

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF INDIANA
SOUTH BEND DIVISION

IN THE MATTER OF)
)
DEBRA ANN ARMSTRONG,) CASE NO. 12-30175 HCD
) CHAPTER 7
)
DEBTOR.)

Appearances:

Rebecca H. Fischer, Esq., Chapter 7 Trustee, Laderer & Fischer, P.C., 112 West Jefferson Boulevard, Suite 310, South Bend, Indiana 46601; and

Bradley J. Adamsky, Esq., counsel for debtor, Newby, Lewis, Kaminski & Jones, LLP, 916 Lincolnway, Post Office Box 1816, LaPorte, Indiana 46530.

MEMORANDUM OF DECISION

At South Bend, Indiana, on November 15, 2012.

Before the court is the Trustee’s Objection to Second Amended Claimed Exemptions, filed by the Chapter 7 Trustee Rebecca Hoyt Fischer (“Trustee”). Chapter 7 debtor Debra Ann Armstrong (“debtor”) claimed an exemption in all of her portion of the “Biehl Living Trust Agreement” established by her parents, now deceased, pursuant to Indiana Code § 30-4-3-2, as a spendthrift trust. After a hearing on the Trustee’s Objection, the court directed the parties to file briefs on the issues presented. Once the briefs were filed and the briefing schedule had passed, the court took the matter under advisement.¹

BACKGROUND

The underlying facts in this case are not contested. James J. Biehl and Rita W. Biehl, the debtor’s parents, created and funded the “Biehl Living Trust Agreement” (“Trust”) as a revocable inter vivos trust on May 13, 1998, and amended it on October 31, 2000, to specify that each of the Biehls’ five children was

¹ The court has jurisdiction to decide the matter before it pursuant to 28 U.S.C. § 1334 and § 157 and the Northern District of Indiana Local Rule 200.1. The court has determined that this matter is a core proceeding pursuant to 28 U.S.C. § 157(b)(2)(B).

a Designated Beneficiary entitled to receive a 20% interest in the Trust upon the death of the surviving spouse. *See* R. 36, Ex. A, at 34-35. The Trust contained a spendthrift provision:

The beneficiaries' interests under this Trust Agreement shall not be subject to the claims of creditors, whether by levy, writ, attachment or otherwise, and may not be voluntarily or involuntarily alienated, assigned, anticipated, pledged, encumbered, sold or otherwise transferred prior to receipt by a beneficiary, except pursuant to the exercise of a power expressly granted in this Trust Agreement to disclaim, appoint or release. . . .

Id., Article Eleven, § B, at 19.

Rita W. Biehl passed away on April 14, 2008, and James J. Biehl died on April 11, 2010. According to the Trust, at the death of the surviving spouse, the Trustees "shall divide the remaining assets into separate shares" and "shall distribute each share created for a Designated Beneficiary . . . directly to that Designated Beneficiary." *Id.*, § C(1), (2). At that time, the sole remaining asset of the Trust was a piece of real estate.

On January 27, 2012, twenty-one months after her father's death and almost three months before the distribution of the Trust proceeds, the debtor (one of the Designated Beneficiaries) filed a chapter 7 bankruptcy petition. The real property was sold thereafter, and the Trustee received the debtor's share of the proceeds on or about April 16, 2012.² On May 4, 2012, the debtor filed a Second Amended Schedule C, claiming an exemption in all of her 20% interest in the Trust proceeds pursuant to Indiana Code § 30-4-3-2, the statute which provides the power "to restrain transfer of a beneficiary's interest." R. 27.

On June 4, 2012, the Trustee filed an objection to the claimed exemption. She stated:

Although it is alleged that the sole asset of the trust is real estate, the nature of the asset is an interest in the family trust, which is an intangible. The real estate has been sold and the Trustee has received the Debtor's share of the proceeds, rather than a distribution of a fractional share of ownership in the real estate. The Debtor has already used her exemption for intangibles under Ind. Code. § 34-55-10-2(c)(3) for other assets.

² The parties list different amounts of Trust Proceeds: The Trustee reports that she received \$27,717.79, but the debtor states that the debtor's portion was \$21,717.79. The court presumes that these differences are typographical errors rather than disputed material facts.

R. 30, ¶ 1. The Trustee's position was that, when the debtor filed her bankruptcy petition, she had a present right to her interest under the Trust, because the Trust terminated at the time James J. Biehl, the surviving spouse, passed away on April 11, 2010. *See* R. 36 at 1-2. That vested interest, she asserted, was part of the bankruptcy estate. *See id.* at 4.

The debtor disagreed. She pointed out that the property in which she held an interest was held in the Trust on the date she filed bankruptcy and was neither sold nor distributed until post-petition. *See* R. 37 at 1. As a result, she argued, at the time she filed her petition, the real estate in question was controlled and maintained by the successor trustee, not by herself. Moreover, she said, the Trust's spendthrift provision protected her interest from the claims of creditors.

Since the Debtor did not have any present dominion or control over the trust corpus at the time she filed her petition, and since the trust contained a valid anti-alienation spendthrift clause, the Debtor's distribution from the eventual sale of the real estate is protected in the bankruptcy proceedings by operation of § 541(c)(2).

Id. at 5. Consequently, the debtor insisted, her interest under the Trust was exempted under 11 U.S.C. § 541(c)(2)³ and under Indiana Code § 30-4-3-2. *See* R. 37 at 2.

DISCUSSION

The issue before the court is whether the debtor's claimed exemption in her 20% portion of the Trust is allowed. Under Federal Rule of Bankruptcy Procedure 4003, the objecting party has the burden of proving that the exemption was not properly claimed. *See* Fed. R. Bankr. P. 4003(c); *see also In re Yonikus*, 996 F.2d 866, 873 (7th Cir. 1993); *In re Fink*, 417 B.R. 786, 789 (Bankr. E.D. Wis. 2009). The objecting Trustee asserts that the Trust asset claimed by the debtor is property of the debtor's bankruptcy estate and is neither exempted nor excluded from that estate. The debtor, by listing the Trust property in her schedules, appears to agree that the property is property of her bankruptcy estate but argues that it is exempt property.

³ Section 541(c)(2) provides: "A restriction on the transfer of a beneficial interest of the debtor in a trust that is enforceable under applicable nonbankruptcy law is enforceable in a case under this title."

Under the Bankruptcy Code, “property of the estate” is broadly comprised of “all legal or equitable interests of the debtor in property as of the commencement of the case.” 11 U.S.C. § 541(a)(1). One exception to the inclusive definition of “property of the estate” is § 541(c)(2), which is designed to apply to traditional spendthrift trusts. *See In re Jones*, 43 B.R. 1002, 1005 (N.D. Ind. 1984). The Bankruptcy Code excludes from the bankruptcy estate any property of the debtor that is subject to “a restriction on the transfer of a beneficial interest of the debtor in a trust that is enforceable under ‘applicable nonbankruptcy law.’” 11 U.S.C. § 541(c)(2); *see Patterson v. Shumate*, 504 U.S. 753, 758, 112 S. Ct. 2242, 119 L.Ed.2d 519 (1992) (“The natural language of [§ 541(c)(2)] entitles a debtor to exclude from property of the estate any interest in a plan or trust that contains a transfer restriction enforceable under any relevant nonbankruptcy law.”). It is noteworthy that this provision excludes property which falls within its definition. The distinction between an exclusion and an exemption is an important one: Property that is excluded never becomes “property of the estate,” whereas property that is exempted is “property of the estate” when the debtor files a bankruptcy petition but is removed from the list of property by state or federal law. *See In re Yonikus*, 996 F.2d at 869 (“A debtor’s interest in property may either be excluded from the estate under 11 U.S.C. § 541 or exempted under § 522.”); *see also Matter of VanMeter*, 137 B.R. 908, 910 (Bankr. N.D. Ind. 1992) (commenting that a debtor need not exempt property which is excluded from being property of the estate under § 541(c)(2)).⁴ The court first considers, therefore, whether the debtor’s interest in the Trust is excluded altogether from becoming property of the estate under § 541(c)(2).

Under § 541(c)(2), Congress intended to exclude qualified spendthrift trusts from property of a debtor’s estate. *See In re Yonikus*, 996 F.2d at 870; *Lunkes v. Gecker*, 427 B.R. 425, 428 n.1 (N.D. Ill. 2010). Whether a trust qualifies as a spendthrift trust is resolved under “applicable nonbankruptcy law,” state or federal. The parties agree that, in this case, the law of Indiana governs the characterization of the trust. *See Morter v. Farm Credit Servs.*, 937 F.2d 354, 356 (7th Cir. 1991) (“State law determines whether

⁴ Indiana opted out of the federal exemptions found at § 522. The Indiana exemptions are found at Indiana Code § 34-55-10-2(c).

access to a fund is sufficiently restricted to qualify for exclusion from the bankruptcy estate.”). In *Morter*, the Seventh Circuit Court of Appeals relied upon the classic Black’s Law Dictionary definition of spendthrift trust:

A spendthrift trust is “one created to provide a fund for the maintenance of a beneficiary and at the same time to secure the fund against his improvidence or incapacity.” *Black’s Law Dictionary* 1400 (6th ed. 1990).

Id. In Indiana, a grantor’s power to create a spendthrift provision is codified at Indiana Code § 30-4-3-2.⁵ See *Sisters of Mercy Health Corp. v. First Bank of Whiting*, 624 N.E.2d 520, 522 (Ind. App. 1993). A trust is recognized as a valid spendthrift trust in Indiana when these requirements are met:

There are three requirements for a trust to be a spendthrift trust. First, the settlor may not be a beneficiary of the trust. Second, the beneficiary must not have any present dominion or control over the plan corpus. Third, the trust must contain an anti-alienation clause which prevents the beneficiary from voluntarily or involuntarily transferring his interest in the trust.

United States v. Grimm, 865 F. Supp. 1303, 1311 (N.D. Ind. 1994) (citing *Matter of Jones*, 43 B.R. 1102 (N.D. Ind. 1984)); see also *Walro v. Striegel*, 131 B.R. 697, 701 (S.D. Ind. 1991); *Matter of VanMeter*, 137 B.R. at 912; 28 Ind. Law Encyc. Trusts § 41 (2012). Indiana’s statutory provision comports with the

⁵ Indiana Code § 30-4-3-2 provides the “Power to restrain transfer of a beneficiary’s interest.”

(a) The settlor may provide in the terms of the trust that the interest of a beneficiary may not be either voluntarily or involuntarily transferred before payment or delivery of the interest to the beneficiary by the trustee.

(b) Except as otherwise provided in subsection (c), if the settlor is also a beneficiary of the trust, a provision restraining the voluntary or involuntary transfer of his beneficial interest will not prevent his creditors from satisfying claims from his interest in the trust estate.

(c) Subsection (a) applies to a trust that meets both of the following requirements, regardless of whether or not the settlor is also a beneficiary of the trust:

(1) The trust is a qualified trust under 26 U.S.C. 401(a).

(2) The limitations on each beneficiary’s control over the beneficiary’s interest in the trust complies with 29 U.S.C. 1056(d).

(d) A trust containing terms authorized under subsection (a) may be referred to wherever appropriate as a trust with protective provisions.

Ind. Code § 30-4-3-2.

common law of trusts and follows the Restatement (Second) of Trusts, particularly §§ 152, 153, and 156. *See* Ind. Code § 30-4-3-2 (Study Commission Comment).

The Trust before this court appears to comport with the spendthrift trust requirements. The settlors, James J. and Rita W. Biehl, were not beneficiaries of the Trust, and the debtor-beneficiary was not a settlor. The Trust instrument contains an anti-alienation clause barring the transfer of a beneficial interest in the trust property. Thus the first and third criteria are met. The parties focused on the second factor, whether the debtor-beneficiary has a “present dominion or control” over the trust property. *See Matter of Cook*, 43 B.R. 996, 1001-02 (D.C. Ind. 1984) (stating that, to be excluded under § 541(c)(2), a trust must provide that the beneficiary not “possess any means” to gain access to the trust funds); *VanMeter*, 137 B.R. at 911 (“‘Access’ requires the court to look at the debtor’s ability to acquire trust funds, rather than the likelihood of actually doing so.”).

In deciding whether the Trust contains the third spendthrift trust component, the court interprets and applies the terms of the Trust before it “so as to implement the intent of the settlor and the purposes of the trust.” Ind. Code § 30-4-1-3. The caselaw in Indiana reiterates the Trust Code’s objective “to ascertain and carry out the settlor’s intent.” *In re Trust Created Under Last Will and Testament of Stonecipher*, 849 N.E.2d 1191, 1195 (Ind. App. 2006). Courts are required to “examine the trust document as a whole to determine the plain and unambiguous purpose of the settlor as that intent appears within the four corners of the instrument.” *Goodwine v. Goodwine*, 819 N.E.2d 824, 829 (Ind. App. 2004).

The court finds that the Trust, within its four corners, clearly evinces the intent of the settlors and the unambiguous purpose of the Trust. The Trust assets were to be used to provide for the care, maintenance, and comfort of the settlors during their lifetimes and, at the death of the surviving spouse, the trustees were required to divide and distribute the remaining assets into separate equal shares for each of the five Designated Beneficiaries. Under the spendthrift provision of the Trust, the beneficiaries were unable to transfer their rights to trust income or principal and their creditors were unable to take the beneficiaries’

interest in payment of their claims while the trust assets were in the hands of the trustees. Therefore the spendthrift requirements appear to be fulfilled under this Trust. The parties do not challenge the Trust's purpose or the settlors' intent.

The question before the court, however, is whether the spendthrift provision has the power "to restrain transfer of a beneficiary's interest" at the time that this beneficiary filed her bankruptcy petition on January 27, 2012. The Trust's spendthrift provision specifically provided that "[t]he beneficiaries' interests under this Trust Agreement shall not be subject to the claims of creditors . . . prior to receipt by a beneficiary." R. 36, Ex. A, at 19. The court considers, therefore, when the beneficiaries *received* their interests under the Trust. According to the Trustee, receipt occurred when the debtor had a present right to her interest in the Trust assets – when the surviving spouse died and the Trust terminated. According to the debtor, receipt occurred when the property was no longer in the hands of the trustees – when she received the distribution from the sale of the sole Trust asset, the real estate.

The Trust does not directly answer this question, but it succinctly reflects the settlors' intent. The "Termination" provision expressly states that the Trust ends when the surviving spouse dies:

At the death of the Surviving Spouse, the Trustees shall distribute the remaining assets of the trust which the Surviving Spouse has not effectively appointed in the manner provided in Section C of this Article Seven.

R. 36, Ex. A, Art. 7, § A(5), at 12. The original Section C of Article 7, which set forth the requirements for the division and distribution of assets to six Designated Beneficiaries, was deleted by the Amendment to the Trust and was replaced with a new Section C. In it only the five Biehl children were named as Designated Beneficiaries, and each was granted an equal 20% share of the remaining assets of the surviving spouse's Trust. The trustees were required to conduct two duties:

- (1) Division of Assets. At the death of the Surviving Spouse, the Trustees *shall* divide the remaining assets into separate shares for each of the Designated Beneficiaries
- (2) Distribution of Assets. . . . [T]he Trustees *shall* distribute each share created for a Designated Beneficiary then living directly to that Designated Beneficiary

R. 36, Ex. A at 34-35 (emphasis added). Although the Trust granted the trustees discretion with respect to incapacitated beneficiaries, the trustees had no other discretion under § C or the Termination provision.⁶

The court concludes that the Trust Amendment clearly requires division and distribution of all the Trust assets at the time of the surviving spouse's death. The Termination provision underscores and reiterates that the trustees *shall* distribute the remaining assets of the Trust on that date. There is no requirement that the trustees first sell the real property, and no discretion was given to the trustees to dispose of the property under those key provisions terminating the Trust.⁷ The court finds that the settlors' intent that all remaining assets be distributed equally to the beneficiaries at the time the surviving spouse died was unambiguously expressed in the terms of the Trust document.

The Supreme Court of Indiana, reviewing a similar trust, has provided helpful guidance in resolving this issue. In *In re Della Lustgarten Nathan Trust*, 638 N.E.2d 789 (Ind. 1994), the trust document established that, upon the settlor's death, the trust was to be terminated and the corpus of the trust, a farm, and any remaining income were to be distributed equally to the five beneficiaries. After the settlor's death, when the trustees attempted to sell the farm property to pay the administrative costs and other obligations under the trust, four of the beneficiaries petitioned the court to terminate the trust and to distribute the trust assets immediately. The Supreme Court concluded that the trial court did not abuse its discretion in terminating the trust and denying trustees the authority to sell the farm.

The purpose of the trust, payment of income to the settlor during her lifetime, ceased with settlor's death. Furthermore, the express terms clearly demonstrate the intent that the trust be terminated at the time of the settlor's death and that the corpus of the trust and any accumulated income be distributed equally to the beneficiaries.

⁶ In both the original Trust and the Amendment, the Trustees were given discretion, under Article Ten of the Trust, to retain assets for beneficiaries who were younger than 25 years of age and/or for incapacitated beneficiaries. No such beneficiaries have been identified, and that issue was not raised herein.

⁷ Of course, the Trust authorizes the trustees to make payments of debts and taxes, to act as personal representatives, and to have other such powers. The court presumes that the two-year delay in distribution can be attributed in some degree to their carrying out of those duties.

Id. at 790; *see also Matter of Estate of Stephan*, 566 N.E.2d 1084, 1086 (Ind. App. 1991) (“When the trust purpose has been satisfied the trust may be terminated.”). Likewise, the Trust before this court unambiguously requires termination of the Trust and distribution of the Trust assets upon the death of the surviving spouse. The court concludes that, pursuant to the purpose of the Trust and its Amendment, the Trust terminated on April 20, 2010, and the debtor, as a Designated Beneficiary, was entitled to receive her allotted distribution of the remaining Trust assets at that time.

It is clear that trusts with valid spendthrift provisions bar beneficiaries from transferring their rights to trust assets and bar their creditors from attaching the beneficiaries’ interests in those trust assets while the trust assets are in the hands of the trustees. It is also clear, under long-settled Indiana law, that the beneficiaries’ benefits are not protected once they have been transferred to the beneficiaries:

When funds from a spendthrift trust are paid to a beneficiary, those funds are no longer protected by the trust. As Professor Bogert observed:

“Such a trust does not involve any restraint on alienability or creditors [*sic*] rights with respect to property after it is received by the beneficiary from the trustee, but rather is merely a restraint with regard to his rights to future payments under the trust.”

Brosamer v. Mark, 540 N.E.2d 652, 655 (Ind. App. 1989) (quoting Bogert, *Trusts* § 40 at 148-49 (6th ed. 1987), citing 76 Am.Jur.2d *Trusts* § 173 (1975); 90 C.J.S. *Trusts* § 198 (1955)). Professor Bogert added further clarification in his highly regarded treatise on trusts:

It has never been the object of the spendthrift trust to restrain the beneficiary from spending income or principal after it has been paid to him by the trustee, or to restrain his creditors from taking trust income or principal from him after he has obtained it from the trustee. The sole object of these trusts is to prevent anticipation of trust income or principal by assignments of the right to receive future income or principal or from attempts by creditors of the beneficiary to reach such right.

George T. Bogert, *Trusts* § 40, at pp. 149-50 (6th ed. 1987).

In this case, the Trust had terminated but the Trust assets had not been distributed when the debtor-beneficiary filed bankruptcy. Because the debtor had not received payment from the Trust’s trustees, she claimed that the assets still were protected by the spendthrift provision of the Trust. After its review of

Indiana trust law, however, the court finds that the debtor's position cannot succeed. The Trust itself undisputedly provided that the Designated Beneficiaries were entitled to their interest in the Trust corpus upon the death of the surviving spouse, and the court finds that their entitlement was fixed at that time, whether the beneficiaries actually received it at that moment or not. The date of death triggered termination of the Trust and distribution of the trust corpus. "The purpose of the trust . . . ceased with settlor's death" and the settlor intended that the trust be terminated at that time. *In re Della Lustgarten Nathan Trust*, 638 N.E.2d at 790.

The court determines that the Trust assets vested in the Designated Beneficiaries upon the death of James J. Biehl. *See Lewis v. Clifton*, 837 N.E.2d 1016, 1021 (Ind. App. 2005) (concluding that, even if the amount and time of receipt of the trust corpus was uncertain, the beneficiary's right to receive it was fixed and vested upon the death of the settlor). "Indiana law favors the early vesting of an estate," and the time of vesting is governed by the date of the death of the settlor or testator. *Id.* at 1019 (citing *Trusteeship of Creech*, 159 N.E.2d 291, 295 (Ind. App. 1959)). Nothing in the Trust or its Amendment suggested otherwise. Therefore, the court gives effect to the settlors' clear intent by declaring that the Trust property vested in the Designated Beneficiaries on April 11, 2010. The time period between the settlor's death and the trustees' handing over of Trust assets to the beneficiaries is not a nebulous period in which entitlement to the assets is not clear. Even though the Trust asset, the real estate, remained in the hands of the trustees undistributed for two years after the surviving spouse's death, the Designated Beneficiaries had an immediate vested right to the distribution of it. *Cf. U.S. v. Grimm*, 865 F.Supp. 1303, 1309 (N.D. Ind. 1994) (concluding that beneficiary held a vested interest at the time of his father's death, with a present fixed right to his interest, although he was required to wait until the final settlement to enjoy that interest).

The court concludes that the Trust property in which the debtor had a vested interest, her share of the distribution under the Trust, was property of her bankruptcy estate when she filed her petition. The Trust having been terminated, the spendthrift trust no longer protected the Trust property. Thus the property

was not excluded from the bankruptcy estate under Indiana Code § 30-4-3-2 or under Bankruptcy Code § 541(c)(2).

The court now considers whether the debtor's interest in the Trust property is entitled to an exemption rather than an exclusion. The debtor is required to declare the property on Schedule C to receive an exemption. *See* Fed. R. Bankr. P. 4003(a); *In re Witt*, 473 B.R. 284, 290 (Bankr. N.D. Ind. 2012). The party objecting to the exemption must prove that the exemption is improper. *See* Fed. R. Bankr. P. 4003(c); *In re Cross*, 255 B.R. 25, 30 (Bankr. N.D. Ind. 2000).

The Trustee argued that the debtor's interest in the Trust property is an intangible under the Indiana Code exemption statute. A debtor domiciled in Indiana can claim an exemption in "intangible personal property," which includes "choses in action, deposit accounts, and cash." Ind. Code § 34-55-10-2(c)(3); *see In re Oakley*, 344 F.3d 709, 713 (7th Cir. 2003). A debtor's interest in a trust is considered intangible property and, in 1988, any exemption in it would be limited to \$100. *See Matter of Gifford*, 93 B.R. 636, 637 (Bankr. N.D. Ind. 1988). The statute has been amended to allow maximum exemptions today of \$300 for intangible property. *See In re Haraughty*, 403 B.R. 607, 611 (Bankr. S.D. Ind. 2009). Any property the debtor claims that is in excess of these amounts does not qualify as an exemption. *See id.*

The Trustee asserted that the debtor had used her exemption for intangibles for other assets. The debtor did not contradict that assertion in any way; she relied entirely on the spendthrift trust statute, not the exemption statute. The court finds, therefore, that the Trustee successfully met her burden of proving that the exemption was not properly claimed.

The court concludes that the debtor's property claimed as exempt pursuant to Indiana Code § 30-4-3-2 on Schedule C – "20% interest in family trust with siblings (sole asset is real estate at 1252 E. St. Rd. 2, LaPorte, IN, property is listed for sale)" – does not qualify for an exemption or an exclusion. It is property of the debtor's estate subject to administration by the Trustee.

CONCLUSION

For the reasons set forth in this Memorandum of Decision, the court sustains the Trustee's Objection to the debtor's Second Amended Claimed Exemption. The exemption claimed on the "20% interest in family trust with siblings" is disallowed.

SO ORDERED.

 /s/ HARRY C. DEES, JR.
Harry C. Dees, Jr., Judge
United States Bankruptcy Court