

# In the United States Bankruptcy Court

## for the Northern District of Iowa

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DENNIS M. O'KEEFE and  
SHARON R. O'KEEFE

Bankruptcy No. X87-01898M

*Debtor(s).*

Chapter 7

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### **ORDER RE: MOTION FOR ACCOUNTING AND TURNOVER PURSUANT TO 11 U.S.C. § 542a**

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The matter before the court is the trustee's Motion for Accounting and Turnover Pursuant to 11 U.S.C. § 542(a). A hearing was held on July 20, 1988 at Mason City, Iowa. The court now states findings of fact and conclusions of law as required by Bankr. R. 7052. This is a core proceeding under 28 U.S.C. § 157(b).

#### **FINDINGS OF FACT**

The debtors filed their bankruptcy petition on September 8, 1987. On Schedule B-2, debtor Dennis O'Keefe listed that he was an income beneficiary under a trust created under the Last Will and Testament of Mary O'Keefe. The debtors also noted on Schedule B-2 that Dennis O'Keefe as trustee had no power to invade the corpus in favor of debtor as the trust was subject to a spendthrift clause.

The Last Will and Testament of Mary O'Keefe provided that all the residue of Mary O'Keefe's estate was to be placed in a testamentary trust with Dennis O'Keefe to serve as the trustee.

Article II(A) of the trust provided that the trustee shall pay the entire net income of the trust to Dennis O'Keefe during his lifetime.

The spendthrift clause of this trust provided as follows:

"No title in the trust created by this Article or in any property at any time becoming a part of the trust, or in the income therefrom, shall vest in any beneficiary, and neither the principal nor the income of the trust shall be liable to be reached in any manner by the creditors of any beneficiary; no beneficiary shall have the power to sell, assign, transfer, encumber or in any other manner anticipate or dispose of his or her interest in the trust or the income produced thereby."

(Article II-D).

Debtor Dennis O'Keefe received a number of payments from the trust during the 180-day period following the filing of the bankruptcy petition.

The following payments totaling \$3,000.00 made to the debtor

during the 180-day period following the filing were noted in the trust records and books:

Date Amount

11-4-87 \$200.00

11-6-87 200.00

11-18-87 200.00

11-25-87 100.00

12-3-87 900.00

12-22-87 800.00

1-11-88 300.00

2-8-88 100.00

2-26-88 200.00

The trustee filed a motion for accounting and turnover pursuant to 11 U.S.C. § 542(a) on March 21, 1988. The trustee requested in his motion that the court order the debtor to account for all the money which he received from the trust and turnover that amount to the trustee as property of the estate.

The trustee contends that the amounts received from the trust were income distributions and therefore includable as property of the estate.

The debtors provided an accounting of the trust distributions to the trustee.(fn.1) The debtors have refused to turn over any amounts received

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1 Trustee has requested relief in the form of an accounting. That accounting has been provided, and therefore further relief as to an

accounting is unnecessary.

from the trust, contending that the payments were loans to the debtor and were not intended to be distributions of trust income.

The trustee also argues that the debtors should be required to turnover \$2,100.00 which the trustee claims is the fair rental value of the house owned by the trust and occupied by the debtors. The trustee contends that the right to occupy the residence is property received within 180 days after the filing of

the petition. The trustee also seeks turnover of trust distributions during the 180-day period made for a newspaper subscription and utility payments for the house where debtors reside.

## I.

The language of the trust document indicates that the testator intended to provide for a spendthrift provision. A spendthrift trust is a trust in which a beneficiary is entitled to the income, but his interest is not transferable by the beneficiary and his interest shall not be subject to the claims of his creditors. See In re Graham, 726 F.2d 1268, 1271 (8th Cir. 1984).

A review of Iowa law indicates a spendthrift trust is valid and enforceable against creditors of a beneficiary. See In re Bucklin's Estate, 243 Iowa 312, 51 N.W.2d 412; Matter of Dodge's Estate, 281 N.W.2d 447 (Iowa 1979).

Under the present Bankruptcy Code, there is a broad definition of what constitutes property of the estate. See 11 U.S.C. § 541(a). However, a restriction on the transfer of a beneficial interest of a debtor in a trust that is enforceable under applicable nonbankruptcy law is enforceable in a case under Title 11. 11 U.S.C. § 541(c)(2). Therefore, this type of restrictive trust is not deemed property of the estate.

The legislative history to § 541(c)(2) indicates that Congress intended that a debtor's interest in a spendthrift trust protected under state law from reach of creditors be excluded from property of the estate. The legislative history provides as follows:

"The bill also continues over the exclusion from property of the estate of the debtor's interest in a spendthrift trust to the extent the trust is protected from creditors under applicable state law. The bankruptcy of the beneficiary should not be permitted to defeat the legitimate expectations of the settlor of the trust."

H.R. Rep. No. 595, 95th Cong. 2d Sess. 5, reprinted in 1978 U.S. Code Cong. & Ad. News 5963, 6136.

Most courts have agreed that a debtor's interest in a valid spendthrift trust is not to be included as property of the bankruptcy estate. See In re Graham, 726 F.2d 1268, 1273 (8th Cir. 1984); Matter of Leimer, 54 B.R. 587, 589-90 (D.C. 1985); Matter of Goff, 706 F.2d 574, 580-82 (5th Cir. 1983).

Property acquired by bequest, devise or inheritance within 180 days after the date of filing becomes property of the estate. 11 U.S.C. § 541(a)(5). Section 541(a)(5) provides that any interest in property that would have been property of the estate if such interest had been an interest of the debtor on the date of the filing of the petition and that the debtor acquires or becomes entitled to acquire within 180 days after such date by bequest, devise or inheritance is considered to be property of the estate.

## II.

The trustee does not contend that the spendthrift clause is unenforceable in this case. However, he says that once income is distributed from the spendthrift trust, it becomes property of the estate. The trustee cites In re Bucklin's Estate, 243 Iowa 312, 51 N.W.2d 412,"416 (Iowa 1952) for the proposition that once income is distributed from a spendthrift trust it becomes the debtor's property. In Bucklin at 416, the court stated:

"The income itself after being paid over to the beneficiary (or more technically perhaps the right to retain and spend it after distribution) of course becomes subject to alienation, voluntary or involuntary, the same as any other property to which he holds legal title."

Several bankruptcy courts have held that distributions received from a spendthrift trust within 180 days of the filing become property of the estate under 11 U.S.C. § 541(a)(5)(A). In In re Hecht, 54 B.R. 379 (Bankr. S.D. N.Y. 1985) affirmed sub nom, Togut v. Hecht, 69 B.R. 290 (S.D. N.Y. 1987), the debtor was a beneficiary of two spendthrift trusts and continued to receive income payments from the trust, but did not include these payments as property of the estate. The court held that the income actually received by the debtor from the spendthrift trust during the 180-day period following the filing of the petition was not shielded from the trustee's avoiding powers. See also Smith v. Moody (In re Moody), 837 F.2d 719 (5th Cir. 1988); In re Kragness, 58 B.R. 939, 944 (Bankr. D. Ore. 1986); In re Goulding, 79 B.R. 874 (Bankr. W.D. Mo. 1987); RESTATEMENT, 2d TRUSTS § 152; G. Bogert, Handbook of the Law of Trusts, § 40.

The debtors argue that income distributed from the trust is not property of the estate because the debtor's interest in the spendthrift trust never became property of the estate, relying on In re Edgar, 728 F.2d 1371 (11th Cir. 1984). In Edgar, which was decided under the Bankruptcy Act, the court concluded that the debtor's interest in a spendthrift trust did not become property of the estate because, although said interest was vested, it was not transferable. The court further concluded that the income distributed did not come into the estate under § 110(a) of the Act because said property did not vest in the debtor within six months as it had vested years before. Id. at 1374.

In Edgar, the court relied on § 70(a) of the Bankruptcy Act which provided that "property . . . which vests in the bankrupt within six months after bankruptcy by bequest, devise or inheritance shall vest in the trustee . . . as of the date when it vested in the bankruptcy." Id. at 1372. However "[s]ection 70(a) of the Act focused on the vesting of interests, and looked at the transferability or leviability of the debtors interest in determining whether property became property of the estate." In re Hecht, 54 B.R. 379, 384 (Bankr. S.D. N.Y. 1985), affirmed sub nom Togut v. Hecht, 69 B.R. 290 (S.D. N.Y. 1987).

The Eighth Circuit Court of Appeals in In re Graham, 726 F.2d 1268, 1271 (8th Cir. 1984) held that under the Bankruptcy Code, the transferability-leviability standard has been entirely abandoned. The court stated in Hecht at 384, "Section 541(a)(5)(A) plainly refers to interests which the debtor 'acquires or becomes entitled to acquire,' and avoids any reference to the term 'vest.'" The court concluded that the term "acquire" means that trust income is acquired by the beneficiary when the income distribution is made. Id. This court agrees with the reasoning of Hecht in concluding that any income payments received by the debtor from a spendthrift trust within 180 days of the filing of the bankruptcy petition constitutes a bequest and becomes property of the debtor's estate pursuant to 11 U.S.C. § 541(a)(5).

### III.

The court must decide whether any distributions of income were made to the debtor. The debtor's bankruptcy petition was filed on September 21, 1987. Therefore, the court will look at all withdrawals from the trust for the period of September 21, 1987 through March 19, 1988 to determine whether any of these transactions were distributions of income.

Withdrawals from the trust were recorded by Dennis O'Keefe, the trustee, in both a record book and savings account ledger. The savings account ledger which was admitted into evidence as defendant's Exhibit

A-1 shows the following payments made to Dennis O'Keefe:

Date Amount Explanation

11-4-87 \$ 200.00 Groceries  
11-6-87 200.00 To Denny, loan check  
11-18-87 200.00 To Dennis, loan check  
12-3-87 900.00 To Denny  
12-10-87 400.00  
12-22-88 300.00  
1-11-88 300.00 To Dennis  
2-8-88 100.00  
2-12-88 1,100.00 Cash loan to Tim  
2-23-88 780.00 To check loan  
2-26-88 200.00 Groceries

The record book for the Mary O'Keefe trust which was admitted into evidence as plaintiff's Exhibit 7 indicates the following amounts were recorded as personal withdrawals:

Date Amount

11-4-87 \$ 200.00  
11-6-88 200.00  
11-18-87 200.00  
11-25-87 100.00  
12-3-87 900.00  
12-22-87 800.00  
1-11-88 300.00  
2-8-88 100.00  
2-26-88 200.00  
Total \$3,000.00

A review of the trust records (plaintiff's Exhibit 7) provides no indication that any of these cash withdrawals from the trust by Dennis O'Keefe were loans. The balance sheet provides a column entitled "Loans Receivable." However, none of the withdrawals by Dennis O'Keefe were recorded under this column. They were all recorded under his personal withdrawal column. The only transactions recorded as loans receivable were loans made to Tim O'Keefe, son of the debtors, on February 12, 1988 in the amount of \$1,100.00 and on February 23, 1988 in the amount of \$780.00.

There is ambiguity between the trust record book and savings account ledger as to the nature of the withdrawals from the trust account.

Debtor Dennis O'Keefe testified that all the personal withdrawals were loans and not intended to be distributions of trust income. Additionally the debtor stated that the loans were not evidenced by any promissory notes or other written loan documents. The debtor stated that there was not any stated date for repayment and he did not intend to pay any interest on his loans. The debtor stated that the loans would be repaid when he was financially capable.

When the debtor filed his Chapter 7 petition, he filed a schedule of current income and current expenditures. This schedule indicates that the debtors expected to receive \$885.00 per month as income beneficiary of the spendthrift trust. During the hearing, the debtor testified that this was only an estimate and that he had not received any income distributions.

Although there is no formal requirement that a loan must be in writing or that it must provide for an interest rate and maturity date, the fact that none of these traditional loan elements exists casts doubt on the character of the transactions as loans. This court believes that the cash payments to the debtor under the trust were never intended to be repaid and were income distributions. The fact that the payments were recorded in the trust record book as "personal withdrawals" rather than "loans receivable" provides additional evidence in support of the conclusion that the payments were income distributions.

The payments made to Dennis O'Keefe, which were recorded in the trust record book as "personal withdrawals" during the 180-day period following the filing of the petition, are property of the estate and must be turned over to the trustee. These payments total \$3,000.00.

#### IV.

The trustee is also requesting the debtor to turn over \$29.25 paid by the trust to the Des Moines Register for a newspaper subscription. The debtor testified that the subscription was a benefit to the trust as the newspaper was used to guide in the management of the trust. The court finds that the newspaper subscription payments were an expense of the trust and not a distribution of income to Dennis O'Keefe.

#### V.

The trustee also contends that the debtors must turnover the fair rental value of a house owned by the trust for the 180-day period following bankruptcy. Although the debtors have lived in the house, they have never paid any rent.

The provisions of the Will, appear to give the trustee the power to rent, lease, or use any property of the trust with or without consideration. Article IV(8) provides the trustee shall

have the following powers:

"To retain, purchase, sell, rent, give away, exchange, improve, partition, grant options regarding, dedicate, manage, convey, use in any manner, or subdivide any real property. To lease or to contract to sell, buy or convey the property to anyone or any entity, with or without consideration, upon any terms or for any period whether within or extending beyond the terms of my estate or any trust."

The trustee introduced evidence that the monthly rental value of the house was \$350.00. This value was determined by a "windshield" appraisal conducted by Elmer Hardin, a real estate agent/broker. Mr. Hardin testified at the trial regarding this appraisal. The trustee contends that if the debtors had not resided in the home during the 180-day period, the house could have been rented for \$350.00 per month which would be trust income required to be paid over to the trustee.

The trustee contends that this right-to-possession is a property right and constitutes an interest in property which becomes property of the estate. This court agrees that the use of the premises by the debtors is an acquired property interest within the meaning of 11 U.S.C. § 541(a)(5). Therefore, the value of the use of the premises during the 180-day period is property of the estate. The court finds this value to be \$350.00 per month or \$2,100.00 for the 180-day period.

The court believes it is highly probable that debtors' interest in the house could be claimed as exempt under Iowa's homestead statute. See Iowa Code § 561.16. Before requiring a turnover of the \$2,100.00, the court will allow the debtors time to amend their claims of exemptions to reflect any possible homestead exemption.

## VI.

Utility bills totaling \$966.98 were paid by the trust during the 180-day period following the filing of the bankruptcy petition. The utility bills were for the use of utilities in both the farming operation and the debtors' residence.

This court believes that any payments of utility bills for the debtors' personal residence are distributions within the meaning of 11 U.S.C. § 541(a)(5) and therefore must be turned over to the trustee.

It is not clear from the record and exhibits what amount of utilities was actually used in the debtors' home. Therefore, the court will rely on the debtors' estimate of \$100.00 per month which was listed on the debtors' schedule of current income and expenditures. Mr. O'Keefe is required to turnover \$600.00 to the trustee for utility bills paid by the trust.

## ORDER

IT IS ORDERED that the debtor Dennis O'Keefe pay the trustee \$3,600.00, which was income distributed from the trust during the 180-day period following the filing of the bankruptcy petition.

IT IS FURTHER ORDERED that Dennis O'Keefe shall turnover to the trustee \$2,100.00 which represents the fair rental value of the house occupied by debtors. This portion of the order is stayed for 30 days to permit debtors to claim a homestead interest, if any, as exempt. If so claimed, this stay shall continue until the interest is determined to be non-exempt. If not claimed as exempt, this stay shall expire automatically in 30 days from the entry of this order.

SO ORDERED THIS 6th DAY OF OCTOBER 1988.

William L. Edmonds  
Chief Bankruptcy Judge