

***TEXAS PROPERTY CODE §42.0021
EXEMPTING CERTAIN RETIREMENT
PLANS***

By Noel C. Ice

Noel C. Ice
Cantey & Hanger, L.L.P.
2100 Burnett Plaza
801 Cherry Street
Fort Worth, Texas 76102-6898
(817) 877-2800 (Main no.)
(817) 877-2805 (Ice)
(817) 877-2807 (Fax)
E-mail: teleice@earthlink.net
Web Page: www.trustsandestates.net

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TEXAS PROPERTY CODE §42.0021 EXEMPTING CERTAIN RETIREMENT PLANS

By Noel C. Ice

ARTICLE 1 INTRODUCTION

Texas has several statutes that exempt retirement plan benefits, including IRAs. The statutes are very broad, but not unlimited. The primary statute is Tex. Prop. Code §42.0021, but there are others, exempting insurance and annuities, which can apply to Individual Retirement Annuities, and nonqualified plans with annuity payment options.

I have read, or at least glanced at, all of the Texas and Federal cases that cite the main Texas statute exempting IRAs and certain other retirement plans from creditor claims. The ones of importance are each discussed below. There are three important 5th Circuit cases¹ that are worth discussing in some detail, and over three dozen bankruptcy court cases, the outcomes of which I found in most cases to be too predictable to brief herein. However, annuities are exempt in Texas,² and one bankruptcy court case³ found that **a nonqualified plan was exempt because it had an annuity payment option**. There is a 5th Circuit case⁴ that held that even though a rollover from a disqualified Keogh plan into an IRA was not exempt under 42.0021 (because the IRA was not exempt), the cause of action against the Keogh sponsor for allowing the plan to become disqualified was exempt under 42.0021! That line of reasoning would never have occurred to me, so it just goes to show what creative lawyering can sometimes accomplish.

The most important of the Texas cases deals with the issue of conflict of laws. This case will be important to all of us, no matter where we practice. Which law applies, when the IRA is in one state and the debtor is in another is a question I think extremely important. If I, as a Texas resident, have an IRA account with a Florida Bank, or vice-versa, and one state exempts my IRA and the other does not, which law governs? Read on, and look for [Bergman v. Bergman](#)⁵.

¹ *Youngblood, William Jr. in re v. FDIC*, 29 F3d 225 (1994, CA5), 74 AFTR 2d 94-5910; *Heitkamp v. Dyke*, 943 F.2d 1435 (5th Cir. 1991); and *State Farm Ins. Co., Matter of State Farm Life Ins. Co. v. Swift*, 129 F3d 792 (5th Cir. 1997).

² Tex. Ins. Code Art. 21.22.

³ *In re Richard R. Standel, Jr., Debtor.*, 08/07/1995 Docket: Bankruptcy No. 394-34693-HCA-11., 185 BR 227, 9 Tex Bankr Ct Rep 199 , 1995 WL 475959.

⁴ *State Farm Ins. Co., Matter of State Farm Life Ins. Co. v. Swift*, 129 F3d 792 (5th Cir. 1997), 12 Tex Bankr Ct Rep 22, CCH Bankr L Rptr ¶77572, 1997 WL 719112.

⁵ *Bergman v. Bergman*, 888 S.W.2d 580 (Tex. App. – El Paso 1994m rehearing overruled).

Where it is clear that if ERISA⁶ applies to a plan, Texas law is obviously preempted. Since ERISA seldom applies to IRAs, we don't have to worry much about the doctrine in that context. However, it has been argued that because the Texas statute mentions ERISA it is preempted even in those cases where ERISA no longer applies. That argument has proven unsuccessful.⁷

Without going into detail here, I note in passing that there are many cases where Title I of ERISA does not apply, and so neither does the ERISA anti-alienation rule. But the rest of ERISA can still apply, including preemption. I have called this the worst of both worlds in my other materials on this subject. There are more than one case cited below where one would think that my "worst of both worlds" scenario would apply, but where ERISA was not mentioned at all. I can only speculate that ERISA either did not apply at all, or the issue was missed.

ARTICLE 2 THE STATUTES

2.1 Employee Death Benefits -Texas Property Code § 121.055.

The important exemption statute is Texas Property Code §42.0021, discussed in the next article; however, I would be remiss if I failed to mention that Texas Property Code §121.055 states that unless the trust document itself, or the decedent's will, provides otherwise, a death benefit paid to a trustee (1) is not part of the deceased employee's estate; (b) is not subject to the debts of the deceased employee; and (3) is not subject to the payment of taxes enforceable against the estate to a greater extent than if paid to an individual, free of trust.

2.2 The Primary Texas Statute, Property Code §42.0021 (Its Own Self).

As of April, 2003, the relevant Texas statute exempting IRAs is Texas Property Code §42.0021, which is reproduced below. It is found in Title 5 "Exempt Property and Liens," Subtitle A, "Property Exempt From Creditor's Claims," Chapter 42, Personal Property. The emphasis (highlighting) is entirely my own.

§42.0021. Additional Exemption for Retirement Plan

(a) In addition to the exemption prescribed by Section 42.001, a person's right to the assets held in or to receive payments, whether vested or not, under any stock bonus, pension, profit-sharing, or similar plan, including a retirement plan for self-employed individuals, and under any annuity or similar contract purchased with assets distributed from that type of plan, and under any retirement annuity or account described by Section 403(b) or 408A of the Internal Revenue Code of 1986, **and under any individual retirement account** or any individual retirement annuity, including a simplified employee pension plan, **is exempt from attachment, execution, and seizure for the satisfaction of debts *unless the plan, contract, or account does not qualify under the applicable provisions of the Internal Revenue Code of 1986.*** A person's right to the

⁶ The Employee Retirement Income Security Act of 1974, 29 U.S.C. §1001, et seq., as amended.

⁷ *Heitkamp v. Dyke*, 943 F.2d 1435 (5th Cir. 1991), 60 USLW 2271, 22 BCD 223, 25 CBC2d 986, 14 EBC 2376, CCH Bankr L Rptr ¶74305, 1991 WL 190108. See also *NCNB Texas Nat. Bank v. Volpe*, 943 F2d 1451 (5th Cir. 1991), 25 CBC2d 1006, CCH Bankr L Rptr ¶74319, 1991 WL 190110.

assets held in or to receive payments, whether vested or not, under a government or church plan or contract is also exempt unless the plan or contract does not qualify under the definition of a government or church plan under the applicable provisions of the federal **Employee Retirement Income Security Act** of 1974. **If this subsection is held invalid or preempted by federal law in whole or in part or in certain circumstances, the subsection remains in effect in all other respects to the maximum extent permitted by law.**

(b) Contributions to an individual retirement account, other than contributions to a Roth IRA described in Section 408A, Internal Revenue Code of 1986, or annuity **that exceed the amounts deductible under the applicable provisions of the Internal Revenue Code of 1986** and any accrued earnings on such contributions are not exempt under this section unless otherwise exempt by law. Amounts qualifying as nontaxable rollover contributions under Section 402(a)(5), 403(a)(4), 403(b)(8), or 408(d)(3) of the Internal Revenue Code of 1986 before January 1, 1993, are treated as exempt amounts under Subsection (a). Amounts treated as qualified rollover contributions under Section 408A, Internal Revenue Code of 1986, are treated as exempt amounts under Subsection (a). **In addition, amounts qualifying as nontaxable rollover contributions under Section 402(c), 402(e)(6), 402(f), 403(a)(4), 403(a)(5), 403(b)(8), 403(b)(10), 408(d)(3), or 408A of the Internal Revenue Code of 1986 on or after January 1, 1993, are treated as exempt amounts under Subsection (a).**

(c) Amounts distributed from a plan or contract entitled to the exemption under Subsection (a) are not subject to seizure for a creditor's claim for 60 days after the date of distribution if the amounts qualify as a nontaxable rollover contribution under Subsection (b).

(d) A participant or beneficiary of a stock bonus, pension, profit-sharing, retirement plan, or government plan is not prohibited from granting a valid and enforceable security interest in the participant's or beneficiary's right to the assets held in or to receive payments under the plan to secure a loan to the participant or beneficiary from the plan, and the right to the assets held in or to receive payments from the plan is subject to attachment, execution, and seizure for the satisfaction of the security interest or lien granted by the participant or beneficiary to secure the loan.

(e) If Subsection (a) is declared invalid or preempted by federal law, in whole or in part or in certain circumstances, as applied to a person who has not brought a proceeding under Title 11, United States Code, the subsection remains in effect, to the maximum extent permitted by law, as to any person who has filed that type of proceeding.

(f) A reference in this section to a specific provision of the Internal Revenue Code of 1986 includes a subsequent amendment of the substance of that provision.

2.3 Article 21.22 Of The Texas Insurance Code.

As we will see, when we come to the cases interpreting the Texas Exemption for retirement plans, the exemption for annuities under Tex. Ins. Code Art. 21.22, can apply to nonqualified

plans, even if Tex. Prop. Code §42.0021 does not. So, for that reason, I discuss and reproduce it below.

2.3(a) The Statute Itself.

The exemption for life insurance and annuities in Texas could hardly be broader. It is found in the Insurance Code. The first broad exemption was added in 1987, but the courts limited its application. In 1991 the statute was amended again. The statute was further amended in 1993 to include individual annuities. The 1993 amendments are indicated in italics below. The pertinent provisions of the statute are set forth verbatim below:

Art. 21.22. *Unlimited Exemption of Insurance Benefits and Certain Annuity Proceeds From Seizure Under Process*

Sec. 1 Notwithstanding any provision of this code other than this article, all money or benefits of any kind, **including policy proceeds and cash values**, to be paid or rendered to the **insured** or any **beneficiary** under any policy of insurance *or annuity contract* issued by a life, health or accident insurance company, **including** mutual and fraternal insurance, **or** under any plan or program of **annuities** and benefits in use by any **employer** *or individual*, shall:

- (1) inure exclusively to the benefit of **the person for whose use and benefit the insurance or annuity is designated in the policy or contract**;
- (2) **be fully exempt from execution**, attachment, garnishment or other process;
- (3) be fully exempt from being seized, taken or appropriated or applied by any legal or equitable process or operation of law to pay any debt or liability **of the insured or of any beneficiary**, either before or after said money or benefits is or are paid or rendered, and
- (4) be fully exempt from all demands in any bankruptcy proceeding of the insured or beneficiary.

Sec. 2 The exemptions provided by Section 1 of this article apply without regard to whether:

- (1) the power to change the beneficiary is reserved to the **insured**; or
- (2) the insured or the insured's estate is a contingent beneficiary.

Sec. 3 The exemptions provided by Section 1 of this article do not apply to:

- (1) premium payments made in fraud of creditors subject to the applicable statute of limitations for the recovery of the premium payments; or
- (2) a debt of the insured or beneficiary secured by a pledge of the policy or its proceeds.

Sec. 4 This article does not prevent the proper assignment of any money or benefits to be paid or rendered under an insurance policy or annuity contract to which this article applies, or any rights under the policy or contract, by the insured, owner, or annuitant in accordance with the terms of the policy or contract.

Sec. 5 Wherever any policy of insurance, annuity contract, or plan or program of annuities and benefits mentioned in Section 1 of this article shall contain a provision against assignment or commutation by any beneficiary thereunder of the money or benefits to be paid or rendered thereunder, or any rights therein, any assignment or commutation or any attempted assignment or commutation by such beneficiary of such money or benefits or rights in violation of such provision shall be wholly void. [Emphasis added.]

Sec. 6 For purposes of regulation under this code, an annuity contract issued by a life, health, or accident insurance company, including a mutual company or fraternal company, or under any plan or program of annuities or benefits in use by an employer or individual, shall be considered a policy or contract of insurance.

2.3(b) Limitations on Application of Statute.

It seems clear that the legislature intended by the amendment for the exemption to extend to the cash value of life insurance without a dollar limitation, in response to a case that had held that the prior version of the statute was limited by the overall exemption dollar limitation for personal property found in Property Code §42.001(a)(1). However, this question is still not free from doubt.

Article 21.22 was amended in 1991. When Section 1 was added in 1987 there was doubt as to whether it would be literally construed. At least one bankruptcy case held that Section 1 of Article 21.22 was limited by Property Code §42.001 which limits the exemption for personal property to \$60,000 in the case of a family and \$30,000 in the case of a single individual.⁸ The 1991 amendment added the phrase “Notwithstanding any provision of this **code** other than this article” to the first sentence of section 1. My interpretation of this article is that it should not be read literally without limitation; however, in the context where the statute is found, the “code” is the Insurance Code and not the Property Code. Therefore, it is possible that contrary to the apparent intent of the legislature, a court may once again seek to limit the application of the statute.

The Texas Attorney General considered this issue in Opinion No. DM-125, and concluded that “the total exemption provided for the cash value of a life insurance policy in article 21.22, section 1 of the Insurance Code to prevail over the limited exemption provided in sections 42.001 and 42.002 of the Property Code. Life insurance proceeds and cash values thus are wholly exempt from seizure under process.”

⁸*In re Brothers*, Bkrcty. N.D. Tex., 1988, 94 B.R. 82.

A 1993 bankruptcy case recognized that there is no limitation on the amount of life insurance exempted under 21.22, but held that **any exemption claimed under 21.22 will reduce the amount available under the personal property exemption found in the Property Code**, which is limited to \$60,000.⁹

Note further that this exemption arguably does not apply to the owner as such, unless the owner is also the insured or a beneficiary. The exemption applies to “policy proceeds and cash values, to be paid or rendered to the *insured* or any *beneficiary*.” Cf. *In re Gould* (*Gould v. Phillips*, 457 F.2d 393 (5th Cir. 1972); *Bartholow v. Garner*, 43 Bankr. 463 (N.D. Tex. 1984).

Private annuities were made exempt under the statute in 1993. The exemption for annuities was recognized by the 5th Circuit in a 1994 decision *Walden v. McGinnes* (5th Cir. 1994) Case No. 93-8207.

Query: What is an annuity? Traditionally an annuity was thought of as the opposite of a life insurance contract. Under the terms of a true, traditional life contingency only annuity, the annuitant received annuity payments at regular fixed intervals and in fixed amounts. On the death of the annuitant the annuity payments ceased. If the annuitant outlives his life expectancy, the annuitant wins; if the annuitant does not outlive his life expectancy, the annuity company wins: the opposite of life insurance. A common variation on the traditional theme is to put a term certain feature in the contract, thereby limiting the risk of premature death to the annuitant. There is a price for this—the periodic payments will be reduced somewhat to reflect this additional obligation of the annuity company. An annuity contract for the life of the participant or for ten years, whichever is longer, is a common annuity feature.

Modern annuity contracts, like life insurance contracts, are beginning to look more and more like investment contracts, little different from an investment in a mutual fund, in the case of certain variable contracts. The IRS has struggled with this issue for years, and periodically Congress responds with legislation such as that which we have seen in recent years under TEFRA and TRA '86 where restrictions have been placed on single premium deferred contracts, modified endowment contracts and the like.

The question posed here is when is a contract that is defined as an “annuity” or “life insurance” under the contract what it purports to be under Art. 21.22. Perhaps the question could favorably be resolved by asking whether the contract is subject to regulation under the Insurance Code, which it probably is, in which case it ought to benefit from the exemption described by the Code.

⁹In *Re Bowes*, Case No. 293-20135, Bkrcty. N.D. Tex. (10/29/93).

ARTICLE 3
**UNDER 42.0021, THE PLAN OR IRA IS NOT EXEMPT “UNLESS
THE PLAN, CONTRACT, OR ACCOUNT DOES NOT QUALIFY
UNDER THE APPLICABLE PROVISIONS OF THE INTERNAL
REVENUE CODE OF 1986”**

3.1 Rollovers From Qualified Plans, Where the Creditor Argues that the Plan Was Not Qualified.

As adumbrated by the heading, the exemption for IRAs and other plans does not apply “*unless the plan, contract, or account does not qualify under the applicable provisions of the Internal Revenue Code of 1986.*” This continues to be the subject of litigation. In *Youngblood, William Jr. in re v. FDIC*, 29 F3d 225 (5th Cir, 1994), 74 AFTR 2d 94-5910, a debtor rolled over a distribution from a qualified plan into an IRA, following the plan’s termination. The qualified plan received a determination letter from the IRS that the plan was qualified and that the termination of the plan did not affect its qualified status. The creditor argued that there had been some improper loans from the plan to the debtor, and thus, the plan was disqualified. Because the plan was not qualified, according to the creditor, the IRA did “not qualify under the applicable provisions of the Internal Revenue Code of 1986,” and thus was not exempt. The debtor was in bankruptcy, and the bankruptcy court bought this argument. We argued successfully that the bankruptcy judge should not be passing on the plan’s qualified status; that it was the province of the IRS to disqualify a plan, and that since the IRS had expressly found that the plan was qualified, the bankruptcy court had exceeded its authority in finding otherwise. The 5th Circuit agreed with us, holding:

Because section 42.0021(b) provides that “[a]mounts qualifying as nontaxable rollover contributions ... are treated as exempt amounts,” the tax treatment of Mr. Youngblood's rollover from the YBI Plan to the IRA is the key to determining whether the IRA is exempt property in the present bankruptcy proceeding. The answer to that question depends on whether the YBI Plan was “qualified” when Mr. Youngblood's distribution from that plan was rolled over into the IRA. Mrs. Youngblood argues that because the IRS determined that the YBI Plan was qualified and did not tax Mr. Youngblood's distribution from the YBI Plan, the bankruptcy court should have deferred to that decision and granted the exemption. The FDIC, on the other hand, argues that the bankruptcy court has the authority to make its own determination as to whether the YBI Plan was qualified under the Internal Revenue Code. **Thus, the resolution of this case turns on whether the bankruptcy court is required to defer to the IRS determination regarding the qualification of the YBI Plan, or whether the bankruptcy court has the authority to decide this question independently. We believe that the answer to this question ultimately depends on the intent of the Texas legislature in enacting section 42.0021.**

In analyzing the legislative intent, we first state the obvious: Texas has no statutory or administrative rules relating to federal taxation. As a practical matter, therefore, the legislature had to know that, in applying section 42.0021, its own state courts would be required to look to federal tax law to determine whether a plan was qualified under the Internal Revenue Code. The IRS, which has been entrusted with the task of implementing

the Internal Revenue Code, has adopted extensive rules and regulations governing income tax in general, and the taxability of pension plans in particular. The IRS also has a wealth of experience in the practical application of the tax laws. *With particular relevance to this case, the IRS has adopted guidelines for distinguishing between violations of section 401(a) justifying monetary sanctions and violations calling for disqualification.* The question in this case therefore narrows to whether the Texas legislature contemplated that its courts would independently decide whether particular violations were sufficiently serious to merit the ultimate sanction of disqualification especially when the IRS has made a contrary determination. [pg. 94-5913] [Emphasis added.]

We answer this question in the negative. We are persuaded that the legislature intended for its own state courts (or bankruptcy courts applying Texas law) to defer to the IRS in determining whether a retirement plan is “qualified” under the Internal Revenue Code. We see no reason that the legislature would want its courts, which are inexperienced in federal tax matters, to second-guess the IRS in such a complex, specialized area. We find it much more reasonable to assume that the legislature contemplated creating an exemption from seizure for a debtor's retirement funds that could be simply and readily determined by referring to the federal tax treatment of those funds. Moreover, we do not believe that the legislature wanted to adopt a scheme that invites frequent, unseemly, conflicting decisions between the state court or bankruptcy court, and the IRS, such as occurred in this case.

I note that *Harris, Howard Morten in re*, (1995, Bkcty Ct FL) 188 BR 444, seems to hold contrary to *Youngblood*.

3.2 Self-Dealing With an IRA As Causing the Loss of the Exemption.

This issue will be discussed again, in a separate article, but it is too important to postpone entirely until then. IRC §408(e)(2), in clear and unambiguous language provides:

“If, during any taxable year of the individual for whose benefit any individual retirement account is established, that individual or his beneficiary engages in any **transaction prohibited by section 4975** with respect to such account, **such account ceases to be an individual retirement account** as of the first day of such taxable year.”

Since this portion of the outline so closely follows the discussion of *Youngblood*, this is perhaps the best time to explain why I believe that the debtor need not wait for the IRS to “disqualify” an IRA.

Not every violation of ERISA, or of §4975, will disqualify an otherwise qualified plan. Acts of self-dealing, for example, though prohibited by ERISA §406, are proscriptive: “a fiduciary with respect to a plan shall not . . .” **ERISA does not mandate that a plan be automatically disqualified if an act of self-dealing occurs.** Instead, IRC §4975 imposes a 15% excise tax for violating most of what ERISA §406 also prohibits. **A violation of §4975 does not result in the automatic disqualification of an otherwise qualified plan; rather, it imposes an automatic excise tax on the plan.** Disqualification is the ultimate sanction, and can apply in a truly egregious case, but that determination is typically made by the IRS under §401, and the IRS in *Youngblood*, after considering the issue, did not choose disqualification as the appropriate remedy. Typically, the excise tax is penalty enough. **In the case of an IRA, the excise tax does**

not even apply; instead, the IRA (so-called) simply ceases to be one. It is not a matter of IRS discretion. Thus, the principle holding in *Youngblood* is probably inapposite in a case involving an IRA. (Texas courts are not bound by federal decisions even if it were applicable, unless ERISA preemption were involved, and that would not be the case with an IRA.)

IRC §4975(c)(3) provides:

(3) Special rule for individual retirement accounts. An individual for whose benefit an individual retirement account is established and his beneficiaries shall be exempt from the tax imposed by this section with respect to any transaction concerning such account (which would otherwise be taxable under this section) if, with respect to such transaction, the account ceases to be an individual retirement account by reason of the application of section 408(e)(2)(A) or if section 408(e)(4) applies to such account.

408(e)(2)(A), in turn, provides:

(2) Loss of exemption of account where employee engages in prohibited transaction.

(A) In general. If, during any taxable year of the individual for whose benefit any individual retirement account is established, that individual or his beneficiary engages in any transaction prohibited by section 4975 with respect to such account, such account ceases to be an individual retirement account as of the first day of such taxable year. For purposes of this paragraph –

- (i)** the individual for whose benefit any account was established is treated as the creator of such account, and
- (ii)** the separate account for any individual within an individual retirement account maintained by an employer or association of employees is treated as a separate individual retirement account.

3.3 Preemption of the Issue of Qualification.

It may well be that, even if *Youngblood*¹⁰ was not explicit on the issue, if the question of the qualified status of the plan from which a rollover was made were before a state court, that court

¹⁰ *Supra.*

would be preempted under ERISA §514(a) from passing on the matter. That is clearly not the case with an IRA, since an IRA is only rarely subject to ERISA preemption.¹¹

3.4 Youngblood is Not Stare Decisis in State Courts, In the Case of an IRA.

Note also, that if the case arises in state court, rather than in bankruptcy, the 5th Circuit decision in *Youngblood* is not *stare decisis* in state courts, unless ERISA preempts the field, which will seldom be the case if an IRA is involved.

3.5 The Statute is “in addition to the exemptions prescribed by Section 42.001.”

The statute states expressly that it is “[i]n addition to the exemption prescribed by Section 42.001.” 42.001 exempts personal property described in 42.002 within certain dollar amounts. It includes such quaint items as household pets, 120 fowl, “two horses, mules, or donkeys and a saddle, blanket, and bridle for each.” (This is Texas, after all.) One wonders whether the statute is also in addition to the all important exemption that Texas gives insurance and annuities, with almost no limit, under Article 21.22 of the Texas Insurance Code. My question: what if what would have been an individual retirement annuity ceases to be one as a result of a violation of §4975?

ARTICLE 4

OTHER CASES CONSTRUING THE TEXAS STATUTE

In preparing this outline I ran a search for all Texas cases containing “42.0021.” I found, and then briefly scanned, 18. About half a dozen are worth mentioning, and so I mention them below.

4.1 Is the Statute Preempted? No.

As far as I am concerned, the question of preemption was settled by the 5th Circuit, in *Heitkamp v. Dyke*¹² which held:

In 1987, the Texas legislature enacted a statute—now codified in section 42.0021(a) of the Texas Property Code—which exempts retirement benefits from the claims of creditors. In these consolidated cases, this Court must determine whether the Employee Retirement Income Security Act of 1974 (“ERISA”), which one court has described as a

¹¹ Simplified Employee Pension Plans (SEPs) may be subject to ERISA. Under a SEP, the employer contributes to an IRA established by or for the employee of the SEP sponsor. It ought to be the case that such an IRA would be outside the reach of ERISA, even though the SEP (the plan) itself might not be. I do not believe that this area is well understood, especially by the courts. For a case that appears to have missed this distinction see Deborah LAMPKINS, Plaintiff-Appellee, v. Robert H. GOLDEN, Trustee, Robert H. Golden P.C. Profit Sharing Trust, Defendant, Robert H. GOLDEN, Defendant-Appellant. (6th Cir. 2002). Slip Copy UNPUBLISHED DISPOSITION NOTICE: THIS IS AN UNPUBLISHED OPINION. Use FI CTA6 Rule 28 and FI CTA6 IOP 206 for rules regarding the citation of unpublished opinions. NOTE: THIS OPINION WILL NOT BE PUBLISHED IN A PRINTED VOLUME. THE DISPOSITION WILL APPEAR IN A REPORTER TABLE. , 01/17/2002. See “New Challenge: Federal Preemption of State Shield Laws Deck,” by Alvin J. Golden (no relation to the defendant, Al assures me).

¹² *Heitkamp v. Dyke*, 943 F.2d 1435 (5th Cir. 1991), 60 USLW 2271, 22 BCD 223, 25 CBC2d 986, 14 EBC 2376, CCH Bankr L Rptr ¶74305, 1991 WL 190108. See also *NCNB Texas Nat. Bank v. Volpe*, 943 F2d 1451 (5th Cir. 1991), 25 CBC2d 1006, CCH Bankr L Rptr ¶74319, 1991 WL 190110.

“quicksand [that] is fast swallowing up everything that steps in it or near it,” I preempt section 42.0021(a) of the Texas Property Code. We conclude that, in this situation, the ERISA quicksand does not run so deep: ERISA does not preempt section 42.0021(a).

4.2 Is the Statute Retroactive? No.

42.0021 was effective September 1, 1987. *Steves & Sons, Inc. v. House of Doors, Inc.*, 749 S.W.2d 172 (Tex. App.- San Antonio 1988) held that 42.0021 did not prevent the garnishment of a debtor’s IRA, where 42.0021 was not in effect at the time the lawsuit was filed or the judgment was signed.¹³ On the other hand, the turnover statute 31.002(f) (about which, more later), was enacted in 1989, but it is retroactive.¹⁴

4.3 What is an Annuity?

I admit that this is a digression, but it is not totally off the subject, and it touches upon a matter of interest to me. *Steves & Sons, Inc. v. House of Doors, Inc.*, 749 S.W.2d 172 (Tex. App.- San Antonio 1988) is interesting for reasons other than its holding that 42.0021 is not retroactive. At that time, life insurance was an exempt asset, within limits. Now, Tex. Ins. Code Art. 21.22 exempts life insurance and annuities without limit. Traditionally, an annuity was simple enough to identify. It was a contract that paid a benefit for, say, life, and then terminated, perhaps with a term certain feature. I have always wondered whether some of the investments products being sold today, though called annuities, and presumably regulated as such, will necessarily qualify as annuities for purposes of the liberal Texas exemption statutes. Usually, mortality is involved, but it is buried so deeply in the contract that it is difficult to tell whether what you have is an annuity or some form of mutual fund. In *Steves*, the debtor owned an Individual Retirement Annuity. It was not exempt under 42.0021, because 42.0021 was not effective at the time the judgment against the debtor was obtained. So the debtor claimed it was exempt as life insurance. The court said:

The Individual Retirement Annuity contract, at issue in this appeal, is a single payment annuity, whereby Wolma purchased the annuity which is to be paid to him as therein provided. In some respects it is similar to a life insurance policy. However, the annuity contract is an investment made primarily for the benefit of the annuitant, while a life insurance policy is primarily for the benefit of a third person (beneficiary). Rather than a death benefit paid to the beneficiary upon the death of the insured, the annuity contract provides for a series of monthly insurance payments to be paid to the annuitant for the remainder of his life, if living at the maturity date. If he is not living at the date of maturity, or if he dies prior to having received 120 such monthly benefits, then the beneficiary shall be paid the remaining benefits until a total of 120 payments in all shall have been paid under the contract. Those provisions clearly indicate that the contract was for the benefit of the annuitant, not the beneficiary. Nothing in the contract indicates that the annuitant intended to purchase insurance in which the risk contemplated and insured against is the death of the insured, which, when it occurs, provides for the payment of a benefit to the beneficiary.

¹³ See also *Williams v. Texas Commerce Bank* (Tex. App. – El Paso 1989).

¹⁴ Acts 1989, 71st Leg., R.S., ch. 1015, § 2, 1989 Tex.Gen.Laws 4112; *Caulley v. Caulley* 806 S.W.2d 795 (Tex. 1991, rehearing overruled).

We hold that the annuity contract is an investment; it is not a life insurance contract. See *Daniel v. Life Ins. Co. of Virginia*, 102 S.W.2d 256, 260 (Tex.Civ.App.--Austin 1937, no writ). It is not exempt under TEX.PROP.CODE ANN. §§ 42.001 and 42.002(7) (Vernon 1984).¹⁵

4.4 Does the Statute Apply in Divorce Proceedings? Probably Not.

The answer to the question whether the statute applies to divorce proceedings is “probably not.”¹⁶

4.5 Does the Statute Apply to Child Support? No.

Tex.Civ.Prac. & Rem.Code Ann. sec. 31.002(f), the Texas “turnover statute,” is the chief means for reaching a person’s IRA. Although the turnover statute expressly does not apply to property exempt under 42.0021,¹⁷ it explicitly does not prohibit the enforcement of a child support order against assets otherwise exempt under 42.0021:

(f) A court may not enter or enforce an order under this section that requires the turnover of the proceeds of, or the disbursement of, property exempt under any statute, including Section 42.0021, Property Code. **This subsection does not apply to the enforcement of a child support obligation or a judgment for past due child support.**¹⁸

Most of the Texas cases in which “42.0021” is found, only deal with this exception.

4.6 Who Has the Burden to Prove Entitlement to the Exemption? The Debtor, Up to a Point.

“It is the burden of the party claiming the exemption to prove that he is entitled to it.”¹⁹ When, if ever, does the burden shift. If the debtor shows that an account purporting to be an IRA has been established, does the burden shift to the creditor to show that there has been a violation of IRC §408(e)(2) (a disqualifying act of self-dealing), for example. This is a tricky fact pattern. In *Lozano v. Lozano*, 975 S.W. 2d 63 (Tex. App. Houston [14th Dist] 1988) the debtor claimed that he had an IRA. In a manner reminiscent of *Youngblood*²⁰ the creditor apparently claimed that the source of the IRA assets was a disqualified plan, but put on absolutely no evidence to support that claim. The Court of Appeals held that once the creditor had met the burden of showing that the account was an IRA, that the IRA would be exempt, “unless evidence is presented that the IRA does not qualify for such treatment under the IRC.” This is a tough call. I can see the court’s logic, but the question involves some begging. Perhaps, a good rule would be that once the

¹⁵ *Steves & Sons, Inc. v. House of Doors, Inc.*, 749 S.W.2d 172, 175-176 (Tex. App.- San Antonio 1988).

¹⁶ See *Rayborn v. Davis*, 795 S.W.2d 716 (Tex 1990, *per curiam*).

¹⁷ *American Express Travel Related Services, Appellant, v. O.L. Harris, Appellee*, 831 S.W.2d 531 (Tex. App. - Houston [14th Dist.] 1992).

¹⁸ *Cain v. Cain*, 746 S.W.2d 861, at footnote 1 (Tex. App. – El Paso 1988).

¹⁹ *Rucker v. Rucker*, 810 S.W.2d 793, 796 (Tex. App – Houston [14th Dist] 1991, rehearing overruled).

²⁰ *Supra*.

creditor puts on evidence that the account is not an IRA, the burden then returns to the debtor to rebut. *Lozano* did not go that far, probably because it did not have to, since the creditor offered no evidence that the source of the IRA funds was a disqualified plan; and so perhaps the reasoning is sound. In any case, I am not sure that *Lozano* is the last word on the subject, and there was a strong (concurring) dissent. Here are some excerpts from the case in chief, and from the dissent. Draw your own conclusions.

It is the burden of the party claiming an exemption under section 42.0021 to prove that he is entitled to it. See *Rucker v. Rucker*, 810 S.W.2d 793, 795-96 (Tex.App.--Houston [14th Dist.] 1991, writ denied); see also *Roosth v. Roosth*, 889 S.W.2d 445, 459-60 (Tex.App.--Houston [14th Dist.] 1994, writ denied). However, Texas courts apply a liberal rule of construction to state exemption statutes. See *In re Volpe*, 943 F.2d 1451, 1453 (5th Cir.1991); see also *Hickman v. Hickman*, 149 Tex. 439, 234 S.W.2d 410, 414 (1950).

* * * *

“[A] person's right to the assets held in or to receive payments ... under any ... individual retirement annuity ... is exempt from attachment, execution, and seizure for the satisfaction of debts unless the plan, contract, or account does not qualify under the applicable provisions of the Internal Revenue Code of 1986.” TEX. PROP.CODE ANN. § 42.0021(a) (Vernon Supp.1998) (emphasis added). By the plain meaning of this provision, **evidence that an account is an individual retirement annuity is sufficient to establish that it is exempt unless evidence is presented that the IRA does not qualify for such treatment under the IRC.** ²¹[footnote 4 reproduced below].

In this case, the evidence is uncontroverted, and appellees do not dispute, that Juan's account at Minnesota Mutual is an individual retirement annuity. Under section 42.0021(a), this fact is sufficient to establish that the account was exempt from execution ***unless any evidence showed that the IRA did not qualify under the IRC.*** Because we have not been cited, nor have we found, any evidence that the IRA failed to so qualify, we have no basis to affirm the trial court's conclusion that the individual retirement annuity was not exempt.

²¹ The following is footnote 4 from the opinion. It discusses *Rucker, supra*. The dissent in *Lorenzo* found that *Rucker* required that the burden remain with person claiming the exemption, and took the majority to task over its interpretation of *Rucker*.

In *Rucker*, the appellant challenged an order requiring him to turnover a portion of his monthly disability retirement payments because, among other reasons, they were exempt under section 42.0021(a) of the Property Code. See *Rucker*, 810 S.W.2d at 794-95. This court rejected that contention because appellant introduced no evidence showing the benefits to be qualified under the IRC. See *id.* at 795-96. However, section 42.0021 states that a plan or account described therein is exempt unless it does not qualify under the IRC. Therefore, contrary to *Rucker*, we believe that the plain meaning of this language imposes a burden upon the debtor to show only that the plan or account is of a type listed in that section but not to also affirmatively prove that it qualifies under the IRC. Instead, the burden is then on the creditor to show that the plan or account does not qualify under the IRC. One commentator has written that this interpretation is also consistent with the inequities which section 42.0021 was intended to address. See Katherine C. Hall, *Retirement Benefits: Texas Property Code Amendment*, 50 Tex. B.J. 993 (1987).

Deana asserts that the dispositive issue is whether appellants proved that the sources of the funds used to establish the IRA were exempt. That factor was pertinent to appellants' alternative claim under subsection 42.0021(b), concerning amounts qualifying as nontaxable rollover contributions under various sections of the IRC. However, because the IRA was shown to be exempt under subsection 42.0021(a), in which the source of the funds is not a factor, the source of the funds need not be addressed. Accordingly, appellants' first point of error is sustained.²² [Emphasis added.]

In other words, once the debtor showed that he had an IRA, the burden was on the creditor to show that the rollover to the IRA was not good. There was a vigorous (concurring) dissent on this burden shifting issue:

YATES, Justice, concurring and dissenting.

I respectfully dissent to the majority's resolution of appellant's first point of error. The exempt status of the Minnesota Mutual IRA is controlled by a prior decision of this court, *Rucker v. Rucker*, 810 S.W.2d 793, 795-96 (Tex.App.--Houston [14th Dist.] 1991, writ denied). In that case, this court interpreted Section 42.0021 of the Texas Property Code as requiring the debtor to introduce evidence showing qualification under the Internal Revenue Code of 1986. See *id.* at 796; TEX. PROP. CODE ANN. § 42.0021 (Vernon Supp.1998). Here, the majority holds the burden is on the debtor to show that the plan or account is of a type described in that section, and the burden is on the creditor to show that the plan or account does not qualify under the IRC. The majority relies on its own interpretation of the "plain meaning" of the statute and a commentator's analysis, instead of the holding in *Rucker* to reach its conclusions.

In doing so, it has ignored the fundamental principle of stare decisis that requires a continued adherence of a court to its previous decisions. "[I]n the area of statutory construction, the doctrine of stare decisis has its greatest force." *Marmon v. Mustang Aviation, Inc.*, 430 S.W.2d 182, 186 (Tex.1968). A court's adherence to its precedents promotes efficiency, fairness, and legitimacy and is the cornerstone of common law. See *Weiner v. Wasson*, 900 S.W.2d 316, 320 (Tex.1995). The majority increased the uncertainty of relying on judicial decisions by rejecting the general rule in Texas adhered to by this and other courts that a party claiming an asset has the burden to prove it is exempt. See *Santibanez, M.D. v. Wier McMahan Co.*, 105 F.3d 234, 239 (5th Cir.1997) (citing *Roosth v. Roosth*, 889 S.W.2d 445, 459-60 (Tex.App.--Houston [14th Dist.] 1994, writ denied); *Jacobs v. Adams*, 874 S.W.2d 166, 167 (Tex.App.--Houston [14th Dist.] 1994, no writ); accord *Dale v. Finance Am. Corp.*, 929 S.W.2d 495, 498-99 (Tex.App.--Texarkana 1996, writ denied).²³

4.7 What if the Debtor is in Texas, but the IRA is in Another State?

It is my humble opinion that the importance of conflict of laws doctrines in exempt property cases, particularly where IRAs are involved, cannot be

²² *Lozano v. Lozano*, 975 S.W. 2d 63, 67-68 (Tex. App. Houston [14th Dist] 1988).

²³ *Lozano, id.* at p. 70.

overemphasized. *Bergman v. Bergman*²⁴ is in many respects the most interesting of the Texas cases applying 42.0021, because it deals with the conflict of laws issue, an issue not unique to Texas, and one which has puzzled me for many years. I have represented multi-state banks before, and have wondered whether a bank client would be better off establishing a rollover account in a jurisdiction other than the jurisdiction of domicile, if the former had a more hospitable state shield law. *Bergman* does not answer all of my questions, but at least the issue was raised and discussed, albeit in a rather unusual context.

In *Bergman*, neither party was a resident of Texas. They got divorced in Connecticut. The divorce settlement agreement provided that Connecticut law was to govern agreement. Thereafter the husband moved to New Mexico and the wife moved to Florida. However the husband was receiving retirement benefits from American Airlines, and these benefits came from American Airlines' offices in Dallas, Texas. (Why ERISA did not apply here to preempt the whole field is not clear to me. The fact that it may have been nonqualified, and thus not subject to Title I or anti-alienation would not have meant that it was not subject to preemption, unless it was a pure Excess Benefit Plan, which is fairly rare.) The wife sued in El Paso, where she was able to catch the husband and serve him. The wife domesticated the Connecticut judgment of arrears for back alimony (not child support) in El Paso, obtaining in the process a ruling that "the Connecticut judgment of arrears be given full faith and credit." Wife then applied for a turnover order which was granted. Husband appealed, citing Texas Property Code §42.0021. Wife claimed that the exemption Connecticut statute should apply, instead of the Texas exemption statute, because the Texas statute was broader in its protection.

I quote the following from the case. at length, because the citations are priceless. So that you won't have to read quite so closely, I will tell you that the Texas court applied the Texas exemption statute (42.0021), and so the husband got to keep his American Airlines retirement.²⁵ They did so on the basis of the "most significant relationship test" found in the RESTATEMENT (SECOND) OF CONFLICTS OF LAWS §§132 and 187 (1971). The court did notice that the parties had agreed in their divorce to apply Connecticut law, but refused to apply the Connecticut exemption statute, holding that the "the issue before us is the enforcement of a judgment, not the construction, interpretation, or enforcement of a contract." **Caution:** as I read the case, if both debtor and creditor had lived in the same state, it is likely that the law of that state would have governed. Read on and draw your own conclusions.

Appellant [Husband] directs us to *Bell v. Indian Live-Stock Co.*, 11 S.W. 344, 345-46 (Tex.1889), *Schultz v. 5th Judicial District Court of Appeals*, 740 (Tex.1991), and *Reynolds v. Kessler*, 804, 805 (Tex.App.--El Paso 1984, no writ) for the proposition that **a Texas court must apply the exemption laws of Texas when execution on a judgment is sought against property in Texas.** The latter two cases deal with the procedural aspects of enforcing a judgment, however, and not with exemption from execution. *Bell* is applicable in that it held that the protection of Texas' constitutional and

²⁴ *Bergman v. Bergman*, 888 S.W.2d 580 (Tex. App. – El Paso 1994 rehearing overruled).

²⁵ ERISA preemption was not mentioned, and I will refrain from speculating about why that was not a central issue.

statutory exemptions for current wages applied to debtors which were residents of other states. *Bell*, 11 S.W. at 345. The Court in *Bell* found support for this proposition from the decisions of other states, and the fact that a previous Texas exemption statute applied only to residents of Texas. *Id.* at 345-46. [Sounds like husband is winning so far.]

Of more guidance is *Strawn Mercantile Co. v. First Nat. Bank of Strawn*, 279 S.W. 473 (Tex. Civ. App.--Eastland 1925, no writ). There the Court announced **the general rule that exemption laws have no extraterritorial effect**. *Strawn Mercantile Co.*, 279 S.W. at 474. **Consequently, exemption laws of other states were inapplicable in a Texas garnishment proceeding**. See *id.* In *Strawn*, the creditor sought garnishment of a Texas bank account containing the proceeds of an Illinois worker's compensation award. However, because the award in question was exempt in Illinois, and would have been exempt in Texas if it were an award of the Texas Industrial Accident Board, the Court held the Illinois exemption would apply under principles of comity. *Id.* at 474-75.

Also of note is *Baumgardner v. Southern Pac. Co.*, 177 S.W.2d 317 (Tex. Civ. App.--El Paso 1943, no writ). In *Baumgardner*, an employee sought to recover wages due from the Southern Pacific Company, a Kentucky Corporation operating a rail line from El Paso westward. The company had been garnished for the employee's wages by a creditor in Arizona. The employee argued that the exempt status of those wages in Texas extended to the garnishment action in Arizona, and that the company wrongfully paid over his wages. This Court stated: "Exemption laws are local in their nature and have no extraterritorial force or operation. They relate to the remedy and depend upon the law of the forum." *Id.* at 320 (citing *Chicago, R.I. & P.R. Co. v. Sturm*, 174 U.S. 710, 717-18, 19 S.Ct. 797, 800, 43 L.Ed. 1144 (1899)).

Since the decisions in *Bell*, *Strawn*, and *Baumgardner* were decided, however, Texas law has undergone a revolution of sorts, in that with the adoption of various sections of the Restatement (Second) of Conflicts of Laws, Texas courts are now often required to apply the law of other states in disputes where once Texas law would have applied. See generally James P. George, Choice of Law: A Guide for Texas Attorneys, 25 TEX.TECH L.REV. 833 (1994). It is therefore necessary to examine those cases adopting the Restatement rules to see if they have changed the result dictated by *Bell*, *Strawn*, and *Baumgardner*. [Now it sounds like the husband may be in trouble.]

In *Gutierrez v. Collins* (Tex.1979), the Supreme Court of Texas abolished the twin doctrines of *lex loci delicti* and dissimilarity. *Id.* at 318, 322. The *lex loci delicti* doctrine required the application of the law of the place of the wrong in cases sounding in tort. *Id.* at 313. The dissimilarity doctrine prevented the application of laws from other states and countries in Texas courts when those laws were different from the laws of Texas. *Id.* at 319-20. This doctrine was based upon notions of public policy, difficulties in translating foreign law, and practicality. *Id.* at 320. After abolishing these doctrines, **the Supreme Court expressly adopted the most significant relationship test**, as applied in Sections 6 and 145 of the Restatement (Second) of Conflict of Laws, to determine the applicable law for cases sounding in tort. *Id.* at 318. [It is looking as if the significant relationship test is going to supersede the blanket rule that a state applies its own exemption laws.]

In *Robertson v. Estate of McKnight* (Tex.1980), the Supreme Court was faced with another conflicts of law question, which it solved by adopting a Restatement provision. The Court adopted Section 169, which applied the most significant relationship test to determine what state's spousal immunity law applied in tort. *Id.* at 536.

In *Duncan v. Cessna Aircraft. Co.* (Tex.1984), **the Supreme Court reaffirmed its commitment to the most significant relationship test and the Restatement (Second) of Conflict of Laws.** *Id.* at 420-21. In *Duncan*, the conflicts issue facing the Court was whether Texas or New Mexico law applied in determining the effect of a release made in settlement of a tort case. *Id.* at 418. **The Court abolished the doctrine of *lex loci contractus*, which required the application of the law of the place where the contract was made.** *Id.* at 421. The Court applied the principles of Section 6 of the Restatement in determining that the facts presented a false conflict, and therefore Texas law applied. 1 *Duncan*, 665 S.W.2d at 422. The most recent foray by the Supreme Court of Texas into the realm of conflicts of law was *DeSantis v. Wackenhut Corp.*, (Tex.1990). In *DeSantis*, the Court adopted **Section 187** of the Restatement to govern those situations **where the parties had chosen a forum's law by contract**, and Section 188 of the Restatement to govern those situations where parties had not effectively chosen law in their contract. *Id.* at 677-78, 678 n. 2. The Court also cited Section 196 with approval with regards to personal services contracts. *Id.* at 679.

Further, we must note that the Restatement provides a rule to determine what property exemptions are applied. The Restatement provides:

§ 132. Exemptions

The local law of the forum determines what property of a debtor within the state is exempt from execution unless another state, by reason of such circumstances as the domicil [sic] of the creditor and the debtor within its territory, has the dominant interest in the question of exemption. In that event, the local law of the other state will be applied.

RESTATEMENT (SECOND) OF CONFLICTS OF LAWS § 132 (1971).

The comments to the section further state: “Even when the creditor and the debtor are not domiciled in the same state, a state to which they both have substantial relationships but which is not the state of the forum may be the state of dominant interest.” *Id.* [emphasis added]. This formulation appears to be the rule in a majority of jurisdictions. Sheldon R. Shapiro, Annotation, Choice of Law as to Exemption of Property From Execution, 100 A.L.R.3d 1235, 1238-39 (1980).

Finally, we take note of the substantial competing policies underlying this issue. Exemptions, by their nature, represent a balancing of the interests of a debtor and a creditor. See Bell, 11 S.W. at 346. Texas law arguably balances more toward the debtor than does the law of Connecticut. Compare TEX.PROP.CODE ANN. §42.0021(a) (Vernon Supp.1994) (providing that pension benefits are completely exempt) with

CONN.GEN.STAT.ANN. §52-352b(m); *id.* §52-361a(f) (providing that pension benefits are only 75 percent exempt). The Texas exemptions are based upon the policy that a debtor should “not be forced into a condition of abject dependence and want.” *Bell*, 11 S.W. at 346; accord *Caulley v. Caulley* 152 (Tex. App.--Houston [14th Dist.] 1989) (Draughn, J., dissenting), *rev'd in part and aff'd in part* (Tex. 1991). While balancing these interests of the debtor and creditor, we must still give full faith and credit to the judgment of the Connecticut court. U.S. CONST. art. IV, § 1.²⁶ [Emphasis added.]

N.B.: But the parties agreed that Connecticut law would apply, and that was the state where the divorce was obtained. Well, that was not good enough. The opinion continues:

Contractual Choice of Law

The judgment upon which Appellee seeks her turnover order is based upon an agreement which states that “**construction and execution**” of the agreement is governed by the law of Connecticut. She asserts that pursuant to the adoption of Section 187 of the Restatement by the Supreme Court of Texas in *DeSantis v. Wackenhut Corp.*, 677 (Tex. 1990), we must apply Connecticut's law of exemptions to the execution of her judgment in Texas. **We disagree.**

In DeSantis, Justice Hecht summarized the Appellant's position thus:

We begin with what Chief Justice Marshall referred to as a principle of 'universal law . . . that, in every forum, a contract is governed by the law with a view to which it was made.' *Wayman v. Southard*, 23 U.S. (10 Wheat.) 1, 48, 6 L.Ed. 253 (1825). This principle derives from the most basic policy of contract law, which is protection of the justified expectations of the parties . . . The parties' understanding of their respective contractual rights and obligations depends in part upon the certainty with which they may predict how the law will interpret and enforce their agreement.

DeSantis, (Citations omitted) [Emphasis added].

Section 187 of the Restatement also speaks to the point: “The law of the state chosen by the parties to govern their contractual rights and duties will be applied if the particular issue is one which the parties could have resolved by an explicit provision in their agreement directed to that issue.” RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 187(1) (1971) [Emphasis added]. **However, the issue before us is the enforcement of a judgment, not the construction, interpretation, or enforcement of a contract. Both *DeSantis* and the Restatement section it relied upon speak to determining the duties and rights produced by that contract, not the enforcement of a judgment arising from breach of that contract.** The Appellee's justified expectation in a contract such as this is that a Court will interpret the duty imposed on Appellant in accordance with Connecticut's family law and contract law, and that on breach of that duty, she receive a judgment for damages stemming from that breach. The trial court's judgment domesticating the Connecticut judgment, and awarding damages for its further

²⁶ *Bergman v. Bergman*, 888 S.W.2d 580, 583-584 (Tex. App. – El Paso 1994 rehearing overruled).

breach, has protected these justified expectations. It is another thing entirely to find that she has a justified expectation of satisfaction of that judgment. Parties, though they might win on the merits, face a separate hurdle in securing satisfaction of judgment. Presumably, all states have exemption laws that will often prevent satisfaction. Similarly, though property may not be exempt, creditors with priority will often exhaust a debtor's assets before judgment creditors can execute. Further, bankruptcy proceedings can also prevent satisfaction of judgment.

We also feel the underlying policies behind exemptions do not favor extending the reach of contractual choice of law provisions to determining what exemptions apply. The long standing public policy of Texas has favored debtors over creditors. See *Bell*, 11 S.W. at 346. Extending the reach of choice of law clauses would, for example, subject thousands of Texans holding credit cards governed by agreements applying the laws of other states to the various exemptions of Utah, South Dakota, and other states favorable in their laws such that they attract the credit card subsidiaries of the large national banks. Based upon such a holding, it is clearly foreseeable that the large national banks operating in Texas would incorporate in their future Texas loan agreements choice of law clauses designating the law of states more favorable to creditors than debtors. Such a holding would clearly eviscerate long standing Texas public policy.

Finally, the Restatement itself contemplates a different choice of law method for determining property exemptions, which is contained in Section 132. **Even accepting the Appellee's argument that the Agreement specifically dictates the use of Connecticut's laws regarding exemptions and enforcement of judgments, such a choice of law clause is not binding with regard to the question of what property exemptions are applied in an action to enforce a judgment.**

Restatement Section 132. Section 132 of the Restatement applies the law of the forum in determining what property within that forum is exempt, unless some other state has a dominant interest. RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 132 (1971). **Usually, the state where the property is located will have the dominant interest in determining whether the property is exempt.** *Id.* cmt. a. A second state has a dominant interest when both parties are domiciled in that second state. *Id.* A dominant interest can arise in favor of a second state when both parties have substantial relationships with that state. *Id.* cmt. a.

Because the Supreme Court of Texas has favored the formulations of Restatement (Second) of Conflict of Laws, and because we feel the rule of Section 132 embodies the holdings in *Bell*, *Strawn* and *Baumgardner*, **we will apply the Restatement rule.**

The rule creates a presumption that the local law, here the law of Texas, determines what property is exempt. This presumption can be overcome by a showing that a second state has a dominant interest in the application of its exemption laws. A showing that both parties are domiciled in a second state overcomes the presumption. The presumption can also be overcome when it is shown that both parties have substantial relationships with a second state. An examination of the record shows that: Appellee is a resident of Florida; Appellant is a resident of New Mexico; they were divorced in Connecticut in 1975; there are no minor children; Appellant was bound to pay Appellee alimony pursuant to a separation agreement executed December 9, 1975;

judgment against Appellant in the amount of \$18,450 was entered in Connecticut Superior Court on October 26, 1987, for breach of the separation agreement; and judgment was entered against Appellant in the amount of \$99,700 in El Paso County Court at Law No. Two on April 25, 1991, on the Connecticut judgment with interest, further breach of the separation agreement, and attorney's fees. Based upon these facts, we conclude that Connecticut does not have a dominant interest in the question of exemption.² Therefore, we hold that the Texas law of exemptions applies in this case. Appellant's Points of Error Nos. Two and Three are sustained.²⁷

Wow. If you can pick any state in which to set up an IRA, pick one with a liberal shield law, and hope that no matter where you are sued, that state will respect the shield law of the state where the IRA is located. But in most cases, the debtor and creditor are likely to be from the same state. According to the court: “The rule creates a presumption that the local law, here the law of Texas, determines what property is exempt. This presumption can be overcome by a showing that a second state has a dominant interest in the application of its exemption laws. A showing that both parties are domiciled in a second state overcomes the presumption.”

4.8 Is a Nonqualified Plan of Deferred Compensation Exempt Either Under 42.0021, or as an Annuity Under Tex. Ins. Code Art. 21.22?

The debtor in the *Standel*²⁸ case was the beneficiary of a nonqualified plan, which had an annuity payment option. (Once again, I do not know why ERISA was inapplicable, so I won't speculate.) He tried to claim that the plan was exempt both under the general exemption for insurance and annuities under Tex. Ins. Code §21.22, and, failing that, under Tex. Prop. Code 42.0021. The court found that the plan was an annuity, entitled to the exemption under Art. 21.22, but not exempt under §42.0021.

4.8(a) Is a Nonqualified Plan With an Annuity Payout Option, Exempt Under The Insurance Code Exemption? Yes.

The exemption for annuities saved the day for the debtor in *Standel*. In the words of the Court:

[2] The Debtor first claims that Article 21.22 of the Texas Insurance Code provides an exemption for the Deferred Compensation Plan. Article 21.22 provides in relevant part, as follows: Sec. 1. [A]ll money or benefits of any kind, including policy proceeds and cash values, to be paid or rendered to the insured or any beneficiary under any policy of insurance or annuity contract issued by a life, health or accident insurance company, including mutual and fraternal insurance, or under any plan or program of annuities and benefits in use by any employer or individual, shall:

(2) be fully exempt from execution, attachment, garnishment or other process; [and]

²⁷ *Bergman v. Bergman*, 888 S.W.2d 580, 585-586 (Tex. App. – El Paso 1994 rehearing overruled).

²⁸ *In re Richard R. Standel, Jr., Debtor.*, 08/07/1995 Docket: Bankruptcy No. 394-34693-HCA-11., 185 BR 227, 9 Tex Bankr Ct Rep 199 , 1995 WL 475959.

(4) be fully exempt from all demands in any bankruptcy proceeding of the insured or beneficiary.”

Tex.Ins.Code Ann. art. 21.22, § 1 (Vernon Supp.1995). The funds in the Deferred Compensation Plan are clearly money that is to be paid to the Debtor. The Deferred Compensation Plan does not involve an annuity contract issued by a life, health, or accident insurance company. Thus, the Plan can only be exempt if the Court finds that the Deferred Compensation Plan qualifies “as a plan or program of annuities and benefits in use by any employer....” Id.

The Court does not find the RTC's arguments to be persuasive. The statute does not explicitly require the purchase of an annuity. The Texas Legislature does not define “annuity.” Black's Law Dictionary defines an annuity as “[a] right to receive fixed, periodic payments, either for life or for a term of years....” Black's Law Dictionary (6th ed. 1990); see also Young, 806 F.2d at 1306 (citing Black's Law Dictionary definition). In addition, the RTC's reading of the statute seems to render the second half of the statute, referring to employer plans or [*pg. 232] programs, to be superfluous. The first half of the statute, which refers to “annuity contract[s] issued by ... insurance compan[ies],” covers purchased annuity contracts. Tex.Ins.Code Ann. art. 21.22, §1. The second half of the statute refers to “all money or benefits of any kind ... to be paid ... under any plan or program of annuities and benefits in use by any employer....” Id. (emphasis added). If the Texas Legislature wanted to exempt only purchased annuity plans, there was no need to add the additional language about employer plans. The Court agrees with the RTC that there are no cases precisely on point, i.e. applying Article 21.22 to a plan that does not include a purchased annuity. Regardless, there is little case law at all on the exemption of annuities pursuant to Article 21.22, and the objective of this Court is to predict what a Texas court would hold on the issue in light of the statutory language, relevant case law, and state policy.

. . . Therefore, installment payment of a debt, or payments of interest on a debt, do not constitute an annuity.

* * * *

. . . The Texas Legislature could have defined the term “annuity” to clarify what arrangements the term encompassed. The Texas Legislature did not do this, however. Rather, the relevant portion of Article 21.22—“any plan or program of annuities and benefits in use by any employer”—invites an expansive, rather than a restrictive reading of the term “annuity.” This Court finds no reason to scrutinize the Deferred Compensation Plan to determine whether it is an account receivable or a “true annuity.” Thus, as **the Court finds that the Deferred Compensation Plan constitutes an annuity for purposes of Article 21.22**, the only determination that remains is whether or not the Deferred Compensation Plan constitutes a plan or program, as required by the statute.

A plan is a “method of design or action, procedure, or arrangement for accomplishment of a particular act or object.” Walden, 12 F.3d at 451 , quoting Black's Law Dictionary (6th ed. 1990). A program is “a plan or system under which action may be taken toward a goal.” Id., quoting Webster's Ninth [*pg.

233] New Collegiate Dictionary 940 (1990). The Walden court noted that “it is not necessary that the plan or program provide annuities for all employees, or that it be of long-standing duration, or that it be of a particular type (such as for retirement).” Id. (footnote and citations omitted). The Court finds that the Deferred Compensation Plan is a plan or program of annuities and benefits. NTI's goal in establishing the Deferred Compensation Plan is to provide its senior employees with a benefit—a means to defer income to a later date such as retirement and possibly receive a tax benefit by doing so. The Court finds that providing compensation and benefits to employees constitutes a sufficient objective for purposes of the Article 21.22 exemption statute. In addition, the Deferred Compensation Plan is a method to accomplish the objective such that the Plan qualifies for the exemption pursuant to Article 21.22.²⁹

4.8(b) Is a Nonqualified Plan Exempt Under 42.0021? No.

The debtor in *Standel* claimed that his benefits under his nonqualified deferred compensation plan amounted to an annuity, and was therefore exempt under Tex. Ins. Code Art. 21.22. He prevailed on that argument. However, he also claimed that it was exempt under 42.0021. This argument was unavailing. In the words of the Court (which technically constitute dicta):

Texas Property Code § 42.0021

[3] The Debtor also contends that his Deferred Compensation Plan is exempt pursuant to §42.0021 of the Texas Property Code. This section provides an exemption for a person's right to the assets held in or to receive payments, whether vested or not, under any stock bonus, pension, profit-sharing, or similar plan ... unless the plan, contract, or account does not qualify under the applicable provisions of the Internal Revenue Code of 1986.

Tex. Prop. Code Ann. § 42.0021 (Vernon Supp.1995). The key issue before the Court is whether the Deferred Compensation Plan qualifies under the applicable provisions of the Internal Revenue Code of 1986.

The Debtor argues that the Plan is “qualified” pursuant to 26 U.S.C. § 451 and the Treasury Regulations and Revenue Rulings corresponding to that statutory section.^[fn] In short, the Debtor contends that the funds in the Plan are eligible for the exemption because the Plan “qualifies” for favorable tax treatment.^[fn] The Court finds, however, that the term “qualify” as it concerns pension, profit-sharing, and stock bonus plans in the Internal Revenue Code has a very specific meaning. Section 401 of Title 26 of the United States Code (“Internal Revenue Code”) is specifically titled “Qualified pension, profit-sharing, and stock bonus plans.” For a plan to “qualify” under the provisions of the Internal Revenue Code, it must comply with the provisions of § 401. *See, e.g.*, 26 U.S.C. § 401(a) (West Supp.1995) (“Requirements for qualification”); 26 U.S.C. § 401(k)(2) (West Supp.1995) (“Qualified cash or deferred arrangement”); *see also* Neal A. Mancoff & David M. Weiner, *Nonqualified Deferred Compensation Arrangements* § 2.01

²⁹ *Standel, supra*.

(1993) (explaining that a plan is “qualified” under the Internal Revenue Code if it satisfies the requirements of 26 U.S.C. § 401(a)). Both §§ 401 and 451 are in the same chapter of the Internal Revenue Code. Section 401, however, is contained in a subchapter of the Internal Revenue Code called “Deferred Compensation, Etc.” It is also within a part of that subchapter called “Pension, Profit-Sharing, Stock Bonus Plans, Etc.” In contrast, § 451 is contained in an entirely different subchapter, “Accounting Periods and Methods of Accounting.” Section 451 does not discuss plans at all, but simply provides the general rule for determining the taxable year of items of gross income. Neither §451, nor the corresponding Treasury Regulation or Revenue Ruling cited by the Debtor,^[fn] discusses any sort of qualified plan. The Court also finds that the phrase “qualify under the applicable provisions of the Internal Revenue Code” in §42.0021 of the Texas Property Code is ambiguous if the Court does not interpret the meaning of the word “qualify” in light of its use and meaning in the Internal Revenue Code. **As the Debtor does not contend that the Plan qualifies under § 401 of the Internal Revenue Code, the Plan is not exempt pursuant to § 42.0021 of the Texas Property Code.**³⁰

4.8(c) Is a Cause of Action Against the Plan Trustee Exempt Under 42.0021, Where the IRA is Not Qualified Due to the Negligence of the Plan Trustee? Yes!

In what might appear to many to be quite a stretch, the 5th Circuit has held in *State Farm Ins. Co., Matter of State Farm Life Ins. Co. v. Swift*³¹ that where an Keogh Plan was disqualified, and yet was rolled over, meaning that the IRA was not tax exempt, that the cause of action against the person who negligently caused the disqualification is exempt under 42.0021. **Who would have guessed?** In the words of the court:

When a retirement account that should have been exempt is lost, the cause of action to replace that account is exempt so that the injured party can be placed in a position that is as near as possible to his original or intended position. The fundamental purpose of a cause of action—to make an injured party whole—dictates this conclusion. State Farm maintains that Swift's causes of action are not exempt, however, because his IRA was defective at the time Swift's creditors objected to the exemption. State Farm's argument fails to account for one critical fact: Swift is seeking recovery for the original acts that made the account defective as well as the eventual loss of the bankruptcy exemption. State Farm cannot escape liability simply because its alleged actions resulted in damage at two separate stages. But for the actions of State Farm, or the failure to act by State Farm, Swift would have a valid, exempt IRA. Swift's causes of action against State Farm, then, are to replace what would have been a valid IRA, not the non-exempt account of which State Farm speaks. As a replacement for exempt

³⁰ *Standel, supra.*

³¹ *State Farm Ins. Co., Matter of State Farm Life Ins. Co. v. Swift*, 129 F3d 792 (5th Cir. 1997), 12 Tex Bankr Ct Rep 22, CCH Bankr L Rptr ¶77572, 1997 WL 719112.

property, we hold that Swift's causes of action are exempt property for purposes of his bankruptcy proceedings.

In conclusion, we find that Swift's causes of action against State Farm accrued before Swift filed his bankruptcy petition because he suffered actual damage before the filing. Those causes of action became the property of the bankruptcy estate under 11 U.S.C. § 541. But, they are exempt property under Texas Prop.Code § 42.0021. Swift has standing to pursue these causes of action against State Farm.

ARTICLE 5

ATTACKING THE EXEMPTION ON THE GROUNDS THAT THE ACCOUNT IS NOT AN IRA, DUE TO THE APPLICATION OF 408(e)

5.1 **“Individual Retirement Accounts” are Exempt.**

Texas Property Code §42.0021(a) provides in pertinent part:

Additional Exemption for Retirement Plan (a) In addition to the exemption prescribed by Section 42.001, a person's right to the assets held in . . . **under any individual retirement account . . . is exempt from attachment, execution, and seizure for the satisfaction of debts *unless the plan, contract, or account does not qualify under the applicable provisions of the Internal Revenue Code of 1986.* . . . [Emphasis added.]**

5.2 **Definition of Individual Retirement Account.**

The applicable provisions of the Internal Revenue Code of 1986 define “individual retirement account” in §408.

5.3 **An Account is Not an Individual Retirement Account Under Tex. Prop. Code §42.0021(a) (or Otherwise), if the IRA Owner Engages in a Transaction Prohibited by IRC §4975.**

IRC §408(e)(2), in clear and unambiguous language provides:

“If, during any taxable year of the individual for whose benefit any individual retirement account is established, that individual or his beneficiary engages in any **transaction prohibited by section 4975** with respect to such account, **such account ceases to be an individual retirement account** as of the first day of such taxable year.”

5.4 **Definition of Prohibited Transaction Under IRC §4975.**

IRC §4975(c) provides:

(c) Prohibited transaction.

(1) General rule.

For purposes of this section, the term “prohibited transaction” means any direct or indirect—

- (A) sale or exchange, or leasing, of any property between a plan and a disqualified person;
- (B) lending of money or other extension of credit between a plan and a disqualified person;
- (C) furnishing of goods, services, or facilities between a plan and a disqualified person;
- (D) transfer to, or use by or for the benefit of, a disqualified person of the income or assets of a plan;
- (E) act by a disqualified person who is a fiduciary whereby he deals with the income or assets of a plan in his own interest or for his own account; or
- (F) receipt of any consideration for his own personal account by any disqualified person who is a fiduciary from any party dealing with the plan in connection with a transaction involving the income or assets of the plan.

5.5 Definition of Disqualified Person.

IRC §4975(e)(2) contains a lengthy definition of a broad list of people who are included within the definition of “disqualified persons.” For our purposes §4975(e)(2)(A) will do:

(2) Disqualified person.

For purposes of this section, the term “disqualified person” means a person who is—

- (A) a fiduciary;

5.6 Is the IRA Owner a “Disqualified Person,” With Respect to His IRA, As a Matter of Law?

If the IRA is self-directed, I think it clear that the IRA owner is a fiduciary as a matter of law.

It is probably true that an IRA owner is always a “disqualified person,” at least in the view of the IRS; however, if the account is self-directed, there is no doubt about it.³² §4975(e)(3) is fairly dispositive about this.

³² “As trustees with investment discretion over the assets in your respective IRAs, you and Mr. Berbit would be fiduciaries and, therefore, disqualified persons under section 4975(e)(2) of the Code.” ERISA Opinion Letter 90-23A , 07/03/1990.

See also, *In re Robert J. HIPPLE, Debtor.*, 08/30/1996, No. A94-68866-SWC. , — B.R. — , 1997 WL 1038201, United States Bankruptcy Court, N.D. Georgia:

(3) Fiduciary.

For purposes of this section, the term “fiduciary” means any person who—

(A) exercises any discretionary authority or discretionary control respecting management of such plan or exercises any authority or control respecting management or disposition of its assets,

* * * *

(C) has any discretionary authority or discretionary responsibility in the administration of such plan.

**ARTICLE 6
CONCLUSION**

Although Tex. Prop. Code §42.0021 looks like a fairly straight forward statute, about which one would expect sparse litigation, this turns out not to be the case. As I hope the above treatment of the decided cases demonstrates, even though not thoroughly comprehensive, is that there are many issues to consider and variations in fact patterns, which can result in the application of the statute being anything but routine.

Under the instrument creating Debtor's SEP/IRA, he has the discretion to direct investments or to dispose of assets. The trustee, First Union, has discretionary authority or responsibility in management and administration of the plan. Therefore, both are fiduciaries. A fiduciary is defined as a person who: (A) exercises any discretionary authority or discretionary control respecting management of such plan or exercises any authority or control respecting management or disposition of its assets, ... (C) has any discretionary authority or discretionary responsibility in the administration of such plan. 26 U.S.C. § 4975(e)(3)(A) and (C).

Section 4975(e)(1)(A) defines a “disqualified person” as a person who is, inter alia, a fiduciary. Therefore, Debtor and First Union are disqualified persons. Id. Under § 4975 a “disqualified person” is prohibited from engaging in certain “prohibited transactions” defined to include: any direct or indirect—lending of money or other extension of credit between a plan and a disqualified person; ... act by a disqualified person who is a fiduciary whereby he deals with the income or assets of a plan in his own interests or for his own account; and receipt of any consideration for his own personal account by any disqualified person who is a fiduciary from any party dealing with the plan in connection with a transaction involving the income or assets of the plan. 26 U.S.C. § 4975(c)(1)(B)(E) and (F).

If the individual or his beneficiary engages in prohibited transactions, the SEP/IRA terminates. 26 U.S.C. § 408(e)(2). [Emphasis added.]

See also DOL Advisory Opinion 89-03A.