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### **ARE YOUR RETIREMENT ASSETS PROTECTED FROM CREDITORS?**

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In today's litigious society, many high-income individuals assume that at least their retirement accounts are safe from creditor claims. While that's generally true, there are exceptions you should be aware of when planning what types of retirement vehicles to use. There's also a bill in Congress that may further open the door for creditor access to retirement accounts.

The strongest protection of retirement assets from creditors is from employee-based "qualified" retirement plans at work such as 401(k)s and profit-sharing plans. The Employee Retirement Income Security Act of 1974 (ERISA) protects these assets from creditors, legal judgments and even bankruptcy claims, a protection upheld by the U.S. Supreme Court. This legal protection of retirement assets is afforded on the premise that retirees whose assets have been stripped by creditors would become burdens to the government.

However, protection of ERISA assets is not absolute. Some types of ERISA plans are not fully protected, such as 403(b) plans in which only the employer's contributions are exempt. Pension plans that benefit only the business owner (including the owner's spouse) and do not benefit employees also are not protected under federal law.

The Internal Revenue Service (and other federal agencies can attach retirement assets from ERISA plans and individual retirement accounts (IRAs) to satisfy claims for back taxes, though it doesn't allow states and local governments to do so. Assets may be claimed for court-ordered child support and as part of a divorce settlement.

Congress may further expand these exceptions with a provision in the controversial bankruptcy bill being considered. The provision would allow creditors in bankruptcy judgments to go after retirement assets if the consumer waives protection when signing up for a credit

card or taking out a loan.

Whether creditors can claim retirement funds once they are distributed from the account remains murky. Lower court decisions have been split on the issue. However, Social Security benefits are not subject to claims with the exception of child support and alimony, though it helps if you don't mix the benefit payments with other financial assets.

Once we leave the ERISA umbrella, protection of retirement assets becomes more tenuous. In the case of nonqualified deferred compensation plans, for example, the employer's creditors may attach funds set aside by the employer for the employee's benefit, but the employee's creditors can't attach the funds until they become payable to the employee. State government pension plans and church-related plans also are not covered under ERISA.

Much of the protection of non-ERISA retirement accounts rests primarily on state laws, which vary significantly. Take annuities, which are popular among doctors, business owners and others who make popular targets for litigation. Some states fully protect the assets in annuities from creditor claims, while other states offer no protection at all. Still others offer limited protection or will protect only a portion of the assets.

ERISA does not cover individual retirement accounts. However, twenty-six states exempt all IRA assets from creditor claims and 18 states and the District of Columbia leave it up to the courts to determine what is a reasonable amount to exempt in order to support the retiree and dependents. For example, a court might award creditors \$2 million out of a \$3 million IRA, leaving only \$1 million to the IRA owner. Eight states offer no protection at all for IRAs.



Retirement accounts used by the self-employed such as SEPs (simplified employee pension) and Keogh plans are not protected federally. Again, protection depends on state law.

If protection of assets is a concern for you, it obviously becomes important what types of retirement plans you choose and how you set them up. For example, a business owner's pension plan might be protected as long as at least one employee is covered by the plan. Rolling assets out of an ERISA-protected 401(k) plan into an IRA might not be a good idea if state law doesn't afford adequate protection. Moving to a different state may also weaken or strengthen the protection of your retirement assets depending on the state.

The important step is to review the vulnerability of your

retirement accounts now with a professional advisor, before any possibilities of lawsuits or bankruptcy arise. Attempts to shift funds in order to protect them from known claims may be considered fraudulent transfers and the loss of any protection regardless of the type of account.

This column is produced by the San Diego Chapter of the Financial Planning Association. We can be a continued resource for your personal finance coverage. If you use this column in whole or part, please credit the chapter or one of our Certified Financial Planner members.

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