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MEMORANDUM
Attorney-Client and Work-Product Privileged

To: Jeffrey M. Verdon
From: Christina Chan
Date: August 28, 2020
Subject: *O'Brien v. AMBS Diagnostics, LLC* – Private Retirement Purpose Analysis

I. Protections Afforded to Private Retirement Plans Under CCP §704.115

California law provides a statutory safe harbor that protects private retirement plan assets from creditors. Specifically, California Code of Civil Procedure §704.115 exempts “[a]ll amounts held, controlled, or in process of distribution by a private retirement plan”¹, but draws a distinction between two types of “private retirement plans” and grants each of them a different type of exemption.² Amounts held in private retirement plans “established or maintained by private employers or employee organizations, such as unions,” including “closely held corporations,” are fully exempt from levy (excluding child, family or spousal support judgments).³ By contrast, amounts held in “[s]elf-employed retirement plans” or “individual retirement ... accounts” are exempt from levy “only to the extent necessary to provide for the support of the judgment debtor when the judgment debtor retires and for the support of the spouse and dependents of the judgment debtor.”⁴ While the protections provided under §704.115 for both types of retirement plans are available in all situations where a judgment creditor seeks money from a judgment debtor (i.e., both bankruptcy and non-bankruptcy)⁵, neither of these exemptions applies unless the plan or account holding the funds was, at the time of the levy, “principally” or “primarily” “designed and used for retirement purposes.”⁶

Generally, there are two primary ways to challenge a debtor’s claim that a retirement plan is exempt under §704.115: (1) by demonstrating that the exemption is per se inapplicable because

¹ Cal Code Civ Proc § 704.115(b).

² *McMullen v. Haycock* (2007) 147 Cal.App.4th 753, 755–756 [54 Cal. Rptr. 3d 660] (*McMullen*).

³ Cal Code Civ Proc § 704.115, subs. (a)(1), (b); *Lieberman v. Hawkins (In re Lieberman)* (9th Cir. 2001) 245 F.3d 1090, 1095.

⁴ Cal Code Civ Proc § 704.115, subs. (a)(3), (e); see *Schwartzman, v. Wilshinsky*, 50 Cal.App.4th 619, 626 (1996).

⁵ *Max R. Moses v. Southern California Permanente Medical Group, (In re Moses)* 167 F.3d 470, 476 (9th Cir. 1999).

⁶ *O'Brien v. AMBS Diagnostics, LLC*, 38 Cal. App. 5th 553, 560 (Aug. 8, 2019).

the private retirement plan was not designed and operated as a bona fide retirement plan; and (2) by proving that the transfer of assets to the private retirement plan was voidable as a fraudulent transfer or voidable transaction, thereby rendering those assets reachable by creditors.

As discussed in greater detail below, California's Court of Appeals recently held in *O'Brien v. AMBS Diagnostics, LLC*, 38 Cal. App. 5th 553 (Aug. 8, 2019) ("*O'Brien II*") that a private retirement plan is not exempt from creditors under §704.115 if it was created primarily for the purpose of asset protection. However, because the facts in *O'Brien II* are highly distinguishable from the circumstances under which we advise our clients to structure their private retirement plans, we believe our clients' retirement plans would likely be exempt under CCP §704.115 if challenged by a creditor.

II. Procedural and Case Background

In *O'Brien v. AMBS Diagnostics, LLC*, 246 Cal. App. 4th 942, 201 Cal. Rptr. 3d 305 (2016) ("*O'Brien I*"), after a creditor obtained a writ of execution for a \$622,957.21 judgment in its favor, debtor O'Brien claimed four IRAs (collectively valued at \$465,350.04) as exempt under 704.115(a)(3). The trial court granted his claim for exemption, concluding that the IRAs were necessary to provide for him and his family upon retirement. However, the appellate court reversed, holding that the trial court erred in exempting the full amount of the IRAs because it did not apply the proper legal standard in evaluating the exemption for private retirement accounts, and held that the funds were only partially exempt to the extent they were necessary to provide for his retirement.

Just 18 days after the appellate court's decision, O'Brien took several actions intended, in his own words, "to protect the assets" in his individual retirement accounts "from [his] creditors." On May 9, 2016, he formed a new limited liability corporation called The Personal Branding Group, LLC (the "LLC"). Less than a month later, on June 3, 2016, the LLC formed a 401(k) plan for the LLC's "[e]mployees" and then formally adopted that plan. In adopting the plan on behalf of the LLC, O'Brien signed both as the LLC's managing member and as the trustee of the 401(k) plan. O'Brien then transferred (or "rolled over") the money from his individual retirement accounts into the 401(k) plan. On March 27, 2017, O'Brien dissolved the LLC.

In October 2017, the creditor served a notice of levy on O'Brien's funds in the 401(k) plan. O'Brien responded by claiming that the funds in the 401(k) plan were fully exempt from levy pursuant to section 704.115, subdivision (a)(1), thereby obviating any need for the trial court to examine the necessity of the funds for his retirement (as ordered in *O'Brien I*). He also asserted that his "repositioning" was "not a fraudulent transfer."

The creditor opposed O'Brien's claim for exemption, arguing that (1) the 401(k) plan was not exempt from levy under section 704.115 because it was neither designed nor used for retirement purposes, (2) O'Brien's purported rollover of funds was invalid because he did not meet the qualifications set forth in the 401(k) plan itself for such a rollover, and (3) transferring the money from a partially exempt individual retirement account to a 401k plan could not, in any event, confer fully exempt status upon the funds.

The trial court issued concluded that the money O'Brien had transferred to the 401(k) plan was fully exempt from levy and declined to invalidate the rollover as a fraudulent transfer. The court also found that the funds in O'Brien's retirement accounts were for retirement purposes and upheld his claim of exemption as to *all* of the funds in the 401(k) plan and without any need to demonstrate what portion of those funds were necessary for his retirement.

The creditor appealed, and in *O'Brien v. AMBS Diagnostics, LLC*, 38 Cal. App. 5th 553, 251 Cal.Rptr.3d 41 (Aug. 8, 2019) ("*O'Brien II*"), the appellate court reversed the trial court's decision, holding that a 401(k) plan that a debtor creates and controls with the avowed purpose of "protect[ing] [his] assets from creditors" was not a plan principally designed and used for retirement purposes, and therefore the funds in the 401(k) plan were not fully exempt from creditors. The appellate court then remanded the matter back to the trial court to assess the partially exempt status those funds previously held while in the individual retirement accounts.

III. Analysis Distinguishing O'Brien II from the Private Retirement Plans Established and Funded by Our Clients

In *O'Brien II*, the appellate court stated that regardless of whether a debtor is claiming an exemption under CCP Section 704.115(a)(1) or (a)(3), neither exemption is available unless the plan or account holding the funds was, at the time of the levy, "principally" or "primarily" "designed and used for retirement purposes."⁷ The appellate court further noted that the trial court applied the incorrect legal standard, clarifying that in *O'Brien II*, the proper inquiry was whether the 401(k) that the funds were subsequently transferred to (as opposed to the IRAs in which the funds were *initially* placed) had a primary retirement purpose – since the creditor was objecting to the exemption O'Brien claimed against the 401(k).

In assessing whether a plan or account was principally or primarily designed and used for retirement purposes, courts must look at the totality of the circumstances.⁸ Relevant circumstances include, but are not limited to (1) the "debtor's subjective intent" in designing and using the plan or account⁹; (2) the "chronology" or timing of the creation of the plan or account vis-à-vis other events¹⁰; (3) the degree of control the debtor maintains "over contributions, management, administration, and use of funds" in the plan or account¹¹; (4) whether the debtor violated or complied with Internal Revenue Service (IRS) rules or the plan's rules in contributing to the plan¹²; and, if the debtor withdraws money from the plan or account, (5) whether those funds were used

⁷ *O'Brien II*, 38 Cal. App. 5th at 561.

⁸ *Id.*, citing *Cunning v. Rucker (In re Rucker)* 570 F.3d 1155, 1161 (9th Cir. 2009); *Dudley v. Anderson (In re Dudley)*, 249 F.3d 1170, 1177 (9th Cir. 2001); *In re Bloom* 839 F.2d 1376, 1379 (9th Cir. 1988).

⁹ *Id.*, citing *In re Rucker*, at p. 1162; and *Simpson v. Burkart (In re Simpson)* (9th Cir. 2009) 557 F.3d 1010, 1018; *see also Yaesu Electronics Corp. v. Tamura (In re Yaesu)*, 28 Cal. App. 4th 8 (account holding funds traceable to debtor's defined benefit pension plan held to be unexempt where debtor testified that he did not and never had a retirement plan and conceded that his purpose in establishing the retirement plan was not to save money to use in his retirement but to take advantage of the tax laws and to save money for his children).

¹⁰ *Id.*, citing *In re Yaesu, supra*, 28 Cal. App. 4th at pp. 14 -15.

¹¹ *Id.*, citing *Schwartzman v. Wilshinsky*, 50 Cal.App.4th at p. 629.

¹² *Id.*, citing *In re Rucker*, at p. 1162; and *Bloom*, at p. 1379.

for retirement or instead some other, nonretirement purpose.¹³ These factors are non-exhaustive¹⁴, and a finding that a plan was principally or primarily designed and used for retirement purposes is based on the particular circumstances of each case.

In applying the foregoing test, the court determined that the 401(k) plan was not primarily designed and used for retirement purposes because:

- 1) O'Brien freely admitted that his subjective intent for creating and transferring the IRA funds into the 401(k) plan was to protect the assets from his creditors;
- 2) the plan was created and funded merely weeks after the trial court declared that funds in the IRA were not fully exempt and the LLC was subsequently dissolved shortly thereafter;
- 3) O'Brien maintained almost total control over his contributions, management and administration and use of the funds; and
- 4) the 401(k) plan violated its own, as well as IRS rules.

While the court did not elaborate on the fifth prong (i.e. whether the funds were used for a nonretirement purpose), the court did note that the fact that O'Brien never withdrew any funds from the 401(k) did not conclusively establish a primary retirement purpose. At most, O'Brien established a secondary retirement purpose that was eclipsed by his principal and primary purpose of creating the 401(k) plan to, in his own words, "protect [his] assets" "from [his] creditors."¹⁵

However, as noted above, the facts in *O'Brien II* are highly distinguishable from the circumstances under which we advise our clients to structure their private retirement plans for the following reasons:

- 1) Our clients understand that the primary reason for creating and funding a private retirement plan ("PRP") is for retirement purposes, and that the asset protection benefits provided by the PRP merely follow incidentally. Unlike O'Brien, we engage professionals to perform an actuarial analysis for our clients to determine the proper amounts that may be funded into the PRP for each client's reasonably necessary retirement, and only fund that amount which has been determined to be reasonably necessary for retirement into the PRP. Additionally, we advise clients that the funds in the PRP should not be withdrawn until retirement.
- 2) Unlike the debtor in O'Brien (who established the 401(k) in the face of collection efforts by a judgment creditor after the court had already determined that the funds in his IRA were only partially exempt to the extent they are reasonably necessary for retirement), we generally do not advise or encourage our clients to fund a PRP in the face of a pending lawsuit, existing judgment or active collections efforts against our clients by creditors.
- 3) Our clients do not maintain substantial control, if any, over their own contributions, management, administration and use of the funds. As noted above, the amount of their contributions is determined by an actuarial analysis. Additionally, the funds in the PRP

¹³ *Id.*, citing *Dudley*, at p. 1177; *Daniel*, *supra*, 771 F.2d at pp. 1354–1357.

¹⁴ For example, other courts have also looked to the contribution amount by a corporation relative to the debtor's wages from the corporation (*In re Rucker*, 570 F.3d 1155, 1161 (9th Cir. 2009)); as well as the debtor's credibility (*In re Rucker*, *supra*, 570 F.3d at 1159), in determining whether the plan was primarily designed and used for retirement purposes.

¹⁵ *O'Brien II*, 38 Cal. App. 5th at 563, (citing *Rucker*, *supra*, 570 F.3d at p. 1161 ["we are ... aware of no precedent stating that the lack of withdrawals or loans in itself conclusively establishes a primary retirement purpose"].)

are managed by an unrelated, professional third-party trustee company. And because the funds are not available for withdrawal until retirement age, our clients do not utilize the assets in the PRP for non-retirement purposes.

- 4) To ensure compliance with the plan's rules, our clients' PRPs are managed and administered by an unrelated, professional third-party trustee company.
- 5) Finally, because the assets in our clients' PRPs remain within the plan until the client's designated retirement age and are managed and administered by a professional trustee company, this ensures that our clients do not use the plan assets for a nonretirement purpose.

IV. Conclusion

It is important to stress that a crucial consideration in determining whether a retirement plan was primarily designed and used for retirement purposes is the debtor's subjective intent. While subjective intent cannot in itself create an exemption, the debtor's subjective intent can easily "take one away."¹⁶ Consequently, even if a plan may otherwise fit the statutory definition of a "private retirement plan," a debtor's subjective intent and expressed goals of establishing the plan primarily or solely for a non-retirement purpose (including but not limited to the general purpose of shielding assets from creditors) may nevertheless exclude the plan from exemption. Thus, it is extremely important that our clients understand that the primary purpose of setting up the plan is for retirement purposes, and that creditor protection will incidentally follow.

Accordingly, because we take the utmost care to ensure that our clients' PRPs are implemented under the right circumstances; and that they are properly designed, funded, managed and administered, we believe our clients' retirement plans would be exempt under CCP §704.115 if challenged by a creditor – so long as our clients' subjective intent and self-expressed goals demonstrate that the PRP was primarily designed and used for retirement purposes.

DISCLAIMERS

The recommendations contained in this Memorandum reflect our best judgment based on our review of the facts and law with respect to the recommended transfers. That stated, we cannot provide assurances that if challenged the conclusions we reached will be recognized by any such opposing party or trier of fact. Therefore, we do not opine, warrant, or guarantee the results of the recommendations presented in this Memorandum with respect to strategies recommended.

Circular 230 Notice: *In accordance with Treasury Regulations, which became applicable to all tax practitioners as of June 20, 2005, please be advised that any tax advice given herein is not intended or written by the practitioner to be used, and it cannot be used by any taxpayer, for the purposes of avoiding penalties that may be imposed on the taxpayer.*

¹⁶ *Simpson v. Burkart (In re Simpson)*, 557 F.3d 1010, 1018 (9th Cir. 2009).