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The Gluck Case

Not all Private Retirement Trusts are created equal and to illustrate this point, as well as the importance of checking off all the boxes in creating Private Retirement Trusts, we at Brown & Streza LLP thought it important to call attention to a recent case in which a Private Retirement Trust failed to survive judicial scrutiny and why.

In the recent case of *Gluck v. Sarkissian*[1], a ruling by the Los Angeles County Trial Court denying a defendant's claim that his private retirement plans are exempt under CCP § 704.115 was affirmed by the Court of Appeal.[2] Although the Opinion of the Court of Appeal is unpublished and noncitable, it is worthy of discussion since it appears to be the most recent case in which a court has evaluated the totality of the circumstances to determine if a private retirement plan ("plan") was principally or primarily designed and used for retirement purposes and thus entitled to the exemption protection of CCP § 704.115.

In determining whether a plan is exempt, the critical inquiry is whether the plan is principally or primarily designed and used for retirement purposes. Unfortunately, CCP § 704.115 provides no guidance as to what factors the court will consider in evaluating whether a plan qualifies as a plan under the statute. Thus, an examination of case law on the issue is necessary in order to provide context.

The case of *O'Brien v. AMBS Diagnostics, LLC*[3], provides that "[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." In doing so, "[a]ll factors are relevant; but no one is dispositive. Rather, all of them must be considered in the light of the fundamental inquiry-whether the plan was designed and used for a retirement purpose."[4] The *O'Brien* case set forth the following nonexclusive list of five factors a court may consider when evaluating the totality of the circumstances to determine if a plan qualifies for the exemption protection of CCP § 704.115:

(1) The "debtor's subjective intent" in designing and using the plan. This factor was considered by the court in the case of *In re Simpson*[5], which noted that "while the debtor's subjective intent cannot create an exemption, it may take one away."

(2) The "chronology" or timing of the creation of the plan in relation to other events. The court in Yaesu *Electronics Corp. v. Tamura*[6] addressed this issue and found that the chronology suggested the debtor intended to conceal money from a creditor and did not consider the plan assets a source of retirement income.

(3) The degree of control the debtor maintains "over contributions, management, administration, and use of funds" in the plan or account. In evaluating this factor, the court in *Schwartzman v. Wilshinsky*[7] stated that "[t]he kind of control which would show a nonretirement purpose would be <u>substantially all control</u> over contributions, management, administration, and use of funds".

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[1]Gluck v. Nick Sarkissian (2021 WL 5407188; unpublished and noncitable).
[2]Court of Appeal, Second District, Division 2, California.
[3]*O'Brien v. AMBS Diagnostics, LLC* (2019) 38 Cal.App.5th 553, 561.
[4]*Bloom v. Robinson*, 839 F.2d 1376, 1379-1380 (9th Cir.1988).
[5]*In re Simpson* (9th Cir. 2009) 557 F.3d 1010, 1018.
[6]*Yaesu Electronics Corp. v. Tamura* (1994) 28 Cal.App.4th 8, 15.
[7]*Schwartzman v. Wilshinsky* (1996) 50 Cal.App.4th 619, 629; internal citation omitted; emphasis added.

In that case, the court found that a high degree of control was not exercised because the debtor had no part in administering the plan, did not take loans or disbursements, and did not contribute more than he was entitled.

(4) Whether the debtor violated or complied with Internal Revenue Service (IRS) rules or the plan's rules in contributing to the plan. This factor was addressed by the court in *In re Rucker*[8], which held that the debtor's unlawful and deceptive behavior in funding his Plans indicates, considering all the circumstances, that his Plans were not designed and used primarily for retirement.

(5) And, if the debtor withdraws money from the plan or account, whether those funds were used for retirement or a nonretirement purpose. In addressing this issue, the court in the case of *In re Jacoway*[9] noted that factors to be considered include "whether the withdrawals or loans 'benefited the plan's retirement purpose' by '[preserving and enhancing] the capital of the plan,' and whether any withdrawals diminished or will diminish the assets in the plan to such an extent that they are inconsistent with the majority of the assets being used for long-term retirement purposes."

In the *Gluck* case, the issue before the Trial Court was whether the plan participant had designed and used the plans for retirement purposes. The plan participant claimed the plans are exempt under CCP § 704.115, and the plaintiffs contested on the grounds that the plans were a sham and a bad faith attempt to shield assets from creditors. The Trial Court ruled against the plan participant finding that:

> "Given the timing of their creation, the fact that [the plan participant] is a part owner of the company that provides the plans, that there is no averment the plans comport with IRS rules, and the totality of the circumstances, the Court finds that the retirement plan exemption does not apply."

In evaluating the factors set forth in *O'Brien* to the particular circumstances in *Gluck*, the Court of Appeal found substantial evidence supported the Trial Court's ruling denying the claim of exemption as follows:

(1) The Court found the plan participant's subjective intent in designing and using the plans was to shield assets from creditors based on the plan participant's own declaration in which he stated that the pending lawsuits could "ruin [his] retirement" if the company and/or his son failed to pay resulting damages.

(2) The Court found that the chronology or timing of the creation of the plans in relation to other events supported the inference that the plans were used to shield assets from creditors. The particular circumstances it relied on in reaching this finding consisted of the following: the plans were created only two months after the plan participant was exposed to personal liability from lawsuits; the plan participant (age 67 or 68) was already past retirement age when the plans were created; and the plan participant's company that sponsored the plans existed for seventeen years and never established any retirement plans until now.

(3) With respect to the degree of control the plan participant maintains over contributions, management, administration, and use of funds in the plan, the Court referenced the plan participant's declaration that states he has no direct control over the plans and that the plans are controlled by an independent trustee, trust protector, and plan advisor. However, the Court focused on the fact that the plan participant "did not discount his indirect control of the plans continued existence or termination" as part owner and CFO of the sponsoring company.

(4) The Court stated that the plan participant had to show he did not violate IRS rules or the plans' rules in

[8] *In re Rucker* (9th Cir. 2009) 570 F.3d 1155, 1162.
[9] *In re Jacoway* (B.A.P. 9th Cir. 2000) 255 B.R. 234, 239–240; internal citations omitted.

contributing to the plan, and found that he did not address the IRS rules and only asserted that he had complied with the plans' rules without any explanation.

(5) The Court acknowledged that the plan participant did not withdraw funds from the plans, however, it referenced its determination in the case of *O'Brien* that a plan participant's decision not to withdraw funds from the retirement plan does not conclusively establish a primary retirement purpose for the plan.

Based on the foregoing, it appears that the Court's findings in the *Gluck* case are consistent with case precedent with the exception of the analysis regarding the third factor dealing with the plan participant's degree of control over the plans. In particular, in *Gluck*, the Court of Appeals stated that "the [plan participant] did not discount his indirect control of the plans continued existence or termination as part owner and CFO" of the sponsoring company. Although the Court of Appeals does not indicate that the plan participant's *indirect control* was a determining factor in its finding that substantial evidence existed to support denying the claimed exemption, the consideration of this type of *indirect control* in this context is concerning.

In our recent article titled *Making it into the Exemption End Zone*[10], we discussed the complicities of properly structuring a plan and noted that "whether or not the debtor exercises control over the plan is irrelevant to the exemption".[11] 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).[12] However, "[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.[13]

Thus, from a high-level, whether or not the plan participant exercises control over the plan is irrelevant to the exemption, however, if the exemption is challenged and a court is tasked with evaluating the totality of the circumstances to determine whether the plan was primarily designed and used for retirement purposes, the plan can lose the exemption if the court determines that the plan participant maintains a high degree of control "over contributions, management, administration, and use of funds" in the plan or account. This has been the longstanding position of the courts. The *Gluck* case takes this analysis a step further and focuses on the *indirect control* of the plan participant.

According to *Gluck*, the retirement plan exemption may be negated if the plan participant is a part owner of the sponsoring company based on the plan participant's *indirect control of the plans continued existence or termination.* The Court made this statement even though the plans have an independent trustee, independent trust protector, independent plan advisor, and an independent plan administer, thereby eliminating the plan participant's *direct control* over the plan. This additional consideration of the plan participant's indirect control of the plans continued existence or termination is directly contrary to well established case law.

In 1978 in I*n re Vigghiany*[14], the court was presented with the issue of whether CCP § 704.115 applies to an IRA considering the debtor has the unlimited right to withdraw from his IRA account. In concluding that the exemption does apply to an IRA, the court stated that: "[u]nder C.C.P. § 704.115, whether or not the debtor has control over the account is irrelevant to the exemption."

In 1991 in *In re Cheng*[15], the court addressed the issue of whether a corporate retirement plan in which one person

[10] *Making it into the Exemption End Zone.* Brown & Streza LLP. By: Dustin I. Nichols and Heather Kocer.
[11] *In re Vigghiany*, 74 B.R. 61 (Bankr.S.D.Cal.1987).
[12] *In re Cheng*, 943 F.2d 1114, 1116 (9th Cir.1991).
[13] *O'Brien v. AMBS Diagnostics, LLC,* (2019) 38 Cal.App.5th 553, 561.
[14] *In re Vigghiany* (Bankr. S.D. Cal. 1987) 74 B.R. 61, 63.
[15] *In re Cheng* (9th Cir. 1991) 943 F.2d 1114, 1117.

controls the corporation and the plan qualifies for the private retirement plan exemption under CCP § 704.115(a)(1) or whether it must be treated as a self-employed retirement plan under subsection (a)(3). That court held that a plan sponsored by a wholly owned corporation qualifies for the full exemption under CCP § 704.115(a)(1) and stated that: "[a]lthough 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."

In 1992 in In re Witwer[16], the debtor was the sole stockholder, President, and employee of the sponsoring corporation and the only beneficiary of the profit sharing plan. As such, the debtor maintained *indirect control of the plans continued existence or termination* as owner of the sponsoring corporation. The creditors challenged the debtor's claim of exemption on the grounds that he exercised control over the plan by treating it like his personal bank account since he made distributions to himself and numerous loans to both himself and his friends. That court acknowledged the control held by the debtor when it stated that:

> "[t]he Plan is subject to amendment or discontinuance at will by the employer/Debtor. Also, the Plan provides that in the event of termination of the Debtor's employment with the corporation, he is entitled to payment of his accrued beneficial interest. Thus, as the Debtor is the sole shareholder and only employee of the corporation, he has sole discretion to terminate the Plan, whereupon all of the assets in the Plan would be distributed to him."

Notwithstanding the court's express acknowledgement that "[t]he Plan is subject to amendment or discontinuance at will by the employer/Debtor", the court ruled that the plan was designed and used for retirement purposes and was entirely exempt under CCP § 704.115. The court came to this conclusion based on the facts that the debtor followed trust procedures in obtaining the loans for himself and others, promissory notes with reasonable interest rates were obtained for all transactions, the plan invested extensively in investments other than loans, and the debtor had not made any contribution to the plan in the last six years.

In 1993 in *In re Crosby*[17], the debtor was the trustee and sole beneficiary of the plan that was sponsored by a company in which she was the President and only employee. The debtor claimed the plan was exempt under CCP § 704.115(b), and the bankruptcy trustee objected on the grounds that the plan was designed and used for present use rather than for retirement purposes. In that case, without even considering the debtor's *indirect control of the plans continued existence or termination*, the court held that "[t]he Trustee has failed to meet its burden of establishing that the Plan was not designed or used for retirement purposes."

In 1998, in *In re Bloom*[18], the debtor was one of two owners of a medical corporation that created a private retirement plan and a profit-sharing plan, in which the two owners served as the trustees. The debtor made a number of loans from the plans to herself in exchange for unsecured promissory notes and only made interest payments on the loans, which meant that a significant portion of the plans assets were unsecured promissory notes. Without even considering the debtor's *indirect control of the plans continued existence or termination* based on her capacity as fifty percent owner of the sponsoring company, the court held that the "plans were not so abused as to lose their retirement purpose."

In *Cheng, Witwer, Crosby,* and *Bloom,* the plan *participant's indirect control of the plans continued existence or termination* as owner (or part owner) of the sponsoring company is either acknowledged and disregarded or not even

[16] *In re Witwer* (Bankr. C.D. Cal. 1992) 148 B.R. 930, 934, aff'd (B.A.P. 9th Cir. 1994) 163 B.R. 614.
[17] *In re Crosby* (Bankr. C.D. Cal. 1993) 162 B.R. 276, 285.
[18] *In re Bloom* (9th Cir. 1988) 839 F.2d 1376, 1379.

considered. And, even though "a court is not limited to considering only those factors previously considered by other California and federal courts"[19], if this type of *indirect control* is a factor that can be considered by the courts when evaluating the totality of the circumstances, then every plan sponsored by a wholly (or partly) owned corporation may not qualify for the exemption. Consequently, case precedents such as *Cheng, Witwer, Crosby,* and *Bloom,* which permit a wholly (or partly) owned corporation to sponsor a retirement plan that qualifies for the exemption under CCP § 704.115, would be obliterated.

Furthermore, the *Gluck* case completely disregarded the standard for assessing the degree of control factor that is set forth in the 1996 case of *Schwartzman v. Wilshinsky*[20] as follows:

> "The dispositive inquiry under [CCP] § 704.115 (exemptions; private retirement plans), was whether the plan was designed and used for retirement purposes. <u>The kind of control that would show a nonretirement purpose would be substantially all control over contributions, management, administration, and use of funds</u> […]. The exemption statutes should be construed, so far as practicable, to the benefit of the judgment debtor."

Had the *Gluck* case applied the standard set forth in the case of *Schwartzman*, which provides that "[t]he kind of control which would show a nonretirement purpose would be *substantially all control* over contributions, management, administration, and use of funds […]", then the degree of control factor would not have negated the exemption because with an independent trustee, independent trust protector, independent plan advisor, and an independent plan administer, the plan participant did not possess *substantially all control* over contributions, management, administration, and use of funds. This factor appears to have been construed to the benefit of the creditor rather than the plan participant, which conflicts with the well-established rule that "[t]he exemption statutes should be construed, so far as practicable, to the benefit of the judgment debtor."

[19] *In re Rucker* (9th Cir. 2009) 570 F.3d 1155, 1162.
[20] *Schwartzman v. Wilshinsky* (1996) 50 Cal.App.4th 619, 619-620, 628; internal citation omitted; emphasis added.