

Protection better for IRAs, but not perfect

By Rick Miller

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CHICAGO - Some financial advisers are predicting a surge in retirement plan rollovers because of a U.S. Supreme Court decision last week extending creditor protection to individual retirement accounts in bankruptcy proceedings - others aren't so sure.

"They won't be able to handle all the business," said Ed Slott, a certified public accountant and editor of Ed Slott's IRA Advisor, a monthly newsletter based in Rockville Centre, N.Y.

"Once [advisers] get word out to clients, they are going to see a wave of rollovers like they've never seen before."

But other experts warned that the Supreme Court's ruling doesn't provide as much protection as it appeared to at first glance. In fact, the level of protection may depend on state bankruptcy rules and the type and size of IRA, the experts said.

So the "huge boom" in IRA rollovers Mr. Slott expects advisers to see may not occur, because the ruling doesn't provide creditor protection akin to that provided by Employee Retirement Income Security Act plans, according to the experts.

The court's unanimous decision in the case of Rousey v. Jacoway removes what for some advisers and planners was a major drawback for rolling money from employer-sponsored plans into an IRA - the loss of federal creditor protection.

Good protection

For clients, such as doctors, who are concerned about liability issues, advisers generally didn't recommend that they roll money out of an employer-sponsored plan, because of the sweeping creditor protection afforded under ERISA.

"Now with the Supreme Court ruling, you can tell a client, 'Listen, we can roll your money into an IRA, and you have pretty good protection,' so it is not as big of a concern," said Steven Podnos, a fee-only planner and part-time medical doctor who runs Wealth Care LLC in Merritt Island, Fla.

"Probably what financial planners are looking for is, 'Am I going to have lines out the door for people doing IRA rollovers?' No, I don't think so," said Christopher Riser, a managing partner and asset protection expert at the law firm Riser Adkisson LLP in Atlanta.

The ruling is significant in just five states - Arkansas, Massachusetts, Minnesota, South Carolina, and Wisconsin, as well as the District of Columbia, according to Mr. Riser.

Those states have limited protection for IRAs and actually allow residents to choose between federal and state exemptions in bankruptcy. In another 10 states where one can choose, there is already "nearly unlimited protection" offered under state law, so most people would choose the state exemptions, Mr. Riser added.

In the remaining 35 states, one has to use the state exemptions, making the federal ruling moot

Still, advisers who think the ruling will provide creditor protection to clients as good as what exists under ERISA are mistaken, several attorneys said.

"Qualified plans, like 401(k)s, are still much better protected, because with the IRA, you have to prove need, you have to prove you need the money for support, and with the 401(k) ... you don't have to prove that," said Natalie Choate, an estate-planning lawyer with Bingham McCutchen LLP in Boston.

The Supreme Court case involved Richard and Betty Jo Rousey of Berryville, Ark., who both worked at Northrop Grumman Corp. The couple, who accumulated \$55,000 in a company-sponsored pension and 401(k) plans, were required to take a lump-sum distribution when they left the Los Angeles company and rolled the funds into two IRAs.

When they later filed for Chapter 7 bankruptcy protection in 2001, they sought to protect their IRAs from creditors. They argued that the IRAs were shielded under bankruptcy law because of the right to receive a payment "under a stock bonus, pension, profit sharing, annuity or similar plan or contract on account of illness, disability, death, age or length of service, to the extent reasonably necessary for the support of the debtor and any dependent of the debtor."

The Chapter 7 trustee, Jill R. Jacoway, objected, setting the court case in motion.

The Supreme Court sided with the Rouseys, stating that IRAs are like other plans in that they "have the same primary purpose, namely, [to] enable Americans to save for their retirement" and have a common feature in that "they provide income that substitutes for wages earned as salary or hourly compensation."

Also, the court said, the right to receive payment from an IRA is on account of age, referring to both the 10% early-withdrawal penalty applicable to IRAs and the age 70½ required-minimum-distribution rules.

However, extremely large IRAs aren't likely protected, because the protection is limited to the amount to support the debtor and dependents, according to the experts.

Ms. Choate said the ruling also appears to leave Roth IRAs vulnerable to creditors in bankruptcy. "The court, in Rousey, relied very heavily on the 10% penalty and the minimum-distribution rules as showing that an IRA is a retirement plan. With a Roth IRA, there are no minimum-distribution rules at age 70½, and the 10% penalty is very weak ... so this ruling really doesn't help Roth IRAs," said Ms. Choate, author of "Life and Death Planning for Retirement Benefits" (Ataxplan Publications, 2003).

According to interviewed advisers, even if the rulings benefits may be limited, they can think of individual clients for whom they can recommend an IRA rollover.

"I have one client in particular that we have not moved money from a 401(k) plan into an IRA, and it hurt me in the sense that I am a fee-only planner, and as long as it was in the old retirement plan, I was not managing the assets," said Dr. Podnos. "Now I can say to him, 'The concern about the IRA assets' being attachable by a creditor is not really as bad, and we can go ahead and effect a transfer.'"

Sidney Blum, director of financial advisory services at Leonetti & Associates Inc. in Buffalo Grove, Ill., said even though IRAs are protected in his state, he is still cautious. "This gives us better a comfort feeling, even here in Illinois," he said.

As Friday is the deadline for 2004 IRA contributions, the headlines concerning the court's IRA ruling could lead to a "small uptick" in IRA contributions this year, said Ken Weingarten, president of Weingarten Associates LLC in Lawrenceville, N.J.

"But longer term, I think you are going to see a lot more IRA rollovers from company plan assets, absolutely," he said. "For many planners and many advisers, I think the biggest drawback of rolling money out of a qualified plan and into an IRA has been removed."
