

Strictly Business

A Business Law Blog for Entrepreneurs, Emerging Companies, and the Investment Management Industry.



ABOUT THE AUTHOR

Alexander J. Davie is an attorney based in the Nashville, TN area. His practice focuses on corporate, finance, and real estate transactions. He works mainly with emerging companies, venture funds, entrepreneurs, and startups. His firm's website can be found at www.alexanderdavie.com.

In his corporate practice, Mr. Davie has worked extensively with his clients on all aspects of their businesses, including company formation, business planning, mergers and acquisitions, vendor and customer contracts, corporate governance, debt and equity financings, and securities offerings. In addition, he has represented investment advisors, securities brokers, hedge funds, private equity funds, and real estate partnership syndicators in numerous private offerings of securities and in ongoing compliance. Prior to returning to private practice, Mr. Davie served as the general counsel to a private investment fund manager.

In his real estate practice, he has participated in property acquisitions, mortgage financings, and commercial leasing matters throughout the United States. He has represented developers, governmental entities, life insurance companies, banks, and owners of malls, shopping centers, industrial parks, and office towers. He has worked on a number of transactions involving the syndication of real estate partnerships, advising sponsors on both real estate and securities issues.

Using Retirement Accounts for Asset Protection

The tax benefits of retirement plans such as 401(k)s and Roth IRAs are well-known; but what many people do not know, is that such plans also provide an added benefit of asset protection. The assets contained within these plans are often exempt from execution on civil court judgments and debtors are also permitted to retain them after Federal bankruptcy proceedings, even in a Chapter 7 liquidation.

The most famous (or rather infamous) use of these rules to shield assets from creditors is that of former NFL star and accused murderer OJ Simpson, who was permitted to keep his NFL pension (which is treated similar to a 401(k)) after being successfully sued in civil court for causing the death of Ronald Goldman. While the unfortunate and unsavory facts of this case might seem to make it an unlikely role model for your financial plan, the fact is, regardless of one's personal beliefs as to Simpson's guilt or innocence, the same legal protections he used are available to all residents of the United States who face potential legal liability. Business owners and professionals are frequent targets of lawsuits. Effective asset protection planning can alleviate some of these risks by putting your retirement assets out of reach from potential plaintiff's attorneys.

The most protected form of retirement account is the so-called "qualified retirement plan" which is protected under the Federal ERISA statute. This category includes traditional pensions like Simpson's NFL pension, but also includes more common "defined contribution" pension arrangements like 401(k) and 403(b) plans. For all of these types of pension plans, retirement assets are completely exempt from civil court judgments and can be retained by a debtor after bankruptcy. The protections in bankruptcy proceedings (but not against civil judgments) also extend to Rollover IRA accounts, in which the assets of a 401(k) from a previous employer are "rolled over" into an IRA.

In addition, Roth IRAs and Traditional IRAs also receive some protection. In bankruptcy, a debtor may retain up to \$1,171,650 (indexed to inflation from an original \$1 million) of assets contained within these accounts. With regards to civil court judgments, treatment varies from state to state. Some states, like Tennessee and North Carolina provide complete protection for these accounts, similar to the treatment of qualified retirement plans like 401(k)s. Other states, like Georgia, provide protection for these accounts only to the extent necessary for the support of the debtor and any dependents. Still others provide limited protections. For example, South Dakota provides protection up to \$1 million, mirroring the amount protected in Federal bankruptcy. Some states, like Alabama and Mississippi provide unlimited protection for Traditional IRAs, but it is currently unclear if they provide any protection for Roth IRAs.

The final types of retirement accounts worth discussing are simplified employee pensions (often called "SEP IRAs") and simple retirement accounts (often called "SIMPLE IRAs"). They receive unlimited protection under Federal bankruptcy, but unfortunately courts have disagreed about whether it is permissible for states to exempt SEP IRAs and SIMPLE IRAs from attachment in civil court judgments. Some courts have ruled that SEP IRAs and SIMPLE IRAs fall within the ERISA statute and consequently, any state statute giving them protection in a civil suit is preempted. Therefore, given this legal uncertainty, owners of SEP IRAs and SIMPLE IRAs should not count on any protection from civil judgments, even if their state explicitly has a statute giving them that protection. However, assets from an SEP IRA or SIMPLE IRA rolled over into a Rollover IRA

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enjoy protection up to the \$1 million+ cap in bankruptcy and are treated like a Traditional IRA for state law purposes.

This confusing set of laws results in two "best practices" for managing retirement accounts with an eye towards optimizing asset protection:

- First, any rolled over assets from a 401(k) (or equivalent) should be kept in a Rollover IRA which is segregated from any Traditional IRA contributions. Recall that Rollover IRAs retain the unlimited bankruptcy exemption, but that Traditional IRAs and Roth IRAs are subject to a \$1 million+ cap. Therefore, in order to insure the best possible treatment for a Rollover IRA, it should not be commingled into a single account with a Traditional IRA or it risks losing this preferential treatment.
- Second, owners of SEP IRAs or SIMPLE IRAs, particularly those with assets in these plans of well under \$1 million, may want to consider rolling over these assets into a Rollover IRA. This would have the effect of gaining state law protections for Traditional IRAs for these accounts, though they would likely lose the unlimited protection under Federal bankruptcy (being replaced with the \$1 million+ exemption).

As always, before making any changes to your retirement account, you should speak with your attorney or financial adviser, as each person's individual situation varies.