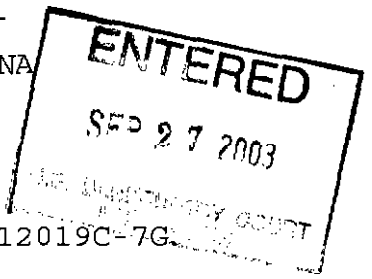
UNITED STATES BANKRUPTCY COURT
MIDDLE DISTRICT OF NORTH CAROLINA
GREENSBORO DIVISION



IN RE:	)	
	)	
Robert E. McDonald,	)	**Case No.** 03-12019C-7G
	)	
Debtor.	)	
	)	

ORDER

This case came before the court on August 19, **2003,** for consideration of Debtor's motion to compel Lorillard Federal Credit Union to turnover funds or, in the alternative, to transfer title to a 1997 Mitsubishi automobile to the Debtor. J. Gordon Boyett appeared on behalf of the Debtor, Everett B. Saslow, Jr. appeared on behalf of the Trustee and William 0. Moseley, Jr. appeared on behalf Lorillard Federal Credit Union. Having considered the motion, the stipulations of fact and the arguments of counsel the court has concluded that the motion should be denied.

FACTS

The parties stipulated to the following facts:

1. At all times relevant to this matter, the Debtor was a participant in An ERISA qualified 401(k) plan provided by his employer.

2. On May 2.9, 2003, the Debtor obtained a loan under the 401(k) plan in the amount of $13,000.00 and received a check for $13,000.00 representing the loan proceeds from the 401(k) loan.

3. On May 29, 2003, the Debtor presented the check for the loan proceeds to the Lorillard Federal Credit Union ("the Credit

Union") where he maintained checking accounts. The Debtor received cash of $1,050.00 and made a deposit of $11,950.00 into one or more of his checking accounts at the Credit Union.,

4. On June 12, 2003, this Chapter 7 case was filed by the Debtor.

5. On the petition date, the Debtor had a balance of $11,214.00 in his checking accounts at the Credit Union, which balances were the result of the Debtor having deposited the 401(k) loan proceeds into his checking accounts on May 29, 2003.

6. On June 12, 2003, the Debtor was indebted to the Credit Union in the amount of $10,408.19, which indebtedness was secured by a lien against Debtor's 1997 Mitsubish automobile.

7. On June 18, 2003, upon receiving notice of Debtor's bankruptcy filing, the Credit Union placed a freeze upon the $10,408.19 which was on deposit in Debtor's checking accounts at the Credit Union, contending that it is entitled to setoff the balance owed by Debtor on his car loan against the proceeds in the checking accounts. Alternatively, the Credit Union contends that it has a security interest in the account balances under the terms of its loan documents.

8. When this case was filed on June 12, 2003, the Debtor filed a claim for property exemptions in which he claimed his interest in the 401(k) plan as exempt property. No objections have been filed to Debtor's claim for property exemptions.

9. Debtor did not claim his 1997 Mitsubishi automobile as exempt property nor did he claim as exempt property any of the proceeds that were on deposit in his checking accounts on June 12, 2003, when this case was filed.

10. The parties have agreed that on the date of the filing of this case, the sum of $6,458.00 is 90% of the NADA retail value of the Debtor's automobile, after taking into account a high mileage adjustment.

ANALYSIS

The Debtor contends that his interest in the 401(k) was exempt property and that the funds he borrowed from the 401(k) retained the same exempt status as his interest in the 401(k) plan when they were deposited and therefore such funds are exempt property as well. Debtor's argument must be rejected. Debtor's interest in the 401(k) plan is not property of the estate in this case, but not because it was exempted by the Debtor. Because North Carolina has opted out of the federal exemptions contained in § 522(d), North Carolina law governs the exemptions that may be claimed by a North Carolina debtor. See Hollar v. U.S., 188 B.R. **539, 541** (M.D.N.C. 1995). Under the applicable statute, G.S. § 1C-1601, an Individual Retirement Account is exemptible, but there is no exemption available for pension plans or 401(k) plans. See G.S. § 1C-1601(a)(9). Nevertheless, Debtor's interest in the 401(k) plan did not become property of the bankruptcy estate when this case was

filed. Under § 541(c)(2) of the Bankruptcy Code, property of the debtor which is subject to a restriction on transfer enforceable under "applicable non-bankruptcy law" is excluded from the bankruptcy estate. The anti-alienation provision required in order for pension or 401(k) plans to receive ERISA qualification "constitutes an enforceable transfer restriction for purposes of § 541(c)(2) exclusion of property from the bankruptcy estate." Patterson v. Shumate, 504 U.S. 753, 760, 112 S.Ct. 2242, 2248, 119 L.Ed.2d 519 (1992). Debtor's interest in the ERISA qualified plan provided by his employer, being subject to an enforceable restriction on transfer, is therefore not property of the estate in this case.

A different situation is presented, however, if funds are withdrawn from a pension or 401(k) plan and in the possession or control of the debtor when a chapter 7 case is filed. Once removed from the pension or 401(k) plan and paid to the employee, the funds no longer are subject to the restriction on alienation contained in the plan documents, and hence not within the exception created by § 541(c)(2). See Guidry v. Sheet Metal Workers Nat'l Pension Fund, 39 F.3d 1078, 1081 (10th Cir. 1994) (en banc), cert. denied, 514 U.S. 1063 (1995) ("ERISA section 206(d)(1) protects ERISA-qualified benefits from garnishment only until paid to and received by plan paticipants or beneficiaries."); NCNB Fin. Servs., Inc. v. Shumate, 829 F.Supp. 178 (W.D.Va. 1993) (once the line of actual receipt is

crossed, ERISA no longer protects funds originating in private pension plan); In re Bresnahan, 183 B.R. 506, 507 (Bankr. S.D.Ohio 1995); In re Collin, 182 B.R. 763, 768 (Bankr. N.D.Ohio 1995) ("Section 541(c)(2) does not operate to require non-recognition of transfers which have already occurred, nor does it apply to assets in the possession of the debtor without restrictions."). Therefore, even if the loan proceeds received by the Debtor could be regarded as a distribution of benefits from the 401(k) plan[1], such proceeds nonetheless would not be excluded from the bankruptcy estate under § 541(c)(2) because such proceeds were distributed to Debtor and within his possession and control when this case was filed. Instead, such funds became property of the bankruptcy estate when this case was filed. It follows that the Debtor is not entitled to an order requiring the Credit Union to turnover the funds to the Debtor. Nor is there any basis for requiring the Credit Union to deliver the title to the 1997 Mitsubishi to the Debtor. The Mitsubishi likewise is property of the bankruptcy estate and remains subject to a perfected security interest that secures indebtedness of $11,408.19 that is owed to the Credit Union. NO exemption has been claimed in either the funds on deposit at the Credit Union or the Mitsubishi. If the

[1]See In re Friedman, 220 B.R. 670, 672 (9th Cir. BAP 1998) (loan proceeds borrowed from a pension plan did not contitute "benefits" and therefore were not exemptible under a statute that permitted exemption of "benefits" payable under a private retirement plan).

Credit Union is permitted to pay such indebtedness from the funds that are on deposit at the Credit Union, the estate, not the Debtor, will benefit from such payment since the vehicle would then be an unencumbered asset of the bankruptcy estate. Accordingly, the Debtor's motion must be denied.

IT IS SO ORDERED.

This 22nd day of September, 2003.

William L. Stocks

WILLIAM L. STOCKS
United States Bankruptcy Judge