

# Asset Protection for Qualified Assets

## *Understanding the protection afforded to IRAs and Qualified Plans at the Federal and State level*

As personal retirement savings have become the primary means for funding retirement, the importance of protecting these accounts while otherwise facing financial hardship has also grown. The laws protecting these assets have changed over time, and although IRAs and qualified plans are now covered by similar rules, the differences in their protection are important to note.

### **Asset Protection and Bankruptcy Overview**

When a debtor is seeking protection for retirement accounts from creditors, a decision must be made whether to file for bankruptcy in federal court or settle the dispute through the state court. Prior to making this decision though, the debtor must have an understanding of the two main bodies of federal law that provide asset protection for qualified retirement accounts:

- Employee Retirement Income Security Act of 1974 (ERISA)
- Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA).

ERISA based plans are automatically afforded creditor protection, regardless of other asset protection steps taken by the owner. IRAs are not covered under the ERISA rules, but through BAPCPA are afforded bankruptcy protection at the federal and state levels. If the debtor does not file for bankruptcy, they then must follow the non bankruptcy creditor exemptions available in their state. State specific exemptions change periodically, so debtors should review their current state laws for treatment of IRAs.

### **Employee Retirement Income Security Act of 1974 (ERISA)**

ERISA plans are specifically provided asset protection at the federal and state levels, independent of whether the debtor has filed for bankruptcy. The ERISA rules cover 401(k), 403(b), ESOP and other defined contribution and defined benefit plans. They also cover SEP IRAs and Simple IRAs even though they are often considered IRAs in other scenarios.

SEP IRAs and Simple IRAs are viewed as “owner only” plans and are not afforded the same creditor protection under ERISA in non-bankruptcy situations. For example, if a SEP IRA owner is sued by a creditor and doesn’t file for bankruptcy, the SEP IRA owner may not be protected by ERISA and may be forced to rely on state statutes for protection.

### **Bankruptcy Abuse Prevention and Consumer Protections Act of 2005 (BAPCPA)**

In 2005, BAPCPA made significant changes in protecting qualified retirement accounts, including ERISA and non ERISA plans. Under BAPCPA, all debtors are entitled to a bankruptcy exemption for retirement funds to the extent that those funds are in a fund or account that is exempt from tax. This exemption is available regardless of a debtor’s choice of federal or state law bankruptcy exemptions.

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First Use 1/2012, Last Updated 1/2017

## Asset Protection for IRAs, *continued.*

The BAPCPA legislation:

- **Extends creditor protection to all IRAs regardless of state law, during and after the bankruptcy proceeding.**
- **Provides an unlimited exemption from the bankruptcy estate for all Rollover, SEP, and Simple IRAs.**
- **Gives Contributory Traditional and Roth IRAs aggregate protection of \$1 million**, which is adjusted for inflation every three years (last adjusted on April 1, 2016 to \$1,283,025) and may be subject to increase if the bankruptcy judge determines that the “interests of justice so require.”<sup>1</sup> If a Rollover IRA or ERISA plan is combined with a Contributory IRA, the combined IRA loses its unlimited protection. Therefore, it may be appropriate to keep contributory and rollover IRAs separate by not commingling the accounts during transfers, rollovers or contributions. Moreover, a Roth conversion from a Rollover IRA may also limit the protection even if the Roth conversion is later recharacterized.

On the other hand, BAPCPA does not provide bankruptcy protection for IRAs:

- **If an IRA engages in a prohibited transaction<sup>2</sup>, or**
- **When there is a Federal Tax Lien or Qualified Domestic Relations Order (QDRO) attached to the account, whether the assets are in or out of bankruptcy.**

### Inherited IRAs

On June 12, 2014, the United States Supreme Court unanimously ruled that Inherited IRAs are not “retirement funds” within the meaning of U.S.C. §522(b)(3)(C). Therefore, Inherited IRAs are not protected from bankruptcy at the Federal level. Debtors must now rely on State laws and exemptions to determine if the Inherited IRA will be protected in bankruptcy. In addition, State laws and exemptions will also determine whether or not Inherited IRAs are protected assets in non-bankruptcy situations.

For IRA owners concerned with providing an IRA Beneficiary with bankruptcy and creditor protection, the IRA owner should consider naming a trust as the beneficiary of the IRA, instead of naming the beneficiary directly. The trust may offer additional protection because the beneficiary does not own the assets within the trust and the beneficiary’s use and enjoyment of the assets are limited.

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<sup>1</sup> Bankruptcy Code Section 522(n)

<sup>2</sup> Willis v. Menotte, 11th Circuit Court of Appeals, 2011

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