Study D-353 April 6, 1995

Memorandum 95-23

Debtor-Creditor Relations: Retirement Account Exemption

At the September 1994 meeting, the Commission deferred consideration of the retirement account exemption issues raised by Bankruptcy Judge Alan M. Ahart until time permitted additional study. (Judge Ahart's letter was attached to Memorandum 94-25, Exhibit pp. 53-54, considered at the May 1994 meeting.) This memorandum commences consideration of the issue.

The Commission needs to review the alternative approaches discussed in this memorandum and give the staff some guidance on the best approach to pursue. The staff recommends some directions in this memorandum and additional options will come to light as we do more research. In a forthcoming supplement for the April 24 meeting, the staff will present any additional ideas of interest and suggest possible drafts for the most appealing alternatives to help focus the discussion.

BACKGROUND

Judge Ahart has suggested revising the retirement account exemption:

> I believe that a one-person corporation should not be able to exempt funds held in a pension plan designed and used for retirement purposes without regard to the support limitation that applies to Keogh and other non-corporate pension plans. See *In re* Cheng, [943 F.2d 1114] (9th Cir. 1991) …; *In re* Bloom, 839 F.2d 1376 (9th Cir. 1988). If such a change is not made, there will continue to be an undue incentive for high-income individuals with one-person corporations, such as doctors, lawyers, and dentists, to file bankruptcy and shield hundreds of thousands of dollars from the claims of creditors.

The statute at issue is Code of Civil Procedure Section 704.115, which provides an exemption in enforcement of money judgments and also applies in bankruptcy where the debtor elects to take the state exemptions instead of the alternate set in Section 703.130. Section 704.115 provides as follows:

§ 704.115. Private retirement and related benefits and contributions

704.115. (a) As used in this section, "private retirement plan" means:

(1) Private retirement plans, including, but not limited to, union retirement plans.

(2) Profit-sharing plans designed and used for retirement purposes.

(3) Self-employed retirement plans and individual retirement annuities or accounts provided for in the Internal Revenue Code of 1954 as amended, to the extent the amounts held in the plans, annuities, or accounts do not exceed the maximum amounts exempt from federal income taxation under that code.

(b) All amounts held, controlled, or in process of distribution by a private retirement plan, for the payment of benefits as an annuity, pension, retirement allowance, disability payment, or death benefit from a private retirement plan are exempt.

(c) Notwithstanding subdivision (b), where an amount described in subdivision (b) becomes payable to a person and is sought to be applied to the satisfaction of a judgment for child , family, or spousal support against that person:

(1) Except as provided in paragraph (2), the amount is exempt only to the extent that the court determines under subdivision (c) of Section 703.070.

(2) If the amount sought to be applied to the satisfaction of the judgment is payable periodically, the amount payable is subject to an earnings assignment order for support as defined in Section 706.011 or any other applicable enforcement procedure, but the amount to be withheld pursuant to the assignment order or other procedure shall not exceed the amount permitted to be withheld on an earnings withholding order for support under Section 706.052.

(d) After payment, the amounts described in subdivision (b) and all contributions and interest thereon returned to any member of a private retirement plan are exempt.

(e) Notwithstanding subdivisions (b) and (d), except as provided in subdivision (f), the amounts described in paragraph (3) of subdivision (a) are exempt only to the extent necessary to provide for the support of the judgment debtor when the judgment debtor retires and for the support of the spouse and dependents of the judgment debtor, taking into account all resources that are likely to be available for the support of the judgment debtor when the judgment debtor retires. In determining the amount to be exempt under this subdivision, the court shall allow the judgment debtor such additional amount as is necessary to pay any federal and state income taxes payable as a result of the applying of an amount described in paragraph (3) of subdivision (a) to the satisfaction of the money judgment.

(f) Where the amounts described in paragraph (3) of subdivision (a) are payable periodically, the amount of such periodic payment that may be applied to the satisfaction of a money judgment is the amount that may be withheld from a like amount of earnings under Chapter 5 (commencing with Section 706.010) (Wage Garnishment Law).

Comment. Section 704.115 supersedes subdivision (d) of former Section 690.18. Subdivision (c) governs the application of the exemption for payable but unpaid benefits against enforcement of child or spousal support. Subdivision (c)(1) applies the general rule governing exemptions in support cases. Subdivision (c)(2) recognizes that federal law requires the protection of periodic payments pursuant to a pension or retirement program to the same extent as wages. See Section 706.052 and the Comment thereto. The exemption provided in subdivision (d) applies whether money received by the judgment debtor is in the actual possession of the recipient or has been deposited. See Section 703.080 (tracing exempt funds). The general rule governing exemptions in support cases provided by Section 703.070 applies to benefits after they have been paid.

Subdivisions (e) and (f) are new. Subdivision (e) requires that the court consider all resources — such as social security payments and other income and assets — that are likely to be available to the judgment debtor when the judgment debtor retires. Accordingly, where it will be a number of years before the judgment debtor will retire, the court will take into account not only all the assets of the judgment debtor at the time the exemption claim is determined but also all the assets and income (including pension rights) that the judgment debtor is likely to acquire prior to retirement. Subdivision (f) recognizes that the federal law requires the protection of periodic payments pursuant to a retirement program. See 15 U.S.C. §§ 1672(a), 1673(a).

A number of bankruptcy cases have struggled to interpret this statute in situations involving one or two-person professional corporations. The section is intended to protect reasonable amounts of retirement assets. It is based on the assumption that private retirement plans will be in a reasonable amount and recognizing that individual plans — e.g., Keogh and IRA — are subject to necessary for support standard. However, a plan set up by a one-person professional corporation does not fall within the necessity exception of Section 704.115(e). Thus, substantial amounts may be shielded from creditors — sometimes in a short period — in judgment enforcement proceedings and in bankruptcy proceedings by this special class of debtors. This appears to be inconsistent with the statute as a whole, but the courts have felt bound by the statutory language.

Judge Ahart recommends that this situation be remedied by applying the necessity standard to one-person corporation retirement plans. The staff is sympathetic to this suggestion. However, it does not appear to be a complete solution to the problem. In *Bloom, supra,* the court was faced with a two-doctor medical corporation in which the bankrupt had an interest valued at $475,000. The problem is just as great in this case as with a one-person professional corporation, which was the situation in *Cheng, supra.* In that case, the Ninth Circuit ruled:

> Although the legislative history indicates that the policy behind section 704.115(e) is to limit the exemption for plans that are controlled by one person, the statute says what it says, and it was improper for the

> bankruptcy court to read beyond it. If the California legislature intended to treat closely held corporations differently than large corporations, it could have done so explicitly.
>
> The bankruptcy court's observations have immense practical significance, and probably constitute a *better* approach than the California statute. We recognize the odd result the statute creates — one-person medical corporations are treated the same as General Motors, creating the opportunity for shareholders of tiny corporations to abuse the exemption scheme — but we may not disregard the statute's language to address problems left to the legislature.
>
> We also fear that the bankruptcy court's approach creates an unnecessary ambiguity in the plain language of the statute.… If corporations with one shareholder are not really corporations, how about corporations with two shareholders? Or three? Or four? When would a closely held corporation become a "real" corporation for the purpose of California exemption law? We are not willing to open the floodgate for this sort of litigation.…

[*In re* Cheng, *supra,* 943 F.2d at 1117.]

The staff does not know whether the Ninth Circuit's fear of a floodgate of litigation is realistic, but the dangers inherent in a more flexible standard for determining the exemption could be limited by legislating some appropriate standard concerning the number of participants in the plan, the degree of control over the plan and the amount of contributions, or other factors that would give the courts more guidance.

POSSIBLE APPROACHES

Other states have faced the same difficulties in crafting an appropriate exemption for pensions and come up with a number of useful ideas. (Several state statutes are discussed in the attached background memorandum prepared for the Commission by Matthew Waddell, a student at the University of Pennsylvania Law School. See Exhibit pp. 1-9.)

Apply Necessity Standard to All Private Plans

Section 704.115 could be amended to apply the necessity standard to all funds described in the section. This would treat private retirement plans, including, but not limited to, union retirement plans (subdivision (a)) and profit-sharing plans designed and used for retirement purposes (subdivision (b)) the same as self-employed retirement plans and IRA's (subdivision (c)).

This approach has the virtue of treating all private plans consistently (and could, theoretically, be extended to public retirement plans under Section 704.110, which are not now subject to a necessity standard). Applying the same necessity standard to all private plans would potentially result in more administrative costs, since a court would be required to determine the amount "necessary to provide for the support of the judgment debtor when the judgment debtor retires and for the support of the spouse and dependents of the judgment debtor, taking into account all resources that are likely to be available for the support of the judgment debtor when the judgment debtor retires."

The existing law is based on the broad assumption that contributions and benefits involved in a fund as a result of negotiations between employees and employers will be fundamentally reasonable and are entitled to protection for non-preferred claims. Use of a general necessity test displaces this assumption and puts all such benefits up to the test. There is also some question as to whether this proposal is politically feasible.

Degree of Control

The bankruptcy judge in *Cheng* noted that the debtor, a doctor, was "the sole shareholder, president, and controlling executive officer of Cheng, M.D., Inc., and also served as the plan's trustee." Treating one-person professional corporations as suggested by Judge Ahart would deal with the control issue in this situation, but does not provide a flexible enough rule to deal with two-person corporations and other closely-held corporations where the same problem exists.

Some states have adopted exemption statutes that turn on the degree of control of the debtor over the fund. (For additional discussion, see Exhibit pp. 3-4.) Connecticut finds dominion if the debtor is self-employed, is a partner, or is a shareholder with 1% or more interest, or if the court finds that dominion is exercised — this standard mixes relatively easy standards with the fallback court determination. Wisconsin defines an "owner-dominated plan" as one "under which 90% or more of the present value of the accrued benefits or 90% or more of the aggregate of the account is for the benefit of one or more individuals who are owner-employees" and an "owner-employee" is "any individual who owns, directly or indirectly, the entire interest in an unincorporated trade or business, or 50% or more of the combined voting of all classes of stock entitled to vote or the total value of shares of all classes of stock of a corporation, or 50% or more of the capital interest or profits interest of a partnership or limited liability company." As can be seen, attempting a statutory definition of domination may be complicated and may be difficult to apply, especially in non-bankruptcy situations. Perhaps a useful standard may be found elsewhere in California law as we devote further research.

Applying a dominion or degree-of-control standard complements the theory of the California statute. The staff believes that fashioning an appropriate dominion standard would be the best starting place for revising Section 704.115.

If the Commission pursues this approach, the next question is what rules are triggered by the requisite dominion. The simplest approach in the framework of the existing statutes would be to apply the necessity standard if the debtor has the requisite degree of control over a private retirement fund. But other consequences, such as the "anti-shuffling" rule (discussed below) could be applied.

Anti-Shuffling

As a general rule, a debtor may convert non-exempt assets into exempt assets of equivalent value despite the fact that this may have the effect of defeating creditors. This is true in state collections as well as bankruptcy proceedings (although the standards are different in bankruptcy).

One technique for dealing with the potential abuse of this rule in the area of pension funds is to allow the exemption as to certain transfers made to debtor-controlled funds only if the payments are made a minimum period before the creditor's claim arose. Thus, in the case of a debtor with dominion over the fund, Connecticut denies the exemption for transfers occurring less than 90 days before the filing of creditor claims. Kentucky provides a 120-day exclusion rule. It appears that Hawaii may apply a three-year rule. This type of provision would help solve the most obvious abuse of the exemption statute, where certain debtors are permitted to exempt large amounts of previously non-exempt funds. Another factor in this type of case is the suspicion that the transfers are not intended for retirement purposes but only for temporary shielding. In bankruptcy, the intent of the debtor will be examined and if the fund is found not to be designed and used for retirement purposes, the exemption can be denied. See, e.g., *In re* Bloom, *supra.* 839 F.2d 1378-79. This exercise is more difficult than applying a mechanical time period to exclude certain funds from coverage of the exemption.

The staff believes a statutory anti-shuffling rule applicable to certain retirement fund contributions is worth consideration. Such a rule can be combined with dominion considerations, as in Connecticut and Kentucky. Other combinations are possible. The anti-shuffling rule could be applied only to contributions over a certain amount or percentage of the fund, or could be applied only to irregular contributions as opposed to regular, periodic contributions.

Fund Value Limitations

Several states set a flat amount exemption of pension accounts (such as $100,000), perhaps with an additional necessity exemption for amounts over $100,000. This approach resembles the homestead exemption which sets flat amounts for certain classes of debtors based on presumed need. Some states determine the exempt dollar value through application of statutory actuarial tables or principles. (For further discussion, see Exhibit pp. 5-6.)

The staff is not inclined to recommend this approach. A flat amount has no particular relation to the debtor's age, obligations, other assets, employment prospects, or other factors, and is an arbitrarily selected figure. A flat amount exemption is easier to administer, however, since no hearing is required if the fund is valued below the amount set. Actuarial tables or principles are a mix of arbitrarily selected standards and complexity, but even then may omit crucial factors such as the length of the contribution period. Overly specific exemptions stating expected rates of return and dollar amounts are also undesirable in that they require frequent legislative attention to keep pace with inflation and other economic conditions.

The staff does not plan to give further consideration to this approach, even though it is similar to the homestead exemption, unless the Commission otherwise directs.

Contribution Value Limitations

Massachusetts limits the exemption of plans maintained by individuals to sums not exceeding 7% of the person's total income in the five-year period preceding entry of judgment or declaration of bankruptcy.

This does not seem preferable to the necessity approach, except that it provides an objective mathematical standard that would be easier to administer.

Respectfully submitted,

Stan Ulrich
Assistant Executive Secretary

TO: Stan Ulrich,
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FROM: Matt Waddell, University of Pennsylvania Law School

Suggested Revisions to
and Source Material for Revision of
California Code of Civil Procedure, §704.115 (1994)

March 27, 1995

Per the suggestion of Bankruptcy Judge Alan M. Ahart, and at the request of the California Law Revision Commission (the Commission), this memorandum responds to inequitable results stemming from the application of §704.115 of the California Code of Civil Procedure to private retirement plans. In brief, §704.115(e) restricts the exemption of self-employed retirement plans and individual retirement annuities organized under the Internal Revenue Code of 1954 as amended. Those plans are exempt only to the extent needed by the debtor in retirement, accounting for all other income and asset resources available. This limitation clearly aims to keep such exempt amounts reasonable and to prevent abuses where the plan beneficiary directly controls the plan sponsor.

No such limitation appears, however, in §704.115 with regard to "private retirement plans" and "profit-sharing plans designed for retirement purposes" held by corporations and other entities. Consequently, personal assets of debtor shareholders held in corporate retirement plans are exempt from creditor claims without limitation whether the corporation is closely held or not. Moreover, private plan assets that are deemed to be for retirement, and hence subject to exemption, escape fraudulent conveyance law upon transfer.

In response to the apparent inequity, the bankruptcy court interpreted private plans held by single-shareholder corporations to be self-employment plans and accordingly held them subject to limitation. The Ninth Circuit reversed, demonstrating an unwillingness to redefine a "corporation" under the statute by its number of shareholders, fearing such a definitional stretch would invite litigation and judicial line-drawing.

The result of the current drafting and interpretation of §704.115 is the potential shielding of millions of dollars of debtor assets from creditors in bankruptcy proceedings. Whenever a debtor professional wishes to safeguard extra retirement funds or establish a safe-harbor fund from which to borrow, the debtor can incorporate, deposit assets in a retirement plan, and avoid creditor claims if the debtor does so in a manner that resembles genuine retirement saving.

Relevant Comparable State Codes

Judge Ahart recommends changing the statute to apply the necessity standard to one-person corporation retirement plans. Such a solution, however, does little to curb abuses by closely held corporations with more than one shareholder. Consequently, alternative means of limiting the exemption are necessary. Several other states have drafted comparable statutes and handled the situation in a variety of ways. Particularly relevant are the statutes of Connecticut,, Georgia, Kentucky, Massachusetts, Montana, Nevada, Tennessee, Virginia, Washington, and Wisconsin. [1]

Retirement Exemptions in Connecticut, Kentucky, and Wisconsin

The statutes of these states handle the problem of CAL. CIV. PROC. CODE §704.115 in several common ways. First, some states determine first if the debtor has dominion or control over the corporation, partnership, or proprietorship, and, if they find dominion, either (i) limit conveyances to and from the plan in the days before bankruptcy (Connecticut), or (ii) require the plan payments to be necessary for support (Wisconsin). These statutes surpass Judge Ahart's recommendation for a necessity restriction on one-person corporate plans because the statutes allow judicial oversight of both disbursements and deposits before bankruptcy and limit exemptions where the closely held entities are controlled by more than one interest holder.

The Connecticut statute defines dominion to exist where the debtor (i) is self-employed, (ii) is a partner, (iii) is a one percent or more shareholder, or (iv) "in the opinion of a court of competent jurisdiction, exercises dominion and control over such proprietorship, partnership, corporation or other entity." The Connecticut statute, however, does not then require retirement disbursements from the plan to be necessary for support, instead limiting transfers *to* the plan in the 90 days before filing of creditor claims by making them subject to judgment. Kentucky applies a pre-bankruptcy scrutiny to all debtor contributions, whether

1 CONN. GEN. STAT. §§52-321a, 52-352b (1992); GA. CODE ANN. §§18-4-22, 18-4-111 (1994); KY. REV. STAT. ANN. §427.150 (Baldwin 1994); MASS. ANN. LAWS ch. 235, §34A (Law. Co-op. 1994); MONT. CODE ANN. §25-13-608 (1994); NEV. REV. STAT. ANN. §21.090 (Michie 1993); TENN. CODE ANN. §26-2-104 (1994); VA. CODE. ANN. §34-34 (Michie 1994); REV. CODE WASH. (ARCW) §6.15.020 (Michie 1994); WIS. STAT. §815.18 (1994).

by a dominant interest holder or otherwise, voiding the statutory exemption for all plan contributions 120 days before bankruptcy.

The Wisconsin statute finds an entity to be "owner-dominated" where 90% or more of (i) the present value of accrued benefits or (ii) the aggregate of the account is for the benefit of one or more individuals who are "owner-employes." An owner-employe is then defined to be an individual who owns, directly or indirectly, (i) the entire interest of the entity, (ii) 50% or more of the combined voting classes of stock, (iii) 50% or more of the total value of all shares of all classes of stock, or (iv) 50% or more of the capital interest or profits interest of a partnership or limited liability company. If the plan is found to be owner-dominated, within these tests, plan payments to owner-employes are limited to the amount reasonably necessary for the support of the debtor and the debtor's dependents. Wisconsin does not specifically limit transfers to the plan before bankruptcy. Moreover, Wisconsin's attempt at expanding the limitation beyond one-person entities is not entirely successful, as it can reach no more than two people owning 50% each. If the closely held entity is controlled or owned by one person with more than 50% interest, the other owners with less than 50% are exempt from the definition of owner-employe and removed from the limitation. Unlike Wisconsin, Kentucky limits all property exempt in bankruptcy, regardless of owner domination, to the extent necessary for the support of the debtor and the debtor's dependents, including all retirement funds.

Perhaps the most valuable suggestion for change toCAL. CIV. PROC. CODE §704.115 is offered by combining the strong points of these three statutes. By defining an owner-dominated entity in broad terms, as Connecticut has, with both ownership guidelines and court discretion, multiple-owner entities are brought within the reach of the statute.

By designating plan additions and withdrawals in the months before bankruptcy as fraudulent where debtor-domination is found, debtor fund shuffling is avoided. Otherwise, if deposits on the eve of bankruptcy are found to be repayments of plan loans or exempt contributions, entity owners are encouraged (i) to borrow from shielded retirement accounts with no intention to repay except in bankruptcy, and (ii) to postpone retirement contributions and withdrawals until creditor claims are imminent. These exempt injections and disbursements would necessarily fall outside the scope of fraudulent conveyance.[2] The Kentucky application of an exemption-voiding pre-bankruptcy time-frame to *all* debtors, however, seems inequitable to debtors genuinely benefiting from three months of plan contributions.

Lastly, by restricting payments under owner-dominated plans to amounts necessary for the support of the debtor and debtor's dependents, as in the Wisconsin statute, burgeoning retirement accounts are equitably brought within the scope of creditor claims. A strong argument can be made for limiting payments under all plans, owner-dominated and otherwise, as endorsed by the Kentucky statute.

Determining Reasonable Amounts for Retirement Funds: Exemptions under Massachusetts, Nevada, and Virginia Law

Massachusetts, Nevada, and Virginia all take unique approaches to calculating what is a reasonable amount necessary for retirement. Massachusetts limits plan amounts to 7% of the individual's total income over the five years preceding bankruptcy. Nevada exempts $100,000 in present value. Virginia limits annual payments under a retirement plan to $17,500, and provides an equation and list of annuity coefficients for calculating the total amount allowed at each year of life to produce $17,500 per year in retirement. Presumably these coefficients will be revised as prevailing interest rates change.

These statutes provide salient alternatives to a requirement based strictly on the debtor's necessity for support. in retirement. A simple example demonstrates the difference. At bankruptcy, Debtor is 35 years old and has a five-year average annual salary of $70,000. Debtor's average annual contribution toward retirement is $5,000. Debtor started contributing when Debtor was 25 years old. Debtor's plan has $50,000. In Massachusetts, debtor is limited to 7% of ($70,000 * 5), which equals $24,500. If Debtor were 60 years old and made the same annual income, the outcome would be the same even if Debtor had $1,000,000 in his retirement plan. In Nevada, the whole $50,000 is exempt

[2] In *Yaesu Electronics Corp. v. Tamura* 28 Cal. App. 4th 8 (1994), withdrawals from the fund were found fraudulent conveyances on the basis that the retirement account was not in fact for retirement purposes and not exempt. Had the debtor's account been found to be for retirement, the debtor's shuffling of funds would have been exempt from an attack of fraudulent conveyance. (See generally, CAL. CIV. CODE, §§3439-3449 [Uniform Fraudulent Transfer Act].)

because it is less than the $100,000 ceiling. In Virginia, according to the statute's table, Debtor would be allowed $11,456; but, if Debtor were 60 years old, Debtor could exempt $89,513. Under a statute based on necessity for support, the outcome could vary widely from a very small exemption, in the view that a 35 year old can earn and save in the coming years, to a relatively large exemption, in the view that age and other factors are irrelevant unless specifically noted in the statutory exemption.

In short, an amount based on income, as in the Massachusetts statute, can lead to an inequitably low exemption at older ages. A fixed figure can be inequitable if the statutorily designated amount is too little or too much. A variable scale, such as Virginia's, accounts for age while imbuing court decisions with predictability. An amount "reasonably necessary for the support of the debtor" will often approximate an equitable amount but may lead to unacceptably variable outcomes.

Of the four schemes, Virginia's seems best at balancing the right of the individual to provide for retirement and the right of the creditor to seize disposable assets. The Virginia statute makes a presumption about the amount necessary for annual support in retirement ($17,500); this amount may deserve reconsideration. In addition, the annuity coefficients in the Virginia statute assume that a 65 year old retiree with a 15 year retirement will be able to garner 8.7% interest per year on the retiree's savings; this may be unreasonable depending on the prevailing interest rates. Nevertheless, the Virginia statute accounts for both the future saving potential of young debtors and the limited resources of the elderly while providing predictable outcome. Except for the complexity of computing a schedule similar to Virginia's, the only significant drawback of the Virginia statute, when compared with statutes that provide for a reasonably necessary amount, is its failure to account for other factors, such as exempt assets and the debtor's earning potential. These considerations are also absent in the Massachusetts and Nevada statutes.

Specific Suggested Revisions to Cal. Civ. Proc. Code §704.115

Based on the foregoing survey of comparable state laws relating to the exemption of retirement funds from creditor claims in bankruptcy, the following alternatives are recommended.

Alternative 1. Amend subdivisions (e) and (f) to read:

(e) Notwithstanding subdivisions (b) and (d), except as provided in subdivision (f), amounts owed to the judgment debtor under plans described in paragraphs (1) and (2) of subdivision (a) and the amounts described in paragraph (3) of subdivision (a) are exempt only to the extent necessary to provide for the support of the judgment debtor when the judgment debtor retires and for the support of the spouse and dependents of the judgment debtor, taking into account all resources that are likely to be available for the support of the judgment debtor when the judgment debtor retires. In determining the amount to be exempt under this subdivision, the court shall allows the judgment debtor such additional amount as is necessary to pay any federal and state income taxes payable as a result of the applying of an amount described in ~~paragraph (3) of~~ subdivision (a) to the satisfaction of the money judgment.

(f) Where the amounts described in ~~paragraph (3) of~~ subdivision (a) are payable periodically, the amount ...

The simplest of the proposed changes, this would effectively make all individual retirement amounts subject to a standard of necessity for support. Such modification would not subject plans with third party beneficiaries to creditor claims because *amounts owed to the debtor* from the plans in paragraphs (1) and (2) are subject to claim but the plans themselves are not. That is, if the plan sponsor files bankruptcy, the plan itself is protected to the extent that plan funds are not "owed" to the sponsor/debtor.

Alternative 2. Amend subdivisions (e) and (f) as described in Alternative 1 and add subdivision (g):

(e) Notwithstanding subdivisions (b) and (d), except as provided in subdivision (f), amounts owed to the judgment debtor under plans described in paragraphs (1) and (2) of subdivision (a) and the amounts described in paragraph (3) of subdivision (a) are exempt only to the extent necessary to provide for the support of the judgment debtor when the judgment debtor retires and for the support of the spouse and dependents of the judgment debtor, taking into account all resources that are likely to be available for the support of the judgment debtor when the judgment debtor retires. In determining the amount to be exempt under this subdivision, the court shall allows the judgment debtor such additional amount as is necessary to pay any federal and state income taxes payable as a result of the applying of an amount described in ~~paragraph (3) of~~ subdivision (a) to the satisfaction of the money judgment.

(f) Where the amounts described in ~~paragraph (3) of~~ subdivision (a) are payable periodically, the amount ...

(g) Nothing in this section shall affect the status of additions to or withdrawals from a trust, account, contract, plan, or other arrangement described in subdivision (a) of this section if (1) (A) the judgment debtor is a self-employed individual, partner of the entity sponsoring the plan, or a ten percent or more shareholder of the corporation sponsoring the retirement plan, or in the opinion of a court of competent jurisdiction, exercises dominion and control over such proprietorship, partnership, corporation or other entity and (B) the addition or contribution is made less than ninety days before the filing of the claim on which the judgment is thereafter entered or (2) such additions or contributions are determined to be a fraudulent conveyance under applicable federal or state law.

In addition to mandating a support requirement for retirement funds, this change would make all retirement funds of owner-dominated plans subject to a 90 day pre-bankruptcy period of scrutiny for deposits and withdrawals by controlling persons. The addition of the subdivision would prevent problems of exempt fund manipulation similar to the attempted manipulation in *Yaesu Electronics Corp. v. Tamura*, 28 Cal. App. 4th 8 (1994). *See infra* note 2. The proposed subdivision (g) is based entirely on CONN. GEN. STAT. §52-321a(c) (1992). It differs from the Connecticut statute only in requiring scrutiny of 10% rather than 1% shareholders. The addition of the subsection allows legitimate contributions by presumed non-control persons while preventing fund shuffling by controlling persons.

Alternative 3. Add subdivision (g) as described in Alternative 2 but also impose a fixed schedule of necessity rather than a discretionary necessity determination in subdivisions (e) and (f):

(e) The exemptions provided under subdivisions (b) and (d) shall not apply to the extent that the interest of the individual in the retirement plan would provide an annual benefit in excess of $17,500. If an individual has an interest in more than one retirement plan, the limitation of this subdivision (e) shall be applied as if all such retirement plans constituted a single plan. The amount required to provide an annual benefit of $17,500 shall be determined under the following table:

Attained Age When Exemption Claimed	Exempted Amount
16	###
...	
65	###
...	
107	###

[DELETE subdivision (f)]

(g) (new subdivision f) Nothing in this section shall affect the status of additions to or withdrawals from a trust, account, contract, plan, or other arrangement described in subdivision (a) of this section if (1) (A) the judgment debtor is a self-employed individual, partner of the entity sponsoring the plan, or a ten percent or more shareholder of the corporation sponsoring the retirement plan, or in the opinion of a court of competent jurisdiction, exercises dominion and control over such proprietorship, partnership, corporation or other entity and (B) the addition or contribution is made less than ninety days before the filing of the claim on which the judgment is thereafter entered or (2) such additions or contributions are determined to be a fraudulent conveyance under applicable federal or state law.

The elimination of subdivision (f) and substantial alteration of subdivision (e) is based on VA. CODE ANN. §34-34 (Michie 1994). Under this alternative, the California legislature would need to determine: (i) the necessary annual income from retirement plans for retirees, (ii) an expected rate of return on savings, and (iii) the average length of retirement. Based on these assumptions, the legislature could then calculate the amount needed at each year of life to provide the necessary amount for a shrinking annuity at retirement. The listed exempted amounts could also reflect the opinion of the legislature as to the earning power of a debtor at each age. The inclusion of such a table would bring certainty to cases involving claims against debtors with retirement funds, although perhaps at the cost of flexibility.

Conclusion

Depending on the goals of the California legislature, CAL. CIV. PROC. CODE §704.115 can be modified in several ways to curb the anomalous results seen in cases such as *In re Cheng*, 943 F.2d 1114 (9th Cir. 1991). Measures can be taken to account for insider manipulations of retirement plans by excluding from exemption insider additions and withdrawals of funds in the months before bankruptcy. Funds currently unfairly exempted only because they are administered by closely-held entities can be reached by subjecting all retirement monies owed to debtors to a requirement of necessity. Alternatively, retirement savings can be limited on a statutorily scheduled basis.

The means for enacting such reform are available through analyzing other states' comparable provisions. Particularly worthy of consideration are the codes of Connecticut, Kentucky, Massachusetts, Nevada, Virginia, and Wisconsin, each of which provide a fresh approach to retirement fund exemption and personal bankruptcy exemptions generally.