

In the United States Bankruptcy Court

for the Northern District of Iowa

KIM ALLEN SCHLITTER
LAURA KAY SCHLITTER
Debtor(s).

Bankruptcy No. 98-02982-C

Chapter 7

ORDER RE TRUSTEE'S OBJECTION TO DEBTORS' CLAIM OF EXEMPTION

This matter came before the undersigned on February 23, 1999 on Trustee's Objection to Debtors' Claim of Exemption. Debtors Kim and Laura Schlitter were represented by Attorney Jean C. Lawrence. Renee Hanrahan appeared as Chapter 7 Trustee. After the presentation of evidence and argument, the Court took the matter under advisement. This is a core proceeding pursuant to 28 U.S.C. §157(b)(2)(B).

STATEMENT OF THE CASE

Debtors claim the interest of Kim Schlitter in a Deferred Compensation Plan offered through his employment with the City of Cedar Rapids is exempt under Iowa Code sec. 627.6(8)(e). Trustee argues this Plan is not a "pension, annuity or similar plan or contract" under that section. She also asserts Debtors' rights in payments under the Plan are not "on account of illness, disability, death, age or length of service."

FINDINGS OF FACT

Debtor Kim Schlitter is a participant in The City of Cedar Rapids Iowa Revised Deferred Compensation Plan. According to its own terms, the Plan is intended to provide retirement income and other deferred benefits to City employees in accordance with Internal Revenue Code, 26 U.S.C. §457. See Exhibit 2. The parties stipulate the Plan is entirely employee-funded and provides for tax deferral of accrued income. At payout, Debtor will receive his investment plus any return on his investment.

Payments may be made from the Plan at a participant's retirement, separation from service, or death. A participant may also apply to the City to receive part of the value of the account in the event of an "unforeseeable emergency." Debtor has not applied to withdraw for an unforeseeable emergency, although he requested an "Emergency Withdrawal Packet". Based on information in the packet, Debtor determined that he was not currently eligible to receive a distribution under the unforeseeable emergency provision. The packet states that a "personal bankruptcy (except when resulting directly and solely from illness or casualty loss)" would "probably not comply with IRS regulations" covering unforeseeable emergencies. See Exhibit A.

Trustee asserts that Debtor decides how distributions are to be made and where and how his contributions are invested. She states payments under the Plan are not tied to Debtor's estimated life span or actuarial tables. Debtor decides how often and in what amount to make contributions.

CONCLUSIONS OF LAW

Debtors in Iowa are entitled to claim exemptions under Iowa Code Chapter 627. Section 627.6(8)(e) allows a debtor to claim exempt "[a] payment or a portion of a payment under a pension, annuity, or similar plan or contract on account of illness, disability, death, age, or length of service." This pension exemption is modeled on the similar federal exemption found at 11 U.S.C. §522(d)(10)(E). In re Eilbert, 162 F.3d 523, 526 (8th Cir. 1998). When the Iowa legislature passes a statute modeled on a federal statute, it can be presumed that the Iowa legislature intended what Congress intended. Id. Congress' intent was to exempt benefits that are akin to future earnings. Id.

Courts should construe exemption statutes liberally in favor of the debtor in light of the purposes of the exemption. In re Wallerstedt, 930 F.2d 630, 631 (8th Cir. 1991); Chariton Feed & Grain, Inc. v. Kinser, 794 F.2d 1329, 1331 (8th Cir. 1986) (applying Iowa law); Frudden Lumber Co. v. Clifton, 183 N.W.2d 201, 203 (Iowa 1971). The exemption of payments under a pension or similar plan is intended to protect payments which function as wage substitutes after retirement or disability, to support the basic requirements of life at a time when the debtor's earning capacity is limited. In re Pettit, 55 B.R. 394, 398 (Bankr. S.D. Iowa), aff'd, 57 B.R. 362 (S.D. Iowa 1985).

No Iowa court has specifically decided whether a deferred compensation plan under 26 U.S.C. §457 is exempt under sec. 627.6(8)(e). Internal Revenue Code §457 sets out the requirements for tax-deferred plans offered by city, state and local governments to their employees. In In re Pedersen, 155 B.R. 750, 758 (Bankr. S.D. Iowa 1993), the court suggested that the §457 deferred compensation plan offered by the City of Council Bluffs would qualify as exempt property under sec. 627.6(8)(e). The current version of the statute, however, was not applicable in Pedersen, where the bankruptcy case was filed before the statute was amended. Id.

Two courts applying §522(d)(10)(E), the federal pension exemption, have concluded deferred compensation plans arising under 26 U.S.C. §457 qualify as exempt. In re Destremps, 193 B.R. 85, 89 (Bankr. D. Mass. 1996); In re Rector, 134 B.R. 611, 617 (Bankr. W.D. Mich. 1991). Like Debtor's plan, the §457 plans in both cases included provision for payment for "unforeseeable emergencies." In Destremps, the court stated the issue was whether the plan was exempt even though it allowed payment for unforeseeable emergency, a reason outside the limits of §522(d)(10)(E). 193 B.R. at 88. The court held that because of the way the administrators of the Plan construed "unforeseeable emergency", the payments constituted future earnings in time of need, based on disability, illness or age. Id. at 89. The Massachusetts state employees' §457 deferred compensation plan was exempt. Id. The court in Rector stated the issues boils down to whether the plan provides payment in the event of one of the §522(d)(10)(E) occurrences, or is merely a savings device or tax shelter. 134 B.R. at 616. It held the Michigan state deferred compensation plan was exempt. Id. at 617.

In Iowa, courts use four factors to determine whether an investment plan qualifies as exempt under sec. 627.6(8)(e): 1) the plan is a formal plan, usually part of a relationship with an employer; 2) the benefits are intended as retirement income; 3) access is not controlled by the debtor and has strong limitations on withdrawal; and 4) payments are on account of illness, disability, death, age or length of service. In re Lingle, 119 B.R. 672, 676 (Bankr. S.D. Iowa 1990). In Eilbert, the Eighth Circuit considered whether a single premium variable annuity was exempt under Iowa Code sec. 627.6(8)(e).

To determine whether the annuity was "a pension, annuity, or similar plan or contract" under that section, the court asked whether it provided benefits in lieu of earnings after retirement. Eilbert, 162 F.3d at 527. To determine whether a payment under a plan is "on account of illness, disability, death, age, or length of service", the court stated the annuity would not qualify where the debtor had unfettered discretion to receive payments, subject only to modest penalties. Id.

In In re Hutton, 893 F.2d 1010, 1012 (8th Cir. 1990), the court found a savings and investment plan provided by an employer was a "similar plan" under sec. 627.6(8)(e). The plan allowed for withdrawals for "financial hardship" as defined by Internal Revenue Service regulations with the decision made by the plan administrator. Id. at 1011. In In re Flygstad, 56 B.R. 884, 890 (Bankr. N.D. Iowa 1986), the court found a profit sharing plan exempt under sec. 627.6(8)(e) as a "similar plan or contract" in terms of the control exercisable by the debtor. One method of access to the assets was termination of service, or the debtor quitting his job, which the court found to be an extreme act not equated with withdrawal from a savings account. Id. A profit sharing plan was exempted in Pettit where disbursements were controlled by a committee. 55 B.R. at 398. There, payment could commence at termination of employment or, in the committee's sole discretion, in a hardship case due to illness or accident. Id. at 396.

Based on the foregoing, the Court concludes Debtors' interest in the Deferred Compensation Plan is exempt under Iowa Code sec. 627.6(8)(e). This is a formal plan related to Debtor's employment with the City of Cedar Rapids. By its own terms, the Plan is intended to provide retirement income to participating city employees. Payments are triggered by the occurrences set forth in the statute, including illness, age, or death. Because of the strictures set out in Internal Revenue Code §457 and the plan administrator's construction of the term "unforeseeable emergency", Debtors access to payment is strictly limited. The Plan is a pension or similar plan payable on account of the occurrences set out in sec. 627.6(8)(e).

WHEREFORE, Trustee's Objection to Debtors' Claim of Exemption is **OVERRULED**.

FURTHER, Debtors' interest in The City of Cedar Rapids Iowa Revised Deferred Compensation Plan is exempt under Iowa Code sec. 627.6(8)(e).

SO ORDERED this 22nd day of March, 1999.

PAUL J. KILBURG

Paul J. Kilburg
U.S. Bankruptcy Judge