

---

## PERSONAL FINANCIAL PLANNING/BANKRUPTCY

New bankruptcy legislation adds protections for retirement plans.

# Protect Retirement Assets

---

BY MARK P. ALTIERI AND RICHARD A. NAEGELE

---

### EXECUTIVE SUMMARY

- **THE NEW BANKRUPTCY LAW** protects tax-qualified retirement plans—pensions, profit-sharing and 401(k) plans—from creditors in bankruptcy.
- **SEP AND SIMPLE IRAs ARE** excluded from bankruptcy estates under the new law, even if they qualify as ERISA pension plans.
- **TRADITIONAL AND ROTH IRAs** that are created and funded by an individual are subject to an aggregate bankruptcy exclusion of \$1 million.
- **SEP AND SIMPLE IRAs, BEING ERISA** plans, but not enjoying ERISA antialienation protections, may be subject to attack in a state action, since any protecting state law may be preempted by ERISA.
- **TRADITIONAL AND ROTH IRAs** are not ERISA pension plans. They are protected in nonbankruptcy proceedings by any state laws specifically protecting IRAs since such state laws are not preempted by ERISA.

MARK P. ALTIERI, CPA/PFS, JD, LL.M., is an associate professor of accounting at Kent State University, Kent, Ohio, and special tax counsel to Wickens, Herzer, Panza, Cook and Batista in Avon. His e-mail address is [maltieri@wickenslaw.com](mailto:maltieri@wickenslaw.com). RICHARD A. NAEGELE, JD, is an attorney and shareholder at Wickens, Herzer, Panza, Cook and Batista. His e-mail address is [rnaegele@wickenslaw.com](mailto:rnaegele@wickenslaw.com).

**D**ebtors have hit a fork in the road. The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (effective October 17, 2005) clarifies the rights of debtors and expands the protections their retirement assets have in federal bankruptcy proceedings. But outside of federal bankruptcy things remain murky, and there still is uncertainty about whether retirement funds are subject to state attachment and garnishment proceedings. This article gives CPAs guidance on what has changed and tips for protecting clients' assets under either scenario.

## EXCLUSION IN BANKRUPTCY

The new law protects retirement funds by excluding them from federal bankruptcy estates. It applies to any fund or account that is tax-exempt under

- IRC section 401(a)—tax-qualified retirement plans (pensions, profit-sharing and IRC section 401(k) plans).
- IRC section 403(b)—tax-sheltered annuity plans generally available to individuals working for IRC section 501(c)(3) employers.
- IRC section 457(b)—deferred compensation plans for employees of tax-exempt and state and local government employers.

## Amount of Money in IRAs

**IRAs are the single largest component of the U.S. retirement market, holding \$3.5 trillion of assets at year-end 2004 (out of a total of \$12.9 trillion of retirement plan assets). Investors hold most (\$3.2 trillion) of their IRA assets in traditional IRAs, which they fund with rollovers from employer-sponsored retirement plans and/or contributions.**

Source: Investment Company Institute, [www.ici.org/stats/latest](http://www.ici.org/stats/latest), August 2005.

The extent of the bankruptcy exclusion for an IRC section 408 IRA varies. IRAs created under an employer-sponsored IRC section 408 SEP IRAs and SIMPLE IRAs, as well as pension, profit-sharing or 401(k) funds transferred to a rollover IRA, enjoy an unlimited exclusion from the federal bankruptcy estate. The U.S. Bankruptcy Code now also excludes traditional IRAs and Roth IRAs. These IRAs, which workers create and fund themselves, are subject to an aggregate \$1 million exclusion limitation (adjusted for inflation and subject to increase if the bankruptcy judge determines that the “interests of justice so require”). The annual contributions individuals make to traditional or Roth IRAs ranged from \$2,000 to \$3,000 for pre-2005 years, and to \$4,000 in 2005, so there is little danger of debtors’ reaching the million-dollar exclusion amount.

Under the new law, a rollover from a SEP or SIMPLE IRA into an IRA appears to receive only \$1 million of protection. Bankruptcy Code section 522(n) allows a general unlimited exclusion for rolled-over qualified retirement plan wealth but does not sanction IRC section 408(d)(3) rollovers. Clients with SEP or SIMPLE IRA assets under \$1 million can roll over these assets and avoid the potential problems with SEP and SIMPLE IRAs outside of bankruptcy discussed below.

## General Debtor Protections for Retirement Assets In and Out of Federal Bankruptcy

	Federal bankruptcy	State law Attachment/garnishment
Qualified retirement plans (pension, profit-sharing, section 401(k))	Generally complete	Generally complete
Rollover IRAs	Generally complete	Generally complete
Traditional and Roth IRAs	\$1 million	Generally complete
SEP and SIMPLE IRAs	Generally complete	Probably none

*Note:* Absolute statements of protection are problematic, as noted in the body of the article. For example, qualified plan assets and IRAs are subject to attachment for qualified domestic relations orders and federal tax liens both in and out of bankruptcy. Additionally, owner-only plans may be attachable outside of bankruptcy. State law protections vary from state to state.

Case law and Department of Labor regulations have held that a qualified retirement plan that benefits only the business owner and spouse was not an ERISA plan and did not qualify for ERISA antialienation protections either inside or outside of bankruptcy. The act now eliminates this concern for federal bankruptcy proceedings, as such plans now do qualify.

***Practical tip.*** Because of the unlimited exclusion for qualified retirement plan assets transferred into a rollover IRA, CPAs should always ensure that rolled-over retirement wealth is segregated in a rollover IRA that is distinct from other traditional or Roth IRAs that the debtor may own.

## **PROTECTIONS OUTSIDE OF FEDERAL BANKRUPTCY**

The new act does not address debtors' retirement funds that are involved in state law insolvency, attachment or garnishment proceedings. In that case a compilation of ERISA, case law and state law comprises the relevant authority. The major concerns are regarding owner-only plans and IRAs. Retirement funds also can be attached through qualified domestic relations orders and federal tax liens in or outside of a bankruptcy.

## **SEP AND SIMPLE IRAs**

Employer-sponsored SEP and SIMPLE IRAs are treated differently from individually created and funded traditional and Roth IRAs. ERISA defines a "pension" plan under its jurisdiction as any "plan, fund or program that is established or maintained by an employer that provides retirement income to employees." Typically pension, profit-sharing and section 401(k) plans qualify. The Labor Department and the Federal Court of Appeals for the Tenth Circuit (in *Garratt v. Walker*) held that SEP and SIMPLE IRAs also are ERISA pension plans because they are arranged by the employer, even though the contributions are immediately allocated to the employee's IRA.

Generally, ERISA pension plans receive extensive antialienation protection from creditors. However, this protection does not extend to an IRA, including a SEP or SIMPLE IRA, even if it qualifies as an ERISA pension plan. ERISA also contains specific preemption provisions that supersede and void state law protections specifically afforded to retirement arrangements that are ERISA pension plans (ERISA section 514(a)).

Thus, the SEP and SIMPLE IRA are at an impasse outside of bankruptcy. They are ERISA pension plans—but do not qualify for ERISA antialienation protections. Moreover, any state law protections may be preempted, and a creditor may be able to bring a successful state action against these assets.

## NON-SEP AND SIMPLE IRAs

An individually established and funded traditional or Roth IRA is not an ERISA pension plan, so state laws can apply to protect them. Usually the owner's state of residency determines whether the IRA is protected. For example, Ohio law specifically exempts both traditional and Roth IRAs from execution, garnishment, attachment or sale to satisfy a judgment or order, with no cap. For a list of state laws protecting IRAs, see "[State-By-State Analysis of Individual Retirement Accounts as Exempt Property.](#)"

**Practical tip.** CPAs should advise their clients that assets rolled over from a SEP or SIMPLE IRA into a rollover IRA should, at that point, no longer be part of an employer-maintained arrangement and therefore would lose their characterization as parts of an ERISA pension plan. The rolled-over assets would not then be subject to ERISA preemption and could take advantage of state law protections for non-SEP and SIMPLE IRAs. If there is less than \$1 million of such rolled-over wealth, the resulting rollover IRA would be afforded unlimited protections under nonbankruptcy proceedings in states such as Ohio and protected in a bankruptcy proceeding.

As an example, Mark Smith is a small business owner who has \$500,000 invested in a SEP IRA established by his company. Under his state's law, assets held in an IRA generally are exempted from any creditor claims. Mark is successfully sued for \$300,000 of damages in state court and is not filing for federal bankruptcy protection.

This matter is outside of federal bankruptcy law, and the new bankruptcy protections therefore do not apply. Because Mark's money is in a SEP IRA, it constitutes an ERISA pension plan, preempting any state law directly protecting it, and it would not qualify for the antialienation protections usually afforded ERISA plans. The judgment creditor therefore may successfully attach Mark's IRA.

If Mark transferred the money in his SEP IRA to a rollover IRA, it no longer would qualify as an ERISA pension plan. Thus it would be protected from creditor claims up to \$1 million either inside a bankruptcy proceeding or possibly to an unlimited extent outside of bankruptcy under applicable state law.

Note that in *Rousey v. Jacoway*, the Supreme Court held that IRAs are a "similar plan or contract" to pension and profit-sharing plans under the limited exemption in the Bankruptcy Code. This decision, although largely irrelevant since the new law, may be authoritative in states that protect pension and profit-sharing plans without specifically protecting IRAs. In these states the fact that the Supreme Court equated IRAs with traditional retirement plans might be persuasive in a nonbankruptcy proceeding involving traditional or Roth IRAs.

CPAs should note the change that has occurred since the advent of the new bankruptcy law. Wealth residing in qualified retirement plans (pension, profit-sharing and section 401(k) plans) continues to possess the most extensive debtor protections both in and outside of a bankruptcy proceeding. A distinct IRA into which qualified retirement plan assets are rolled, an asset frequently attacked under pre-act bankruptcy law, would constitute as strong a protected reservoir of wealth under the new post-act unlimited exclusion for such IRAs in a federal bankruptcy proceeding. Similarly, in states providing strong IRA protection (such as Ohio), the rollover IRA would enjoy unlimited protection from creditors in a nonbankruptcy proceeding.

## OWNER-ONLY PLANS

ERISA and the Internal Revenue Code's broad antialienation protections generally have protected a debtor's pension plan, profit-sharing or 401(k) plan benefits from creditor claims both in and outside of bankruptcy. However, under case law and Department of Labor regulations, a plan that benefits only an owner and his or her spouse is not an ERISA plan, and so does not qualify for antialienation

protections under Title I of ERISA.

As noted above, owner-only plans are not at risk in bankruptcy proceedings. Outside of bankruptcy, the owner-only category does not apply if nonowner participants are added to the plan. So the easiest way to protect funds in such plans is by adding other participants. Alternatively, one could make the same argument, as was just examined with regard to traditional and Roth IRAs outside of bankruptcy, that since owner-only plans are not ERISA plans, state law protecting retirement plans would not be preempted.

## THE CURRENT STATE OF PROTECTIONS

Qualified retirement plans and IRAs are protected under the new bankruptcy legislation. Outside of bankruptcy, ERISA provides nearly unlimited antialienation protection to qualified retirement plans (pensions, profit-sharing and 401(k) plans). State law generally protects traditional and Roth IRAs. SEP and SIMPLE IRAs and owner-only plans, however, require additional planning to insulate them from creditor claims. ■

## RESOURCES

### AICPA Resources

#### JofA Article

“[Protecting Retirement Plan Assets from Creditor Claims](#),” *JofA*, Apr.05, page 34.

#### Publication

“Financial Guidance for Every American” by Mark Altieri, CPA/PFS, is available at [www.360financialliteracy.org/Financial+Guidance+Book](http://www.360financialliteracy.org/Financial+Guidance+Book).

### Other Resources

- “Bankruptcy Abuse Prevention and Consumer Protection Act of 2005,” <http://pfp.aicpa.org/Bankruptcy+Abuse+Prevention+and+Consumer+Protection+Act+of+2005.htm>.
- Bankruptcy Reform Bill, [www.govtrack.us/congress/bill.xpd?bill=s109-256](http://www.govtrack.us/congress/bill.xpd?bill=s109-256).
- Benefits Blog, [www.benefitscounsel.com/archives/001458.html](http://www.benefitscounsel.com/archives/001458.html).
- CCH Bankruptcy Reform Act Briefing, [www.cch.com/bankruptcy/Bankruptcy\\_04-15.pdf](http://www.cch.com/bankruptcy/Bankruptcy_04-15.pdf).

## State-By-State Analysis of Individual Retirement Accounts as Exempt Property

STATE	STATE STATUTE	IRA EXEMPT	ROTH IRA EXEMPT	SPECIAL STATUTORY PROVISIONS
<b>Alabama</b>	Ala. Code Section 19-3-1(b)	Yes	No	
<b>Alaska</b>	Alaska Stat. Section 09.38.017	Yes	Yes	The exemption does not apply to amounts contributed within 120 days before the debtor files for bankruptcy.
<b>Arizona</b>	Ariz. Rev.	Yes	Yes	The exemption does not apply to

	Stat. Ann. Section 33- 1126(C)			amounts contributed within 120 days before a debtor files for bankruptcy.
<b>Arkansas</b>	Ark. Code Ann. Section 16-66-220	Yes	Yes	A bankruptcy court held that the creditor exemption for IRAs violates Arkansas Constitution — at least with respect to contract claims.
<b>California</b>	Cal. Code of Civil Procedure Section 704.115	No	No	IRA's are exempt 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, taking into account all resources that are likely to be available for the support of the judgment debtor when the judgment debtor retires.
<b>Colorado</b>	Colo. Rev. Stat. Section 13-54-102	Yes	Yes	Any retirement benefit or payment is subject to attachment or levy in satisfaction of a judgment taken for arrears in child support; any pension or retirement benefit is also subject to attachment or levy in satisfaction of a judgment awarded for a felonious killing.
<b>Connecticut</b>	Conn. Gen. Stat. Section 52-321a	Yes	Yes	
<b>Delaware</b>	Del. Code Ann. Tit. 10, Section 4915	Yes	Yes	An IRA is not exempt from a claim made pursuant to Title 13 of the Delaware Code, which Title pertains to domestic relations order.
<b>Florida</b>	Fla. Stat. Ann. Section 222.21	Yes	Yes	
<b>Georgia</b>	Ga. Code Ann. Section 44-13-100	No	No	IRA's are exempt only to the extent necessary for the support of the debtor and any dependent.
<b>Hawaii</b>	Haw. Rev. Stat. Section 651-124	Yes	No	The exemption does not apply to contributions made to a plan or arrangement within three years before the date a debtor files for bankruptcy, whether voluntary or involuntary, or within three years before the date a civil action is initiated against the debtor.
<b>Idaho</b>	Idaho Code Section 55- 1011	Yes	Yes	The exemption only applies for claims of judgment creditors of the beneficiary or participant arising out of a negligent or otherwise wrongful act or omission of the beneficiary or participant resulting in money damages to the judgment creditor.
<b>Illinois</b>	Ill. Rev. Stat. Ch. 735, Para. 5/12- 1006	Yes	Yes	

<b>Indiana</b>	Ind. Code Section 34- 55-10-2	Yes	No	Indiana only protects deductible contributions made to a retirement plan.
<b>Iowa</b>	Iowa Code Section 627.6	Yes	Yes	
<b>Kansas</b>	Kan. Stat. Ann. Section 60-2308	Yes	Yes	
<b>Kentucky</b>	Ky. Rev. Stat. Ann. Section 427.150(2)(f)	Yes	Yes	The exemption does not apply to any amounts contributed to an individual retirement account if the contribution occurred within 120 days before the debtor filed for bankruptcy. The exemption also does not apply to the right or interest of a person in individual retirement account to the extent that right or interest is subject to a court order for payment of maintenance or child support.
<b>Louisiana</b>	La. Rev. Stat. Ann. Sections. 20-33(1) and 13-3881(D)	Yes	Yes	No contribution to an IRA is exempt if made less than one calendar year from the date of filing bankruptcy, whether voluntary or involuntary, or the date rights of seizure are filed against the account. The exemption also does not apply to liabilities for alimony and child support.
<b>Maine</b>	Me. Rev. Stat. Ann. Tit. 14, Section 4422(13) (E)	No	No	IRA's are exempt only to the extent reasonably necessary for the support of the debtor and any dependent.
<b>Maryland</b>	Md. Code Ann. Cts. & Jud. Proc. Section 11- 504(h)	Yes	Yes	IRA's are exempt from any and all claims of creditors of the beneficiary or participant other than claims by the Department of Health and Mental Hygiene.
<b>Massachusetts</b>	Mass. Gen. L.Ch. 235, Section 34A	Yes	Yes	The exemption does not apply to an order of court concerning divorce, separate maintenance or child support, or an order of court requiring an individual convicted of a crime to satisfy a monetary penalty or to make restitution, or sums deposited in a plan in excess of 7% of the total income of the individual within 5 years of the individual's declaration of bankruptcy or entry of judgment.
<b>Michigan</b>	Mich. Comp. Laws 600.6023	Yes	Yes	The exemption does not apply to amounts contributed to an individual retirement account or individual retirement annuity if the contribution occurs within 120 days before the debtor files for bankruptcy. The exemption also does not apply to an order of the domestic relations court
<b>Minnesota</b>	Minn. Stat.	Yes	Yes	Exempt to a present value of \$30,000

	Section 550.37			and additional amounts reasonably necessary to support the debtor, spouse or dependents.
<b>Mississippi</b>	Miss. Code Ann. Section 85-3-1	Yes	No	
<b>Missouri</b>	Mo. Rev. Stat. Section 513.430	Yes	Yes	If proceedings under Title 11 of United States Code are commenced by or against the debtor, no amount of funds shall be exempt in such proceedings under any plan or trust which is fraudulent as defined in Section 456.630 of the Missouri Code, and for the period such person participated within 3 years prior to the commencement of such proceedings.
<b>Montana</b>	Mont. Code Ann. Section 31-2-106(3)	Yes	No	The exemption excludes that portion of contributions made by the individual within one year before the filing of the petition of bankruptcy which exceeds 15% of the gross income of the individual for that one-year period.
<b>Nebraska</b>	Neb. Rev. Stat. Section 25-1563.01	Yes	Yes	The exemption only applies to the extent reasonably necessary for the support of the Debtor and any dependent of the Debtor.
<b>Nevada</b>	Nev. Rev. Stat. Section 21.090(1)(q)	Yes	No	The exemption is limited to \$500,000 in present value held in an individual retirement account, which conforms with Section 408.
<b>New Hampshire</b>	N.H. Tit. 52 Section 511:2	Yes	Yes	Exemption only applies to extensions of credit and debts arising after January 1, 1999.
<b>New Jersey</b>	N.J. Stat. Ann. 25:2-1 (b)	Yes	Yes	
<b>New Mexico</b>	N.M. Stat. Ann. Section 42-10-1	Yes	Yes	A retirement fund of a person supporting another person is exempt from receivers or trustees in bankruptcy or other insolvency proceedings, fines, attachment, execution or foreclosure by a judgement creditor.
<b>New York</b>	N.Y. Civ. Prac. L. and R. Section 5205(c)	Yes	Yes	Additions to individual retirement accounts are not exempt from judgments if contributions were made after a date that is 90 days before the interposition of the claim on which the judgment was entered.
<b>North Carolina</b>	N.C. Gen. Stat. Section 1C-1601(a) (9)	Yes	Yes	
<b>North Dakota</b>	N.D. Cent. Code Section 28-22-03.1(3)	Yes	Yes	The account must have been in effect for a period of at least one year. Each individual account is exempt to a limit of up to \$100,000 per account, with an



				aggregate limitation of \$200,000 for all accounts. The dollar limit does not apply to the extent the debtor can prove the property is reasonably necessary for the support of the debtor, spouse, or dependents.
<b>Ohio</b>	Ohio Rev. Code Ann. Section 2329.66(A)(10)	Yes	Yes	SEPs and SIMPLE IRAs are not exempt.
<b>Oklahoma</b>	Okla. Stat. Tit. 31, Section 1(A)(20)	Yes	Yes	
<b>Oregon</b>	OR. Rev. Stat. 23.170	Yes	Yes	
<b>Pennsylvania</b>	42 PA. Cons. Stat. Section 8124	Yes	Yes	The exemption does not apply to amounts contributed to the retirement fund within one year before the debtor filed for bankruptcy.
<b>Rhode Island</b>	R.I. Gen. Laws Section 9-26-4	Yes	Yes	The exemption does not apply to an order of court pursuant to a judgment of divorce or separate maintenance, or an order of court concerning child support.
<b>South Carolina</b>	S.C. Code Ann. Section 15-41-30	No	No	The debtor's right to receive individual retirement accounts and Roth accounts are exempt to the extent reasonably necessary for the support of the debtor and any dependent of the debtor.
<b>South Dakota</b>	S.D. Cod. Laws 43-45-16	No	No	Exempts "certain retirement benefits" up to \$250,000.00. Cites ¶401(a)(13) of Internal Revenue Code (Tax-Qualified Plan Non-Alienation Provision). Unclear whether IRAs fall within exemption.
<b>Tennessee</b>	Tenn. Code Ann. Section 26-2-105	Yes	Yes	
<b>Texas</b>	Tex. Prop. Code Ann. Section 42.0021	Yes	Yes	
<b>Utah</b>	Utah Code Ann. Section 78-23-5(1)	Yes	Yes	The exemption does not apply to amounts contributed or benefits accrued by or on behalf of a debtor within one year before the debtor files for bankruptcy.
<b>Vermont</b>	Vt. Stat. Ann. Tit. 12 Section 2740(16)	Yes	Yes	
<b>Virginia</b>	Va. Code Ann. Section 34-34	Yes	Yes	The exemption does not apply to the extent that the interest of the individual in the retirement plan would provide an

annual benefit in excess of \$17,500.00. If an individual has an interest in more than one retirement plan, the limitation is applied as if all retirement plans constituted a single plan. The Code provides a table from which the annual benefit may be determined.

<b>Washington</b>	Wash. Rev. Code Section 6.15.020	Yes	Yes
<b>West Virginia</b>	W.Va. Code Section 38-10-4	Yes	No
<b>Wisconsin</b>	Wis. Stat. Section 815.18(3)(j)	Yes	Yes
<b>Wyoming</b>	Wyo. Stat. Section 1-20-110	No	No

The exemption does not apply to an order of court concerning child support, family support or maintenance, or any judgments of annulment, divorce or legal separation.



[go back](#)  
©2006 AICPA