw the $5,000 or transfer them to any other tax qualified plan subject to ERISA. If the Debtor transferred the $5,000 to another ERISA qualified plan, she would suffer no adverse tax consequences. The Debtor may totally liquidate her interest but if she did so, she would be subject to income tax consequences but not subject to the 10% penalty for early withdrawal.

The Debtor claimed the Funds as exempt and asserted that they are not property of the estate under Patterson v. Shumate, 504 U.S. 753 (1992). The Trustee asserted that the Funds are neither exempt under *Patterson* nor Ind. Code § 34-55-10-2(b)(6) since the Debtor did not contribute to the 401(k) plan and the contributions that were made by former husband were not made on the Debtor's behalf.

In his decision, Judge Metz first notes that the 401(k) plan itself is a qualified pension plan under ERISA and when the debtor is a *plan participant* under an ERISA qualified plan, the debtor's interest in the plan *remains out of reach* by his or her creditors and the bankruptcy trustee because ERISA's anti-alienation provisions fall under §541(c)(2)'s limited exception to that which is considered property of the estate, citing Patterson v. Shumate, 504 U.S. 753, 112. Noted Judge Metz, "these anti alienation provisions restrict a plan participant's right to transfer any interest he or she may have under the plan and likewise protect a plan participant's interest against the claims of his or her creditors." However, Judge Metz points out that under The Retirement Equity Act (REA) amendments to ERISA in 1984, an exception to the anti-alienation provisions was created which *allows* the assignment or placing a lien on a pension to collect *family support* obligations if it was pursuant to a QDRO.

The heart of the Tew decision is whether the $5,000 is property of the estate, given a split of authority in the Courts on whether the §541(c)(2)/Patterson exception extends to debtors whose interests are obtained via QDRO's and therefore the debtor's interest in the plan is not property of the estate. Judge Metz notes that the interest of the ex spouse taking under the QDRO is *not* property of the estate where: (1) that which is awarded the ex spouse via the QDRO is *an entitlement to receive from the plan participant a portion of the distributions the plan participant receives under the plan, rather than an outright assignment of a portion of the plan*, or (2) the QDRO orders the ex spouse to transfer the interest into another ERISA qualified plan, see, *In re Lalchandani,* 279 B.R. 880 (1st Cir BAP, 2002). Judge Metz concluded that the $5,000 is property of the estate on two alternate grounds: (1) the Debtor's interest is not in the 401(k) plan; rather it is in the $5,000 that originated from the 401(k) plan but which was made her sole and separate property and later segregated and transferred to the Schwab mutual fund; and (2) the Debtor has immediate and unrestricted access to the $5,000, which is inconsistent with the anti-alienation provisions of ERISA.

Finally Judge Metz addressed exemptions under Indiana law available to the Debtor. Judge Metz noted that Debtors residing in Indiana are entitled to exempt their interest in contributions, earnings on contributions, or roll overs of contributions to a pension plan as long as the contributions to the plan were made "by or on behalf *of the debtor*". Since the Debtor made no contributions to the 401(k) plan and since the Debtor was not a "participant" under the 401(k) plan, Judge Metz concludes that the contributions could not have been made on her behalf, and in fact were made only on behalf of the former husband. Accordingly the $5,000 were ruled to be not exempt under Ind. Code 34-55-10-2(b)(6).

HOW THIS ISSUE IS EFFECTED BY THE NEW INDIANA EXEMPTION LAW

The Indiana exemption statute was amended by and signed into law by Governor Daniels on May 2005. The effective date of the amendment is July 1, 2005. Among the amendments to the exemption statute, is an amendment to Ind. Code 34-55-10-2(b)(6). Thankfully for ex-spouses who take an interest in an ERISA plan as the debtor in Tew did, the amended statute provides relief. It states:

> (6) An interest, whether vested or not, that the ~~judgment~~ debtor has in a retirement plan or fund to the extent of:
>
> (A) contributions, or portions of contributions, that were made to the retirement plan or fund by or on behalf of the debtor or the debtor's spouse:
>
> ~~(i) by or on behalf of the debtor and~~
>
> ~~(ii)~~(i) which were not subject to federal income taxation to the debtor at the time of the contribution; or
>
> (ii) which are made to an individual retirement account in the manner prescribed by Section 408A of the Internal Revenue Code of 1986;
>
> (B) earnings on contributions made under clause (A) that are not subject to federal income taxation at the time of the ~~judgment;~~ levy; and
>
> (C) roll-overs of contributions made under clause (A) that are not subject to federal income taxation at the time of the ~~judgment.~~ levy.

Under the facts of Tew the addition of the phrase "or the debtor's spouse" in (6)(A) makes all the difference in the world because in Tew the contributions were made by the Debtor's spouse and not her. If Tew were filed after July 1, 2005, it seems clear that spouses who take an interest in an ERISA plan via a QDRO will not have to worry about whether their interest is exempt.

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