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JUDGE: M. A. Mahoney
PARTIES: Don Wade Rawls
CHAPTER:
ATTORNEYS: T. L. Hall, J. D. Barlar, Jr.
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UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF ALABAMA

In Re

DON WADE RAWLS Case No. 97-10096

Debtor.

ORDER

Theodore L. Hall, Chapter 7 Trustee, Mobile, Alabama, pro se.
J. Daniel Barlar, Jr., Mobile, Alabama, for Don Wade Rawls.

This matter is before the Court on the trustee's objection to Don Wade Rawls' exemption of his individual retirement account. The Court has jurisdiction to hear this matter pursuant to 28 U.S.C. §§ 157 and 1334 and the Order of Reference of the District Court. This is a core proceeding pursuant to 28 U.S.C. § 157(b)(2). For the reasons indicated below, the Court finds that Don Wade Rawls' individual retirement account is exempt from property of his bankruptcy estate pursuant to Alabama Code § 19-3-1(b) and 11 U.S.C. § 522(b)(2).

FACTS

In December 1993, Don Wade Rawls sought to purchase an individual retirement annuity (IRA). He submitted an application and an initial payment of $30,229.77 to an insurance representative working in Satsuma, Alabama. On January 10, 1994, Rawls was issued a contract by the Western Reserve Life Assurance Co. of Ohio (Western Reserve). Western Reserve's president and secretary signed the contract at the company's administrative office in Clearwater, Florida. Rawls' contract consists of a basic annuity contract and two endorsements. The first endorsement addresses the possibility of the annuitant being confined to a nursing care facility, and

the second endorsement proposes to amend the contract so that it qualifies as an individual retirement annuity under Section 408(b) of the Internal Revenue Code. The contract gives Rawls the ability to transfer funds out of the IRA subject to a tax penalty.

Rawls filed Chapter 7 on January 9, 1997. The parties agree that at the date of his bankruptcy filing the IRA had a balance of $11,061.02. In Schedule B of his bankruptcy petition Rawls' lists the IRA as excluded from his bankruptcy estate, and in Schedule C he claims his interest in the IRA as exempt pursuant to Alabama Code § 19-3-1(b) and Alabama Code § 6-10-6. In addition, Rawls' Statement of Financial Affairs shows withdrawals from the IRA of $10,000 in 1994, $3,200 in 1995, and $10,000 in 1996. The trustee filed an objection to Rawls' exemption of the IRA. The trustee alleged that Rawls was not entitled to claim the IRA as exempt under Alabama Code § 19-3-1(b); and, to the extent that Rawls can claim it as exempt under Alabama Code § 6-10-6, the value exceeds that which is allowed as exempt.

Counsel presented legal arguments. The trustee argued that the facts in this case are substantially similar to the facts in the case of *In re Slepian*, 170 B.R. 712 (Bankr. S.D. Ala. 1994). This Court held in *Slepian* that under Alabama law an IRA is property of the estate and is not exempt pursuant to 11 U.S.C. § 522 or Alabama Code § 19-3-1. The trustee also argued that because Rawls can withdraw funds from the IRA at any time, it would be unfair to creditors to protect those funds. Debtor's counsel argued that the facts of this case differ from the facts in *Slepian*. The contract in this case contains anti-alienation language, while the contract at issue in *Slepian* did not. Debtor's counsel also suggested that this Court should follow the analysis set forth in the case of *In re Harless,* 187 B.R. 719 (Bankr. N.D. Ala. 1995). In *Harless*, it was determined that under Alabama law an IRA is property of the estate, but is exempt pursuant to Alabama Code

§ 19-3-1(b). The parties stipulated to three things: (1) The contract qualifies per § 408(b) of the Internal Revenue Code; (2) The endorsements amend the basic contract and replace any contrary provisions; and (3) Alabama law is applicable.

LAW

There are two issues presented by this case: 1) whether the IRA is exempt pursuant to 11 U.S.C. § 522(b)(2), if it is determined to be property of the bankruptcy estate, and 2) whether the IRA is excluded from the bankruptcy estate pursuant to 11 U.S.C. § 541(c). Property that is excluded from the bankruptcy estate never comes into the estate, while exempt property comes into the estate but is protected from the reach of creditors if the debtor exercises the statutory exemption option. 11 U.S.C. § 522.

I.

For different reasons, both *Slepian* and *Harless* determined that, under Alabama law, IRAs were property of the bankruptcy estate. The Courts disagreed, however, on whether IRAs were exempt property. In the *Harless* case, Judge Michael Stilson found that IRAs were exempt from the bankruptcy estate.

> The Alabama Legislature had the power, delegated to it by Congress, to define the property a debtor can claim back as exempt from the bankruptcy estate. It is plain that the Legislature intended to use this power to allow debtors to exempt their IRAs and the other retirement assets covered by Section 19-3-1(b).

In re Harless, 187 B.R. 719, 733 (Bankr. N.D. Ala. 1995). Although the language of § 19-3-1(b) is not a model of clarity, this Court now concludes that its basic premise is clear. Alabama intends to allow debtors to exempt IRAs from the claims of creditors in a bankruptcy case. This intent, and the language implementing it, can be read separate and apart from other language in the statute.

Section 19-3-1(4)(b) states: "It is further intended for this section to provide an exemption from creditors' claims within 11 U.S.C. § 522." After a careful review of *Harless* and this Court's own prior decision in *Slepian*, this Court now agrees that IRAs are exempt from the bankruptcy estate pursuant to Alabama Code § 19-3-1(b). This is the better reasoned view.

II.

Virtually all property interests of a debtor come into the bankruptcy estate. Section 541(c)(2) provides the following exception to the general rule:

> 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 *Slepian* and in *Harless*, IRAs were found not to fit within the exception provided by § 541(c)(2) because of the degree of control an owner may exercise over IRA funds. As determined in *Slepian* and *Harless,* an IRA is not a traditional spendthift trust, nor does Alabama Code § 19-3-1 provide an IRA with an ERISA antialienation provision. However, the Eleventh Circuit has held in the case of *In re Meehan*, 102 F.3d 1209, 1213 (11th Cir. 1997), that an owner's control of an IRA, even if extensive, does not necessarily bar exclusion pursuant to § 541(c)(2). The opinion suggests that § 541(c)(2) should be plainly read and enforced according to its terms. See *United States v. Ron Pair Enterprises, Inc.*, 489 U.S. 235, 241, 109 S.Ct. 1026, 1030, 103 L.Ed.2d 290 (1989). The *Meehan* decision raises many questions in regard to exclusion of Rawls' IRA from his bankruptcy estate.

For Rawls' IRA to be excluded from property of the bankruptcy estate, there must exist a restriction on its transfer that is enforceable under applicable nonbankruptcy law. According, to the Eleventh Circuit, this restriction must be one which precludes creditor attachment or seizure of the

funds. *Meehan* held that "the debtor's ability to withdraw the corpus for personal use" is not grounds for a determination that a state statute is insufficient to shield property from being property of the estate. *Meehan,* 102 F.3d at 1212. It is unclear whether the Rawls contract by itself or together with Alabama Code § 19-3-1(b) provides the necessary preclusion of creditor seizure.

There are restrictions on transfer within Rawls' contract. The relevant parts state:

> (2) The Contract is not transferable or assignable (other than pursuant to a divorce decree in accordance with applicable law) and is established for the exclusive benefit of the Owner and the Owner's beneficiaries. It may not be sold, assigned, alienated, or pledged as collateral for a loan or as security.
>
> (3) The Owner's entire interest in the Contract shall be nonforfeitable.

These provisions alone are not enough to preclude attachment or seizure of the funds as to creditors who are not a party to the contract. Only state or federal law can create an exemption or restriction.

Alabama Code § 19-3-1(b) states that a qualified trust "shall be exempt from the operation of any bankruptcy or insolvency laws *under 11 U.S.C. § 522(b)*." (emphasis added) Additionally, Section 19-3-1(b)(4) states that the intent of the section is to "provide an exemption from creditors' claims *within 11 U.S.C. § 522*." (emphasis added) As stated above, it is clear that IRAs are exempt from the bankruptcy estate because the language of the statute is explicit. It is not clear from the language of the statute that IRAs are exempt from debt collection on the state level. There are no published state law cases interpreting Alabama Code § 19-3-1(b). Although *Harless* stated that the statute created an exemption "within bankruptcy and without", this Court is not prepared to so hold. *Harless*, 187 B.R. at 731.

Alabama Code § 19-3-1(b) provides that "benefits provided under a plan which includes a trust that constitutes a "qualified trust" may not be assigned or alienated, voluntarily or involuntarily." The section is to be interpreted so as to "provide restrictions on alienation and

assignment to the extent, and only to the extent, the same are required" for the qualified trust to maintain its tax-deferred status. In order for an individual retirement annuity to maintain its tax-deferred status, the Internal Revenue Code at 26 U.S.C. § 408(b) requires, among other things, that the contract is not transferable by the owner and that the entire interest of the owner is nonforfeitable. The second endorsement to Rawls' contract incorporates those requirements. Thus, when Alabama Code § 19-3-1 is applied to the contract at issue, it arguably provides enforceable restrictions on (1) transfer of the contract by Rawls' and (2) forfeiture of Rawls' entire interest. In light of *Meehan*, the restrictions may qualify IRA's for the exception provided by § 541(c)(2).

Other issues also arise in the context of a ruling that Rawls' IRA is not property of the bankruptcy estate. Even if § 19-3-1(b) is an exemption from seizure under state law, or the restrictions on transfer and forfeiture were determined to be valid pursuant to *Meehan*, Rawls holds an individual retirement annuity. 26 U.S.C. § 408 distinguishes between a trust and an annuity as two different methods of establishing retirement plans. For Rawls' IRA to be excluded from property of the bankruptcy estate, the restrictions must apply to "a beneficial interest of the debtor in a trust." An individual retirement annuity, defined by Alabama Code § 19-3-1(5) as a "qualified trust", may or may not constitute a trust for purposes of § 541(c)(2).

These issues, at least, and possibly others would need to be argued and considered if a ruling were to be made on whether Rawls' IRA is excluded from his bankruptcy estate. This Court need not decide these issues due to the decision to follow *Harless* in regard to the exemption issue. Therefore, it is ORDERED that the trustee's objection to Don Wade Rawls' exemption of his individual retirement account is overruled and the debtor's exemption is valid under Alabama Code § 19-3-1(b).

Dated: May 9, 1997

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MARGARET A. MAHONEY
CHIEF BANKRUPTCY JUDGE