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Making it into the Exemption End Zone

The exemption protection afforded to California residents for private retirement plans under CCP § 704.115(b) is astounding. "The very purpose of the exemption is to permit a judgment debtor to place funds beyond the reach of creditors [...]," and the statute is to "be construed, so far as practicable, to the benefit of the judgment debtor." *(Schwartzman v. Wilshinsky (1996) 50 Cal.App.4th 619, 628 & 630).* So where is the catch? If this exemption protection is so great, then why don't all estate planning attorneys in California incorporate private retirement plans into their client's advanced planning strategies? I would venture to guess the reason is the simplicity of the statue. CCP § 704.115(b) provides that:

> *"[a]ll 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."*

The exemption protection provided by the statute appears to be in black and white; however, the validity of such plans is not stated in absolute terms and is instead governed by case law that tackles (and sometimes fumbles) issues that materialize in contrasting shades of grey. It is this simplicity, in corresponding ambiguity, that requires advanced study of the case law interpreting the statute and providing guidance as to properly structuring to capture its benefits. Most noteworthy is the fact that the statute fails to define a "private retirement plan" and fails to set forth a list of required elements or even factors that should be considered when establishing a plan. In addressing what constitutes a "private retirement plan," the court in the case of *In re Phillips (206 B.R. 196)*, stated that "[t]he critical question for the court to decide is whether the Retirement Plan constitutes a "private retirement plan" as provided in [CCP § 704.115(a)(1)], which section curiously and unhelpfully defines "private retirement plan" as a "Private retirement plan."

If the practitioner is able to overcome the hurdle of deciding whether a private retirement plan qualifies as a private retirement plan under the statute, the next question becomes whether the plan is designed and used for retirement purposes. Determining the answer to this question requires extensive knowledge of case law and a practitioner capable of navigating through the holdings of various courts that fall along a spectrum of grey since such holdings and judicial guidance tend to be based on particular fact-based scenarios that differ from case to case. For example, in order to effectuate the purpose of a private retirement plan, there must be a vehicle to hold the retirement assets. This vehicle is sometimes referred to as a Private Retirement Trust ("PRT"). Like all trusts, the PRT requires a settlor, a trustee, and a beneficiary, but unlike most trusts, PRTs are not required to be valid spendthrift trusts in order to prevent creditors from reaching the assets. Rather, courts have made clear that "whether or not the debtor exercises control over the plan is irrelevant to the exemption." *(In re Vigghiany, 74 B.R. 61 (Bankr.S.D.Cal.1987).)* Thus, a wholly owned corporation that establishes a retirement plan with a single shareholder, director, plan trustee and beneficiary, qualifies for the full exemption under CCP § 704.115 (a)(1) or (a)(2). *(In re Cheng, 943 F.2d 1114, 1116 (9th Cir.1991).)*

In practice, however, the grey area therein lies because "[i]n assessing whether a plan or account was principally or primarily designed and used for retirement purposes, courts are to look at the totality of the circumstances." One such circumstance is the degree of control the debtor maintains "over contributions, management, administration, and use of funds" in the plan or account *(O'Brien v. AMBS Diagnostics, LLC (2019) 38 Cal.App.5th 553, 561).* Thus, although case law provides that the plan beneficiary can be the trustee, structuring a plan as such is detrimental to the survival of the plan. If the trustee/beneficiary exercises a high degree of control over the plan (i.e. makes a withdrawal rather than a loan), the legitimacy of the plan will be litigated and the scales of justice may weigh in favor of creditors' objections to the declared exemption. Not only will such litigation be costly but an interception by the creditors will negate the very purpose of the plan which is to place retirement funds beyond the reach of creditors.

To sum it up, to score a legal touchdown with a PRT, careful thought must be placed on the exemption playbook design, creation, implementation, use, and maintenance of the structure. In turn, the PRT beneficiary secures the proverbial PRT Lombardy trophy by winning the exemption game and protecting needed retirement assets.