

Quarterly Supplement To
**Business, Legal,
And Tax Planning
for the Dental Practice**

Second Edition,
ISBN 0-87814-800-0, © 2001 PennWell Corp.



The purpose of the Quarterly Supplement is to continually update the material contained in **Business, Legal, And Tax Planning for the Dental Practice**, Second Edition, as "free-standing" articles relative to current business, legal, tax and pending legislative matters that affect your practice. These Quarterly Supplements also reflect my ongoing experiences as an attorney representing dental and dental specialty practices. At times, articles will be written by friends who consist of tax attorneys, accountants, actuaries and dentists. The articles contained in the Quarterly Supplements are consistent with the chapters contained in my book, which you may download at www.wickenslaw.com at no charge.



William P. Prescott, M.B.A., J.D.
Practice Transition Attorney
Former Dental Equipment and Supply Salesman

WINTER, 2007

In This Supplement

PROTECT RETIREMENT ASSETS

The attached important article titled, Protect Retirement Assets, was written by my partners, Richard A. Naegele and Mark P. Altieri and published by the Journal of Accountancy in January, 2006. This material should be shared with your CPA or investment advisor and shows the importance of protecting assets through tax-qualified retirement plans and IRAs.

© Copyright 2006,
William P. Prescott, M.B.A., J.D., and
Wickens, Herzer, Panza, Cook & Batista Co.
All rights reserved.

William P. Prescott, M.B.A., J.D.
Wickens, Herzer, Panza, Cook & Batista Co.
35765 Chester Road
Avon, Ohio 44011-1262
Direct: 440.930.8067
Fax: 440.930.8098
wprescott@wickenslaw.com
www.wickenslaw.com

This Quarterly Supplement is not intended to provide the reader with specific legal or tax advice. For specific solutions to legal and tax matters, please consult with your legal counsel and CPA.

IRS CIRCULAR 230 DISCLOSURE

To ensure compliance with the requirements imposed by IRS Circular 230, we inform you that any tax advice contained in this communication is not intended or written to be used, and cannot be used, for the purpose of (1) avoiding tax-related penalties under the Internal Revenue Code or (2) promoting, marketing or recommending to another party any tax-related matter(s) addressed herein.

PREFACE

In this Quarterly Supplement, my partner, Dick Naegele, has graciously granted me permission to include his article on this important topic of creditor protection. Please feel free to share his Supplement with your attorney, accountant and financial planners/investment counselors. As you will see from the article, the safest place to protect your savings is in a tax-qualified retirement plan, e.g., a safe harbor 401(k) profit-sharing plan or defined benefit plan. Absent federal tax liens and child support orders, tax-qualified retirement plan assets are fully protected from creditors. Dick Naegele's email is: RNaegele@wickenslaw.com and his direct dial is 440-930-8074. Enjoy and we will welcome your comments!

PROTECTIONS FOR IRA AND OTHER RETIREMENT PLAN ASSETS AFTER BANKRUPTCY REFORM

By

Richard A. Naegele, Mark P. Altieri and Jason A. Rothman

Overview. The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (the "Act") brought much needed clarity to debtor and creditor rights relative to retirement assets in a federal bankruptcy proceeding. Prior to the Act, debtor and creditor rights with regard to such assets were in a state of great confusion both within and outside of federal bankruptcy. For debtors in financial distress under the federal bankruptcy laws, the Act not only provides clarification but actually extends bankruptcy protection for the debtor's retirement funds. For debtors in financial distress who are subject to state attachment and garnishment proceedings outside of bankruptcy, the confusion continues. We will first review the new provisions in federal bankruptcy proceedings and will conclude with an analysis of the law relative to creditors' rights in retirement funds outside of bankruptcy.

RETIREMENT FUNDS WITHIN BANKRUPTCY

The General Effect of the Act on Retirement Funds. Effective as of October 17, 2005, the following rules give protection to a debtor's retirement funds in bankruptcy by way of exempting them from the bankruptcy estate. The general exemption found in Section 522 of the Bankruptcy Code¹ relative to retirement assets applies to any fund or account that is exempt from taxation under the following Internal Revenue Code ("Code") sections:

- Section 401(a) (tax qualified retirement plans - pensions, profit-sharing and Section 401(k) plans);
- Section 403 (tax-sheltered annuity plans generally available to employees of Section 501(c)(3) employers);
- Section 457 (deferred compensation plans for employees of tax-exempt and state and local governmental employers).

Section 522 also includes an exemption for traditional IRAs under Code Section 408 and Roth IRAs under Code Section 408A. IRAs created under an employer-sponsored Code Section 408(k) simplified employee pension (a "SEP IRA") or a Code Section 408(p) simple retirement account (a "SIMPLE IRA"), as well as pension, profit-sharing or Section 401(l) wealth transferred to a rollover IRA, enjoy an unlimited exemption from the bankruptcy estate as do the bulleted exemptions just noted. Traditional and Roth IRAs that are created and funded by the debtor are subject to an exemption limitation of \$1 million in the aggregate for all such IRAs (adjusted for inflation and subject to increase if the bankruptcy judge determines that the "interests of justice so require"). It appears that a rollover from a SEP or SIMPLE IRA into a

¹ 11 USC Section 522

rollover IRA would receive only \$1 million of protection since such a Code Section 408(d)(3) rollover is not one of the rollovers sanctioned under Bankruptcy Code Section 522(n). Because of the unlimited exemption for qualified retirement plan assets transferred into a rollover IRA, advisers should assure that rolled-over retirement wealth is segregated in a rollover IRA that is contractually distinct from other traditional or Roth IRAs that the debtor may own. Because of the historically low annual contributions that may be made to a traditional or Roth IRA (\$2 or \$3 thousand dollars for pre-2005 years, increasing to \$4 thousand dollars in 2005-2007), for the foreseeable future the one million dollar exemption should provide sufficient protection for the vast majority of traditional and Roth IRAs.

As noted above, the bankruptcy exempted funds or accounts must be exempt from taxation under the Code. Section 224 of the Act provides a very lenient rule in determining whether funds or accounts are exempt from taxation under the Code. For bankruptcy law purposes, there is a presumption of exemption from tax if the fund or account has received a favorable ruling from the IRS (e.g., an IRS favorable determination letter issued to an employer-sponsored tax-qualified retirement plan). Additionally, a fund or account is considered exempt from tax even if it has not received a favorable IRS ruling provided that it is in substantial compliance with the Code. Lastly, even if the fund or account has neither a favorable ruling nor is in substantial compliance with the Code, it is still considered exempt for bankruptcy law purposes if the debtor is not materially responsible for its noncompliance.

As will be detailed below, there is case law and Department of Labor Regulations holding that a qualified retirement plan that benefited only the business owner (and/or the owner's spouse) was not an Employee Retirement Income Security Act ("ERISA") Plan and, therefore, could not invoke ERISA anti-alienation protections either inside or outside of bankruptcy. Within a federal bankruptcy proceeding, this concern has been eliminated to the extent that the debtor has a non-fraudulent favorable ruling from the IRS or is otherwise deemed to have a tax-exempt plan as just noted.

RETIREMENT FUNDS OUTSIDE OF BANKRUPTCY

What if the debtor is not under the jurisdiction of the federal bankruptcy court but rather has become embroiled in a state law insolvency, enforcement or garnishment proceeding. To what extent are his or her retirement funds protected? At this point, the Act is inapplicable and we default to a confusing compilation of ERISA, case and state law. The major concerns here are with owner-only plans and IRAs. Qualified domestic relations orders and federal tax liens can attach retirement funds inside or outside of a bankruptcy situation.

Owner-Only Plans. A debtor's plan benefits under a pension, profit-sharing or Section 401(k) Plan are generally safe from creditor claims both inside and outside of bankruptcy due to ERISA and the Code's broad anti-alienation protections. However, case law and Department of Labor Regulation have held that such a plan that benefits only an owner (and/or an owner's

spouse) are not ERISA plans thus voiding the anti-alienation protections generally afforded to ERISA plans. This still appears to be a concern outside of a federal bankruptcy scenario.²

IRAs. Here we find a fascinating dichotomy between IRAs constituted as parts of SEP and SIMPLE IRAs and individually created and funded traditional and Roth IRAs. To follow this analysis, we need to explore some of the intricacies of ERISA as well as state law protections for IRAs.

ERISA defines a "pension" plan under its jurisdiction as any "plan, fund or program which is established or maintained by an employer ... that provides retirement income to employees"³. Thus, the typical pension, profit-sharing or Section 401(k) plan constitutes an ERISA pension plan. Although contributions under both SEP and SIMPLE IRAs are immediately allocated among the individually owned IRAs of the participating employees, the DOL⁴ and the Federal Court of Appeals⁵ have held that SEP and SIMPLE IRAs are ERISA pension plans due to the employer involvement in such arrangements. Conversely, traditional and Roth IRAs that are created and funded without employer involvement are not ERISA pension plans.

As noted above, generally ERISA pension plans are afforded extensive anti-alienation creditor protection both inside and outside of bankruptcy.⁶ However, these extensive anti-alienation protections do not extend to an IRA arrangement under Code Section 408 even if the IRA constitutes an ERISA pension plan due to being established as a SEP or SIMPLE IRA⁷. ERISA also contains specific preemption provisions⁸ that supersede and make inoperative any state law relating to ERISA pension plans. Thus, state law protections specifically afforded to ERISA pension plans are preempted and inoperative.

Thus, the SEP and SIMPLE IRA is in a quandary outside of bankruptcy – this IRA is deemed an ERISA pension plan but has no ERISA anti-alienation protection, and being an ERISA pension plan, any state law protecting its wealth is preempted by ERISA and opens it to attachment under state actions.

² 29 CFR Section 2510.3-3(b); *In re Witwer*, 148 B.R. 930 (Dec., 1992, Cal.); *In re Lane*, 149 B.R. 760 (Jan., 1993, N.Y.); *In re Hall*, 151 B.R. 412 (Feb., 1993, Michigan); *In re Watson*, 192 B.R. 238 (Feb., 1998, Nevada), affd. 22 EBC 1091 (9th Cir. 1998).

³ ERISA Section 3(2)(A)

⁴ preamble to DOL Regulation Section 2520.104-48

⁵ *Garratt v. Walker*, 164 F. 3d 1249 (10th Cir. 1998)

⁶ ERISA Section 206(d).

⁷ ERISA Sections 4(b) and 201

⁸ ERISA Section 514(a)

Non-SEP and SIMPLE IRAs. As just noted, an individually-established and funded traditional or Roth IRA is not an ERISA pension plan. That being the case, state law that relates to such IRAs is not preempted under ERISA. Many states provide protection to IRAs based on the IRA owner's state of residency. Ohio law⁹, for example, specifically exempts traditional and Roth IRAs from execution, garnishment, attachment, or sale to satisfy a judgment or order. There is no cap under the Ohio exemption. A list of different state laws protecting IRAs is attached as a final section. Note that a similar argument might be applicable to invoke non-preempted state law protecting retirement plans to protect a deemed non-ERISA owner-only plan outside of bankruptcy.

A simple solution is available. Assets rolled from a SEP or SIMPLE IRA into a rollover IRA should lose their characterization as parts of an ERISA pension plan, would not thereafter be subject to ERISA preemption, and could then take advantage of state law protections for non-SEP and SIMPLE IRAs. If there is less than \$1 million of wealth rolled-over, such IRAs would then be afforded unlimited protections under non-bankruptcy proceedings in states like Ohio and be allowed \$1 million dollars worth of protection in a bankruptcy proceeding.

CONCLUSION-NEW PLANNING OPPORTUNITIES

The Act has created a new planning paradigm. Wealth residing in qualified retirement plans (pension, profit-sharing and Section 401(k) plans) continue to possess the most extensive debtor protections both within and outside of a bankruptcy proceeding. An IRA into which qualified retirement plan assets are rolled — an asset frequently attacked under pre-Act bankruptcy law — would constitute as strong a debtor protected reservoir of wealth in states providing strong IRA protection (such as Ohio) and under the new post-Act unlimited exemption for such IRAs in a bankruptcy proceeding.

⁹ Ohio Revised Code Section 2329.66(A)(10)(c)

STATE LAWS PROTECTING IRAS

**STATE-BY-STATE ANALYSIS OF
INDIVIDUAL RETIREMENT ACCOUNTS AS EXEMPT PROPERTY***

STATE	STATE STATUTE	IRA EXEMPT	ROTH IRA EXEMPT	SPECIAL STATUTORY PROVISIONS
Alabama	Ala. Code §19-3-1(b)	Yes	No	
Alaska	Alaska Stat. §09.38.017	Yes	Yes	The exemption does not apply to amounts contributed within 120 days before the debtor files for bankruptcy.
Arizona	Ariz. Rev. Stat. Ann. §33-1126(B)	Yes	Yes	The exemption does not apply to amounts contributed within 120 days before a debtor files for bankruptcy.
Arkansas	Ark. Code Ann. §16-66-220	Yes	Yes	A bankruptcy court held that the creditor exemption for IRAs violates the Arkansas Constitution — at least with respect to contract claims.
California	Cal. Code of Civ. Proc. §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.
Colorado	Colo. Rev. Stat. §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.
Connecticut	Conn. Gen. Stat. §52-321a	Yes	Yes	
Delaware	Del. Code Ann. Tit. 10, §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.
Florida	Fla. Stat. Ann. §222.21	Yes	Yes	
Georgia	Ga. Code Ann. §44-13-100	No	No	IRA's are exempt only to the extent necessary for the support of the debtor and any dependent.

STATE	STATE STATUTE	IRA EXEMPT	ROTH IRA EXEMPT	SPECIAL STATUTORY PROVISIONS
Hawaii	Haw. Rev. Stat. §651-124	Yes	Yes	The exemption does not apply to contributions made to a plan or arrangement within three years before the date a civil action is initiated against the debtor.
Idaho	Idaho Code §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.
Illinois	Ill. Rev. Stat. Ch. 735, Para. 5/12-1006	Yes	Yes	
Indiana	Ind. Code §34-55-10-2	Yes	Yes	
Iowa	Iowa Code §627.6	Yes	Yes	
Kansas	Kan. Stat. Ann. §60-2308	Yes	Yes	
Kentucky*	Ky. Rev. Stat. Ann. §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.
Louisiana	La. Rev. Stat. Ann. Sects. 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 writs of seizure are filed against the account. The exemption also does not apply to liabilities for alimony and child support.
Maine	Me. Rev. Stat. Ann. Tit. 14, §4422(13) (E)	No	No	IRA's are exempt only to the extent reasonably necessary for the support of the debtor and any dependent.

STATE	STATE STATUTE	IRA EXEMPT	ROTH IRA EXEMPT	SPECIAL STATUTORY PROVISIONS
Maryland	Md. Code Ann. Cts. & Jud. Proc. §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.
Massachusetts	Mass. Gen. L.Ch. 235, §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.
Michigan*	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
Minnesota	Minn. Stat. §550.37	Yes	Yes	Exempt to a present value of \$30,000 and additional amounts reasonably necessary to support the debtor, spouse or dependents.
Mississippi	Miss. Code Ann. §85-3-1	Yes	No	
Missouri	Mo. Rev. Stat. §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.

STATE	STATE STATUTE	IRA EXEMPT	ROTH IRA EXEMPT	SPECIAL STATUTORY PROVISIONS
Montana	Mont. Code Ann. §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.
Nebraska	Neb. Rev. Stat. §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.
Nevada	Nev. Rev. Stat. §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.
New Hampshire	N.H. Tit. 52 §511:2	Yes	Yes	Exemption only applies to extensions of credit and debts arising after January 1, 1999.
New Jersey	N.J. Stat. Ann. 25:2-1(b)	Yes	Yes	
New Mexico	N.M. Stat. Ann. §42-10-1, §42-10-2	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 judgment creditor.
New York	N.Y. Civ. Prac. L. and R. §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.
North Carolina	N.C. Gen. Stat. §1C-1601(a)(9)	Yes	Yes	
North Dakota	N.D. Cent. Code §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.
Ohio*	Ohio Rev. Code Ann. §2329.66(A)(10)	Yes	Yes	SEPs and SIMPLE IRAs are not exempt.

STATE	STATE STATUTE	IRA EXEMPT	ROTH IRA EXEMPT	SPECIAL STATUTORY PROVISIONS
Oklahoma	Okla. Stat. Tit. 31, §1(A)(20)	Yes	Yes	
Oregon	OR. Rev. Stat. 18.358	Yes	Yes	
Pennsylvania	42 PA. Cons. Stat. §8124	Yes	Yes	The exemption does not apply to amounts contributed to the retirement fund within one year before the debtor filed for bankruptcy.
Rhode Island	R.I. Gen. Laws §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.
South Carolina	S.C. Code Ann. §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.
South Dakota	S.D. Cod. Laws 43-45-16; 43-45-17	Yes	Yes	Exempts "certain retirement benefits" up to \$250,000.00. Cites §401(a)(13) of Internal Revenue Code (Tax-Qualified Plan Non-Alienation Provision).
Tennessee*	Tenn. Code Ann. §26-2-105	Yes	Yes	
Texas	Tex. Prop. Code Ann. §42.0021	Yes	Yes	
Utah	Utah Code Ann. §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.
Vermont	Vt. Stat. Ann. Tit. 12 §2740(16)	Yes	Yes	
Virginia	Va. Code Ann. §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 \$25,000.00. 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.

STATE	STATE STATUTE	IRA EXEMPT	ROTH IRA EXEMPT	SPECIAL STATUTORY PROVISIONS
Washington	Wash. Rev. Code §6.15.020	Yes	Yes	
West Virginia	W.Va. Code §38-10-4	Yes	No	
Wisconsin	Wis. Stat. §815.18(3)(j)	Yes	Yes	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.
Wyoming	Wyo. Stat. §1-20-110	No	No	

*Kentucky, Michigan, Ohio, and Tennessee: The U.S. Court of Appeals for the Sixth Circuit in Lampkins v. Golden, 2002 U.S. App. LEXIS 900, 2002-1 USTC par. 50,216 (6th Cir. 2002) held that a Michigan statute exempting SEPs and IRAs from creditor claims was preempted by ERISA. The decision appears to be limited to SEPs and SIMPLE-IRAs.