Asset Protection Planning for Qualified Retirement Plans

Includes discussion of non-qualified plans, IRAs, 403(b), 457, state pensions, Education IRAs (Coverdell ESAs), 529 Plans, Health/Medical Savings Accounts (MSA/HSAs), Qualified and Non-Qualified Annuities, Long-Term Care Insurance, Disability Insurance and Group, Individual and Business-Owned Life Insurance and Irrevocable Trusts and UTMA Accounts inheriting such accounts

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Author:

Edwin P. Morrow III, J.D., LL.M. (tax), MBA, CFP®, RFC®
Board Certified Specialist in Estate Planning, Probate & Trust
Through the Ohio State Bar Association

Director, Wealth Transfer Planning and Tax Strategies
Key Private Bank Family Wealth Advisory Services

(937) 285-5343
Edwin_P_Morrow@keybank.com
edwinmorrow@msn.com

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I. The Importance of Asset Protection as Part of Financial and Estate Planning

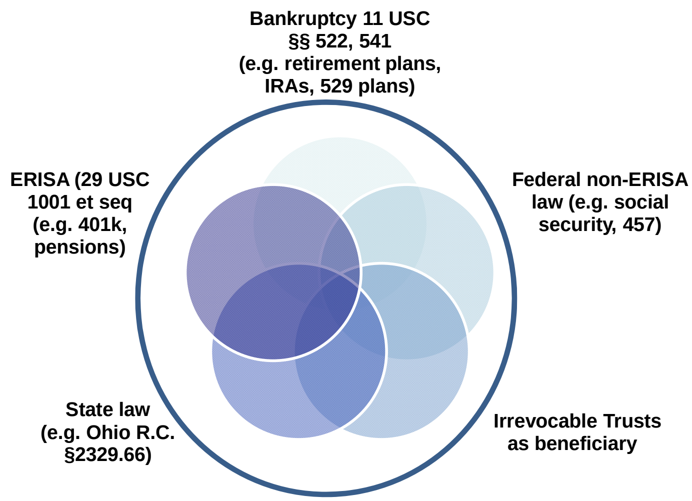
Asset Protection has become a ubiquitous buzz-word in the legal and financial community. It often means different things to different people. It may encompass anything from buying umbrella liability insurance to funding offshore trusts. What is most likely to wipe out a client's entire net worth? Identity theft? A Ponzi scheme or investment scam, investment losses, an economic recession or depression, a lawsuit, divorce or long-term health care expenses? "Asset protection" may be construed to address all of these scenarios, but this outline will cover risk from creditors (including ex-spouses) as opposed to risk from theft, fraud, bad investments, disaster, medical bills or excessive spending.

Prudent business practice and limited liability entity use (LP, LLP, LLC, Corporation, etc) is the first (and cheapest) line of defense against many such risks. Similarly, good liability insurance and umbrella insurance coverage is paramount. Does the client know the gaps when they don't have an umbrella insurance policy for each residence – covering liability from pets, the boat or the ATV? Even with good insurance coverage, there is a palpable fear among many of frivolous lawsuits and rogue juries. Damages might exceed coverage limits. Moreover, insurance policies often have large gaps in coverage (e.g. intentional torts, "gross" negligence, asbestos or mold claims, sexual harassment, punitive damages, terrorism, to name a few). As many doctors in Ohio know all too well, malpractice insurance companies can fail, too.

Just as we advise clients regarding legal ways to legitimately avoid income and estate taxes or qualify for benefits, so we advise how to protect family assets from creditors. Ask your clients, "What level of asset protection do you want for yourself? For the inheritance you leave to your family?" Do any clients answer "none" or "low"? Trusts that are mere beneficiary designation form or POD/TOD substitutes are going out of style in favor of "beneficiary-controlled trusts", "inheritance trusts" and the like.

This outline will discuss the sometimes substantial difference in legal treatment and protection for various investment vehicles and retirement accounts, with some further discussion of important issues to consider when trusts receive such assets. Beware of general observations like: "retirement plans, insurance, IRAs and annuities are protected assets" – that may often be true, but Murphy's law will make your client the exception to the general rules. The better part of this outline is pointing out those exceptions.

Overlapping Asset Protection



The World of Tax Qualified Account Protection - Mind the Gap

II. State Non-Bankruptcy Protections

Each state has some level of protection against garnishment/seizure for certain categories of assets. See the attached 50 state plus D.C. chart with links to each state's main statute. However, states often have multiple statutes that might protect assets, so do not assume the statute for your state referenced in the chart is the ***only*** one. For instance, there are several Ohio statutes that provide creditor protection for certain financial assets. The most important by far is Ohio Revised Code § 2329.66, which outlines which assets are exempt from judicial foreclosure, garnishment, sale, execution or attachment. This and two other insurance/annuity statutes are copied into Appendix A, and many other miscellaneous statutes are copied and/or referenced herein. States will often have a statute for state pension plans, disability plans, worker's compensation or 529 plans – and many states may soon include protection for "ABLE" accounts, with passage of new law.[1]

Ohio law greatly increased its protections for IRAs in 1998, and many other states have amended their laws in this area in the last two decades, so be careful not to rely on old articles or analysis. Previously, Ohio law only protected IRAs to the extent "reasonably necessary for support", a standard which has been very conservatively construed by the courts.[2] Under this old IRA standard (and still the current standard for certain other retirement accounts), consideration is given to spouses and dependents of the debtor, but not children who are not dependents.[3] There are a few states (e.g. California, Maine, etc) that still have similar limitations even for IRAs, which are noted on the chart.

Aside from Ohio law, federal law may also apply to certain accounts, even when the bankruptcy court is not involved. The Employee Retirement Income Security Act of 1974 ("ERISA") preempts state law if the question "relates to" employer-sponsored plans subject to the law.[4] Courts have broadly construed what "relates to" means. This will be discussed in the next section.

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[1] ABLE accounts are tax advantaged savings accounts for individuals with disabilities created through passage of The Achieving a Better Life Experience (ABLE) Act, signed by President Obama December 14, 2014. They are similar to 529 plans, indeed, the Act adds IRC §529A. Like college savings 529 plans, they rely on state passage of state law to enable accounts for residents. This website tracks the status of bills and passage in the various states: http://www.ndss.org/Advocacy/Legislative-Agenda/Creating-an-Economic-Future-for-Individuals-with-Down-Syndrome/ABLE-State-Bills/.

[2] *In Re Herzog*, 118 BR 529 (Bankr. ND Ohio 1990). There are many cases from various states where younger debtors who could save more later for retirement were totally denied any exemption under this standard.

[3] *In re Guikema*, 329 BR 607 (Bankr. S.D. Ohio 2005)

[4] ERISA in general is at 29 U.S.C. § 1001 et seq., preemption section at 29 U.S.C. § 1144(a), anti-alienation provision at 29 U.S.C. §1056(d)(1)

This section assumes that an owner/debtor is NOT in bankruptcy and the plan is NOT subject to ERISA. In this case, a debtor must rely on state law or federal non-ERISA law.

a. Qualified Plans Subject to, but not protected by, ERISA

Not all employer-sponsored qualified retirement plans are protected by ERISA from creditors. In addition to the self-employed exceptions noted in the ERISA section, the most common employer-sponsored plans not receiving the ERISA-based protection are **S**implified **E**mployee **P**ension individual retirement accounts (SEP-IRAs)[5] and **S**avings **I**ncentive **M**atch for Em**pl**oye**es** individual retirement accounts (SIMPLE IRAs)[6].

Most traditional and Roth IRAs are completely outside of ERISA purview, being neither governed by ERISA, nor receiving any ERISA-based creditor protection.[7] One exception to this may be the so-called "deemed IRA".[8] Since 2003, employers have been able (but are not required) to offer a "deemed IRA" as part of their qualified plan, which in most respects acts like an ordinary IRA. I could find no cases with deemed IRAs, and have only run across one plan providing them.[9] ERISA treats these similar to SEP-IRAs.[10]

SEP and SIMPLE IRAs (and "deemed IRAs") are in an ERISA "nether world". They are covered by some portions of ERISA because they are employer-sponsored, but do not receive the same protection because they do not have the same anti-alienation protection.[11] One might expect that these accounts would then be covered by state statute, but, at least in the Sixth Circuit, they may not be.[12]

In *Lampkins*, the plaintiff, a secretary in a Michigan law firm, won judgments against her employer for accrued benefits in her employer's profit sharing and pension plans. Her employer, a lawyer, refused to pay the judgments claiming he had no assets or income despite his continued law practice. The plaintiff attempted to garnish the lawyer's SEP-IRA. After the district court granted summary judgment to the plaintiff, the circuit court affirmed. In affirming, the Sixth Circuit held that the

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[5] For basics, see https://www.irs.gov/Retirement-Plans/Plan-Sponsor/Simplified-Employee-Pension-Plan-(SEP)
[6] For basics, see https://www.irs.gov/Retirement-Plans/Choosing-a-Retirement-Plan-SIMPLE-IRA-Plan
[7] 26 CFR §2510.3-2, there have been numerous cases trying to apply *Lampkins* ERISA preemption to traditional IRAs without success – for good reason, since ERISA does not govern traditional IRAs or Roth IRAs.
[8] IRC §408(q). 29 CFR 2510.3-2(d). See also Treas. Reg. 1.408(q)-1 for a good general description of the deemed IRA.
[9] For New York City employees, who apparently have over $100 million in deemed IRAs though their plan: https://www.dol.gov/ebsa/pdf/ACgestely082114.pdf
[10] 29 U.S.C. (ERISA title) §1003(c)
[11] 29 U.S.C. § 1056(d)(1) contains anti-alienation provision
[12] See, *Lampkins v. Golden*, 28 Fed.Appx. 409 (6th Cir. 2002) (unpublished, but often cited).

SEP-IRA was not exempt under federal law, specifically ERISA's anti-alienation provision, because IRAs are specifically excluded from protection under this provision. Thus, ERISA did not prevent the SEP from being garnished. This part of the decision is not controversial. *Furthermore*, however, the Sixth Circuit held that a Michigan state statute that purported to exempt from garnishment all § 408 individual retirement plans was *preempted* by the language of ERISA's preemption clause, which supersedes state laws relating to employee benefit plans. Consequently, the plaintiff was able to garnish the SEP to satisfy the judgments. Ohio courts have followed this.[13] Thus, ERISA, a law whose principal purpose was to protect employee retirement benefits and enacted to give greater employee rights than under various state laws, was used to accomplish the *exact opposite*.

A recent case outside the 6th Circuit has failed to follow *Lampkins'* rationale, citing older precedent in the 5th, 8th and 11th Circuits.[14] The argument was essentially that ERISA does not preempt federal law ("[n]othing in this subchapter shall be construed to alter, amend, modify, invalidate, impair, or supersede any law of the United States...")[15], and that because bankruptcy law uses state law exemptions, ERISA should not preempt state law exemptions. This author's opinion is that the *Wasteney* court argument is sound and persuasive ***when in bankruptcy***, but not necessarily when a debtor is in a state proceeding where the bankruptcy code is irrelevant. Note that the *Lampkins* case was not in bankruptcy, so it may still be persuasive in other circuits outside of bankruptcy.

Lampkins is brushed off by some commentators as an aberrant case without much authority because it was "unpublished". This did not stop the *Diguilio* court from citing it, nor will this prevent creditors from attempting to use the same argument in other Circuits, because there is no better published law specifically on point:

> "Citation of unpublished decisions in briefs and oral arguments in this Court and the district courts within this Circuit is disfavored, except for the purpose of establishing res judicata, estoppel, or the law of the case. If a party believes, nevertheless, that an unpublished disposition has precedential value in relation to a material issue in a case, and that there is no published opinion that would serve as well, such decision may be cited if that party serves a copy thereof on all other parties in the case and on this Court….

In short, while I personally believe the Lampkins and Diguilio courts were wrong in their analysis, and ERISA should not preempt state law protecting SEP, SIMPLE or deemed IRAs, I would not hesitate to

[13] *In re DiGuilio*, 303 BR 144 (Bankr. ND Ohio 2003), in which the debtor's $30,000 SEP-IRA held **not** exempt despite Ohio R.C. §2329.66 exemption, under a *Lampkins* type analysis
[14] *In re Wasteney*, 2004 Bankr. LEXIS 2597 (S.D. Iowa 2004)
[15] 29 U.S.C. §1144(d)

use this rationale if I represented a creditor. Prudence dictates that someone concerned about asset protection, particularly if they for various reasons do not want to rely on bankruptcy, should consider rolling such accounts into either fully ERISA-protected accounts, if possible, or accounts that would not have this quasi-ERISA netherworld taint, yet be better protected under state law (in most states, this would be IRAs). As will be discussed later, bankruptcy changes the comparison and analysis.

b. IRAs

Most states have significant creditor protection for IRAs, usually without any dollar limit.[16] Some have unlimited exemptions, but many only protect amounts reasonably necessary for support of debtor, spouse and dependents.[17] As mentioned above, Ohio amended its statute effective March 22, 1999 to greatly increase IRA protection. It *seemingly* protects §408(k) (SEP-IRA) and §408(p) SIMPLE IRAs as well as §408A Roth IRAs. Why did Ohio give unlimited protection to IRAs and not other similar assets? Note that a rollover from a §403(b) or other plan to an IRA is included.

Also beware that many state statutes require RESIDENCY or DOMICILE to protect such assets.[18] Be careful if your client is in the military, for example, and may claim another state as his or her domicile, or is not a current Ohio resident – that state may not grant the same protections and Ohio's protections may not apply.[19] Some states, such as Idaho, will honor the exemptions of the state of the residence of the debtor, but this may not always be the case.[20] See the additional discussion in Section XVIII on Conflicts of Laws.

"Contributions of the Person" and other Snags

Ohio's statute is not so simple as to simply protect IRAs. You will notice reasonable prohibitions on "overfunding" the plan beyond IRS limits, lack of protection for fraudulent transfers, and references to alimony/child support statutes. More curiously, and perhaps nefariously, there is only protection for "contributions of the person". If a working spouse puts funds into a non-working spouse's IRA, as the IRS specifically allows and good tax and financial planning might dictate, is this asset protection requirement still met? Must it be traced? What about SEP-IRAs which are funded with contributions from the *employer*, rather than employee/IRA owner, not to mention employer contributions/matching funds in qualified plans rolled over to IRAs? Although (c)(iii) protects rollovers, is the entire IRA now a

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[16] Although, Maine, e.g., only protects $15,000 absolutely, or more if needed for "support". ME Code §4422(13)(F). Nevada has a $500,000 cap: Nev. Rev. Stat. §21.090(q)
[17] E.g., California Code of Civil Procedure 703.140 and 704.115, state exemption chart in Appendix E
[18] E.g. Ohio R.C. §2329.66, Washington D.C. Code §15-501
[19] As was the case for Louisiana resident in Ohio court in *Pallante v. International Venture Invest., Ltd*, 622 F. Supp. 667 (N.D. Ohio 1985), which denied Ohio exemptions because he was not resident and denied Louisiana exemptions because proceedings were not in Louisiana. See Section XVIII of this outline for more disturbing cases on this theme.
[20] Idaho Code § 11-602: "Protection of property of residents and nonresidents: (1) Residents of this state are entitled to the exemptions provided by this act. Nonresidents are entitled to the exemptions provided by the law of the jurisdiction of their residence. (2) The term "resident" means an individual who intends to maintain his home in this state."

"contribution of the person" simply because the person directed the trustee to trustee transfer, or only the portion attributable to the employee's contributions? Personally, I think the statute should be read to protect the entire amount, but if I were a creditor's attorney I'd say there is a colorable argument otherwise.

Another "snag" to IRA protection is that if an IRA owner engages in self-dealing or other "prohibited transactions", it can lose protection under state law as well. This is more likely to happen when someone uses a self-directed IRA with "outside-the-box" investments, or uses cross-collateralization. These concepts are more fully discussed in *Section V* of this outline, *Breaking the Plan – How Debtors can Lose Protection*.

Distinguishing SEP and SIMPLE IRAs

The *Lampkins v. Golden* case cited above creates further jeopardy for SEP and SIMPLE IRAs beyond simply limiting the protection to "support". If ERISA preempts these IRAs, yet offers no protection, it essentially eviscerates the protection altogether (forcing a debtor into bankruptcy).[21] The *Lampkins* rationale has been followed in subsequent cases that distinguish SEP and SIMPLE IRAs as employer-sponsored, in holding that ERISA does not preempt other IRAs.[22] However, since the *Lampkins* case is unreported, one might still try to fight the issue and at least try to protect what is needed for support.

However, even if one were successful in getting a court to ignore the ERISA preemption argument, precedent previous to *Lampkins* held that SEP-IRAs are more analogous to employer sponsored pension plans than IRAs. Accordingly, even if there were no preemption, SEP-IRAs would not get the unlimited protection under paragraph (c) of Ohio's statute, but come under the less advantageous paragraph (b) that only allows protection for "support".[23] SIMPLE IRAs may be jeopardized as well under this same reasoning, although there is an important distinguishing factor: unlike SEP-IRAs, SIMPLE IRAs have no contributions from the employer – all contributions come from the employee.

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[21] Not just in Ohio: the U.S. District Court in Virginia recently held a doctor's SEP was subject to forfeiture because ERISA's anti-alienation provisions do not apply to IRAs, including SEPs. *U.S. v. Norton*, 2002 WL 31039138, No. 2:99CV10078 (W.D.Va. 2002).

[22] *Lampkins*, supra at footnote 6. *In re Christine P. Mitchell*, 2002 Bankr. Lexis 1217 (Bankr. N.D. Ohio 2002), *In re Robert and Lynn Fixel*, 286 B.R. 638 (Bankr. N.D. Ohio 2002) (all distinguishing *Lampkins* and holding ERISA does not preempt or apply to ordinary IRAs), *In re Buzza*, 287 B.R. 417 (Bankr. S.D. Ohio 2002).

[23] *In re Schreiner*, 255 BR 545 (Bankr. S.D. Ohio 2000), where entire $17,564.83 SEP-IRA was lost to creditors.

Distinguishing IRA Annuities

One might have an IRA that is an Individual Retirement *Annuity* under IRC §408(b). This should be protected in the same manner as any other IRA under Ohio law, since they are specifically mentioned. However, do NOT assume this to be the case in other states that seem to protect IRAs. For instance, one fairly recent case held under another state law that IRA annuities did not get the same protection.[24]

Distinguishing Roth IRAs

Some states have never updated their statutes to include Roth IRAs under IRC §408A.[25] Ohio specifically includes "Roth IRAs" in its protection. Or does it? Arguably, the statute requires that the IRA "provides benefits by reason of illness, disability, death, or age"- unlike traditional IRAs, Roth IRAs have no required beginning date or required minimum distribution during the IRA owner's lifetime, so *how does it provide any benefits by reason of death or age* unless it happens to own an annuity with a death benefit? While reason should prevail to provide protection, I would still bring up this issue were I representing a creditor.

[24] *In re Kemmerer (Huisinga v. Kemmerer)*, 251 B.R. 50 (BAP 8th Cir. 2000), though a federal district court declined to follow the 8th circuit bankruptcy appellate court in *In re Pepmeyer*, 273 B.R. 782 (N.D. Iowa, 2002)

[25] See state chart in Appendix E

c. §403(b) and §457 plans

IRC § 403(b) plans (which can be either mutual fund type accounts or annuities) can be ERISA or non-ERISA. For instance, a governmental plan under IRC §457 or §403(b) is specifically NOT governed by ERISA, but a 403(b) plan for employees of charities might be ERISA. Generally speaking, 403(b) plans with only employee contributions do not fall under ERISA reporting and disclosure regulations and require no plan administration such as discrimination testing and Series 5500 tax filings. If the plan has both employee and employer contributions, it becomes subject to ERISA regulations and requires plan administration similar to a 401(k) plan with a similar cost structure.

Note, however, that Ohio exempts "property that is specifically exempted from execution, attachment, garnishment, or sale by federal statutes other than the [Bankruptcy Act]". Thus, since Section 457 plans should contain an anti-alienation provision, they may yet be protected. Section §403(b) plans do not have such a provision.

However, because not all states will have a similar provision to Ohio, residents of many states may wish to move §457 plans to IRAs, or at least examine state law. Many states that have broad protection for IRAs simply omit §457 plans – many states mention such accounts by code section – 408, 408A, 403, etc, but do not mention 457 plans. Outside of bankruptcy, the protection for such plans will rest on applicable state law – not ERISA. So, to illustrate two cases in this regard, Florida's broad statute did not protect 457 plans, yet Detroit Michigan 457 plan was protected.[26]

Remember that at least in most cases, when in bankruptcy, such plans will have equal protection to other retirement plans, as will be later discussed.

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[26] Contrast In re Wilcox, 233 F.3d 899 (6th Cir. 2000)(Detroit City employee plan protected), with In re Pedersen, 155 BR 750 (Bankr. S.D. Iowa 1993) (457 plan not excluded), In re Madia, 294 BR 177 (Bankr. M.D. Fla 2003)(not excluded)

d. Life Insurance (and, distinguishing group life insurance)

Life Insurance, as protected by R.C. § 3911.10 (see appendix A), has strong protections under Ohio law. Although courts have been harsh with annuity contracts that it sees as primarily "investments" (discussed below), they still protect insurance policies, even when they have large cash surrender value and withdrawal rights.[27] Note that, if there is no beneficiary named, or a beneficiary other than a spouse, children or dependent, that protection is unavailable.[28] This penalizes unmarried or gay and lesbian couples (query – could they be considered a "dependent"?). A trust for the above (such as a revocable living trust) also receives protection, but query how to exactly determine that if there are "spray" provisions or other confusing factors.

Other states such as Hawaii, Illinois and Tennessee have statutes similar to Ohio. Others protect regardless of who the insured is – Florida, Texas, Kansas, Michigan. Others protect specified amounts – Alaska, $10,000, Connecticut, $4,000, Arizona, $25,000).[29]

This asset protection feature contained in many state statutes was recently tested in an Oklahoma case with a statute similar to Ohio's where a creditor of a deceased spouse sought to impose a constructive trust on proceeds of insurance on the decedent's life. The court held the proceeds were exempt from the decedent's estate's creditors.[30]

Furthermore, Ohio's statute and case law re insurance is very debtor-friendly – *even when there is clearly a fraudulent transfer funding the insurance policies*. Consider the last sentence of Ohio R.C. §3911.10:

> Subject to the statute of limitations, the amount of any premium upon such contracts, endowments, or annuities, paid in fraud of creditors, with interest thereon, shall inure to their benefit from the proceeds of the contracts, but the company issuing any such contract is discharged of all liability thereon by the payment of its proceeds in accordance with its terms, unless, before such payment, written notice is given to it by a creditor, specifying the amount of the claim and the premiums which the creditor alleges have been fraudulently paid.

So, even when a debtor knows he has creditors and purposefully adds cash to his insurance policies for his family, the only effect is to put a lien on the policy until death (or cashing in the policy). And even that is subject to the statute of limitations. It is hard to believe in such a large debtor-friendly

[27] *Matter of Bess*, 40 BR 509 (Bankr. S.D. Ohio 1984), aff'd 47 BR 414
[28] Not protected: *In re Peacock*, 292 BR 593 (Bankr. S.D. Ohio 2002), where Mother and Aunt who were not dependents were named beneficiaries.
[29] Bove, *Protecting Assets Through Insurance and Annuities*, Estate Planning, Vol. 31, No. 6 (2004)
[30] *Carts and Parts Inc. v. Rosales*, 225 P.3d 1 (Okla. Civ. App. 2009).

loophole, but that is precisely the conclusion that a recent First District appeals case reached.[31] In *Huntington National Bank v. Winter*, a debtor owed various banks hundreds of thousands of dollars. He dumped $144,000 into his wife's trust, then into various life insurance policies, transfers which the court deemed fraudulent. Still, the court held the banks could not attach the policy cash value. Was this the result of brilliant lawyering? No - the debtor appeared *pro se* and the two banks were represented by two highly regarded law firms.

While the *Winter* case may be right on Ohio law and enable some rather aggressive planning with life insurance, I caution that this was NOT a bankruptcy case. If such a case went into bankruptcy court (by the debtor filing, or creditors instigating – query whether creditors subsequently tried that), such planning may lead to a different result – via denial of discharge or other negative consequences.

Note that tax liens on an insured debtor/decedent apply to cash values of insurance owned by debtor/decedent, but not to death benefits.[32] For example, Joe Debtor has a $1Million face amount insurance policy with $70,000 cash value. He dies with tax liens. The IRS may foreclose on $70,000 (the cash value accessible by decedent prior to death), but not the remaining $930,000 payable to family. While there is no case to this effect, query whether a tax lien may apply to a greater value if Joe Debtor had a lengthy terminal illness that caused the value of the insurance policy to skyrocket prior to death? For example, what if Joe Debtor could have sold his policy to a viatical company for $600,000 before his death? The IRS could argue that the lien in such a case extended to $600,000, a rather harsh result to the family.

Warning: Beware Cross-Ownership

Note how cross-ownership of policies, especially large cash value polices, are covered (or not covered) under the statute. Note the statute's language in Appendix A: "**free from all claims of the creditors of such insured person or annuitant**", ***not*** "free from all claims of the creditors of such **OWNER** or insured person or annuitant." Insurance policies and annuities may have an owner different from the insured or annuitant.

Example: Mary and John both own $2Million face amount policies insuring ***the other*** with $300,000 cash value in each policy. Mary, an OB/GYN, is sued. Her policy on John is "free from claims of creditors of insured" (John), but are they free from her creditor's claims? Because of the way the

[31] *Huntington National Bank v. Winter*, 2011-Ohio-1751
[32] *US v. Bess*, 357 US 51 (1958)

insurance policies are owned, creditors now have an argument to reach the $300,000 cash value in Mary's policy insuring John. While you might be able to convince a court that the statute should be interpreted to cover such a situation, there is no reported case on this issue, and wiser proactive planning would ensure the issue does not arise by avoiding cross-ownership structures altogether.

IMPLICATIONS FOR BUY-SELL AGREEMENTS:

Note that this feature of insurance protection in Ohio creates an additional argument for cross-purchase or trusteed cross-purchase agreements as opposed to corporate owned life insurance (even aside from the estate tax/basis implications).

> <u>Example</u>: Billy Bob and his brother Mortimer each own 50% of the family business. They have grown it into a $10MM business. Their attorney drafted an "entity" buy-sell agreement wherein the business purchased and owns $5M whole life policies on each of them, naming the corporation as the beneficiary. One night to celebrate a new account, Billy Bob and Mortimer have a few tequila and red bulls. On the way home, Billy Bob wrecks into Britney Spears' tour bus, sending both Britney and Billy Bob off to a better place.
>
> *Effect*: Both the $5M death benefit and the cash value in Mortimer's $5M policy are at risk. If this were done with cross-owned policies in separate ILITs, the insurance would be protected from creditors (and there may be other income tax benefits to survivors, such as a step up in basis on company stock bought with the insurance).

Warning #2: Don't Give Up the ILIT or other Trust as Insurance Beneficiary!

As noted above, R.C. §3911.10 protects proceeds and avails of insurance from creditors of the *insured or owner*, but NOT of the *beneficiaries*. This is unlike the statute for group life insurance noted in R.C. § 3917.05 and 2929.66(A)(6)(c) (in Appendix A). This brings up the issue of whether a court will protect insurance proceeds from the creditors of the *beneficiary* when the beneficiary is neither owner nor insured.

In one recent SW Ohio case, a debtor inherited $35,000 in life insurance proceeds from their spouse who had recently deceased. The court held that, while §3911.10 and §2329.66(A)(6) protected insurance from the decedent/insured's creditors, that the two statutes above do not protect proceeds from a beneficiaries' creditors.[33] The court did entertain an argument that §3911.14 applied to protect the proceeds (this statute is discussed further below in the section on annuities), but unfortunately for the debtor, no evidence was put on the record that the insurance company's contract included any spendthrift provision (as discussed below, that statute merely permits an insurance company to include the protection). Not researching this may have cost the debtor dearly.

Group Life Insurance may avail a beneficiary of a different, broader statute, with some important differences to 3911.10 in **bold** below:

3917.05 Exemption of policy proceeds from attachment.

> No policy of group insurance, nor the proceeds thereof, *when paid to any employee* thereunder, is liable to attachment, garnishment, or other process, or to be seized, taken, appropriated, or applied by any legal or equitable process or operation of law, to pay any liability of such employee, **his beneficiary**, or any other person who may have a right thereunder, **either before or after payment**.

Courts have correctly interpreted this to provide greater protection for beneficiaries, and thus, for group life insurance, the protection is much broader. For example, one recent Ohio case found that $160,000 of group insurance inherited by a spouse from her decedent husband was protected under this statute and therefore protected in bankruptcy.[34] A creditor might argue that the italicized language above "paid to any employee" precludes protection for non-employee beneficiaries, but this argument has been unsuccessful. The bold language above trumps and beneficiaries need not be *employees* to be protected.[35]

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[33] *In Re Schramm (Menninger v. Schramm)*, 431 B.R. 397; 2010 Bankr. LEXIS 1863 (Bankr. S.D.Oh. 2010)
[34] *In re McCall*, Case 05-75245 (Bankr.N.D.Oh. 2007) https://www.ohnb.uscourts.gov/judges/Judge_Speer/op_20071019_In%20re%20Eugene%20and%20Judy%20Anne%20McCall_rs_05-75245.pdf, citing two previous Ohio bankruptcy cases holding the same.
[35] *In re Lewis*, 327 B.R. 645, 2005 Bankr. Lexis 1372 (Bankr. S.D.OH 2005)

e. Long-Term Care Insurance, Health/Accident/Disability

In Appendix A you will find Ohio R.C. §2329.66(A)(6)(e) and §3923.19 which provides protection to proceeds from "all policies of sickness and accident insurance". Note there is specific tracing language to protect proceeds "either before or after payment of the benefits". However, the protection is limited to "the extent that the benefits are reasonably necessary for the support of the debtor and any dependents of the debtor." Dismemberment payment protection is not subject to that limitation.

Query whether HSAs, MSAs, FSAs could come under this statutory exception because they are ultimately tied in and arguably part of a policy of sickness and accident insurance. The only case I could find on these types of accounts, discussed below in paragraph i, denied protection, but the debtors in that case tried to rely on a different statute and not the statute discussed above.

f. Non-Qualified Annuities

Despite what you might think reading the two statutes in the Appendix, courts have not been kind to annuity holders. In fact, there is not a single reported Ohio case under that statute that protects annuities at all, at least in the manner that they are ordinarily owned.[36] Courts look at annuity contracts as primarily available to the owner/debtor, and not really "on the life of any person" at all similar to insurance, but more analogous to an investment.[37] Thus, deferred annuity contracts in general that allow for withdrawals, surrenders, and change of investments seem to receive **no protection whatsoever under Ohio law**.

So, why are annuities even mentioned in the statutes? Annuities that might yet receive protection under this statute are immediate annuities that have no rights to change investments, surrender for additional payment, withdraw, etc. Note – nearly 99% of annuities are not annuitized, and newer, more common lifetime benefit riders (GLWB, GLIB, etc) are NOT the same as annuitization.

What *might* qualify? Say a client takes out an immediate annuity payable for the life of himself and his wife, perhaps with a 10 year period certain naming his children. While no court has addressed this, such an annuity may pass muster. Another possibility – insurance proceeds converted to an annuity for a beneficiary upon the death of insured or annuities purchased via gift for another (with the purchaser not a beneficiary in any way). One might call such annuities a "poor man's trust".

Note that some states, such as Florida, Texas, Colorado, Illinois and Michigan are much more protective of insurance and annuities than Ohio (as well as unlimited homestead and other protections).[38] Hence Ken Lay and his wife's purchase of $4,000,000 in annuities before Enron imploded while corporate management warned their own employees against buying annuities.

The prevailing view is that annuities are contracts with debtors and creditors rather than as trusts with a trustee and beneficiaries.[39] This can have negative consequences for annuity beneficiaries. Traditional "spendthrift" protection requires a trust. Thus, an annuity that was purchased as a personal injury settlement was not exempt from the creditors of the debtor/beneficiary, because it did not

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[36] Not protected: *In re Fichter*, 45 BR 534 (Bankr. N.D. Ohio 1984), although this case would be decided differently today because it was an annuity within an IRA, which is now protected under 2329.66(A)(10)(c). Also, *In re Andrews*, 301 BR 211 (Bankr. N.D. Ohio 2003), *In re Domanski*, 362 BR 824 (Bankr. N.D. Ohio 2006), *In re Quintero*, 253 BR 832 (Bankr. N.D. Ohio 2000)

[37] Also see recent case of *In re Simpson* (9th Cir. 2009), holding that a non-qualified annuity cannot be analogized to a private retirement plan or insurance under California law.

[38] Bove, *Protecting Assets Through Insurance and Annuities*, supra note 29

[39] *In re Adams*, 302 BR 535, 540-541 (6th Cir. BAP 2003), *Wilson v. Dixon*, 73 Ohio App.3d 706 (8th Dist. 1991)

qualify under Ohio's garnishment statute and **parties cannot establish spendthrift protection by contract** (as opposed to trust).[40]

However, there is recent contrary case law from the Eight District (Cuyahoga County) that held that an annuity purchased under similar circumstances (lawsuit settlement) with a spendthrift clause should receive the exact same protection as a spendthrift trust, and denied the creditor access.[41] I believe this case was wrongly decided because 1) annuities are not legally the same as trusts and 2) self-settled trusts are not protected in Ohio anyway.

Also unique under Ohio law is the potential protection available for beneficiaries other than the insured:

> § 3911.14. Proceeds of policy
> Any life insurance company, organized or licensed to do business under the laws of this state, ***may* hold the proceeds of any life** or endowment insurance **or annuity contract** issued by it upon such terms and restrictions as to revocation by the insured and control by beneficiaries, with such exemptions from legal process and the claims of creditors of beneficiaries other than the insured, and upon such other terms and conditions, irrespective of the time and manner of payment of said proceeds, as have been *agreed to in writing by such company and the insured or beneficiary*. Such insurance company is not required to segregate funds so held but may hold them as a part of its general corporate assets. Any life or endowment insurance or annuity contract issued by a domestic, foreign, or alien company may provide that the proceeds thereof or payments thereunder shall not be subject to transfer, anticipation, commutation, or encumbrances by any beneficiary, and **shall not be subject to the claims of creditors of any beneficiary other than the insured or any legal process against any beneficiary other than the insured; if said contract so provides, the benefits accruing thereunder to such beneficiary other than the insured shall not be transferable nor subject to commutation, encumbrance, or legal process.**

There are no cases interpreting how broadly this might be interpreted, or who the "insured" should be in the context of garden variety non-qualified annuities. Could a debtor purchase a "spendthrift trust" annuity for a spouse or children? What if he simply makes his wife or child the annuitant ("insured"?) and remains a beneficiary? What do we make of all these situations where companies buy annuity interests? With the exception of the Eight District in *Seaway*, courts interpret this statute and 3911.10 to protect third parties only, rather than the most common annuities which

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[40] *Wilson*, supra

[41] *Seaway Acceptance Corp. v. Ligtvoet*, 2007-Ohio-405 (8th Dist. 2007), though the court did not address the *Wilson* or *Adams* case noted above and contained no support for its conclusion that annuities are the same as trusts. Discretionary appeal was denied in the case.

have owner withdrawal rights, and even third party beneficiaries' protections are uncertain – in the least, the above statute requires spendthrift-type language in the insurance policy/contract.

A recent third-party annuity case was just recently decided in SW Ohio that sheds some light on this trend.[42] In *Hollister*, the Dayton-area debtor inherited a $15,000 annuity from his mother and sought to protect it in bankruptcy under R.C. §3911.10 and R.C. 2329.66(A)(6) and (12). The court cited many of the cases cited above and denied protection on grounds that annuity proceeds are not like insurance and simply not covered by the above statutes. There was no discussion or argument concerning R.C. §3914.11 or the *Seaway* case.

[42] *In re Hollister*, 2011 Bankr. LEXIS 66 (Bankr. S.D. Oh. 2011)

F. Coverdell Education Savings Accounts (ESAs) aka Education IRAs

Education IRAs, now known as Coverdell Education Savings Accounts (ESAs), allow a non-deductible contribution to an IRA-like account.[43] They do not have the investment straightjacket that 529 plans have, and unlike 529 plans, can be used for K-12 as well as college educational expenses, and a broader array of expenses.[44] Contributions are limited, however, to $2,000 per year – unlike IRAs this limit has not been increased over the years.

Note that R.C. §2329.66(A)(10)(c) specifically includes education IRAs and a reference to IRC §530 that establishes them. This should presumably cover the newly named Coverdell ESAs that are under that code section. New law in Ohio clarifies the protection of both education IRAs and 529 plans by adding some important language to the statute – it later also clarifies inherited account protections:

> (10)(c) Except for any portion of the assets that were deposited for the purpose of evading the payment of any debt and except as provided in sections 3119.80, 3119.81, 3121.02, 3121.03, and 3123.06 of the Revised Code, the person's ~~right~~ rights or interests in the assets held in, or to directly or indirectly receive any payment or benefit under, any individual retirement account, individual retirement annuity, "Roth IRA," "529 plan," or education individual retirement account that provides payments or benefits by reason of illness, disability, death, retirement, or age or provides payments or benefits for purposes of education, to the extent that the assets, payments, or benefits described in division (A)(10)(c) of this section are attributable to or derived from any of the following or from any earnings, dividends, interest, appreciation, or gains on any of the following:

[43] IRC § 530(b)(1)
[44] IRC §530(b)(2) &(3)

G. 529 Plans

Ohio's main exemption statute now includes 529 plans, no matter which state's plan is chosen.[45] Not all states are so catholic in their protections. As of 2010 at least, Illinois, Michigan and California, for instance, did not provide protection for 529 plans.

h. Miscellaneous accounts or funds protected under Ohio or Federal Law

Federal (either via preemption or via Ohio R.C. 2329.66(A)(17) which references federal law)-

Foreign Service Retirement and Disability payments, 22 U.S.C. §1104;
Social security payments, 42 U.S.C. §407;
Injury or death compensation payments from war risk hazards, 42 U.S.C. §1717;
Wages of fishermen, seamen, and apprentices, 46 U.S.C. §601;
Civil service retirement benefits, 5 U.S.C. §8346 – cases split whether proceed protection *traced*
Longshoremen/Harbor Workers' Compensation Act death and disability benefits, 33 U.S.C. §916;
Railroad Retirement Act annuities and pensions, 45 U.S.C. §228(L);
Veterans benefits, 45 U.S.C. §352(E);
Special pensions paid to winners of the Congressional Medal of Honor, 38 U.S.C. §3101

Ohio various additional Revised Code Sections –

145.56 - Public employee's pension
146.13 - Volunteer firefighters' dependents
742.47 - Police officers and firefighters pension
3309.66 - Public school employees pension
5505.22 - State highway patrol employees pension

Public Benefits

2329.66 & 2743.66 - Crime victims' compensation received within 1 year of filing for bankruptcy
2329.66 & 3304.19 - Vocational rehabilitation benefits
2329.66 & 4123.67 - Workers' compensation
2329.66 & 4141.32 - Unemployment compensation
2329.66 & 5107.12 - Public assistance
2329.66 & 5115.07 - Disability assistance

[45] Ohio R.C. §2329.66

i. Health Savings Accounts (HSAs), Medical Savings Accounts (MSA), Flexible Spending Accounts (FSA), Health Reimbursement Arrangements (HRAs)

Some states, such as Idaho, have specific statutory protections for some of these accounts. Ohio does not. See discussion of possible protection of these accounts as "health insurance" discussed in paragraph d above. A recent Ohio bankruptcy case held that a debtor's $7,743.37 HSA account with KeyBank was NOT exempt under either the bankruptcy code or Ohio RC §2329.66 (A)(10)(c).[46] The debtor unsuccessfully tried the valiant argument that the account was a quasi-retirement account and should be afforded protection similar to an IRA. While there is certainly a policy rationale for according similar treatment, there is no statutory basis for calling an HSA a retirement account. R.C. 2329.66(A)(10)(c) protects retirement plans based on listed tax code sections, and the tax exemption statute for HSAs, IRC §223(d), is not mentioned there nor in bankruptcy code §522. As discussed elsewhere herein, they might have had a better chance protecting it as health insurance under a different code section, since these accounts may only be established in conjunction with health insurance.

[46] *In re Lombardy*, 2012 Bankr. LEXIS 827

j. Joint Tenancy and Tenancy by the Entireties

As a general rule, joint tenancy with right of survivorship does not have much protection against creditors. It might temporarily fend off execution against a tax lien. If the federal government has a tax lien against husband, who owns property JTWROS with wife, the government will simply proceed full force against the husband if the wife predeceases. However, if the husband predeceases (assuming the wife does not also have a lien), the wife takes the entire property and the husband's tax lien should NOT attach to her share.[47] This assumes there is no colorable claim for fraudulent transfer. For example, if the title were in joint tenancy long before the lien attached, there is unlikely to be a UFTA or other federal claim, whereas if the JTWROS were added after the lien attached it probably would be.

Ohio abolished recognition of tenancy by the entireties for real estate in 1985.[48] However, Ohioans have property in other states like Michigan that may yet honor the tenancy by the entireties, and the law of situs rather than residency should prevail for real estate owned directly, not through an entity such as an LP/LLC. The U.S. government does not have to recognize the entireties for federal tax *lien* purposes.[49] However, this lien will not necessarily hit the surviving spouse.[50] Thus, there is some limited protection even against government collections. Note that the estate tax lien, if the estate is large enough, may be in some circumstances more powerful than other tax liens – it is created automatically when any U.S. resident dies, without need for recording, and it applies to any non-probate asset like TbyE. [51]

Some states have amended their statutes to permit revocable living trusts owned by husband and wife to own property as tenancy by the entireties.[52] Other states permit Domestic Asset Protection Trusts to layer in TbyE protections.[53] For more on special situations in which the federal government is a creditor, see Part XIII of this outline.

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[47] Internal Revenue Manual § 5.17.2.5.2.2(4): "In most states, if the individual, against whose property a federal tax lien attaches, dies before any of the other joint tenants, then the lien ceases to attach to the property … [S]tate law should always be consulted to determine whether there is an exception to the general rule." See also *NPA Assocs. v. Estate of Cunning*, 2014 U.S. Dist. LEXIS 151488
[48] Ohio R.C. §5302.21
[49] *United States v. Craft*, 535 U.S. 274 (Apr. 17, 2002).
[50] IRS Notice 2003-60
[51] IRC §6324
[52] N.C. General Statutes section 39-13.7, effective January 1, 2015
[53] *David Ruben & Jonathan Gopman on the Delaware Statutory Tenancy by the Entireties Trust: Potentially Powerful Asset Protection for Couples Across the Country,* LISI Asset Protection Planning Newsletter #233 (December 19, 2013)

k. Homestead protections

Each state has a homestead protection, but some states are extremely meager and were drafted a century ago. Ohio's was very recently in this category, but the protection has been greatly expanded, with some added exceptions for state and local tax obligations and drunk driving judgments.[54] It is now $132,900 adjusted for inflation. It was adjusted just after the effective date of H.B. 479 on April 1, 2013 – and is due to next be adjusted April 1, 2016.[55]

There is a slight difference in protection the statute accords when the debt arises from health care services and suppliers. This section only delays the enforcement. So, if a debtor has a judgment related to health care, and goes to close on the sale of their home, they may find their equity reduced to pay the debt even if their equity is far under $132,900.[56]

Because "every person" is accorded this protection, married couples owning a property jointly may now protect up to $250,000 triennially adjusted for inflation – now $265,800.[57] This protects the majority of the middle class, and even many of those with higher net worth and more expensive homes who are simply more leveraged with mortgages.

Of course, "stacking" requires joint ownership. There is no such thing as "portability" of a spouse's $132,900 homestead exemption. Let's take a common example many of you have seen in your practice and what this new law permits in planning.

Mary, a relatively new physician, and her husband John, an employee of Nationwide, purchased a home a few years back for $500,000, which has since recovered from the market crash and is now worth the same amount. It now has $200,000 in equity with $300,000 remaining on the mortgage. Naturally, like many physician families, they kept or changed the title to the home solely in John's name

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[54] See Ohio R.C. §2329.66 and §2329.661 – to $125,000 adjusted for inflation triennially like bankruptcy code
[55] Ohio R.C. §2329.66(B), inflation adjusted numbers can be found online from the ohiojudges.org homepage at http://ohiojudges.org/_cms/tools/act_Download.cfm?FileID=4479&/Flanders%20LSC%20Satisfaction%20of%20Judgments%20031513.pdf
[56] Ohio R.C. §2329.66(B), inflation adjusted numbers can be found online from the ohiojudges.org homepage at http://ohiojudges.org/_cms/tools/act_Download.cfm?FileID=4479&/Flanders%20LSC%20Satisfaction%20of%20Judgments%20031513.pdf
[57] In bankruptcy parlance, the exemptions are "stackable"

for fear of tort liability.[58] Ironically, this ownership structure may now LOWER their overall asset protection. Should John face a creditor/bankruptcy situation, $67,100 of home equity is exposed to creditors. If John were to transfer a percentage of tenancy in common ownership to his wife Mary or establish JTWROS 50/50 ownership, all of the home equity would be protected, at least for the next 5-8 years as the mortgage is slowly paid off, until the equity exceeds the exemptions.

Placing a home in a revocable living trust, or joint revocable living trust, should not impair the protection.[59] Although there is no Ohio Supreme Court case on this issue, a recent bankruptcy court in Ohio held that a home placed by the debtor in her revocable trust was property of the bankruptcy estate and eligible for Ohio's homestead protection (which at the time of petition was only $20,200).[60]

However, placing such an asset in an LLC structure probably does destroy protection – even if it's a single member LLC disregarded for federal income tax purposes.[61] The Bankruptcy Appellate Panel of the Sixth Circuit recently confirmed an Ohio bankruptcy case in our area on this issue: Monae Breece filed for bankruptcy and was the sole owner of Gardenia Breeze, LLC, which had no debt and one sole asset – a residential property. The court held that the LLC interest was personal property and the debtor had no direct interest in the real property owned by that separate legal entity, therefore no homestead exemption under Ohio R.C. 2329.66(A)(1) or 11 U.S.C. § 522(b).[62] In other words, you can't pierce your own veil to ignore the corporate structure and the legal change of interest from real property to personal property.

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[58] This example assumes dower right was waived (as it may be in a prenup, or by deed), but if Mary has dower interest that too would be an "interest" eligible to be protected up to $132,900. See *In re Rudicil*, 343 B.R. 181 (Bankr. S.D. Ohio 2006), which noted longstanding rule that dower is a property interest (back when only $5000 was protected), not a lien. Strange aside – what if Mary commits adultery? Ohio R.C. §2103.05 "Adultery a bar to dower. A husband or wife who leaves the other and dwells in adultery will be barred from dower in the real property of the other, unless the offense is condoned by the injured consort."

[59] Equitable title should still be an "interest" eligible for homestead – see *Radford v. Kachman*, 27 Ohio App. 86, 5 Ohio Law Abs. 742, 160 N.E. 875 (Ct. App., Athens County 1927), recently cited in the *Breece* case below. Other state's supreme courts have extended homestead protection to settlor/beneficiaries of revocable living trusts as equitable owners – see *Fitton v. Bank of Little Rock, 365 S.W. 3d 888 (Ar 2010),* which cited cases in Kansas and Florida (which has one adverse case, but the majority are favorable to debtor/homesteaders).

[60] *In re Starr*, 485 B.R. 835 (Bankr. N.D. Ohio 2012)

[61] *In re Breece*, 2013 Bankr. LEXIS 203 (BAP 6th Cir. 2013)

[62] *Id*. The court also cited other district level cases and cases in other states similarly holding.

Look out for the physician who buys the $2500 "FLP in a box" from some out of state asset protection planning guru who advises them to put their home into an FLP. This may be dangerous planning.

Such LLC planning might be used to protect exposed equity with charging order protection, but would violate the general maxim used by many asset protection planners that LLCs be used for business interests and trusts for personal interests, for veil piercing, tax and other reasons. For instance, LLC/LP ownership would impair the $250,000/$500,000 capital gains tax exclusion,[63] potentially cause less "step up in basis" and potentially taint valuation discount planning. Thus, better solutions for exposed home equity would be to continue to keep the property leveraged or perhaps utilize separate QPRTs[64], SLATs[65] or even an Ohio Legacy Trust, which may double as a QPRT.[66]

Also note the two new exceptions in R.C. §2329.661 that actually DECREASE creditor protection for homestead in two narrowly defined areas – state/local tax liens and tort liability from accidents where the defendant/debtor had no minimal insurance coverage. These were put in place as a concession with legislators to get the increased homestead exemption. Hopefully all our clients will have the minimal auto insurance coverage mandated by law, and pay their property, local and other state taxes.

Federal tax liens, of course, already overrode state exemptions regardless of Ohio's new protections, including homestead exemptions. This rule should be kept in mind for all exemption planning.[67] The Government's right to collect for tax liabilities extends to any property "of whatever nature" the taxpayer owns.[68]

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63 IRC §121, assuming the LLC/LP is not a disregarded entity taxable to one owner for federal tax purposes

64 See *Pergament v. Yerushalmi (In re Yerushalmi)*, 487 B.R. 98 (Bankr. E.D. NY 2012) - A debtor/QPRT beneficiary fought off an attempt by bankruptcy trustee to "pierce the trust veil" under alter ego theory where his spouse was trustee and settlor/debtor allegedly "controlled" the trust

65 Surprisingly to many, IRC §2036 is not necessarily triggered if a settlor transfers a home to a trust for their spouse and continues living there rent free while the donee/beneficiary spouse is still living. *Estate of Gutchess*, 46 T.C. 554 (1966). This could also be transferred via installment sale to such a trust, which would be a grantor trust.

66 See Ohio R.C. §5816.05(J)

67 See the recent case of *U.S. v. Johnson*, 2013 WL 1403973 (S.D.Tex., April 5, 2013), citing 26 U.S.C. § 7403(a), *United States v. Rodgers*, 461 U.S. 677, 103 S.Ct. 2132, 76 L.Ed.2d 236 (1983); *Harris v. United States*, 764 F.2d 1126, 1130 (5th Cir.1985).

68 26 U.S.C. § 7403(a).

III. Federal ERISA Protections Outside Bankruptcy

(Is ERISA protection overrated and overstated?)

As mentioned above, federal ERISA law preempts state law regarding certain employer-sponsored plans. Church plans and governmental plans are excluded.[69] As discussed in the deferred compensation section, most deferred compensation and "top hat" plans are excluded. SEP and SIMPLE IRAs may be employer sponsored plans subject to ERISA, but are not afforded creditor/anti-alienation protection under ERISA.[70]

Often state law, such as Ohio R.C. § 2329.66(a)(17) will apply protections for ERISA qualified plans in state court, but if a defendant did not want to count on a state court to apply this, or trust it to apply federal law appropriately, the defendant/debtor could file action in federal court to "remove" the case from the state court to the federal court, where the court will then likely dismiss the case unless some rare exception to ERISA protection can be availed upon. ERISA protection is broad, and can even protect against criminal conduct and state taxes.[71]

It is not, however, unlimited. The IRS and family creditors have special rules. Federal criminal fines and tax levies, liens and judgments are exempted.[72] The Mandatory Victim's Restitution Act (MVRA) overrides ERISA protection for court-ordered restitution for various criminal offenses.[73] Ex-spouses and dependents of a debtor can access plans via qualified domestic relations orders (QDROs), or the government can demand withholding taxes.[74]

The amount is not limited to only what is necessary for support. A debtor could have $10 million in a qualified plan and it may be completely exempt under ERISA. The U.S. Supreme Court has generally been extremely protective of ERISA preemption and protection for qualified plans subject to ERISA.[75]

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[69] 29 U.S.C.§1003(a)

[70] ERISA §4(b) and §201

[71] An oft-cited example of protected criminal conduct is the union embezzler in *Guidry v. Sheetmetal Pension Fund*, 493 US 365 (1990). There are multiple cases that agree ERISA protects from state tax levies, e.g. *General Motors Corp. v. Buhau*, 623 F.2d 455 (6th Cir. 1980).

[72] Treas. Reg. § 1.401(a)-13(b), See also *McIntyre v. United States*, Case No. 98-171192 (9th Cir. 2000), *In re Vermande*, 94 TNT 190-9 (Bankr. N.D. Ind. 1994). But even the IRS has acknowledged defeat if a worker is not yet entitled to benefits: see FSA 199930039, CCA 200102021 (no garnishment), *U.S. v. Snyder*, 343 F.3d 1171 (9th Cir. 2003)(too early to apply lien).

[73] 18 U.S.C. § 3663A-3664, *U.S. v. Miller*, 588 F.Supp.2d 789 (W.D. MI 2007) cites multiple cases to that effect

[74] IRC § 401(a)(13), 29 U.S.C. § 1056(d)(2)

[75] See, *Patterson v. Shumate*, 504 U.S. 753 (1992), *Guidry*, supra footnote 3

Unlike state law protections for self-settled spendthrift trusts, it does not matter if a debtor started or controlled the ERISA plan as owner or part-owner of the business.[76]

HOWEVER, there are exceptions when there are no employees other than the business owner and his or her spouse. For ERISA protection to apply, there must be at least one employee other than an owner and/or spouse.[77] Thus, a plan may start as an ERISA governed plan when there are one or more employee-participants, but when the business winds down or there are otherwise no other employees in the plan, the owner/spouse may lose ERISA protection. Those who are at one time "participants" can later be excluded from this definition in several ways, notably, if they become ineligible to receive any benefit or the plan or the plan trustee utilizes an insurance/annuity company to fully guarantee its entire obligation to the employee.[78]

An old Keogh or "HR 10" plan for a sole proprietorship or partnership that has no other employees will **not** be covered under ERISA. Similarly, sole shareholders of corporations who, along with spouses, are the **only** participants in the plan, are also **excluded** from ERISA protection. For owners of partnerships, including LPs and probably LLCs taxed as partnerships, note that *partners* are also excluded from this definition:[79]

> (c) Employees. For purposes of this section: (1) An individual and his or her spouse shall not be deemed to be employees with respect to a trade or business, whether incorporated or unincorporated, which is wholly owned by the individual or by the individual and his or her spouse, and (2) A partner in a partnership and his or her spouse shall not be deemed to be employees with respect to the partnership.

This is measured from the time creditor asserts the claim.[80] However, an employer can always add another legitimate employee, even a relative, and then all participants, including the

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[76] See, e.g., *Raymond B. Yates, M.D., P.C. Profit Sharing Plan v. Hendon*, 124 S. Ct. 1330, 541 US 1 (2004).

[77] *Yates*, supra footnote 8

[78] 29 CFR § 2510.3-3(d)(2)

[79] 29 CFR § 2510.3-3(c), see also DOL Advisory Opinion 1999-04A – multiple cases have followed the Regulation: *Lowenschuss v. Selnick*, 170 F.3d 923 (9th Cir. 1999), *In re Watson*, 161 F.3d 593 (9th Cir. 1998), *In re Branch*, 1994 U.S. App Lexis 2870 (7th Cir. 1994), *In re Witwer*, 148 B.R. 930 (Bankr. C.D. Cal. 1992) (sole participant cases); *In re Blais* and *In Re Hall* (spouse and participant cases), and *Zeiger v. Zeiger* (partnership case); *In re Stern*, 345 F.3d 1036 (9th Cir. 2003), cert denied, 541 US 936 (2004)

[80] *In re Stern*, supra, whether there is extant non-owner employee is measured "as of the bankruptcy filing date", citing *In re Lowenschuss*

owner/employee or partner/spouse, are covered by the plan's ERISA protection.[81] Or, husband and wife participants can get divorced and this exception would no longer apply if one is awarded benefits via QDRO or both end up as participants.[82] However, many small businesses increasingly outsource, employ workers classified as independent contractors rather than employees, employ part-timers ineligible for the retirement plan or otherwise have no other "employees" in the plan, so this gap in protection is probably more common than realized. Perversely, a business owner that rewards his employees with LP/LLC shares may turn a plan into an owner-only plan ineligible for ERISA protection.

Other prerequisites for ERISA protection are judicially imposed requirements that: 1) assets are held in a trust; 2) the trust contains an anti-alienation clause and 3) the plan be qualified as tax-deferred under the Internal Revenue Code.[83]

Effect of an ERISA plan being held in custody or as an annuity, not in trust

Courts are divided, but some have interpreted these requirements to **exclude 403(b) plans** that would otherwise be subject to ERISA, simply because they are fashioned as a custodial account or annuity instead of a trust.[84] (Note that some 403(b)s are subject to ERISA and some are not). If your client loses the ERISA preemption/protection argument, remember that Ohio has a "backup" statute (last paragraph of 2329.66 in the appendix – (A)(17)). In one recent case, the bankruptcy court accepted the *Rheil/Adams* argument that the annuity in question was not a "trust", but found that it was still protected under Ohio's statute. However, neither the plaintiffs/trustee nor the court addressed a *Lampkins* type argument that Ohio's statute should be preempted by ERISA.[85] Additionally, BAPCPAs new provisions discussed in the next section should override this loss IF the debtor is in bankruptcy.

Effect of Disqualifying Actions

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[81] See *Santino v. Provident Life & Accident Co.*, 276 F.3d 772 (6th Cir. 2001), where owner, spouse *and stepdaughter* were the only participants in the plan – held ERISA still applied; See *Raymond B. Yates M.D., P.C. Profit Sharing Plan v. Hendon*, 124 S. Ct. 1330 (2004); interesting issue – could adding an employee when creditor is at bay be a fraudulent transfer?

[82] See, *McDonald v. Metz*, 225 BR 173 (9th Cir. BAP 1998)

[83] *In re Foy*, 164 BR 595 (Bankr. SD Ohio 1994)

[84] Denying ERISA protection for a 403(b) plan sponsored by the United Negro College Fund, *In re Adams*, 302 BR 535 (6th Cir. BAP 2003); *Rheil v. Adams*, 302 BR 535 (6th Cir. BAP); upholding ERISA coverage, I*n re Gould*, 322 BR 742 (Bankr. WD Pa. 2005). Rejecting the need for a trust for 541(c)(2) protection for 403(b): *In re Laher*, 496 F.3d 279 (3rd Cir. 2007). Upholding 403(b) in Ohio under other anti-alienation statute, *In re True*, 340 B.R. 597 (Bankr. N.D. Ohio 2006)

[85] *In re Sforzo*, 332 B.R. 294 (N.D. Ohio 2005)

Another loophole in ERISA protection might be to do anything that disqualifies the plan or contributions to it. For instance, although technically not an ERISA case, a recent 9th Circuit case upheld the bankruptcy court's ignoring protection where the plan participant established several plans with three different controlled corporations. This in itself would not have led to negative results, but he also 1) OVERFUNDED the plans by more than 20%; 2) In two years, the contributions were $30,000 greater than his salary, while in two other years, they were about equal; 3) he underreported the contributions in IRS filings by large sums ($160,000 in one plan, $150,000 to another); 4) the plan purchased property upon which he lived rent-free (the fact that it was probably a prohibited transaction was not discussed); 5) he used a wholly owned offshore corporation and foreign bank account to make some contributions. These factors led the court to find that the purpose of the plans was not to save for retirement, and therefore not eligible for the exemption.[86] However, note that the 9th Circuit was overturning a district court that had initially overruled the bankruptcy court's denial of protection (even on such egregious facts), on the theory that the plans were "primarily" retirement plans still entitled to protection. There was no discussion of fraudulent transfers in this case.

Tax disqualification, unlike for IRAs in most state, is unlikely to destroy ERISA protection

Despite the above case, there are several more persuasive cases that hold that tax issues, ERISA violations or even tax disqualification of a ERISA qualified plan should not destroy the asset protection afforded under ERISA.[87] This is in sharp contrast to the cases discussed herein regarding IRAs.

Equitable Ownership and Lack of Tracing – the "end run" around ERISA

There is an even larger loophole in ERISA protection for beneficiaries that is scarcely known – that the plan ONLY provides protection while the assets are within the plan. Once the check is cut from an ERISA governed group-term life policy or other retirement plan to the beneficiary, it is probably **NOT** protected once it is in the hands of the beneficiary.[88] This is unlike the protection afforded many state

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[86] *Cunning v. Rucker (In re Rucker)*, 570 F.3d 1155 (9th Cir. 2009)
[87] *In re Sewell*, 180 F.3d 707 (5th Cir. 1999) and *In re Baker*, 114 F.3d 636 (7th. Cir. 1997)
[88] See *Guidry*, supra, 39 F.3d 1078, 1082, as well as *U.S. v. Smith*, 47 F.3d 681 (4th Cir. 1995) (distinguishing pre retirement lump sum payments (not protected) and post retirement annuity benefits (protected)), *State Treasurer v. Abbott*, 660 NW2d 714 (Mich. 2003), *Central States SE and SW Areas Pension Fund v. Howell*, 227 F.3d 672, 679 (6th Cir. 2000), *Estate of William E. Kensinger v. URL Pharma, Inc. and Adele Kensinger*, No. 10-4525 (3rd Cir. 2012) (allowing state law actions against ex-wife beneficiary even though she was beneficiary under ERISA pursuant to *Egelhoff* and *Kennedy* US Supreme Court cases)

creditor protection statutes, or federal statutes such as social security, which "follow the money".[89] This means that clever and patient creditors may yet be able to get at these funds if they can get to a beneficiary when they have a check and/or funds in an account received from the ERISA plan. In addition, there may be more devious ways.

Consider the case of *In Re Hoult.*[90] A debtor had begun to withdraw $4800/mo from his plan. His creditor obtained a court order for the debtor to place all payments received into a bank account, where it was then subject to garnishment and payment to the creditor. **Because the suit/order was not against the plan, the first circuit found that anti-alienation provisions did not apply and the assets were not protected**. The court contrasted social security benefits, which were also at issue in the case, and held to be protected under the broad protection of 45 U.S.C. §231m(a), extending to funds after placed into bank accounts, and ERISA protection, which does NOT extend to funds once outside the plan.[91]

This puts the debtor in an awkward position. If a debtor simply refuses to take the money, the plan may force the distribution out by sending a check or send the money to unclaimed funds. Or, it may be considered to be an improper contribution, having other consequences, notably a 6% excise tax. In addition, state courts will likely view the funds as being accessible to the beneficiary and may even

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[89] For partial list of federal statutes, see Section II.h. For state law, see *Daugherty v. Central Trust Co.*, 28 Ohio St.3d 441, 504 N.E.2d 1100 (1986), holding that property exempt under RC 2329.66 (in this case, earnings) moved into a bank account is still exempt if the funds can be sufficiently traced. Similar holding: *In re Bresnahan*, 183 BR 506 (Bankr. SD Ohio 1995) (citing *Daugherty*, debtor's $7,000 retirement fund check deposited in personal checking still protected under Ohio RC 2329.66(A)(10)), also *Haggerty v. George*, 2001-Ohio 3481, following *Daugherty* if funds can be traced. A few other states hold similarly, such as this recent Kentucky bankruptcy case citing the above Ohio cases and holding the same under KY law: *In re Cornett*, 332 B.R. 289 (2006), *In re Christensen*, 122 Nev. 1309 (2006) (Nevada - tracing exempt earnings), *Auto Owners Insurance v. Berkshire*, 225 Ill.App.3d 695, 588 N.E.2d 1230 (2d Dist. Il. 1992) (oddly, if kept as checking/savings, protection remains, but if distributed funds are invested, they lose their protected character), but Washington state recently ruled otherwise in *Anthis v. Copeland*, 270 P.3d 574 (2012), denying "tracing" the protection due to retirement benefits in its state once placed in checking. The Washington state legislature, in reaction to *Anthis*, amended its statutes to grant/clarify tracing protection, effective June 7, 2012 (see WA statute 6.27.140, HB 1552). For another case protecting traceable assets, see *In re Sunstrom*, 2012 Bankr. LEXIS 5035 (Bankr. D. Md. Oct. 26, 2012) (retirement plan distribution and social security paid and traceable to bank account protected). There is favorable dicta arguing for tracing in *Wolff v. Gibson (In re Gibson)*, 300 B.R. 866 (D. Md. 2003). See also *In re Ladd*, 258 B.R. 824 (Bankr. N.D. Fla. 2001) (qualified plan distribution placed in traceable segregated checking account protected, not per ERISA, but via FL exemption). Another recent case *In re Massenburg*, 508 B.R. 362 (Bankr. D. Md. 2014) protected early retirement pension payments payable to checking account that were still traceable. By contrast, *Carbaugh v. Carbaugh (In re Carbaugh)*, 278 B.R. 512 (B.A.P. 10th Cir. 2002), denied tracing protection because ERISA protection ends once out of the plan, and Kansas exemption law only protects retirement plan interests and accounts "payable to" the debtor, rather than, as many other statutes do, "payments from"

[90] *In re Hoult*, 373 F.3d 47 (1st Cir. 2004), denied cert, *Hoult v. Hoult*, 2004 U.S. LEXIS 7730 (U.S., Nov. 29, 2004)

[91] *Id*. At 55

hold the debtor/beneficiary in contempt for refusing to pay amounts owed when they have access to funds. Courts have held that the state courts' consideration of ERISA funds in its proceedings is NOT preempted.

So what kind of protection is there if a court can order a debtor/beneficiary to deposit retirement funds into an account, where it could thereafter be garnished under state law? This is exactly the case in recent litigation in Michigan, where a court ordered four prisoners to deposit their Daimler-Chrysler pension checks into a certain account where state law garnishment would take 90% of the funds. When three of the four refused, the judge ordered Chrysler to send the checks to the appropriate accounts. The Sixth Circuit held that, while state courts have jurisdiction over funds once in the hands of the debtor/pensioner, ERISA prohibited the courts from ordering Chrysler to do anything regarding these accounts.[92]

BUT, note that the important issue for creditor protection is this: the state can impose a constructive trust on benefits once received from the ERISA retirement plan and it can probably order the debtor/retirement plan owner to change the address and/or account on file with the retirement plan administrator and hold them in contempt if they do not, or if they attempt to change it.[93]

The above concerns and cases appear to completely ***gut*** the sacrosanct ERISA protection of ERISA retirement plans. Can these "bad facts make bad law" cases simply be ignored? At one's peril perhaps. Most of the cases that indirectly attach retirement funds pertain to regular pension payments. What about a 401(k)? Would it matter if an employee were past his or her retired beginning date (usually April 1 of the year after turning 70 ½)? Could a state court simply order an employee/debtor to deposit any payments into a particular account where it could then be subject to state law garnishment?

[92] *Daimler Chrysler Corp. et al v. Cox et al*, 447 F.3d 967 (6th Cir. 2006), http://www.ca6.uscourts.gov/opinions.pdf/06a0175p-06.pdf, cert requested from U.S. Supreme Court. The Michigan Supreme Court gave even less protection to the pension plans, holding that this process was not prohibited by ERISA: *State Treasurer v. Abbott*, 660 NW 2d. 714 (Mich 2003), cert denied at *Abbott v. Rising*, 540 U.S. 1112 (2004).

[93] *Id*., the court did not address the latter point, but it seems likely from the opinion, and from the *State Treasurer v. Abbott* case and others cited above, that such state orders would be permitted. Update – recent case of *SelfLube v JJMT Inc*., 278 Mich App. 298 (2008) in a similar fact case refused to follow its own Supreme Court precedent in *Abbott*, following the 6th Circuit's reasoning in *Daimler Chrysler* in above footnote. The Supreme Court of Michigan granted cert and changed its mind at 483 Mich. 897. Another Michigan case upheld the same concept

In most circuits the surprising answer appears to be "yes" – and the debtor can be held in contempt for failure to do so. Debtors can even be jailed for continued contempt of court.[94] Whether an owner/employee is in pay status that is mandated by the plan may be relevant.

The most egregious of the above cases concern prisoners and "bad facts", but the courts' reasoning has nothing to do with the federal Mandatory Victims Restitution Act (MVRA), which applies to the federal government only (see the *U.S. v. Novak* case and later discussion in the section of this outline, *Exceptions When the Federal Government is a Creditor*).

This author accomplished a similar attachment to an ERISA account in a Southwest Ohio case about a decade ago. Because I knew it was futile to attack or get an order against the plan administrator regarding the pension funds, we went after the purported beneficiary and did not name the plan as a defendant. After removal to federal court, dismissal and remand back to state court and successful trial, plaintiff sought and the court ordered a remedy establishing a constructive trust and court order *to the beneficiary*, not the plan administrator, to deposit pension funds into a joint account requiring two signatures with the attorney, debtor and creditor as joint owners, wherein the creditor and attorney could easily take the funds after deposit.

In the case mentioned above (as well as *In re Hoult* and the various Michigan cases), the distributions from the pension were mandatory. Thus, we can conclude that ERISA plans that are not in mandatory pay status (e.g. the employee is still working, under 70 ½, etc.) have far superior protection to those that do not. Query whether a court could order a beneficiary to take out funds once permitted, but not required to do so (e.g. usually between 59 ½ and 70 ½). While these cases would be rare, since a debtor would usually be able to file bankruptcy to protect such assets, it would be an important distinction if the debt were not dischargeable, as a restitution order might be (see next section for various discharge exceptions).

It has been held to be irrelevant that someone is no longer an employee, so simply retiring or changing jobs does not jeopardize protection at all.[95] Of course, this assumes someone is still covered in the plan – rolling out to an IRA, 403(b) or otherwise loses the ERISA protection.

State Treasurer v. Sprague, 772 N.W.2d 452 (2009). Also followed by *Bittick v. Nixon*, 2009 US Dist Lexis 120888 (W.D. Mo. 2009)

[94] Debtor served six years for refusing to repatriate offshore trust funds, *In re Lawrence*, 279 F.3d 1294 (11th Cir. 2002)

[95] *Corzin v. Larson (In re Larson*), 340 BR 852 (6th Cir. 2006)

Even if ERISA protection is eroded, one cannot stop there in analysis, and must consider the overlapping circles of state law protection as well as federal bankruptcy protection. In Ohio, as can be seen from the statute excerpts in Appendix A, pension plans are only protected **"***to the extent reasonably necessary for the support of the person and any of the person's dependents***".**[96] As discussed previously, this is normally extremely narrowly construed and courts are sparse in their interpretation of such guidelines. Due to the *Lampkins* rationale, one should not count on any Ohio protection for plans governed by, but not protected by ERISA, such as SEP-IRAs, SIMPLE IRAs, or plans covering only the owner/partner and/or spouse.

Of course, a debtor facing such a situation may (should?) file bankruptcy to get more uniform treatment, but that brings up the complications that will be discussed in the next section.

If ERISA does protect the plan assets, it may do so even if there is some disqualifying deficiency for tax law purposes, which is discussed in Section VI.

[96] Ohio R.C § 2329.66(A)(10)(b)

IV. Federal Bankruptcy Scheme of Creditor Protection

On April 20, 2005, the President signed the Bankruptcy Abuse Protection and Consumer Protection Act of 2005 (BAPCPA), which became effective on October 17, 2005. BAPCPA substantially increased the creditor protection available to retirement accounts and clarified the protection available for those who declare bankruptcy.[97]

However, the law also made it more difficult to file and obtain a discharge of debt – particularly consumer debt. For instance, debtors whose income is above the State Median Income for their state may be denied relief under Chapter 7 if the debtor can file Chapter 13 and pay as little as a hundred dollars a month to the general, unsecured creditors.[98] But Chapter 13 has limitations as well, such as unsecured debt of less than $336,900. Debtors who do not meet Chapter 13 requirements might be able to file under Chapter 11.[99]

Bankruptcy exemptions and exclusions don't always foreclose Ohio and federal debtor/creditor law application. *They only provide adequate protection for accounts and assets when the debtor is otherwise eligible for a discharge*. The bankruptcy code outlines nineteen various exceptions to discharge, such as certain taxes, fines, drunk driving, restitution orders, fraud, domestic support, school loans and even "defalcation" (a word which has invited much litigation and might be construed to imply to a mere breach of fiduciary duty).[100] Fraudulent transfers and other actions may also deny a discharge, or revoke one that was previously granted.[101] So, you might have a struggling or disorganized business owner, for example, that failed to properly remit sales taxes or employee withholding taxes – those would not be dischargeable.[102]

A debtor might file in various states, but **a debtor may only claim exemptions from his state of "domicile."[103]** Domicile is basically residence plus the intent of making it a permanent home. Courts will consider which state the debtor has paid taxes, voted in, registered vehicles, and so forth. This can become an important issue for debtors who have moved.

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[97] See, primarily, 11 U.S.C. § 522, portions highlighted in Appendix C
[98] 11 U.S.C. § 707(b)(2)(D)
[99] 11 U.S.C. § 109(e), see discussion in general, Gassmann, *Bankruptcy – What Every Estate Planner Needs to Know*, Steve Leimberg's Asset Protection Planning Newsletter #102 (May 2, 2007)
[100] 11 U.S.C §523(a)
[101] For a recent case revoking a previously granted discharge for fraud, see *Jones v. U.S. Trustee*, *Eugene*, at http://caselaw.findlaw.com/us-9th-circuit/1651228.html?DCMP=NWL-pro_bankruptcy
[102] See also, 11 U.S.C. §507(a)(8)(C)
[103] 11 U.S.C. §522(b)(2)(A)

Before BAPCPA, the protection of retirement accounts from creditors during bankruptcy had been subject to multiple rules depending on the type of account and the applicable state. Employer retirement plans have received creditor protection due to the Employer Retirement Income Security Act of 1974 (ERISA), but only a limited number of retirement account types are actually subject to ERISA.

Because Ohio is an "opt-out" state, Ohio debtors must use Ohio's exemptions, not the federally provided exemptions.[104] Usually this is better. Although most of this scheme of whether a debtor can choose or is forced into state versus federal bankruptcy exemptions remains the same, BAPCPA amended the "anti-stacking" rules that forces one or the other and under Section 522(b)(3)(C) and (d)(12), discussed below, the debtor gets the best of both worlds vis a vis retirement accounts.

a. ERISA Qualified Plans

BAPCPA has simplified retirement account creditor protection by eliminating much of the differentiation among types of plans and bankruptcy jurisdictions. Thus, in bankruptcy, SEP (Simplified Employee Pension) IRAs, SIMPLE (Savings Incentive Match Plan for Employees of Small Employers) IRAs, and all defined-benefit and defined-contribution employer retirement plans now receive creditor protection in bankruptcy, regardless of whether the plan is subject to ERISA, protecting "retirement funds to the extent that those funds are in a fund or account that is exempt from taxation under Sections 401, 403, 408, 408A, 414, 457, or 501(a) of the Internal Revenue Code."[105] This exemption can be used even if the debtor is not otherwise using state exemptions.

b. IRAs

Traditional and ROTH IRAs have one catch under BAPCPA: if they are a rollover from a non-IRA qualified plan, they are completely protected, but if not, there is a $1,245,475 limit ($1,000,000 pursuant to statute, subject to triennial inflation adjustment).[106] However, even this may be increased by the bankruptcy judge "as the interests of justice so require".[107] BAPCPA included an explicit protection applicable to such accounts under 11 USC § 522(b)(3)(C) or § 522(d)(12) (depending on

[104] See 11 USC § 522(b)(1) - Ohio's statute to "opt out' is R.C. §2329.662
[105] BAPCPA Sec. 224; 11 USC § 522(b)(3)(C); 11 USC § 522(d)(12)
[106] 11 U.S.C § 522(n), adjusted for inflation by Federal Register Vol. 72, No. 30 (February 14, 2007), Vol. 75, No. 23 (Feb 25, 2010), Vol. 78, No. 35 (February 21, 2013).
[107] Id.

whether it's a state that applies Federal exemptions or like Ohio has uses its own 'opt-out' rules) and by extension of 11 USC § 522(n) (preserving unlimited protection for IRA accounts under IRC Section 408 that have received rollover contributions under IRC § 402(c). Note that it appears that a SEP or SIMPLE IRA to traditional IRA rollover does ***not*** qualify for the unlimited exemption, but would have to come under the $1,245,475 limit, because IRC § 408(d)(3) intra-IRA rollovers are not mentioned in that section. This greatly simplifies the analysis when in bankruptcy. Remember that bankruptcy rules are irrelevant if in state court or even federal district court (unless the state statute, like Virginia, references the protection under bankruptcy statute)[108].

Thus, much of the negative precedent in Ohio discussed above regarding retirement plans may be overruled by new bankruptcy protections – ***if*** a debtor is in bankruptcy court.

It may be prudent not to commingle contributory and rollover IRAs if the amounts approach the $1,245,475 ceiling. Although 11 U.S.C. §522(n) is clear that "earnings thereon" attributable to a qualified plan rollover to an IRA are protected, it may be difficult to trace funds applicable to each. It's not a disaster if they are commingled though – just keep good records and/or resegregate them to keep the two sources traceable.

There is one more back up provision that may apply to IRAs or other plans, but only in relatively rare instances now - §522(d)(10)(E). This would never be used in Ohio, or in the majority of states or situations, but may be useful in rare instances in those states that permit the use of federal rather than state exemptions. If a debtor, because of residency requirements, or because of *Clark v. Rameker*, cannot avail himself of protections under §522(b)(3)(C) or §522(d)(12), he may be able to protect payments "to the extent reasonably necessary for the support of the debtor and any dependent of the debtor", but this would require the choice of federal exemptions – usually the state options overall are better.[109]

[108] Va. Code Ann. § 34-34(B)
[109] 11 U.S.C. §522(d)(10)

c. Education IRAs (Coverdell ESAs) in Bankruptcy

BAPCPA added protections for education IRAs. Contributions thereto are excluded if made more than one-year prior to filing and the designated beneficiary is a child, grandchild (or steps) of the debtor in the year of contribution. For contributions made between one year and two years prior to filing, only $6,225 per beneficiary is excluded.[110]

d. Insurance and Non-Qualified Annuities in Bankruptcy

Unlike the Bankruptcy Act's special provisions and treatment for IRAs and ERISA plans, any exceptions for insurance and non-qualified annuities would be granted under Ohio law since Ohio is an opt-out (of federal exemptions) state.

If state exemptions do not apply, and a debtor elects to use federal exemptions, there is a federal provision whereby annuities may be protected to extent reasonably necessary for support of debtor and dependents, and only if payable by reason of "illness, disability, death, age, or length of service".[111] Life insurance has some protection up to "The debtor's aggregate interest, not to exceed in value $10,775" under 11 U.S.C. §522(d)(7) and (8).

Note that some states have questioned unlimited protection for insurance on the basis that it violates state constitutional restrictions that permit only a "reasonable" exemption.[112]

e. 529 Plans in Bankruptcy

529 Plans have some protection in bankruptcy. Note that the statute under Section 541 is an exclusion, not an exemption, and thus impervious to "opt-out" nullification or whether state or federal exemptions are chosen. These have similar time-limit limitations to the education IRA exceptions above[113]. Note that, unlike most state law exemptions for 529 plans, there is a limitation to protection based on the relationship of the beneficiary to the 529 plan owner.

11 Section 541(b)(6) provide an exclusion for:

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[110] 11 U.S.C. §541(b)(5), triennially adjusted for inflation, see Vol. 78, No. 35, February 21, 2013

[111] 11 U.S.C. §522(d)(10)(E)

[112] *Citizens Nat'l Bank v. Foster*, 668 N.E.2d 1236 (Ind. Sup.Ct. 1996)

[113] 11 U.S.C. §541(b)(6)

(6) funds used to purchase a tuition credit or certificate or contributed to an account in accordance with section 529(b)(1)(A) of the Internal Revenue Code of 1986 under a qualified State tuition program (as defined in section 529(b)(1) of such Code) **not later than 365 days before the date of the filing** of the petition in a case under this title, but--

(A) **only if the designated beneficiary of the amounts paid or contributed to such tuition program was a child, stepchild, grandchild, or stepgrandchild of the debtor for the taxable year for which funds were paid or contributed**;

(B) with respect to the aggregate amount paid or contributed to such program having the same designated beneficiary, only so much of such amount as does not exceed the total contributions permitted under section 529(b)(7) of such Code with respect to such beneficiary, as adjusted beginning on the date of the filing of the petition in a case under this title by the annual increase or decrease (rounded to the nearest tenth of 1 percent) in the education expenditure category of the Consumer Price Index prepared by the Department of Labor; and

(C) **in the case of funds paid or contributed to such program having the same designated beneficiary not earlier than 720 days nor later than 365 days before such date, only so much of such funds as does not exceed $5,000**;

Note that the $5,000 education IRA/529 plan amounts are triennially indexed for inflation similar to the IRA exemption, and as of February 21, 2013 is $6,225.[114]

Inherited 529 plans do not fundamentally change their character (unlike retirement plans). Thus, where a child/debtor inherited a 529 plan established by his mother for her grandchildren (the child/debtor's children), the debtor was still permitted to exclude the 529 plan from his bankruptcy estate, despite the bankruptcy trustee's attempt to argue that *Clark v. Rameker* precluded protection for inherited 529 plan accounts.[115]

Note that 529 plans can have the same protective nature as a self-settled trust – after all, you can change and name yourself as beneficiary later and take back the funds – it is only a completed gift at all because of statutory exceptions (and may not be if you name yourself as primary beneficiary). The same tax deferral can apply, *and the same asset protection* – there is no requirement in the state statute above that someone else even be named, nor any prohibition in the bankruptcy code, that someone else be irrevocably named beneficiary without the right to change the beneficiary back to the owner.

[114] 11 U.S.C. §541(b). See Federal Register Vol. 72, No. 30 (February 14, 2007), Vol. 75, No. 23 (Feb 25, 2010), Vol. 78, No. 35, February 21, 2013.
[115] *In re Hennessy*, 526 B.R. 806 (Bankr. Minn. 2015)

This enables hundreds of thousands of dollars to be creditor protected similar to (and some may say better than) a Domestic Asset Protection Trust, such as an Ohio Legacy Trust, but with a $2,000 state income tax deduction and ongoing tax deferral![116] Ohio has very good low cost investment options in its 529 plan now, so this may not be as crazy as it sounds. There is, of course, a 10% penalty for non-qualified distributions (i.e. taking out funds not used for educational purposes), but this penalty is on the *earnings*, not on the principal, so do not confuse this with the same penalty someone might incur if taking an early IRA distribution, for example.[117] The savings from deferral may offset the penalty in some cases.

I do not advocate that everyone to plunk a million dollars into multiple 529 plans for asset protection purposes (as with any transfer to exempt accounts, it could be a fraudulent transfer/conversion, so you don't get around the same solvency/UFTA rules applicable to transfers to trusts). However, if someone may have intent to go back to graduate school or help pay relatives tuition costs someday, the asset protection side benefits should certainly be considered into the calculation and planning. It is a legitimate planning tool for smaller amounts to protect.

g. Health Savings Accounts (HSAs), Medical Savings Accounts, Flexible Spending Accounts, Health Reimbursement Arrangements (MSA, FSA, HRA) in Bankruptcy

See discussion of recent Ohio bankruptcy case regarding HSAs in the section on Ohio exemptions.

[116] Limit of Ohio's plan as of 2013 is $377,000 total cap *per individual beneficiary* – that's a lot of contributions that could be made!
[117] IRC §529, see also http://www.savingforcollege.com for a good website on 529 plan issues, http://www.collegeadvantage.com/ for Ohio's plan.

V. Non-Qualified Deferred Compensation

Non-qualified deferred compensation ("NQDC") arrangements include plans such as incentive stock options (ISOs), non-qualified stock options (NQSOs), restricted stock, stock appreciation rights (SARs), secular trusts, rabbi trusts, top hat plans (SERPs) and excess benefit plans. They are harder to analyze, and may come under state law, ERISA, or "none of the above". After all, one of the advantages of being "non-qualified" would be to get around ERISA requirements, but do not assume that *all* NQDC arrangements get no ERISA protections (although most probably do not). First, let's start with some generalizations that apply to most benefits, accounts and assets.

Creditors often "step into the shoes" of the debtor. If the debtor/employee can't get at his or her NQDC yet, his or her creditor probably can't (although one might imagine exceptions to this, such as single owner/employee companies having a NQ deferred comp program wholly controlled by the employee/debtor). Of course, this truism doesn't help in planning against a patient creditor who might wait until the benefit vests and then attach the proceeds then available (or, perhaps better, a court order for the employee/debtor to make any election and transfer funds to creditor as soon as vested/available). But, check the plan to see if spousal consent, committee approval or some other restriction may apply to deny absolute unfettered access to the funds.

State statutory protections may apply. Check out R.C. §2329.66(A)(10)(a) and (b) in the appendix. These might apply to certain non-qualified deferred comp, but note the particular limitation in paragraph (b) "to the extent reasonably necessary for the support of the person and any of the person's dependents". As noted elsewhere herein, courts have been rather stingy in defining what is reasonably necessary. Also note the carve out under (b)(i)(ii) and (iii), echoing the parenthetical above, that the law will probably *not* protect the business owner who simply puts his controlled corporation's money into a non-qualified deferred comp account.

State spendthrift trust protection may apply. You might try this defense, but once the employee/debtor has unrestricted rights, it would seem that it would have no more protection than a standard revocable trust. Recall the many cases discussed in Section III above that deny ERISA's protections once the assets are out of the plan's protective umbrella. An employee might achieve better protection if the plan established a trust that complied with a DAPT statute, such as the Delaware

Qualified Dispositions in Trust Act, but that might require an assignment or action by the employee, no different from if the employee had simply taken the assets and contributed them him or herself.

ERISA may yet apply to even a non-qualified employer plan.

Check to see whether the plan has an anti-alienation clause (generally mandated by ERISA). Is the plan perhaps subject to ERISA even though it is non-qualified? Most top hat and excess benefit plans would not be, but funded secular trusts (popular in the past two decades with several large airlines) may be subject to ERISA and therefore receive the anti-alienation protection. Secular trusts are not usually preferred by employees because, unlike Rabbi trusts, there is no tax deferral benefit for the employee, but they might get better asset protection treatment under ERISA. The Department of Labor, which has jurisdiction over ERISA plans, has ruled that Rabbi Trusts, because they are subject to the corporation's creditors, are exempted from ERISA since they are considered unfunded.[118]

The exact nature of the funding and ERISA coverage should be explored in analyzing the protection for any non-qualified plan. Generally, non-elective deferrals might have a substantial risk of forfeiture and be considered unfunded, whereas deferrals made at the behest and election of the employee probably do not contain such risks of forfeiture and are likely to be granted ERISA's protections.

Bankruptcy is unlikely to be helpful if state or ERISA protections do not apply. In one recent case, an insurance agent had approximately $261,347 accrued in a deferred compensation arrangement with Nationwide Insurance that would pay upon death, disability or retirement.[119] The Plan was funded by Nationwide upon an individual agent's separation from service and was maintained as a general debt of Nationwide, owed and paid to the individual agent from Nationwide's general assets. The funds were not maintained in separate, individually designated accounts for specified agents. The agent declared bankruptcy and attempted to exempt the account. Held – it was not "qualified", and, while state law might have protected it, Tennessee law did not and was therefore not exempt from creditors. There are citations in that case to other failed attempts to protect deferred compensation accounts. To save that kind of nest egg, the debtor should have considered moving!

[118] DOL Advisory Opinion 92-13 at http://www.dol.gov/ebsa/programs/ori/advisory92/92-13a.htm

[119] *In re Lawless*, 2012 Bankr. LEXIS 3345 (Bankr. E.D. Tenn. July 20, 2012), affirmed by *Lawless v. Newton (In re Lawless)*, 591 Fed. Appx. 415 (6th Cir. Tenn. 2014)

VI. How Debtors Can Lose Protection for Plans

Anything that jeopardizes the IRA as a valid IRA (or 403b, etc) under federal law, has the potential to kill the asset protection under state law – even if the DOL or tax authorities are unaware. Consider the recent unpublished case of *Aebig v. Cox*[120], where IRA owner purchased real estate in his IRA (clearly permitted under DOL/Treasury Regulations), but then leased the property to an S Corporation owned by his wife. The state court found, without need to address veil piercing arguments, that the corporation was a "disqualified person" under 26 USC §4975(e)(2) and thus a prohibited transaction under §4975(c)(1)(A). Therefore, under IRC §408(e)(2)(A), it was no longer an IRA, and hence, no longer afforded protection under state law.

Similarly, a local case found that where the debtor pledged his IRA for a loan, which is forbidden under IRC §408(e)(4), the loss of the tax protection of the IRA account similarly negated the asset protection afforded under Ohio's statute and bankruptcy code.[121] This disqualification is true for loans from an IRA – even if they are paid pack soon thereafter.[122]

Under BAPCPA, plans must be properly exempt from tax to be protected. However, there are favorable presumptions to this effect if the plan has received a favorable ruling from the IRS, or if not, if it is in substantial compliance. Even if none of those apply, it is usually still considered exempt unless the debtor is materially responsible for the non-compliance.[123] Yet, people can still screw this up through self-dealing, such as loans or "creative" tax and investment schemes, whether for IRAs or ERISA plans[124], and it can be jeopardized by IRA providers' putting lien provisions in their IRA agreements. A bankruptcy or other court may question whether a plan is tax-qualified without any IRS involvement.[125]

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[120] *Aebig v. Cox*, 2006 Mich App. Lexis 1695 (note that Michigan's statute re IRAs at 600.6023(l) is similar to Ohio's.
[121] *In re Roberts*, 326 B.R. 424 (S.D. Ohio 2004)
[122] E.g. *In re Hughes*, 293 B.R. 528 (Bankr. M.D. Fla 2003), and the Willis case discussed on page following
[123] BAPCPA §224, 11 U.S.C. 522 - see bolded sections in Appendix B
[124] For some more egregious examples, with caveats to investors about IRA custodian's lack of required due diligence, see the SEC's Alert: *Self-Directed IRAs and the Risk of Fraud* http://www.sos.ga.gov/securities/acrobat/sdira_investor_alert_2011.pdf
[125] *In re Don Royal Plunk*, 481 F.3d (5^{th} Cir. 2007)

For instance, if you contribute more than is allowed under the plan and/or tax law to an ERISA plan, plan assets may not be excluded from bankruptcy.[126] Also, recall the discussion of *In re Rucker* in the previous section on ERISA protections.

Or, consider a very recent case from Florida where the debtor had over $1 million in his Merrill Lynch (now Bank of America) IRA. He took a series of loans/distributions from his IRA (many more than the 1 per 12 month period allowed). The court held, even though neither the IRS nor the DOL ever questioned the scheme, that the prohibited transactions cancelled the asset protection of the IRA. In fact, the law is quite explicit that prohibited transactions cause an IRA to cease to be an IRA as of the first day of the year.[127] Note that most of the transactions in *Willis* occurred ***twelve*** years before the bankruptcy, so you obviously had some very diligent discovery work by creditors.[128]

Also, unlike qualified rollovers to IRAs (or other plans), note that Required Minimum Distributions and Hardship Distributions are not protected in bankruptcy once the money leaves the plan. This probably applies to loans as well.

For a more disturbing yet mundane application of the above principles, it is important to understand how brokerage firms can destroy IRA protections by overreaching in their IRA account agreements. This is discussed in the next section, but first, a few basics about prohibited transactions.

Prohibited Transactions

Prohibited transaction rules are set out in two (mostly) similar and overlapping sections of the law – ERISA and the Internal Revenue Code (IRC).[129] For instance, ERISA rules refer to “parties in interest” whereas the IRC refers to “disqualified persons”. In theory, one could have a transaction that passes the ERISA PT rules only to be snagged by the IRC. However, for most practical purposes they are identical and only the IRC will be discussed herein because it will apply to ERISA plans as well as non-ERISA plans, such as IRAs, many 403(b)s, and other qualified plans not under ERISA (such as single owner/employee/spouse/partner exceptions discussed in Section III).

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[126] See *In re Bell & Beckwith*, 5 F.3d 150 (6th Cir. 1993), denying protection to contributions to profit sharing plan when company made no profits and thus pursuant to the plan should not have been made

[127] IRC §408(e)(2)(A)

[128] *Menotte v. Willis (In re Willis)*, 411 BR 783 (Bankr. S.D. Fla 2009), recently affirmed in April 2010 by *Willis v. Menotte*, 2010 U.S. Dist. LEXIS 44773

[129] IRC §4975, 29 U.S.C. §1106 (ERISA §406)

IRC §4975 imposes a penalty tax on 'disqualified persons' engaged in specified transactions with qualified plans, IRAs and similar accounts. Luckily, the tax is only 100% (no, that is not a typo).[130] However, if timely corrected within the taxable period, the IRS must be generous and assess a mere 15% tax – per year.[131] If that does not sound bad enough, the IRS may assess the tax NOT ONLY against the owner, but any disqualified person involved as a party in the transaction.[132] So, in the *Aebig v. Cox* case discussed above, this could extend to the debtor/IRA owner's wife and her S Corp, not just the husband who owned the IRA.

For many but not all prohibited transactions, IRC §4975(c)(3) can exempt an IRA owner from the 15%/100% tax (although the tax exemption/creditor exemption is still lost, so that is "in lieu" of the 15%/100% penalty that might apply to other plans):

> **4973(c)(3) Special rule for individual retirement accounts**
> An individual for whose benefit an individual retirement account is established and his beneficiaries shall be exempt from the tax imposed by this section with respect to any transaction concerning such account (which would otherwise be taxable under this section) if, with respect to such transaction, the account ceases to be an individual retirement account by reason of the application of section 408 (e)(2)(A) or if section 408 (e)(4) applies to such account.
>
> **408(e)(2) Loss of exemption of account where employee engages in prohibited transaction**
> **(A) In general**
> If, during any taxable year of the individual for whose benefit any individual retirement account is established, that individual or his beneficiary engages in any transaction prohibited by section 4975 with respect to such account, such account ceases to be an individual retirement account as of the first day of such taxable year.
>
> **408(e)(4) Effect of pledging account as security**
> If, during any taxable year of the individual for whose benefit an individual retirement account is established, that individual uses the account or any portion thereof as security for a loan, the portion so used is treated as distributed to that individual.

Of course, these sections beg the question of what happens if another disqualified person, not the IRA owner, engages in the prohibited transaction (e.g. the IRA owner's parent, spouse, controlled corporation). A literal reading of the above statutes seems to indicate that the IRA is not necessarily disqualified, but the 15%/100% tax still applies against the participating disqualified person.

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130 IRC §4975(b)
131 IRC §4975(a)
132 IRC §4975(a) and (b)

Although there is no provision in the Internal Revenue Code that defines permissible investments[133], the IRC addresses what is a prohibited transaction. The following are prohibited transactions defined in IRC §4975(c) (1) ("plan" in the statute is changed to "IRA" below – the rules apply to qualified plans, 403bs, IRAs, even HSAs, MSAs and Coverdell ESAs[134], but I chose to use "IRA" for emphasis because IRAs are more ubiquitous and susceptible to abuse):[135]

(A) the sale, exchange, or leasing of any property between an IRA and any disqualified person;

(B) the lending of money or other extensions of credit between an IRA and any disqualified person;

(C) the furnishing of goods, services, or facilities between any disqualified person and an IRA;

(D) the transfer to any disqualified person or use by any disqualified person (or for the disqualified person's benefit) of the income or assets of an IRA;

(E) act by a disqualified person who is a fiduciary whereby he deals with the income or assets of an IRA in his own interest or for his own account; or

(F) the receipt by any disqualified person of any consideration in connection with a transaction involving an IRA.

Disqualified Person. The following are considered "disqualified persons" (again, these apply to other plans as well as IRAs):

IRA owner - *§*4975(e)(2)(A)

IRA owner's spouse - *§*4975(e)(2)(F)

IRA owner's ancestors - *§*4975(e)(2)(F)

Any lineal descendants of IRA owner - *§*4975(e)(2)(F)

Any spouse of lineal descendants of the IRA owner - *§*4975(e)(2)(F)

Investment managers and advisors - *§*4975(e)(2)(B)

Anyone providing services to the plan - *§*4975(e)(2)(B)

[133] Although IRAs are prohibited from owning insurance and collectibles per IRC §408(a)(3) and §408(m)
[134] IRC §4975(e)(1) – Roth IRAs are not mentioned in the statute, but I suspect are covered by subsequent regulation
[135] IRC §4975(c), exceptions are in (c)(2)

Any corporation, partnership, trust, or estate in which the IRA owner individually has a 50 percent or greater interest. - §4975(e)(2)(C), (D), (E),(I),(G), and (H)[136]

You will inevitably encounter a client who wants to purchase "fixer-uppers" or distressed real estate in his or her IRA. This is acceptable, but the minute the IRA owner (or other disqualified person) works on the property - even mowing the lawn - you potentially have a prohibited transaction. Ditto for displaying artwork or using or fixing up planes, boats, vacation homes owned by the IRA (even if you let a non-disqualified person such as a friend use such assets, you arguably have an indirect benefit). There is an infinite number of ways people can trip themselves up with self-directed IRAs when they stray into these areas. Providing services also opens the door for other avenues to invalidate the IRA, such as the disqualification because the IRA owner made a non-cash contribution.[137]

There is no "de minimis" amount permitted by the code or regulations, and no need for there to be "harm". Mere "management", such as investigating stocks and bonds and making the investments, is permitted, but the lines become very fuzzy when you veer from traditional money management into these areas, and there is very little guidance on them.

Tax Shelter Transactions – and, as if the above penalties were not severe enough, some shenanigans by taxpayers using qualified plans, IRAs, 403bs etc for what might be prohibited transactions could also be eligible for another $20,000 excise tax on prohibited tax-shelter transactions, since these are tax-exempt entities.[138] Discussion of those rules is beyond the scope of this outline.

Ponzi Schemes and Con Artists targeting self-directed IRAs. Unfortunately, many con artists and scammers target self-directed IRAs with "alternative" investment opportunities– the North American Securities Administrators Association just issued a release on this threat.[139] Recently, victims of Madoff attempted to lay blame on the self-directed IRA custodian. Their case was thrown out. Caveat emptor.

[136] An officer, director, highly compensated employee, or 10% or more shareholder of the sponsoring employer, of an employee organization, the owner of 50% or more of an employer or employee organization, or an entity in which the IRA holder or other specified disqualified persons owns 50% or more of the equity in the entity IRC §4975(e)(2)(H)
[137] IRC §408(a)(1)
[138] See IRC §4965 and IRS Notice 2006-65
[139] http://www.nasaa.org/14679/laws-provide-con-artists-with-personal-economic-growth-plan/

The Mother of All Prohibited Transactions –

It's good to be too big to fail. Why it still matters.

Millions of Americans have IRAs with brokerage firms such as Schwab and Merrill Lynch. Recent court cases recently alleged that many (perhaps millions) of Charles Schwab and Merrill Lynch IRAs were established with a provision that granted the brokerage firm an impermissible lien on IRA assets. Other brokerage firms with margin or cross-collateralization agreements may have similar provisions in their IRA agreements.

Curiously, the IRAs are not void because of IRC §408(a)(4)'s requirement that "the interest of an individual in his account must be nonforfeitable" – it is because of prohibited transaction rules. It is unavailing that the IRS approved the firm's IRA prototype agreement, since the IRS specifically stated in its approval letter that its analysis and approval did not extend to IRC § 4975 prohibited transactions.

On October 27, 2009, the Department of Labor (DOL), which has concurrent jurisdiction for prohibited transactions, issued Advisory Opinion 2009-03A, holding that the grant to a broker of a security interest in the individual's IRA accounts would be an impermissible extension of credit from the IRA owner to the individual's IRA, and a prohibited transaction under IRC §4975 (quoted in bold in above section).

On October 11, 2011, a U.S. Bankruptcy Court found that **the opening** of a typical Merrill Lynch IRA agreement was a prohibited transaction, even though the IRA owner never borrowed or requested a loan from the IRA, nor was there ever any attachment or transfer from the IRA to any non-IRA accounts.[140] The mere *signing* of the agreement (which granted Merrill Lynch a lien) was enough. Not only does this potentially have devastating consequences from a tax perspective, but because the prohibited transaction caused the IRA to cease to be a qualified IRA, the Bankruptcy court denied the IRA owner creditor protection under both Tennessee law and federal Bankruptcy law. Accordingly, the debtor almost lost his $61,000 IRA to creditors when it would have otherwise been protected. To add insult to injury, the former IRA owner would have had to pay income tax, excise tax and penalties that are not dischargeable in bankruptcy (this was not addressed by the court).[141] Thankfully, the appellate

[140] *In re James L. Daley, Jr.*, 459 B.R. 270 (U.S. Bankr E.D. Tenn 2011), reversed by *Daley v. Mostoller (In re Daley)*, 717 F.3d 506 (6th Cir. Tenn. 2013)

[141] The tax situation is complicated for an older PT (and any awards through lawsuit) – has the statute of limitations run on the initial disqualification and income (or, for a Roth, a possible tax loss, but even that is complicated), on the years of subsequent dividends, capital gains and interest not reported, the 6% excise tax for excess contributions,

court reversed this decision, in part because the debtor never opened another account for there to be cross-collateralization. However, the case is still a wake up call for creditors to review IRA agreements for any possible liens or cross-collateralization.

In a similar, but much larger concurrent case, a U.S. District Court considered a class action lawsuit brought on behalf of Schwab IRA owners.[142] Schwab had IRA agreement provisions nearly identical to the Merrill Lynch provision discussed above. In the class action, the plaintiffs alleged that, even though the IRS/DOL has not yet taken any action, the establishment of the IRA with that feature caused a prohibited transaction which in turn caused the disqualification of approximately four million IRAs totaling upwards of $384 billion (yes, you read that correctly, $384 billion).

On December 12, 2011, the Department of Labor (DOL) backtracked from their previous interpretation and agreed to consider a blanket prohibited transaction exemption request from the Securities Industry and Financial Markets Assn (SIFMA) for such agreements. The IRS agreed to temporarily ignore the prohibited transaction ramifications of such agreements as long as no execution or enforcement has occurred, pending further DOL ruling.[143]

The DOL went beyond a mere advisory opinion and issued a proposed prohibited transaction exemption. The statute permits the DOL Secretary to grant an exemption, either conditional or unconditional, under certain circumstances.[144] And it was retroactive.

So, Merrill Lynch and Schwab IRA owners dodged a bullet. However, since the proposed DOL exemption is not forever, any creditor's attorney or bankruptcy trustee may still conduct discovery and subpoena brokerage firms for large enough IRAs to get all pertinent documents in hopes of finding a similar brokerage firm IRA that is not covered by the DOL exemption. This will, of course, include discovery of those rolled over years earlier in the *"chain of title",* since any IRA or plan containing tainted funds may still be at risk if it was rolled over from an offending IRA. If you think this is an exaggeration, read the *Willis* and *Daley* cases cited above, not to mention the dozen or so inherited IRA cases in the appendix. If creditors were that aggressive for a $60,000 IRA in *Daley*, or dogged enough to explore twelve years of transactions in *Willis*, they will certainly pursue larger IRAs that don't even

etc? Generally, IRC §6501 requires a return be filed, and the IRS may argue that this means Form 5329, 5330 or 5498 in addition to Form 1040

[142] *Yoshioka v. Charles Schwab Corp*, 2011 U.S. Dist. LEXIS 147483 (N.D. Ca. 2011)

[143] IRS Announcement 2011-81; http://www.irs.gov/pub/irs-drop/a-11-81.pdf

[144] IRC §4975(c)(2); in ERISA at 11 U.S.C. §1108(a)

require the extensive discovery similar to *Willis*. There is ample case law finding that there is no requirement that the IRS or DOL find or prosecute a prohibited transaction for creditors to exploit one.[145]

So, what options might be available for those who fear they may own an IRA with the taint of a prohibited transaction of some kind? The following will assume that the IRA owner has no issues with the IRS/DOL, yet still has issues vis a vis creditors as discussed above.

Let's analyze a few solutions for such IRA owners, or perhaps other IRA owners, such as inherited IRA owners or QDRO payees, who fear their accounts may not be protected: 1) annuitizing the IRA; 2) moving it to another ERISA tax qualified account; 3) transferring the IRA to an irrevocable grantor trust, 4) transferring the IRA to a disregarded LLC; 5) cashing the IRA in and moving funds to another asset protected vehicle, and lastly, and perhaps the most promising for many reasons, 6) moving to a state that offers protection for IRAs regardless of whether they are tax-qualified; 7) moving the IRA to an irrevocable trusteed IRA sitused in a state with a self-settled asset protection trust statute (DAPT-IRA).

Annuitizing the IRA

In some states, this might be a viable option, because annuities are protected under some state laws. Depending on the state statute, a true "annuitized" stream of income might be required rather than a deferred annuity contract. As discussed herein, Ohio has case law that guts what appears to be statutory protection for a deferred annuity contract, and probably a true annuity (income stream) as well. Even if possible, this solution would still be anathema to many investors, because of the high surrender charges, higher costs, limited investment choices, lack of trust in long-term financial viability of the insurance company and many other reasons. Foremost among those would be that the proceeds would then be largely unavailable to pay any taxes, penalties, negotiated settlement or other unforeseen expenses (except to the extent of the income stream or amount allowed pursuant to contract to be removed without surrender charge, e.g. 5% annually)

Moving the IRA to an ERISA 401(k), 403(b)

A few IRA owners may have the option to transfer their account to an ERISA plan, such as a 401(k) or 403(b). As noted in Section III of this outline, some 403(b) plans are not ERISA, and even if the 403(b) is covered by ERISA, there are gaps in ERISA protection for 403(b)s. Additionally, plans are not

[145] In addition to the cases cited in the material above, see also *Nu-Way Energy Corp. v. Delp*, 205 S.W.3d. 667, *2006 Tex. App. LEXIS 8003*, *In re Hughes*, 293 B.R. 528, 530 (Bankr. M.D. Fla. 2003), *In re Meredith*, 2005 Bankr. LEXIS 2798

required to accept IRA rollovers, even if the IRS permits them - and many do not. Problems like the Schwab/ML cases may be a good reason why plans would not want to accept IRA or 403b rollovers –it might be inviting unwanted uncertainty and risks to the rest of the plan participants.

A savvy IRA owner might think they can start a small business and set up their own ERISA 401k that would permit a rollover. However, recall that owner/spouse-only ERISA plans receive no ERISA protection, as discussed in Section III.

In contrast to state/bankruptcy IRA cases, which uniformly hold that tax disqualification destroys the asset protection,[146] ERISA plan cases are mixed. Generally, tax disqualification will *not* destroy the ERISA protection,[147] but those cases dealt with technical deficiencies rather than whether rollover contributions were eligible to begin with. Arguably, you may only have a "retirement plan", not a "ERISA-qualified retirement plan".

Even in the best case, it is questionable whether this would provide any protection, and it could taint whatever protected 401k account is there. It might simply put you in federal court rather than state court, which arguably favors the creditor. And, for retirees over 70 ½, there is the problem of loss of ERISA protection for any RMDs, as discussed in Section III. Even with all of these problems an IRA owner might still consider transfer because of the additional discovery, research, complexity, federal preemption and other issues the creditor must tackle – but it is unlikely to fend off a creditor who smells blood in the water.

Transferring the IRA to an Irrevocable Grantor Trust

Could an IRA owner transfer their IRA to an irrevocable grantor trust? A recent Trusts and Estates article touted the strategy of selling your Roth IRA to an intentionally defective grantor trust.[148] In addition, one of the most widely respected authors on IRA strategies, Michael Jones, authored an article concluding that an IRA should be able to be transferred to an irrevocable grantor trust without ill effect.[149] I respectfully disagree, more so with the former article, and offer a contrary solution.

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[146] At least my research has not yet located an exception to the half dozen or more cases in this outline to the contrary

[147] E.g. recent cases of *U.S. v. Jewell*, 538 F. Supp. 1087 (2008), protecting ERISA accounts from alleged money laundering seizure and *In re Hemmer*, 2011 Bankr. LEXIS 135 (Bankr. S.D. In. 2011), both of which cited 5th and 7th circuit precedent

[148] *A Decent Proposal: An owner of a Roth IRA can save on taxes by selling his beneficial interest to an intentionally defective irrevocable trust*, S. Horwitz & J. Damicone, Trusts and Estates, November 2011

[149] *Mike Jones on PLR 2011-17042: Can a Grantor Trust Hold an IRA?* Steve Leimberg's Employee Benefits and Retirement Planning Newsletter #575

PLR 2006-20025 and PLR 2008-26008 both allowed a beneficiary to transfer their inherited IRA to an irrevocable grantor trust, and Rev. Rul. 85-13 supposedly ignores grantor trust transactions for income tax purposes,[150] so why did the IRS rule differently in PLR 2011-16005 and 2011-17042? The IRS offered no rationale for the inconsistency. To make their case, arguably the "I" in IRA stands for Individual. An IRA must be for "the exclusive benefit of an individual or his beneficiaries".[151] Note the "or", not "and". Once someone transfers assets to an irrevocable trust that has other vested beneficiaries which is a completed gift, the individual IRA owner no longer has the exclusive benefit of the IRA. This would appear to violate IRC §408(a)(4) as well, as discussed above, and treasury regulation regarding assignments.[152] And, as discussed elsewhere herein, courts have required such accounts to be "primarily for retirement" to be afforded bankruptcy protection, and such schemes seem to argue against that.[153]

But then, many of these arguments could also be used against any IRA that is community property, and no one has ever argued that those are invalid (although apparently some CP states take IRAs out of the definition of community property and the IRS deems all taxable distributions to be separate)[154]. And, is this not equally the case when someone transfers an inherited IRA to a trust as the IRS allowed in two PLRs? Arguably it would then no longer be exclusively for the benefit of the original owner's beneficiaries.

A transfer to a garden variety revocable living trust may well be acceptable, since it is really the alter ego of the grantor in many (though not all) ways. And, arguably, when Congress wanted to prohibit a transfer, it did so – transfers of IRA annuities are expressly prohibited in IRC §408(b)(1), a provision conspicuously absent from the rest of the code section describing IRA "accounts" which are trust or custodial arrangements.

Despite the weakness of the above potential IRS arguments against Rev. Rul. 85-13's allowing such a transfer, there may be a risk that the transaction involves a prohibited transaction under IRC

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[150] Rev. Rul. 85-13, in the author's opinion, often cited for more than it really said – for instance, it is a real stretch to apply this revenue ruling to ignore the trust for prohibited transaction rules
[151] IRC §408(a)
[152] Treas. Reg §1.408-4(a)(2) – "For purposes of this section, an assignment of an individual's rights under an individual retirement account or an individual retirement annuity shall, except as provided in § 1.408-4(g) (relating to transfer incident to divorce), be deemed a distribution to such individual from such account or annuity of the amount assigned."
[153] For instance the *In re Rucker* and *Nessa* cases cited herein
[154] IRS Publication 555: "Therefore, taxable IRA and ESA distributions are separate property, even if the funds in the account would otherwise be community property."

§4975(c)(1)(A). And, while I don't quite see this as an issue, the service may also question whether the new trustee holding title to the IRA should also itself be a US qualified bank or approved custodian pursuant to IRC §408(a)(2).[155]

Transferring the IRA to a LP/LLC disregarded for federal tax purposes

For all the reasons noted above, transferring an IRA to another disregarded entity would be equally problematic, and probably worse. The sole advantage over the irrevocable trust use noted above would be the possible distinguishing treatment as a transfer for "reasonably equivalent value", possibly negating some fraudulent transfer arguments.[156] As planners are well aware, single member LLCs have not fared well of late as asset protection vehicles.[157] Trying to circumvent these cases by having two or more owners for state law, yet still be disregarded for federal tax law (e.g., having your grantor trust be co-owner with yourself) is unlikely to be availing, and would probably stir up even greater prohibited transaction risk. Not to mention the fact that there are multiple urban myths surrounding the protective features of LP/LLCs, such as "the creditor will get my K-1/1099 and have to pay my tax" or "my state law of incorporation will settle all creditor/charging order issues."[158] In short, transferring IRAs to LLCs is a lousy option.

Cashing in the IRA and Transferring Proceeds to NQ Protected Trusts/Entities

This brings to mind the adage, "the cure is worse than the disease". If the IRS/DOL will not prosecute the prohibited transaction, it would take an extreme situation to convince any IRA owner to cash in their account – and give up a Roth conversion. Once the offending IRA is cashed in (and taxes paid), funds could buy a non-qualified annuity, life or long-term care insurance, 529 plan, Coverdell ESA, pay off home mortgage, contribute to a new IRA/401k or other solutions, depending on the state law (many of the above discussed herein). The multiple options are well beyond this outline.

Moving to a state that offers protection for IRAs regardless of tax-qualification

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155 For a list of approved non-bank custodians, see http://www.irs.gov/irb/2005-37_IRB/ar15.html

156 Although frankly, you wonder how people equate them when there is so much FLP marketing literature/tax cases touting "discounts", and the more you get away from single member for state law, such as two members disregarded, the more likely the transfer would diverge from "reasonably equivalent value", see authors separate CLE outline on UFTA/fraudulent transfers

157 In re Albright, In re Olmstead, etc – look up citations

158 *Is the KO by K-1 KO'd by the Code?* Christopher Riser, Asset Protection Journal, Winter 1999, and *LLC Charging Orders: A Jurisdictional and Governing Law Quagmire*, Carter G. Bishop, 12 No. 3 BUSENT 14, 2010 WL 2594393

While most state statutes require the IRA to be "tax qualified" to meet the state's creditor protection requirements, there may be a handful of debtor-friendly states that offer protection regardless of whether the IRA is still qualified. For instance, Florida's statute will exempt a disqualified IRA if "the person claiming exemption proves by a preponderance of the evidence that the fund or account is maintained in accordance with a plan or governing instrument" or that it:

> b. Would have been in substantial compliance with the applicable requirements for tax exemption under s. 401(a), s. 403(a), s. 403(b), s. 408, s. 408A, s. 409, s. 414, s. 457(b), or s. 501(a) of the Internal Revenue Code of 1986, as amended, but for the negligent or wrongful conduct of a person or persons other than the person who is claiming the exemption under this section.[159]

Of course, that puts the burden on the IRA owner to prove their IRA would have been compliant but for negligent or wrongful conduct of the custodian, but it does give a clear roadmap for protection. It also brings up some interesting issues should the IRA owner be in bankruptcy.

Transfer to an Irrevocable Domestic Asset Protected Trusteed IRA (DAPT-IRA)

A general description of all the various advantages of trusteed IRAs is beyond the scope of this outline.[160] Heretofore undiscussed in IRA literature is the potential advantage of making the trusteed IRA comply simultaneously with both IRA code and regulations and one of the various state self-settled asset protection statutes, such as Delaware's Qualified Dispositions in Trusts Act or Ohio's Legacy Trust Act.[161] I will refer to this as a DAPT-IRA. You cannot have an offshore APT-IRA – an IRA must be "created or organized in the United States".[162]

A DAPT-IRA has several potential advantages: application to sticky divorce scenarios, alimony and child support situations where simple divisions are not ideal, potentially enabling better options in the Medicaid planning context, better creditor protection for IRA owners in states with weak protection for IRAs[163], better protection for those in states with various holes in their statutes or preference

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[159] Fla Stat. §221.21, Illinois has a similar provision at 735 ILCS 5 §12-1006 "intended in good faith to qualify"
[160] See, *Trusteed IRAs: An Elegant Estate Planning Solution*, Morrow, Trusts and Estates, September 2009
[161] http://delcode.delaware.gov/title12/c035/sc06/index.shtml, Ohio R.C. §5816.01 et seq.
[162] IRC §408(a)
[163] Such as Nevada, California, Maine

creditors[164], better protection for inherited IRAs (in bankruptcy or not) and better protection for special needs or vulnerable IRA owners.[165]

But why would this be different than the sale or transfer of an IRA to an irrevocable grantor trust idea debunked earlier? It differs for several important reasons, summarized in part as taxable gift issues, exclusive benefit rule, transfer/assignment rules, qualified custodian/trustee, practical issues and prohibited transactions. Many of these distinctions are indirectly emphasized by the IRS' recent approval of certain self-imposed IRA restrictions in PLR 2011-50037. Benefits are even greater for Roth IRAs.

Taxable Gift Issues. Unlike the transfer to an irrevocable grantor trust idea, a DAPT-IRA would never involve a completed gift, and there would never be an audit/PT risk regarding valuation, seed gift or personal guarantees typically associated with sales to grantor trusts. The DAPT-IRA owner would at all times have the right to change beneficiaries – a testamentary power of appointment executed by beneficiary designation form. This is consistent with both DAPTs and the Code.[166] Unlike a typical irrevocable grantor trust, no transfers can be made from a DAPT-IRA to anyone other than the IRA owner during the IRA owner's lifetime, so this is consistent in keeping with the recent IRS advisory on complete/incomplete gifts.[167] There would be no completed gift.

Exclusive Benefit Rule. Unlike an installment sale of the IRA to an irrevocable grantor trust, using a DAPT-IRA keeps the IRA owner as the sole beneficiary during his or her lifetime.

Qualified custodian/trustee. As mentioned above, would the IRS demand a trustee of an irrevocable grantor trust owning an IRA to in turn be a qualified IRA trustee? This is not a problem if a national bank or trust company is trustee, but could be when someone names an attorney, accountant, advisor or family member as trustee.

Practical issues/concerns. What IRA provider is going to allow transfer of ownership of an IRA to a trust at all (most prototypes forbid it, having a clause that the IRA is non-assignable/transferable)? Even if they do, they would certainly send a 1099-R showing a full distribution (as the custodian did in

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[164] This would be many if not most state IRA creditor protection statutes, even favorable one's like Florida's, and the scope of all the problems of the various states' statutes, which as a whole are riddled with openings for creditors, is beyond the scope of this outline – some of Ohio's faults are discussed in Section II(a) and (b)
[165] See, e.g. *Natalie Choate's Discussion of PLR 2011-50037: Disability Planning for IRAs* Steve Leimberg's Employee Benefits and Retirement Planning Newsletter #597
[166] Treas. Reg. 25.2511-2(c), E.g. Delaware's *Qualified Dispositions in Trust Act*, Del. Laws §3570(11)(b)(2)
[167] Chief Counsel Advisory 2012-08026

PLR 2011-50037, which the IRS noted was the proper course)? However, a handful of sophisticated trustees have been customizing trusteed IRAs for quite some time and would have no cause to issue a 1099-R at all, especially if it were using a newly approved prototype.

Nonforfeitability. As mentioned above, selling an IRA to an irrevocable grantor trust seems to violate IRC §408's requirement that "The interest of an individual in the balance in his account is nonforfeitable", since the individual no longer has any interest in the balance of his account, if you can even call it his. And even if the new irrevocable grantor trust is protected from "outside" creditors, there seems to be the potential for "inside" creditors, such as the non-IRA trustee, attorney or accountant providing services, or even remainder beneficiary claims and liens applying through the non-IRA trust to the IRA now. By contrast, a DAPT-IRA can only benefit the grantor during the grantor's lifetime, and is arguably MORE nonforfeitable than a garden variety IRA, because of the additional protections to the account.

Prohibited Transaction Risk. Insider sales, transfers, powers of substitution to create grantor trust status, new fiduciaries – all of these features of selling an IRA to a separate grantor trust reek of prohibited transaction risk. This is probably the most important area where the DAPT-IRA should be preferred over transferring the IRA to another legal owner. There are probably multiple ways that such structures might trigger PT risk, but let's take just one – if the grantor, spouse, child or other related party serves as trustee of the trust, or pays drafting/attorney/trustee fees, have they provided goods and services to the IRA (a violation of IRC §4975(c)(1)(C))? Arguably not, they merely provided services or contributions to the trust holding it, but then if you are going to argue that Rev. Rul. 85-13 requires ignoring the grantor trust, then you are logically left with the conclusion that the services inure to the IRA itself and create a prohibited transaction or cause a non-cash contribution. The IRS, which is usually mercilessly whipsawed by taxpayers using Rev. Rul. 85-13, would relish for once being in the enviable position of the one with the whip.

PLR 2011-50037. Although PLRs are not "precedent", this ruling, in conjunction with the other PLRs negatively ruling on transferring ownership of IRAs to separate trusts, does inform how the IRS will (and should) see the DAPT-IRA differently. In this ruling, the IRA owner was getting divorced from his wife who suffered bipolar disorder, and the IRA would be divided pursuant to the divorce. As a result of the divorce decree, certain delays, restrictions and notifications to third parties were desired to be placed on the wife getting at IRA funds beyond the RMDs, to better protect her from temporary uncontrolled spending. At issue and addressed by the PLR are many of the issues discussed above, such as whether such restrictions would: 1) cause the IRA to not be held for the "exclusive benefit" of wife; 2) be considered a prohibited transaction; 3) give rise to a deemed distribution; 4) "give rise to an assignment" of the IRA; or 5) cause the IRA to lose its income tax exemption under § 408(e)(2)(A). The IRS answered "no" to all of these. A DAPT-IRA's restrictions are hardly different from the restrictions accepted by the IRS in this PLR. Indeed, irrevocable trusteed IRAs would offer greater retirement protections and certainty than the somewhat meager notice restrictions in this PLR, and, properly tailored, could even be a "major advance in disability protection" and "substantially protect the participant from the fraudulent characters who prey on seniors' IRAs and generally from taking excess distributions unwisely".[168]

DAPT protection for mandatory distributions – Compelling Case for Roth Conversions

One of the many arguments that DAPT proponents make is that under the various state DAPT statutes, a purely discretionary interest in a DAPT is not even an attachable property right. So, if a creditor gets a judgment against debtor/beneficiary in State X, and seeks to enforce the attachment against the trustee in the DAPT state, the trustee must accept the validity of the judgment under the US Constitution's full faith and credit clause, but will simply reply that the debtor/beneficiary subject to attachment has no property rights in the trust upon which the judgment may attach.

A "traditional" DAPT-IRA would have no mandatory distributions until April 1 of the year after the grantor/owner reaches ager 70 ½. A "Roth" DAPT-IRA would have no mandatory distributions during the grantor/owner's lifetime at all. Accordingly, a Roth conversion may be in order for traditional DAPT-IRAs to better assure this treatment, and has the added benefit of reducing the outside funds in non-asset protected accounts through payment of the income tax. For further discussion of these issues, plus why such conversions are unlikely to trigger fraudulent transfer concerns, see other material developed by the author.[169]

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[168] *Natalie Choate & PLR 2011-50037: Disability Planning for IRAs* Steve Leimberg's Employee Benefits and Retirement Planning Newsletter #597, though speaking of allowing restrictions on IRAs in general rather than DAPT-IRAs specifically

[169] *Roth IRA Conversion Analysis: What Advisors Miss and Software Won't Tell You*, 2010 CLE, *Fraudulent Transfer Law for Financial and Estate Planners*, 2010 CLE

VII. Post-Mortem – Protections for a Decedent's Estate

Imagine your client fell asleep at the wheel and drove across the line killing himself and other people. You now represent the estate, which faces large potential wrongful death claims, as well as widow who receives certain assets outright or in trust. Can creditors of the estate get at these protected accounts? Could they claim that the transfer at death is a fraudulent transfer?[170] If you advise to pay out to creditors when you don't have to, the executor (or you yourself) may face claims. Let's take the easiest category first, and assume someone was smart enough to not name their estate as beneficiary (a bad idea for many reasons). On a related note, naming a subtrust of a revocable living trust may be completely different from naming a living trust as beneficiary, for both asset protection reasons as well as "see through trust" reasons.[171]

Insurance – Ohio R.C. §3911.10 (and §3911.14) clearly protects insurance proceeds payable to eligible beneficiaries from claims of a decedent's creditors.

Ohio R.C. §2329.66 exemptions (IRAs, homestead, retirement plans, education IRAs, etc) – "Every person who is domiciled in this state may hold property exempt from execution, garnishment, attachment, or sale to satisfy a judgment or order, as follows:" Is the estate (PR) a "person"? Perhaps, but there are other reasons that an estate will not qualify for many of the §2329.66 exemptions (e.g., whether you can still have a "homestead", whether the estate made "contributions").

Notably, none of the probate court insolvency forms contemplate having any property exempt from creditors, so at the very least you may have more difficulty utilizing the exemption, if it exists at all.[172]

Other states are mixed. Under New York state's statutes, CPLR §5205(c) and more specifically, EPTL §13-3.2 (for estates/beneficiaries), NY clearly extends creditor protection for retirement plan/IRA assets to an estate from a decedent's creditors.[173] Another Oklahoma court case held the same under its law.[174] A California case also protected an decedent's IRA payable to beneficiaries from a decedent's

[170] See discussion in separate UFTA outline and section

[171] See related cases in Section X herein on trusts, as well as *Commerce Bank, NA v. Bolander*, 44 Kan App.2d 1 (2007) (denying protection to rev trust as beneficiary of decedent debtor's IRA), see author's separate CLE outline and checklists on see through trusts and stretch IRA rules

[172] See Ohio R.C. §2117.15, Probate Forms 24.0, 24.4, 24.6

[173] See also, *In re Estate of King*, 196 Misc.2d 250 (Sur Ct. NY 2003), *Matter of Gallet*, 196 Misc. 2d 303 (2003)

[174] *Matter of Estate of Patee*, 1983 OK 65, 664 P.2d 1035 (Okla. 1983)

estate's creditors.[175]

What about the federal government collecting tax? Estates owing estate tax will not usually be insolvent, but an executor still has to worry about other taxes owed by a decedent.

In the case of an insolvency, the IRS may be entitled to payment of federal taxes ahead of other creditors under the Federal Priority Statute.[176] If a fiduciary pays other claimants ahead of the IRS, the fiduciary may be *personally* liable.[177] Although the statute does not provide for any exceptions to the Government's priority, courts have held that certain classes of claim can be paid before the tax debt. These excepted classes include administrative expenses, funeral expenses, and homestead or family allowances. Administrative expenses are expenses incurred for the general welfare of creditors and include court costs, reasonable compensation for the fiduciary and fiduciary's attorney and expenses incurred to collect and preserve assets.

[175] *Estate of Davis*, 171 Cal. App.3d 853 (1985),
[176] 31 U.S.C. § 3713(a)
[177] 31 U.S.C. § 3713(b)

VIII. Post-Mortem –Protections for Beneficiaries

a. ERISA

ERISA generally protects beneficiaries equally to plan participants.[178] However, there is a minority of district court cases that hold that benefits derived pursuant to a QDRO are NOT exempt. While many treatises and commentators (including this author) believe they are wrongly decided, they do set a negative precedent and one of these cases is from the Southern District of Ohio.[179] Thankfully Ohio amended and clarified its law in this area recently to more clearly provide QDRO alternate payees similar to protections to other owners.[180] However, all states are not so generous, and a spouse receiving a portion of a plan pursuant to QDRO may not be protected (at least, not without filing bankruptcy) and should consider rolling plan proceeds into an IRA or his or her own qualified plan if possible (ideally by plan to plan transfer).

It is also unclear whether ERISA protection fully extends to beneficiaries. In theory, it should, because ERISA is worded to protect "benefits" not "employees" or some other narrower definition. As discussed above, courts are split as to protecting QDRO interests. The U.S. Supreme Court has stated that the purpose of ERISA protection for retirement plans is to "safeguard a stream of income for pensioners (and their dependents, who may be, and perhaps usually are, blameless)".[181] This begs the questions: What about protection for beneficiaries who are not blameless? Or beneficiaries who are not dependents? Once the pensioner and potentially spouse/dependents are dead, is there a public policy rationale to protect the retirement benefits? Would it matter if children are no longer dependents?

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[178] See, 11 U.S.C. § 1056(d)
[179] *In Re Hageman*, 260 BR 852, 857 (Bankr. SD Ohio 2001)
[180] Ohio R.C. §2329.66(f) "The exemptions under divisions (A)(10)(a) to (e) of this section also shall apply or otherwise be available to an alternate payee under a qualified domestic relations order (QDRO) or other similar court order."
[181] *Guidry v. Sheetmetal Pension Fund*, 493 US 365, 376 (1990), protecting ERISA retirement funds for an embezzling union worker.

b. State exemption law regarding inherited IRAs

If one reads Ohio's creditor exemption for IRAs carefully, one will note that it is protected to the extent of *contributions of the debtor*. It is highly doubtful that this includes inherited IRAs. Courts have not been kind to non-employees who have interests in retirement funds, previously ruling that the applicable Ohio exemption for certain retirement funds was personal to the individual whose work gave rise to the right to receive a benefit.[182]

Two recent cases in the Northern District of Ohio recently held that inherited IRAs are NOT protected under Ohio law, because the funds are not "contributions of the debtor" and are not made "by reason of illness, disability, death, or age" (citations to the R.C. §2329.66(A)(10)(c) requirements).[183] The court held they were protected in bankruptcy, however (discussed in next section).

In Indiana, the legislature recently changed its statute to cover spouses ("contributions, or portions of contributions, that were made to the retirement plan or fund by or on behalf of the debtor *or the debtor's spouse")*.[184] Other courts, cited in the section below, have uniformly refused to protect IRAs and similar plans under various states' laws – even spouses. In Florida, recent legislation provides excellent protection to not only spouses but clearly to beneficiaries.[185]

c. State spendthrift trust law for third-party created trusteed IRAs

While state creditor protection statutes are unlikely to protect a beneficiary of an IRA (outside of the exception in the 8 states noted above for qualifying resident beneficiaries), the common law of third party trusts, including the Uniform Trust Code, should protect third party created *irrevocable trusts that happen to be in the form of IRAs*. This is a minority of IRAs and is an often overlooked option.[186] IRAs can be in the legal form of a contract or a trust. Most are custodial agreements – contracts.

A trusteed IRA that allows the beneficiary to withdraw the entire amount at will is akin to a lifetime presently exercisable general power of appointment and should not offer any more protection than an ordinary custodial IRA.[187] However, a trusteed IRA that limits distributions to the required minimum distributions (RMDs), perhaps with trustee discretion to pay more, should afford the

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[182] *In re Mabrey*, 51 B.R. 383, 384-85 (Bankr. S.D. Ohio 1985)
[183] *In re Kochta*, 434 B.R. 837
[184] IND. CODE § 34-55-10-2
[185] Fla Stat. §221.21
[186] See, *Trusteed IRAs: An Elegant Estate Planning Option*, Morrow, Trusts and Estates Sept 2009
[187] For discussion why ordinary custodial inherited IRAs are denied protection and exclusion (as opposed to exemption) in bankruptcy, see the second section of the court's discussion in *In Re Kochta* cited above.

beneficiary the same protections as any trust with a mandatory income distribution provision.[188]

[188] See Uniform Trust Code Article 5 for general protections, even for mandatory distribution trusts, provided there are no unreasonably overdue distributions. See 11 U.S.C. §541(c)(2) for bankruptcy protection of spendthrift trusts

IX Post-Mortem – Bankruptcy Protections for Beneficiaries

Where a debtor's interest in a plan is distributed after the filing of petition but prior to closure of a bankruptcy case, the distribution may be part of the estate to the extent it represents benefits accrued prebankruptcy.

Most exemptions in bankruptcy for inherited plans will now be a result of ERISA or state statutes discussed above. It is now clear that the additional retirement plan bankruptcy exemption sections added by the BAPCPA that are applicable regardless of whether the state or federal exemptions are used, 11 U.S.C. §522(b)(3)(C) and §522(d)(12), have been made inapplicable for inherited accounts – at least for non-spouse beneficiaries.

Steve Leimberg's Asset Protection Planning Email Newsletter - Archive Message #248

Date: 16-Jun-14

From: Steve Leimberg's Asset Protection Planning Newsletter

Subject: Ed Morrow on Clark v. Rameker: Supreme Court Holds that Inherited IRAs Are Not Protected in Bankruptcy Are Spousal Inherited IRAs and Even Rollover IRAs Threatened As Well?

"On June 12, 2014, Justice Sotomayor, writing for a unanimous Supreme Court, resolved a split among circuits as to the protection afforded under the Bankruptcy Code for inherited IRAs. The Court affirmed the underlying 7th Circuit decision and held that once such accounts are inherited, they lose their character as "retirement funds" in the hands of the inheriting party within the meaning of 11 U.S.C. §522(b)(3)(C).

The ramifications of the Court's decision may be broader than you think – it may threaten creditor protection in bankruptcy for surviving spouses as well as other beneficiaries. While inherited spousal IRAs might be protected in bankruptcy under the Supreme Court's interpretation once they are rolled over, they may not be protected until that time and any spousal rollover may be subject to avoidance under fraudulent transfer law.

The Supreme Court decision in Clark should encourage owners of larger IRAs concerned about asset protection for their beneficiaries, even for their spouse, to reconsider outright bequests of IRAs, especially in blended family situations where there may already be other non-tax reasons to consider a trust."

Ed Morrow provides members with important commentary on the Supreme Court's recent decision in Clark v. Rameker.

Ed Morrow, J.D., LL.M., MBA, CFP®, is an Ohio attorney and national wealth specialist with Key Private Bank. His last LISI newsletter, a white paper discussing redesigning trusts for more optimal income tax planning, has been updated (The Optimal Basis Increase Trust, LISI Estate Planning Newsletter #2081, March 20, 2013, updated version at this link). He can be reached at edwin_p_morrow@keybank.com or edwin.morrow3@gmail.com.

Before we get to Ed's commentary, members should note that a new 60 Second Planner by Michelle Ward was recently posted to the LISI homepage. In her commentary, Michelle reports on the United States Supreme Court decision in Clark v. Rameker, where the Court held that inherited IRAs are not "retirement funds" and therefore are not excluded from the bankruptcy estate of the owner. You don't need any special equipment - just click on this link.

Now, here is Ed Morrow's commentary:

EXECUTIVE SUMMARY:

On June 12, 2014, Justice Sotomayor, writing for a unanimous Supreme Court, resolved a split among circuits as to the protection afforded under the Bankruptcy Code for inherited IRAs. The Court affirmed the underlying 7th Circuit decision and held that once such accounts are inherited, they lose their character as "retirement funds" in the hands of the inheriting party within the meaning of 11 U.S.C. §522(b)(3)(C).

The ramifications of the Court's decision are broader than you think – it may threaten creditor protection for surviving spouses as well as other beneficiaries. While inherited spousal IRAs might be protected in bankruptcy under the Supreme Court's interpretation once they are rolled over, they may not be protected until that time and any spousal rollover may be subject to avoidance under fraudulent transfer law.

FACTS:

This commentary will quickly frame the central issue before the Court, recap the case and the rationale of the Supreme Court's decision, discuss how the case threatens protection for surviving spouses as well as protection for other beneficiaries and explore solutions to ensure creditor protection.

Issue Resolved by the Supreme Court

After a retirement plan owner dies, are such funds still "retirement funds" for purposes of the Bankruptcy Code, 11 U.S.C. §522(b)(3)(C) and (d)(12), which exempt "retirement funds to the extent that those funds are in a fund or account that is exempt from taxation under section 401, 403, 408, 408A, 414, 457, or 501(a) of the Internal Revenue Code of 1986?"

Answer

No. "Funds held in inherited IRAs are not "retirement funds" within the meaning of §522(b)(3)(C)."

Facts of Underlying Case

Ruth Heffron died and left her IRA to her daughter Heidi Heffron-Clark as beneficiary, which had dwindled to about $300,000 by the time Heidi and her husband filed bankruptcy. Heidi argued that the bankruptcy statute, 11 U.S.C. §522(b)(3)(C), should exempt those assets from creditor claims against her bankruptcy estate. The bankruptcy court had disagreed and held they were not exempt. The district court reversed and held that such plans were protected but the court of appeals reversed, halting a trend among other circuits and many lower courts to protect inherited IRAs.

Rationale of 7th Circuit and the Supreme Court in Affirming the 7th Circuit:

The bankruptcy code protects "retirement funds to the extent that those funds are in a fund or account that is exempt from taxation under Sections 401, 403, 408, 408A, 414, 457 or 501(a) of the Internal Revenue Code." [1] The funds were in an account exempt from taxation under IRC §408 – an IRA. What the Court questioned, and answered in the negative, was whether her account was even a "retirement fund" in Heidi's hands at all once she inherited the account. The bankruptcy code does not define "retirement fund." To the Supreme Court, funds cease to be "retirement funds" once the owner dies.

The Supreme Court adopted a narrow view of what "retirement funds" can be, and settled on what it termed the "ordinary meaning" of the term:

> The ordinary meaning of "fund[s]" is "sum[s] of money . . . set aside for a specific purpose." American Heritage Dictionary 712 (4th ed. 2000). And "retirement" means "[w]ithdrawal from one's occupation, business, or office." Id., at 1489. Section 522(b)(3)(C)'s reference to "retirement funds" is therefore properly understood to mean sums of money set aside for the day an individual stops working.

The Court cited three legal characteristics of inherited IRAs that helped lead to its conclusion that these are not "sums of money set aside for the day an individual stops working":

> 1) the holder of an inherited IRA may never invest additional money in the account
>
> 2) holders of inherited IRAs are required to withdraw money from such accounts, no matter how many years they may be from retirement
>
> 3) the holder of an inherited IRA may withdraw the entire balance of the account at any time— and for any purpose— without penalty.

The public policy arguments behind the interpretation are clear – why should inherited retirement accounts be creditor protected?

For if an individual is allowed to exempt an inherited IRA from her bankruptcy estate, nothing about the inherited IRA's legal characteristics would prevent (or even discourage) the individual from using the entire balance of the account on a vacation home or sports car immediately after her bankruptcy proceedings are complete. Allowing that kind of exemption would convert the Bankruptcy Code's purposes of preserving debtors' ability to meet their basic needs and ensuring that they have a "fresh start," Rousey, 544 U. S., at 325, into a "free pass," Schwab, 560 U. S., at 791. We decline to read the retirement funds provision in that manner.

Spousal Inherited IRAs at Risk? Extending the Court's Rationale to Spouses Who Inherit

Let's apply the Court's definition of "retirement funds" and the above rationale to surviving spouses who inherit IRAs. Again, to quote the Court:

> An inherited IRA is a traditional or Roth IRA that has been inherited after its owner's death. See §§408(d)(3)(C)(ii), 408A(a). If the heir is the owner's spouse, as is often the case, the spouse has a choice: He or she may "roll over" the IRA funds into his or her own IRA, or he or she may keep the IRA as an inherited IRA.

Thus, spousal rollovers are NOT automatic, though they may be accomplished in rather passive manner, such as not taking an RMD or contributing to the account, and therein lies the rub.

The spouse who inherits an IRA did not set aside his or her own funds, and it's hard to see how spousal inherited IRAs can achieve protection under the Court's rationale:

> In ordinary usage, to speak of a person's "retirement funds" implies that the funds are currently in an account set aside for retirement, not that they were set aside for that purpose at some prior date by an entirely different person.

Most people consider their spouse "an entirely different person."

Going back to the Court's three characteristics of inherited IRAs and why they are not "retirement funds," surviving spouses, like other inheriting parties, cannot add to the inherited IRA without causing or executing a rollover, they may be required to withdraw money earlier than reaching 70 ½, and can withdraw the entire account for a "vacation home or sports car" without penalty as well. The required beginning date for a spousal inherited IRA may depend on whether the spouse is a "sole beneficiary" or not, and the age of decedent.[2]

Financial and estate planners often advise surviving spouses who are under age 59 ½ to delay rollovers, at least in part, and keep funds as an inherited IRA until that age, depending on other liquidity. This is because, while their account enjoys the same tax deferral, in an emergency (unlike a rollover), they could get access to funds without the 10% early withdrawal penalty. There is no hard and fast deadline for a spousal rollover, but now surviving spouses under 59 ½ concerned about creditor protection should more strongly consider earlier rollovers.

Protection for Spousal Rollovers

Once a spouse rolls over the IRA to his or her own, it is unclear whether and how the Bankruptcy Code will protect the funds. The Bankruptcy Code has a special paragraph to allow spousal rollovers and transfers between different qualified plans to continue to be qualified.[3]

However, this merely begs the question of whether the IRA loses its qualification as a "retirement fund" once inherited. While courts may ultimately carve an exception and protect spousal IRA rollovers, the fact that the Supreme Court has now defined "retirement funds" to exclude funds set aside by a different person merely invites aggressive creditor attorneys to attack any spousal rollovers under this line of argument and it may be years before we get further clarification.

Even if spousal IRA rollovers do not qualify as “retirement funds” under the Supreme Court’s interpretation of §522(b)(3)(C) and (d)(12), a surviving spouse might argue that the funds should be protected under state law, pursuant to §522(b)(3)(A), if the state statute would otherwise protect such funds, and if the state statute requires or allows “opting out” of federal exemptions, and if the debtor/spouse has met the 720-day state residency requirement.

Fraudulent Transfer Surprise and Why Spousal Rollovers May Even Have a 10-Year Statute of Limitations Look Back

So, big deal, every surviving spouse over 59 ½ will likely rollover funds to his or her own IRA, and those who are younger will do so later or at least in part, courts will probably carve out a spousal rollover exception and if they run into creditor problems, they can always roll it all over then, right?

Not so fast. What if the surviving spouse is insolvent or has pending legal/creditor problems at the time? Normally, we don’t think of IRA rollovers as ever implicating the Uniform Fraudulent Transfer Act (“UFTA”), because qualified plans and IRAs are normally exempt and therefore not normally considered an “asset” as defined under §1(2) of the UFTA. Perhaps if the surviving spouse lives in one of the seven states that provide protection for inherited IRAs, this would still be true. However, certainly under most states’ laws, under Clark, a spousal rollover by a debtor could be a fraudulent conversion of non-exempt assets (inherited IRA) to an exempt asset (spouse’s own IRA) and creditor attorneys should pursue that line of attack in the right circumstance as well.

Among the many myths out there about fraudulent transfers are that that you always have to prove malice or that valid “financial or estate planning” reasons prevent the finding of a fraudulent transfer or that “mere retitling” or other more passive actions or inactions that don’t sound like a “transfer” cannot be a fraudulent transfer. All untrue.

“Constructive” fraudulent transfers involve more of an insolvency test at the time of transfer and require no adverse finding of subjective intent whatsoever. Assets that cannot be attached by creditors are not counted for this analysis, so many people who think they are solvent or even moderately wealthy may not be solvent at all, when homestead, life insurance, 529 plans, qualified plans, third-party or DAPT trusts and potentially other assets are subtracted from the analysis.

“Actual” fraudulent transfers typically involve analysis of many factors called “badges of fraud,” and actual fraudulent transfers can still be found despite a compelling and legitimate financial or estate planning reason. Furthermore, 11 USC §548(e) of the Bankruptcy Code established a new 10-year statute of limitations for avoiding transfers to “self-settled trusts or a similar device.” Surprise – courts have found IRAs to be a “similar device” – and no wonder, since they are really just a self-settled trust with special tax characteristics. [4]

Voiding a spousal IRA rollover for “actual” fraud would certainly be more difficult than voiding more egregious transfers, but not impossible. A creditor would undoubtedly prefer to attempt to void a rollover for “constructive” fraud if the facts fit, and this type of avoidance action would not be subject to the additional ten year statute of limitations under §548(e). Some professionals would undoubtedly prefer to avoid either risk.

ERISA or State Law May Still Provide Protection for Inherited Accounts - But May Not

While not at issue in Clark, inherited retirement plans may also receive creditor protection under ERISA, which would not rely on a court’s interpretation of 11 USC §522, but in bankruptcy relies on 11 USC §541 (an exclusion, not an exemption – often these work to the same effect, but there are subtle differences). Many pre-BAPCPA cases (Bankruptcy Abuse Prevention and Consumer Protection Act of 2005) held that some 403(b) or other annuity or custodial arrangements under ERISA plans do NOT qualify because there is no “trust.” This difference is one of the reasons Congress amended the Bankruptcy Code to put all retirement plans on equal footing, but debtor and creditor attorneys may now be going back to the Wild West of trying to determine when inherited ERISA plans qualify for exclusion.

However, most ERISA plans do not permit non-employee beneficiaries to remain in the plan to "stretch out" distributions over their lifetimes , so this may only provide protection to spouses who can rollover directly to their own qualified retirement plan without leaving the confines of ERISA, or perhaps those who can file bankruptcy in the short period they are still allowed in the plan. Either case still begs the question of whether the original ERISA plan qualifies for an exclusion rather than exemption.

Lest we conclude that ERISA plan protection is always superior to IRA protection, there are plenty of instances where the exact opposite is the case, most recently, the 9th Circuit decision permitting the IRS to levy on an ERISA plan where the same levy would not have been allowed had the debtor owned a mere IRA.[5] Moreover, many small ERISA plans, similar to SEP-IRAs, do not qualify for creditor protection under ERISA (hence, not eligible for an exclusion) anyway.

A handful of states have added provisions to their creditor/garnishment protection statutes to clarify that inherited IRAs equally qualify, or have a favorable state court decision, but those are a minority.[6] Such protection, if the state allows it, would fall under 11 U.S.C. §522(b)(3)(A), which protects "any property that is exempt under… State or local law that is applicable on the date of the filing of the petition…," rather than under §522 (b)(3)(C). It is difficult to count on these state statutes for long-term planning, however, since beneficiaries are mobile and may change their state of residency years later. Moreover, the debtor/beneficiary cannot simply "pull an O.J." and move to Florida before filing; Congress added a 730 day pre-filing residency requirement under §522(b)(3)(A).

What Options Are There To Protect Inherited Retirement Plan Accounts and Why Do Options Differ for Spouses?

Naming a separate fully discretionary trust as beneficiary is the best option for creditor protection, and you also have simpler trusteed IRA options for larger IRAs, and IRA annuities with restricted payout options, probably more applicable for smaller IRAs, that might provide alternative protection if the beneficiary lives in a state that protects annuity proceeds.[7] A third party created trust or trusteed IRA should be considered a third-party created spendthrift trust as to a beneficiary, eligible for exclusion under §541 of the Bankruptcy code, rather than an exemption under §522.

Properly drafted, the trust would qualify as a "see through trust" to enable substantial tax deferral as well. But even in the best circumstances, it would not be as advantageous for tax deferral as a rollover: a see through trust would still have to use the single life expectancy table of the spouse, rather than the more advantageous joint life expectancy tables. A conduit trust (or trusteed IRA) in which the spouse is the "sole beneficiary" would get better income tax deferral than an accumulation trust, because the spouse's life expectancy can be recalculated every year, and there may be a delayed required beginning date, but this is still less advantageous than a rollover. While a conduit trust, which requires minimum distributions to the beneficiary every year, does undercut creditor protection somewhat, it may do so less than people think, since some states would allow such mandatory payments to be paid "for the benefit of" the debtor/beneficiary without creditor attachment.[8]

For those with significant charitable intent as part of their estate plan, someone could simply forget the stretch IRA rules and leave IRA funds to a charitable remainder trust for a spouse or other beneficiary. From an asset protection perspective, CRTs suffer from the same limitations as the conduit trust and trusteed IRA, due to the mandatory annuity or unitrust payout, and have additional ones, in that no discretionary payments can be made beyond the annuity/unitrust.

What about a beneficiary contributing their IRA to a domestic asset protection trust? As discussed above, this would trigger UFTA and §548 concerns, but just as importantly, it would probably trigger income tax if it is a taxable gift, with attendant penalties to boot.[9] If it is structured as an incomplete gift, grantor trust, there is at least a good argument to avoid a taxable event, but it's still very uncertain. There is scant guidance on such transfers and for any large IRA, practitioners may consider obtaining a PLR.

The Promise (and Dangers) of Relying on Disclaimer-Based Planning for Creditor Protection

A disclaimer -based contingency plan might be considered. In the vast majority of states, qualified disclaimers cannot be considered fraudulent transfers, but even this protection has more holes in it than practitioners realize. Generally, if an owner names the surviving spouse as primary beneficiary and establishes a discretionary “see through trust” as contingent beneficiary, and the surviving spouse has creditor concerns at the time of the owner’s death, he or she might disclaim into the more protected trust without fear of fraudulent transfer under most states’ laws.

This assumes the disclaimant will exercise no prior acceptance or control that might taint a disclaimer. In addition, a handful of states have exceptions for insolvent disclaimant/debtors, and there is a clear exception when the creditor happens to be the IRS with a tax lien.[10] Moreover, in bankruptcy, the analysis is complicated further, and may depend on whether the disclaimer is pre- or post-petition or made within one year - there is still uncertainty as to whether and when the bankruptcy court must follow state disclaimer “relation back” law, and whether disclaimers made within one year may deny a discharge.[11] Denying a discharge may be even worse than avoiding a transfer! So, the common wisdom that disclaimers to discretionary trusts can work asset protection magic may not be so wise – if asset protection is truly important to the client, do not rely on disclaimer funding.

Note that the typical disclaimer-to-trust strategy does not work for other beneficiaries, since disclaimers causing transfers into a trust for one’s benefit are only “qualified” for surviving spouses, unless the contingent beneficiary trust into which funds are disclaimed is not overly controlled by or benefitting the disclaimant.[12]

Conclusion

The Supreme Court decision in Clark should encourage owners of larger IRAs concerned about asset protection for their beneficiaries, even for their spouse, to reconsider outright bequests. Inheriting spouses now have one more reason to quickly rollover any inherited retirement plan, or consider disclaiming into a trust if one had already been named as a contingent beneficiary.

HOPE THIS HELPS YOU HELP OTHERS MAKE A POSITIVE DIFFERENCE!

Ed Morrow

TECHNICAL EDITOR: DUNCAN OSBORNE

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Clark v. Rameker, 573 U. S.________________(2014).

CITATIONS:

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[1] 11 U.S.C. § 522(b)(3)(C) and (d)(12), the former applicable to those required to, eligible for or opting to use state exemptions and the latter applicable to those debtors who opt-in or are required to use federal bankruptcy exemptions in lieu of state exemptions. While the Court did not address paragraph (d)(12), it has the exact same wording and the Court's decision should apply equally to that paragraph as well.

[2] For a good overview of spousal rollovers, deemed rollovers, elections and different RMD rules between inherited and rollover IRAs, see ¶3.2, Life and Death Planning for Retirement Benefits, 7th Edition, Natalie Choate.

[3] 11 U.S.C. §522(b)(4)(D)

[4] In re Thomas, 2012 WL 2792348 (Bankr. D. Id., Slip Copy, July 9, 2012). [5] Gross v. Commissioner, Case No. 12-72279 (9th Cir. Feb. 25, 2014)

(unpublished).

[6] Tex. Prop. Code § 42.0021, Fla. Stat. Ann. §222.21, Ohio R.C. §2329.66 (A)(10)(e), Ariz. Rev. Stat. §33 1126(B), Mo. Rev. Stat. §513.430.1(10)(f), Alaska Stat. §09.38.017(a)(3), N.C. Stat. §1C-1601(a)(9), In re McClelland, 2008 Bankr. Lexis 41 (Bankr. D. Id. Case 07-40300, 2008), construing Idaho Code Ann. § 11-604A

[7] See Ensuring the Stretch, July/August 2007 Journal of Retirement Planning, Phil Kavesh and Ed Morrow, comparing and contrasting standalone IRA trusts, trusteed IRAs and restrictive IRA annuities.

[8] Ohio R.C. §5805.05(B), modeled on UTC §506, which, while forbidding attachments of mandatory distributions, is nonetheless silent on whether the trustee can make payments for the benefit of a mandatory distribution beneficiary. More specifically, see Ohio R.C. §5815.24(D), modeled in part on Del. C. §3536(a) and SDCL §55-1-42, which are all more specific on such points. If in Bankruptcy, the court should still allow an exclusion for a third party created spendthrift trust with mandatory distribution provisions, depending on state law, but may count any such payments that were made or should have been made pre- or 180 days post-petition. McCauley v. Hersloff, 147 B.R. 262 (Bankr. M.D. Fla. 1992)

[9] Some DAPT statutes are touted as having specific provisions for this, such as Alaska Stat. 34.40.110(b)(3). See Treas. Reg. §1.408A-6, Q&A19

[10] E.g., Fla.Stat. §739.402(2)(d), but the vast majority of states follow something akin to the rule in the Uniform Disclaimer of Property Interests Act § 6,§ 13 at Qualified disclaimers do not defeat tax liens. U.S. v. Drye, 528 U.S. 49 (1999)

[11] See discussion of cases and articles in Gaughan v. Edward Dittlof Revocable Trust (In re Costas), 555 F.3d 790 (9th Cir. 2009), in which the 9th Circuit decided that a pre-petition qualified disclaimer valid under state law to avoid a fraudulent transfer would be honored even in bankruptcy under §548, refusing to extend Drye beyond tax liens, at least for pre-petition disclaimers. Not all beneficiaries live in

the 9th Circuit, and like Nessa and Chilton, even appellate court rulings can be overruled by the Supreme Court. Costas hinted that post-petition disclaimers would be treated differently. More importantly, Caterpillar Fin. Servs. Corp. v. White (In re White), 2014 Bankr. LEXIS 578 (Bankr. Ne. 2014), recently refused to follow the reasoning in Costas where a debtor had disclaimed a $560,000 inheritance within one year of a bankruptcy filing. It found that a disclaimer could be an improper transfer denying discharge and set the case for trial on the debtor's intent, but importantly noted that, in cases of gratuitous transfer, the burden of proof shifts to the debtor/disclaimant to prove his intent was not to hinder, delay or defraud creditors. A tough burden. The creditor/trustee in White was attempting to deny the debtor a discharge under §727 rather than avoid the transfer under §548. In some cases the effect of this may be the same or even worse than merely avoiding the transfer. If the discharge is denied, the creditor may go after other assets otherwise protected in bankruptcy or continue to garnish wages, etc., thus severely negating the use of a disclaimer to avoid creditors, even if the transfer cannot be voided.

[12] IRC §2518(b). While §2518 is a gift tax section, practitioners should not be lulled into thinking that failure to be "qualified" only has gift tax effects (after all, how many debtors have $5.34 million estates?). It may also cause income tax effects, just like any lifetime transfer of an IRA to another owner.

In *In re Andolino*, we have the first reported inherited IRA case post-*Rameker* to address whether inherited IRAs can be protected in bankruptcy where the state statute is ambiguous as to inherited accounts. Somewhat surprisingly in light of the recent *Rameker* case, it resulted in a victory for the debtor and protection for the inherited IRA – not as an *exemption*, but as an *exclusion*. Not only should debtors with inherited IRAs examine their state law for rationale for a state-based exemption for inherited IRAs under Section 522(b)(3)(A), but they should also consider whether such IRAs can also be entitled to an ***exclusion*** under Section 541(c)(2) of the Bankruptcy Code.

The case may eventually have broader impact as practitioners absorb the arguments and dust off some of the older cases on exclusions. Under some decisions interpreting Section 541(c)(2), the legal form and terms of the IRA or qualified plan agreement matter. Is it a contractual custodial agreement, annuity or a trust agreement? Despite these forms being irrelevant for income tax law, they are not necessarily the same for other law – including creditor and bankruptcy protection. Furthermore, does the agreement itself have any restriction on transfer? It is unclear the extent to which either of those questions matter. This case may also encourage debtors to claim an exclusion for other trust and quasi-trust assets beyond just inherited IRAs that might be protected under state law and may be unavailable in certain circumstances as an exemption.

Basic facts of case:

On April 4, 2013, the Debtor, Christopher P. Andolino, filed a voluntary Chapter 7 bankruptcy petition. Shortly thereafter, on May 28, 2013, the Chapter 7 case was converted to a Chapter 13 proceeding.

The debtor initially claimed a full exemption of a $120,000 IRA inherited from his mother, pursuant to 11 U.S.C. § 522(d)(12), but later amended his petition again claiming that the IRA was excluded from the bankruptcy estate pursuant to 11 U.S.C. § 541(c)(2). In recognition of the unsettled case law on certain issues relative to inherited IRAs, and in light of the U.S. Supreme Court's grant of certiorari in *Clark v. Rameker*, the parties agreed to await the Court's decision in *Clark* and then file supplemental briefs on the issue.

After the smoke cleared from the *Clark v. Rameker* decision, the bankruptcy court still found the inherited IRA to be protected, not under §522(d)(12), which was squarely decided under the *Rameker* decision, but under §541(c)(2), due to New Jersey statute. Let's revisit those two statutes specifically:
11 U.S.C. §541(c)(2) provides that:

> "A restriction on the transfer of a beneficial interest of the debtor in a trust that is enforceable under applicable nonbankruptcy law is enforceable in a case under this title."

New Jersey statute § 25:2-1(b) provides that:

> "Notwithstanding the provisions of any other law to the contrary, any property held in a qualifying trust and any distributions from a qualifying trust, regardless of the distribution plan elected for the qualifying trust, shall be exempt from all claims of creditors and shall be excluded from the estate in bankruptcy . . . ."

The court concluded that the inherited IRA was a trust (although there is no indication in the record of a trusteed IRA agreement), and therefore came under the protection of the above New Jersey statute, and therefore was excluded under §541(c)(2). This was not without precedent – the court cited an earlier bankruptcy court decision, *In re Yuhas*, 186 BR 381 (Bk DC NJ 1995) concluding similarly. State law created the enforceable restriction on transfer necessary for §541(c)(2) exclusion.

In re Andolino is only a bankruptcy court level case and it was not appealed, and there are conflicting cases in other circuits and districts on the requirements for Section 541(c)(2) exclusion. Despite those caveats, it does raise issues that may interest practitioners concerned about estate and asset protection planning for retirement accounts. Let's explore §541(c)(2) a bit more, why exclusions under Section 541 may in some cases be different from exemptions under Section 522, and why these issues may still matter outside of New Jersey.

Most practitioners who are only vaguely familiar with §541(c)(2) tend to think of it as "the provision that protects ERISA plans." This is partly true, but highly misleading. §541(c)(2) in no way protects all ERISA accounts, and §541(c)(2) may protect well beyond ERISA plans. Imagine an overlapping Venn diagram between the two. Nothing in Section 541 mentions ERISA at all. A "restriction on the transfer of a beneficial interest…in trust that is enforceable under applicable nonbankruptcy law" may be enforceable under *any non-bankruptcy law*, which may include ERISA, other federal law (including tax law), or state law.

The fact that ERISA law can qualify as such an exclusion was squarely settled by the Supreme Court in *Patterson v. Shumate*, and this is probably why most practitioners see §541(c)(2) as an ERISA provision. However, it should be noted that even cases following *Shumate* do not conclude that all ERISA accounts are excluded in bankruptcy.

The *Andolino* court cited *In re Yuhas*, in which the Third Circuit held that funds of a debtor in an individual retirement account which did not contain transfer restrictions were excluded from the bankruptcy estate of the debtor pursuant to § 541(c)(2) because state law provided that funds in an individual retirement accounts were exempt from the claims of the creditors and this was sufficient to create an enforceable restriction on transfer under § 541(c)(2), stating that while other courts had suggested that a plan must be ERISA qualified in order for restrictions to be enforceable under § 541(c)(2) *there is no reference in § 541(c)(2) to ERISA* and that while the Supreme Court in *Patterson v Shumate* (1992) 504 US 753, held that ERISA-required anti-alienation provisions were sufficient restrictions on transfer *it did not limit the source of restrictions to ERISA*. The court stated that the most interesting question presented by the suit was *whether the restrictions on transfer have to be contained within the plan or trust to be enforceable and though three bankruptcy courts had held that the transfer restrictions had to be in the account agreement.*[189]

[189] *In re Meehan* (Bankr. 1994, SD Ga) 173 BR 818, *In re Van Nostrand* (Bankr. DC NJ 1995) 1995 Bankr LEXIS 812, and *In re Lamb* 179 BR 419 (Bankr. DC NJ 1994)

d. Impact of *Clark v. Rameker* on inherited retirement accounts *other than IRAs*

Generally, the same negative characteristics of inherited IRAs cited by the Court in *Clark* should apply equally to other inherited retirement accounts. To wit, you cannot simply add funds to an inherited pension/401(k)/403(b), etc. You have to start RMDs regardless of age. Lastly, the 10% penalty is waived regardless of age. The only distinction from inherited IRAs might be that for some pension plans, you may not be able to get a lump sum payout, for instance, if the participant had chosen an annuity payout for a term of years.

This is unlikely to ever be litigated, however, for three reasons:

1) for most plans, it's a very weak argument - *Clark* likely applies to all inherited retirement accounts for §522(b)(3)(C) and (d)(12), not just IRAs, because they are so similar;

2) however, since such funds would probably be eligible for an exclusion under §541(c) (unlike most IRAs), any exemption under §522 would be largely moot;

3) more importantly, for all but the rare pension exception noted above, most inheritors are forced to transfer inherited retirement funds to an inherited IRA to get the "stretch", usually within one year. Thus, the number of debtors who will file within this short window will be quite small – many more debtors will have inherited IRAs than inherited 401(k)s, because of the likely longevity differences of such accounts.

Thus, as a practical matter, *Clark* still controls protection for most inherited accounts. Despite my conclusion above that inherited pensions should be protected pursuant to ERISA and §541(c)(2), the only post-*Clark* cases I could find on this issue concluded to the contrary! In In *In re Baker*, the client's inherited pension, despite favorable Florida law on inherited accounts, despite ERISA, was denied an exemption – strangely, the case did not have any detailed discussion at all on whether it qualified as an exclusion, or whether Florida law could provide an exemption through §522(b)(3)(A).[190]

In re Pacheco, the debtor inherited a 401(k) from her husband, but the court allowed the exemption because of Arizona's statutory protection, not under 541(c).[191]

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[190] *In re Baker*, 2015 Bankr. LEXIS 2465 (Bankr. M.D. Fl. 2015)
[191] In re Pacheco, 537 B.R. 935 (Bankr. N.D. Az 2015)

e. Potential impact of *Clark v. Rameker* on non-inherited accounts

The *Clark* case concerned an inherited IRA. No blog, speaker or commentator, law journal article or otherwise has argued that the case has any impact on retirement accounts established by debtors that are not inherited.

Except me. And, any bankruptcy trustee who reads the next few paragraphs.

Let's revisit what the court did in *Clark v. Rameker* – it sought to determine whether "retirement funds" included inherited retirement funds, but it felt it had to define the term. It did not create a good working definition, but outlined some general guidance, citing common meaning and various tax and access characteristics between inherited funds and ordinary debtor-established tax qualified funds, and then concluded that inherited funds, even if under the exact same tax code sections, were simply not the same and had such different characteristics that they should not be considered "retirement funds" for purposes of 11 U.S.C. §522(b)(3)(C) and (d)(12).

Under any reasonable reading of the Court's opinion most debtor-established funds should still be exempt under this section, but the Court declined to say so explicitly. It was backed into a corner into trying to negatively define "retirement funds". Let's revisit what it termed the "ordinary meaning" of the term:

> The ordinary meaning of "fund[s]" is "sum[s] of money . . . set aside for a specific purpose." American Heritage Dictionary 712 (4th ed. 2000). And "retirement" means "[w]ithdrawal from one's occupation, business, or office." Id., at 1489. Section 522(b)(3)(C)'s reference to "retirement funds" is therefore **properly understood to mean sums of money set aside for the day an individual stops working**.

Thankfully the Court was not so foolish to look *only* to a debtor's subjective intent. The Court then cited three legal characteristics of inherited IRAs that helped lead to its conclusion that they are objectively not "sums of money set aside for the day an individual stops working":

1) the holder of an inherited IRA may never invest additional money in the account
2) holders of inherited IRAs are required to withdraw money from such accounts, no matter how many years they may be from retirement
3) the holder of an inherited IRA may withdraw the entire balance of the account at any time— and for any purpose— without penalty.

Now, let's apply the above definitions and characteristics to a young 45 year old debtor, still working, who has started early withdrawals from his IRA through a series of substantially equal payments (a.k.a. "SOSEPP") exception,[192] perhaps to establish a new business, pay debts, gift to children, buy a vacation home or anything else. Like an inherited IRA as analyzed by the Court in *Clark*, it's hard to see how such IRA funds are "set aside for the day an individual stops working" when it's being used for current consumption. Like an inherited IRA, SOSEPPs cannot "accept additional contributions" once started.[193] Like an inherited IRA, owners of SOSEPPs are "required to withdraw money from such accounts no matter how many years they are from retirement" (at least 5 years and past age 59 ½). They are only different in that they don't allow a lump sum withdrawal without penalty, at least not until age 59 1/2. Is that one small difference enough to differentiate such accounts from inherited IRAs so vilified in *Clark v. Rameker's* amorphous definition of "retirement funds"?

I predict we will see this question up for appellate or Supreme Court review someday:

> After a retirement plan owner initiates a series of substantially equal periodic payments pursuant to Internal Revenue Code Section 72(t)(2)(A)(iv), are such funds still "retirement funds" for purposes of 11 U.S.C. §522(b)(3)(C) and (d)(12), which exempt "retirement funds to the extent that those funds are in a fund or account that is exempt from taxation under section 401, 403, 408, 408A, 414, 457, or 501(a) of the Internal Revenue Code of 1986?"

While I may be a minority of one, I would advise those considering a SOSEPP that there is a significant potential that SOSEPPs are not protected under §522(b)(3)(C) or (d)(12). However, unlike inherited IRAs, there are more state laws that will protect such accounts, and thus, if a debtor otherwise qualifies by residency and choice of state exemption, such accounts may be exempt under §522(b)(3)(A) and excluded in spite of *Clark*. Thus, potential gaps in SOSEPP protection resulting from *Clark* may only be an issue for those who do not yet meet state residency requirements for §522(b)(3)(A) or who live in a state such as Nevada, California or Maine that do not have good unlimited protections for IRA owners (SOSEPPs can be done through other plans, but most are through IRAs).

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[192] IRC §72(t)(2)(A)(iv) "part of a series of substantially equal periodic payments (not less frequently than annually) made for the life (or life expectancy) of the employee or the joint lives (or joint life expectancies) of such employee and his designated beneficiary,". See IRS FAQs at https://www.irs.gov/Retirement-Plans/Retirement-Plans-FAQs-regarding-Substantially-Equal-Periodic-Payments or better and probably more accurate, Life and Death Planning for Retirement Benefits, Ch. 9.2, Natalie Choate

[193] Rev. Rul. 2002-62

IX. Dangers and Advantages of Inheriting Retirement Plans, IRAs, Insurance and Annuities Through Trusts

People often make gifts in trusts for asset protection purposes. When someone gifts or leaves assets to other beneficiaries in trust (called a third-party discretionary or spendthrift trust), all states generally provide strong asset protection from creditors of the beneficiaries.[194] This is also true in bankruptcy court. However, trusts without a spendthrift clause (especially those without wide discretion granted to the trustee) will receive little if any protection.[195]

But what about creditors of the grantor? Can leaving assets in a revocable living trust instead of outright or through other non-probate means evade creditors of the deceased? In most states, the answer is NO. But in Ohio, we have an anomalous case that very well may protect these assets.

Ohio Supreme Court precedent currently protects a decedent's funded revocable trusts from a decedent's creditors.[196] Obviously this is not the same if the trust were unfunded and relied on pour-over will to fund it, because such assets would pass through the probate estate.

But what if the living trust has a clause that provides that the trustee can or must help the probate estate/executor pay debts, taxes and expenses of the probate estate? In this case, asset protection may very well be lost. This recently happened in a Florida case, where insurance proceeds that otherwise would have been protected lost their protection by paying to a trust with such a clause.[197] Ohio, in light of the *Zahn* case discussed below, would probably follow this logic.

Can the trust step in the shoes of the decedent/debtor and use Ohio's creditor exemptions in R.C. §2329.66(A)(10)? We do not have an Ohio court case on this issue, but a Kansas appellate court has argued that their state creditor exemption did not apply to a revocable living trust as beneficiary, that the exemption effectively died with the decedent.[198] Ohio would probably rule the same way (with exception for insurance/annuities, under which the statute specifically include beneficiaries).

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[194] See, e.g. *Schierer v. Ostafin*, 1999 Ohio App. LEXIS 3261 (Ohio Ct. App. 1999).

[195] See, *In re Delmoe*, 365 BR 124 (S.D. Ohio 2007), where bankruptcy court attached beneficiary's $600/mo income interest in trust with no spendthrift clause drafted pro se by her father.

[196] *Schofield v. Cleveland Trust Co.*, 21 N.E.2d 119 (Ohio 1939), revisited/limited in recent 3d District case of *Sowers v. Luginbill*, 175 Ohio App.3d 745, 2008-Ohio-1486. See also *Greenwich Trust Co. v. Tipon*, 27 A.2d 166 (Conn. 1942). More states are contra: see, e.g., *State Street Bank and Trust Co. v. Riser*, 389 N.E.2d 768 (Mass. App. 1979)

[197] **LISI** Asset Protection Planning Newsletter #205 by Jerry Wolf, discussion of *Morey v. Everbank*.

[198] *Commerce Bank v. Bolander*, 2007 WL 1041760 (Kan. App. 2007), unpublished.

This is a particular danger for qualified plans, IRAs and insurance that may otherwise be completely protected: when they are paid to a trust that is available to estate creditors this asset protection may be lost. However, it gets worse. There may also be adverse tax consequences. A trust subject to an estate's creditors may no longer qualify as a see-through designated beneficiary trust eligible for the tax deferral based on the beneficiary's life expectancy.[199] In addition, there may be adverse Ohio estate tax consequences because the estate inadvertently becomes a de facto beneficiary of the insurance, triggering Ohio estate tax.[200]

For one example of this danger, see PLR 2004-40031, where this very situation occurred. Creditors of the decedent had access to the IRA through his revocable (now irrevocable) living trust. The issue for the IRS was "does this make the trust like an estate for designated beneficiary status?" The IRS was lenient in this ruling and ruled that in this instance it would not consider the estate or creditors as a beneficiary of the IRA for MRD purposes.[201]

> Example: Joe Graduate has contracted a terrible disease. He has accumulated $100,000 in private school loans and may die soon with over $100,000 in credit card debt and medical expenses. Plus, his new wife's ex-husband recently won a judgment against him for "alienation of affection" for $750,000. He has spent liquid assets but has a $100,000 IRA, $50,000 401(k), $50,000 group term life insurance and a $200,000 home with a $150,000 mortgage. If he leaves this to his family in a revocable trust his family has a fighting chance to save the insurance, home and IRA, but if the trust provides for payment of debts, taxes and expenses of the probate estate this may jeopardize both (of course, the mortgage follows regardless).

Another example of how an Ohio court may view such a provision is found in *Zahn v. Nelson*. In *Zahn*, William Zahn had filed for a divorce from his wife Donna, but they remained married at his death. William understandably left his estate to his children from a prior marriage and used the William J Zahn Revocable Trust to pass most of the assets. But his trust stated that should his probate estate be insufficient, "there shall be paid" to the estate sums necessary to pay taxes and amounts requested by

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199 See, e.g., LTR 200537044, LTR 200608032
200 Ohio R.C. §5731.12
201 PLR 200440031

the executor to pay expenses, specific bequests, and statutory allowances. [202] Some call this a "pour-up" or "transportation" clause. The *Zahn* court held that the language required the trustee to pay to the estate funds necessary to pay to the decedent's surviving spouse her $40,000 statutory support allowance under R.C. § 2106.13. So much for avoiding probate.

In addition, practitioners should be concerned from an asset protection perspective about naming beneficiaries as sole trustees of their own trust share. Restricting distributions to ascertainable standards is required to avoid being considered a general power of appointment, but even with such a clause, treating the trust as a personal bank account and ignoring formalities may allow creditors to "pierce the trust veil".[203] Figurehead co-trustees can be ignored by the court.[204] An independent corporate trustee assures much better asset protection. Naming a beneficiary as sole trustee of his or her own trust invites lax administration and severely curtails the protective nature of the trust.[205]

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[202] *Zahn v. Nelson*, 2007-Ohio-667, 170 Ohio App.3d 111 (Ohio Ct. App. 2007)
[203] See, e.g., *In re Pugh*, 274 B.R. 883 (Bankr. D. Ariz. 2002); *In re Baldwin*, 142 BR 210, 215 (Bankr. SD Ohio 1992)
[204] See *Pugh* cited above, where sister was co-trustee but did not even know she was or act as one until creditor problems arose.
[205] See *Beneficiary Controlled Trusts Can Lose Asset Protection*, December 2006 Trusts and Estates by Tye Klooster and Charles Harris

X. Piercing UTMA and Trust Accounts

As discussed in the above section, the common wisdom is that irrevocable UTMA/UGMA accounts are protected from a donor/custodian's creditors, and irrevocable third party trust accounts are generally protected from the donor/settlor as well as beneficiary's creditors. The above bromides serve as a good general rule, but this outline is about noting the exceptions our clients may fall into.

Piercing UTMA Accounts

Contrary to the common wisdom that UTMA accounts are always protected from a custodian's creditors, courts have on occasion pierced them, including a relatively recent Ohio case. Although tax liens and fraudulent transfers first come to mind, these piercings generally fall into two categories involving improper administration: 1) commingling assets, which negates the intent to make a completed gift and 2) alter ego theory, where the custodian treats property as if it were his or her own.[206]

In one Ohio case, there were elements of both. A mother established a UTMA account with herself as custodian for her minor daughter. She pled guilty to various crimes and the state attempted to place a lien on her assets - and the UTMA assets as well. The daughter's father objected as guardian. At trial, the court decided that the mother "did not comply with the Ohio Transfers to Minors Act (R.C. 1339.31 *et seq.*) and that [she] lacked sufficient donative intent to make an unconditional gift of the money to [daughter]."[207] The appellate court cited several UGMA/UTMA cases noting that there must be *donative intent* to establish a true transfer; and that, although establishing a properly titled bank account establishes prima facie evidence of intent, this evidence can be (and was) rebutted. Notably, the mother had made a $20,000 "loan" to herself shortly after opening the UTMA account to purchase some commercial property. "By treating the money as her own, [her] claim of a gift was drawn into serious doubt."

Failing to properly administer UTMA accounts and breaching fiduciary duties through commingling and self-dealing can therefore destroy asset protection (and could create negative gift and estate tax effects). This could also occur when a UTMA custodian purchases illiquid, unmarketable, non-voting/minority FLP or LLC interests, which are often touted as the solution for parents who don't want beneficiaries to get access at age 21.

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[206] *Planning With UTMA Accounts and Other Transfers to Minors, Part I*, Stephanie Heilborn and Jonathan Blattmachr, in Estate Planning Vol 34, No 12 (Dec 2007)
[207] *State v. Keith*, 81 Ohio App.3d 192 (1991)

Piercing Third Party Created Irrevocable Trusts

It is more and more common to see "beneficiary-controlled trusts" often structured with spouses or children as sole trustees of their own trust. Many people think that because there is an ascertainable standard in a trust and that a trust is not in someone's estate for gift/estate/gst purposes, that it is must be protected for asset protection purposes as well (there is a similar misconception about such standards affecting IRC 678(a) grantor trust rules, but that's another topic altogether). They believe that the IRC, Restatement of Trusts or Ohio Trust Code has the last word.[208] Often, it will – but the goal of this outline is to highlight the exceptions.

The common wisdom ignores time-honored tests that bankruptcy courts use to examine trusts. Not only will the bankruptcy court narrowly view exclusions for such trusts, but they also have additional weapons, such as nominee trusts, alter ego, constructive and resulting trusts (sometimes referred to as purchase money resulting trusts). Not to mention expanded fraudulent transfer provisions and theories.[209]

Before examining any of these more esoteric theories, let's first examine the basic garden variety third party created beneficiary-controlled spendthrift trust, ostensibly exempt under 11 USC 541(c)(2), with pertinent sections bolded in Appendix B. To a bankruptcy court, "The existence of an anti-alienation provision does not in and of itself qualify the trust as a spendthrift trust." The court may well go beyond basic state spendthrift law to examine "other provisions which may mitigate against such a finding".[210] This Southern District of Ohio case adopted the following test from another case:

> The *Gallagher* court concluded that a trust that contains a spendthrift provision cannot be a spendthrift trust if: (1) the settlor of the trust is also the beneficiary of the trust; (2) the beneficiary has dominion and control over the trust; (3) the beneficiary may revoke **[**11]** the trust; **or** (4) the beneficiary has powers in the trust. *Gallagher* 101 Bankr. 594, 600, citing *Swanson,* 873 F.2d 1121, 1124; *O'Brien,* 94 Bankr. 583, 587. The existence of such powers rather than the exercise of the powers deny spendthrift status. *Swanson,* 873 F.2d 1121, 1124.
>
> In determining whether such defects exist, the overriding policies of the Bankruptcy Code must be kept in mind. It is the policy of the Code to enlarge the bankruptcy estate to the extent

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[208] E.g. Restatement, Trusts, 3d §60, comment g, Ohio R.C. §5805.04(F), important Ohio cases upholding spendthrift/discretionary trust protection are *Scott v. Bank One Trust Co.*, 62 Ohio.St.3d 39 (1991) and *Domo v. McCarthy*, 66 Ohio St.3d 312 (1993)

[209] See author's separate CLE outline on Fraudulent Transfer Law for Ohio Estate Planners. For an example of a debtor busting an irrevocable trust due in part to the settlor's use of related party trustees, see *Kilker v. Stillman*, 2012 WL 5902348 (Cal. App. 4 Dist.), Nov. 26, 2012

[210] *In re Baldwin (Scott v. Bank One Trust Co.),* 142 BR 210, 214 (S.D. OH 1992), citing several cases

> possible under the Code in an effort to provide creditors with the distribution to which they are entitled. Accordingly, § 541(c)(2) must be narrowly construed to avoid impinging upon the policies sought to be furthered by the Code.
>
> Clearly, the Trust in the instant action contains neither a provision that renders it a self-settled trust, nor a provision that grants the beneficiary revocation powers. Thus, the only remaining question is whether the Trust gives the beneficiary dominion and control over the Trust so as to preclude a conclusion that the Trust is a spendthrift trust.

So, you might be wondering, what abusive and sneaky technique was the beneficiary exploiting in the *Baldwin* case to exercise so much dominion and control so as to negate the spendthrift protection of the trust? Was he using the trust as his de facto checking account? Taking loans? No – the trust merely had a provision that allowed him to fire/replace the independent corporate trustee with another corporate trustee. Because, according to the court, he could have created and appointed a controlled corporation to act as trustee, and because the trust had wide discretionary provisions, the debtor had unfettered control. Moreover, this potential for control is damning even though the debtor never attempted to assert it; it was sufficient to simply have the power. The creditor won this case *on summary judgment*!

The usual reaction of attorneys to *Baldwin* is to ignore it as an aberrant case, to disbelieve that another court would ever follow it, because it so contravenes the strong demand and trend towards beneficiary-controlled trusts in the estate planning world. There is only one case citing *Baldwin* for this test, and it is a truly "bad facts" case.

In *In re McCullough*, spendthrift protection was denied in bankruptcy despite an otherwise valid provision in the trust because, while debtor/beneficiary's dad was titularly trustee, the debtor/beneficiary wrote checks from the trust checkbook, used his father's signature stamp, controlled an eTrade trust account, etc. The court stated "the original trust should not be examined in a vacuum, but must be looked at together with the Addendum *and the conduct of the Debtor*, which discloses blatant and unfettered dominion and control over the Trust assets"[211] Recall the similar tests in the UTMA cases discussed above.

In re Schwen – Parent died and left assets to debtor child in trust, with debtor and his sister as co-trustees. This case follows a similar test with the rationale behind denying spendthrift protection

[211] *In re McCollough (Richardson v. McCollough)*, 259 BR 509 (Bkpt D.R.I. 2001)

that is instructive, but, in upholding protection, it also provides the remedy in its analysis – a bona fide co-trustee and proper administration:

> "The purpose of a spendthrift trust is to protect the beneficiary from himself and his creditors. *Cattafi*, 237 B.R. at 856. Therefore, such a trust fails where the beneficiary exercises dominion or control over the property of the trust. *Id.*; *Bottom*, 176 B.R. at 952. In bankruptcy proceedings, the debtor's degree of control over the spendthrift trust is often the primary consideration in determining its validity. *Kaplan v. Primerit Bank*, 97 B.R. 572, 577 (B.A.P. 9th Cir. 1989). It is clear that if the beneficiary has absolute and sole discretion to compel distribution of the trust assets, the spendthrift provision must fail. *See* *Bottom*, 176 B.R. at 952 (noting that the sole trustee and the sole beneficiary cannot be one in the same); *Govaert v. Strehlow (In re Strehlow)*, 84 B.R. 241, 244 (Bankr. S.D. Fla. 1988). However, something less than absolute control may also destroy the spendthrift character of a trust. *Hersloff*, 147 B.R. at 266.
> In this case the Plaintiff is one of two co-trustees, both of whom must consent **[**8]** prior to any withdrawal from the trust. The case of *McCauley v. Hersloff (In re Hersloff)*, 147 B.R. 262 (Bankr. M.D. Fla. 1992), holds that when the debtor is one of three trustees, she does not exercise enough control over the trust to invalidate the spendthrift provision. *Id.* at 265 ("An HN8 otherwise valid spendthrift trust will not be disallowed . . . merely because the beneficiary happens to represent a minority of the voting trustees."). The case goes on to note that even if there were only two trustees, the debtor still would not have sufficient control over the trust to invalidate its spendthrift provision. *Id.* at 266 n.2.
> The present case is distinguishable from the *Strehlow* case cited by the Defendant. The court in that case found that a spendthrift provision was invalid because the debtor had sole discretion to compel distribution without the consent of his co-trustee. *Strehlow*, 84 B.R. at 244. Here, the parties agree that the Plaintiff must have the consent of her brother prior to any distribution. Thus, Plaintiff's control is sufficiently limited by her co-trustee to uphold the spendthrift provision."[212]

In re Pugh is a very similar case holding differently on "bad facts". There, a debtor inherited money in trust and was beneficiary-trustee with his sister as co-trustee. However, unlike the *Schwen* case, and similar to *McCollough*, the sister as titular co-trustee had absolutely no role in practice - the debtor/trustee acted without her consent or knowledge. Held – spendthrift protection **denied**.[213]

Another recent case in Washington state denied spendthrift protection to a third party created trust as well under bad facts.[214]

For those of you familiar with the tax area, these cases starts to remind one of the *Atkinson* case, which should be required reading for anyone recommending, administering or counseling trustees of charitable trusts, GRATs, QPRTs and other statutory safe harbor trusts. In that case, a properly drawn and executed trust was denied the charitable deduction both prospectively and AB INITIO, because the beneficiary/trustee did not properly administer the CRT – even though she gained absolutely no pecuniary benefit (indeed, lost money) by delaying her own payments. To the IRS, the lack of

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[212] *In re Schwen (Schwen v. Ramette)*, 240 BR 754 (Bankr. Minn. 1999)
[213] *In re Pugh*, 274 BR 883, 887 (Bankr. D. Ariz 2002)
[214] *Britannia Holdings Ltd. v. Greer*, 127 Wn. App. 926 (2005)

compliance violated the terms and therefore the legal benefits of the trust. There is no reason why a bankruptcy court would not look the same way regarding towards loose or abusive administration of a spendthrift trust.

Moreover, do not assume that bankruptcy (or even appellate) courts will understand fundamental trust law, much less "beneficiary-controlled trust" nuances. Here is another recent third-party trust piercing case that will surprise readers:

In *In re Heifner*,[215] Charlotte Heifner died and left her estate to her young son Robert (the debtor/defendant) in trust. In what readers would assume is a very positive and prudent move, the trust did not pay outright to her son, and had a valid spendthrift clause. Contrary to what we might recommend, but what we would not assume to be fatal, the trust directed that 20 quarterly distributions be made for five years after her death. You might think – aha!, the creditor can get at the mandatory distributions that were not made (bankruptcy was filed a year or so after his mother died so five distributions should have been made) – and that would be a logical, and the Ohio Trust Code has specific provisions about that. But the bankruptcy court took a completely different interpretation that threatens many so-called "beneficiary-controlled trusts". Under the trust terms, once Robert reached age 25 (and he was by this point), he was entitled to fire the trustee and appoint himself or another related or subordinate party. Of course, attorneys do this every day of the week – how many bypass trusts appoint the surviving spouse as a trustee or allow them to appoint themselves as trustee while being the sole current beneficiary, as in *Heifner*? Yet, as in the other cases quoted above, the bankruptcy court focused on CONTROL, or POTENTIAL CONTROL, rather than the state law validity of a spendthrift provision. Moreover, the bankruptcy court simply misunderstood Ohio trust law:

> "Under Ohio law, it is well established that a trustee may not be the sole trustee and the sole beneficiary of a trust. *OHIO REV. CODE ANN. § 5804.02(A)(5)*; *UAP-Columbus v. Young, 2010 Ohio 485, P14 (Ohio Ct. App. 2010)* (citing *Hill v. Irons, 160 Ohio St. 21, 27, 113 N.E.2d 243 (Ohio 1953))*. A trust must involve a separation of the legal and equitable or beneficial interests in property. *In re Estate of Bicknell, 108 Ohio App. 51, 54, 160 N.E.2d 550 (1958)*. "If the legal title to the trust property and the beneficial interest become united in one person who is not under an incapacity, the trust fails." *Id. at 55*. In the instant matter, it is clear under Ohio law that if [*7] the Debtor is able to remove the current trustee and designate himself as trustee, then the trust fails.****
>
> **Since Debtor is able to designate himself as trustee under the terms of the trust, he has a large degree of control over the assets of the trust. *This factor strongly favors the failure of the spendthrift clause*** and, accordingly, inclusion of the trust assets in the bankruptcy estate. Just because Debtor would

[215] *Rosen v. Heifner (In re Heifner)*, 2012 Bankr. LEXIS 3032 (Bankr. N.D. Ohio July 3, 2012)

> not designate himself as trustee to keep the trust valid does not mean that Debtor cannot designate himself as trustee.
>
> Following from the above, the court finds that, pursuant to the terms of the trust, Debtor can remove the current trustee and designate himself as trustee. Once Debtor designates himself as trustee, under Ohio law, the trust fails and is [*10] no longer a valid trust. Therefore, **the trust is not excluded from property of the estate** under *11 U.S.C. § 541(c)(2)*. Accordingly, Debtor's interest in the trust constitutes property of the estate pursuant to *11U.S.C. § 541*.

The *Heifner* court ignored the remainder/contingent beneficiaries as potential equitable owners in the first paragraph and ignores basic precepts of the Ohio Trust Code. The case does not quote extensive language from the trust, but 99.99% of trusts have a clause that if the son dies the son's issue or other relatives of the mother become beneficiaries – so that son is hardly the sole beneficiary and the trust hardly "fails" under Ohio law. The court's conclusion of trust failure whenever a current beneficiary is trustee (or could be trustee) should not withstand any scrutiny. However, the middle paragraph above has more bankruptcy court case authority behind it without being completely wrong on Ohio law (though it is not clear if that would have been enough to deny protection). But my smug conclusion of bankruptcy court incompetence in the field of trust law does not help Mr. Heifner, who was represented by counsel, nor other debtor/beneficiaries (at least in northern Ohio, but conceivably elsewhere) whose families were told that they could establish beneficiary-controlled trusts with no negative asset protection effect.

Should we simply ignore all these bankruptcy court cases about beneficiary control, or advise clients that there is a strong element of risk associated with such "beneficiary-controlled trusts"? Practitioners are generally good at pointing out negatives to FLPs, gifting strategies, reciprocal trusts and other techniques to clients, but have so far ignored bankruptcy court cases busting common everyday trusts without independent trustees.

The Efficacy of Forfeiture Provisions and Hold Back Clauses:

A forfeiture-on-alienation clause in a trust terminates the beneficiary's interest when he or she files a voluntary Chapter 11 petition in bankruptcy. Discuss: *In re Fitzsimmons*, 896 F.2d 373 (9th Cir. 1990); Restatement (Third) of Trusts § 57, cmts b–c (2003), SEC v. WYLY, *Castellano* case.

Other third party created trust busting cases: summarize these cases quoted in Wyly memo: See, e.g., *Zmuda v. Commissioner*, 731 F.2d 1417 (9th Cir. 1984); *Dahlstrom v. Commissioner*, T.C. Memo. 1991-264; *Markosian v. Commissioner*, 73 T .C. 12 35 (1980); *Muhich v. Commissioner*, T.C. Memo. 1999-192.

XII. Issues and Exceptions for Ex-Spouses and Dependents

Ohio creditor protection law has special protections for spouses, dependents and child support when they or an intervening state agency is the creditor. These are the exception statutes referred to in R.C. § 2329.66(A)(10). Nearly every state has exceptions in their statutes for alimony/child support (see 50 state chart in Appendix).

In addition, ERISA allows qualified domestic relations orders (QDROs) to affect ERISA plans. Divorce courts can divide IRAs in a similar manner, but such divisions are not technically called "QDROs".

Ex-spouse's interests in retirement plans pursuant to a QDRO or other separation agreement might NOT be granted creditor protection. This is true under state laws.[216] It can also be true under ERISA.[217] Section 522 of the bankruptcy code for retirement plans should override these, as discussed above, but that of course requires a bankruptcy filing and eligibility for discharge. Thus, not only should a divorcing spouse appoint new beneficiaries[218], but QDRO assets should be rolled over to IRAs or, plan permitting, to the ex-spouse's own employer plan.

Note the irony, however, that small company ERISA plans that offer no protection for husband and wife as sole owner/employees would then offer such protection upon divorce.

As for spouse's protection from disinheritance that is granted under ERISA[219] (as you will note on change of beneficiary forms that require a spouse's signature), this protection does not extend to IRAs or other plans simply because the funds originated in ERISA protected accounts.[220]

Granting assets to ex-spouse/dependents in a divorce could be invalidated as a fraudulent transfer (see author's separate UFTA outline), but ironically, it may be honored for ERISA/QDRO purposes *even if the divorce is a complete sham*.[221]

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[216] *In Re Wilbur*, 126 F.3d 1218 (9th Cir. 1997). See also cases under Footnote 43 regarding inherited IRAs, which will use similar reasoning.

[217] Although most district/circuit courts protect ex-spouse's ERISA plan interests, there are two cases holding contrary, including one local, *In Re Hageman*, 260 BR 852 (Bankr. SD Ohio 2001). More recently, the case of *In re Hartman*, 345 B.R. 826 (N.D. Ohio 2005), rejected *Hageman's* holding and held the QDRO funded IRA exempt.

[218] Ohio's statute to disinherit beneficiaries of such plans upon divorce will be preempted by federal ERISA law pursuant to the Supreme Court's holding in *Egelhoff v. Egelhoff*, 532 U.S. 141 (2001). The Supreme Court recently addressed whether a divorce decree wherein ex-spouse apparently waives all rights to benefits from an ERISA plan (but without getting a QDRO) can function as a waiver of ERISA benefits as beneficiary. Held: the administrator cannot be bound by state decree if not a QDRO. *Kennedy v. Plan Administrator for DuPont Savings and Investment Plan*, 129 S. Ct. 865 (2009).

[219] Specifically, see 29 U.S.C. § 1055

[220] See, e.g., *Charles Schwab & Co v. Chandler*, CV-06-00119-FJM, (9th Cir. 2010), an interpleader action between surviving spouse and children from prior marriage who were named primary beneficiaries on IRA.

Ex-Spouse/Dependent Obligations in Bankruptcy

You must distinguish an ordinary debt owed to an ex-spouse or dependent from court-ordered support obligations.

> "Alimony, a domestic support obligation under sections 101(14A) and 523(a)(5), is not dischargeable under any chapter of the Bankruptcy Code. A property settlement obligation under section 523(a)(15) is dischargeable in chapter 13 under section 1328(a)(2)."[222]

Thus, in the *Inman* case quoted above, a wife and husband mediated a divorce and the agreement (very cleverly on the wife or her counsel's part) characterized the property settlement as alimony "not dischargeable in bankruptcy" (even though it clearly did not qualify as such for tax purposes and was really a property settlement in all but name). Held – not dischargeable.

Child Support Issues regarding third-party created spendthrift trusts

Surprisingly, even deadbeat dads can get trust protections. In *Hardin County Child Support Enforcement Agency v. Styer*, a father was behind on child support payments. He inherited money from his father in a spendthrift trust. The ex-wife and child support agency sought an order to attach trust funds. The court found for the deadbeat dad.[223] Since that case, the Ohio Trust Code was enacted and now requires looking to the terms of the trust.[224] An ordinary spendthrift trust will not protect assets; but a wholly discretionary trust should:

> **5805.02 Enforceability and enforcement of spendthrift provisions.**
>
> (A) As used in this section, "child" includes any person for whom an order or judgment for child support has been entered in this or another state.
>
> (B) Subject to section 5805.03 of the Revised Code, a spendthrift provision is unenforceable against either of the following:
>
> (1) The beneficiary's child or spouse who has a judgment or court order against the beneficiary for support, but only if distributions can be made for the beneficiary's support or the beneficiary is entitled to receive mandatory distributions under the terms of the trust; [remainder of statute omitted]
>
> **5805.03 Creditors of discretionary trust beneficiary may not reach interest.**

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[221] *Brown v. Continental*, 647 F.3d 221 (5th Cir. 2011)
[222] *In re Inman*, 2012 WL 2309359, *4(Bkrtcy.S.D.Fla., Slip Copy, June 18, 2012), in a case that also calls into question state-specific charging order protections (which will discussed in future versions of this outline).
[223] *Styer v. Styer*, 2006-Ohio-606
[224] Ohio R.C. §5802.02, §5802.03, effective Jan 1, 2007

Notwithstanding anything to the contrary in division (B) of section 5805.02 of the Revised Code, no creditor or assignee of a beneficiary of a wholly discretionary trust may reach the beneficiary's interest in the trust, or a distribution by the trustee before its receipt by the beneficiary, whether by attachment of present or future distributions to or for the benefit of the beneficiary, by judicial sale, by obtaining an order compelling the trustee to make distributions from the trust, or by any other means, regardless of whether the terms of the trust include a spendthrift provision.

XIII. Exceptions when the State or IRS is the Creditor

Do not assume that the same rules apply to the state of Ohio or the federal government as a creditor.

For instance, federal tax authorities may reach ERISA qualified plan assets (discussed later herein), but state law authorities may not.[225] Indeed there is specific language in the tax code that exempts federal tax debts from ERISA's anti-alienation provisions.[226] Court cases have expanded this to include non-tax federal criminal fines,[227] and the Federal Debt Collection Practices Act (FDCPA) specifically provides that a federal order of restitution shall be treated "as if the liability of the person fined were a liability of tax assessed under the Internal Revenue Code".[228]

However, this highlights one of the few advantages to ERISA plans over IRAs – potential protection for **state** tax lien/garnishments (note, however, the success of creditors in Michigan in the recent cases cited under the ERISA section).

Pre-bankruptcy petition tax liens survive the bankruptcy (yes, even for ERISA plans) and will not be affected by "discretionary" or spendthrift trust protections.[229] Ohio's spendthrift trust statute specifically precludes application to "a claim of this state or the United States to the extent provided by the Revised Code or federal law".[230]

In addition, federal court orders may not necessarily defer to state exemption law protections, as can be evidenced in the recent *SEC v. Solow* case.[231]

People often mistakenly confuse bankruptcy protections with assets exempt from IRS levy. Property exempt from IRS levy is quite limited, and is outlined in IRC §6334, summarized below.[232] Some detail is omitted, but note the major categories NOT listed:

"There shall be exempt from levy—

(1) Wearing apparel and school books***

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[225] See cases in Footnote 4
[226] IRC §401(a)(13), Treas Reg. §1.401(a)-13(b)
[227] *U.S. v Novak*, 476 F.3d 1041 (9th Cir. 2007)
[228] 18 U.S.C. §3613(c)
[229] *Vance L. Wadleigh v. Commissioner*, 134 T.C. No. 14 (2010) – Fed's intent to levy on ERISA plan for taxes that were discharged in bankruptcy allowed because lien attached to ERISA plan assets *in rem*. Even though plan was 9 months from payout status, the levy could attach
[230] Ohio R.C. §5805.02(B)(2)
[231] *Securities and Exchange Commission vs. Jamie Solow*, 2010 WL 303959 (S.D. FL., Jan 22, 2010)
[232] IRC §6334

(2) Fuel, provisions, furniture, and personal effects***, as does not exceed $6,250;

(3) Books and tools of a trade, business, or profession***as do not exceed $3,125;

(4) Unemployment benefits;

(5) Undelivered mail;

(6) Certain annuity and pension payments; (limited)

(7) Workmen's compensation;

(8) Judgments for support of minor children;

(9) Minimum exemption for wages, salary, and other income;

(10) Certain service-connected disability payments;

(11) Certain public assistance payments; (e.g. SSI)

(12) Assistance under Job Training Partnership Act;

(13) Residences exempt in small deficiency cases ($5k+infl.) and principal residences and certain business assets exempt in absence of certain approval or jeopardy

***

(c) **No other property exempt**

Notwithstanding any other law of the United States (including section 207 of the Social Security Act), no property or rights to property shall be exempt from levy other than the property specifically made exempt by subsection (a).

***

(g) Inflation adjustment" – [numbers may adjust for inflation every three years]

Note that 529 plans, retirement accounts, insurance, annuities, HSAs, Coverdell ESAs and other assets are not exempted from levy, and the statute is quite specific about other law (paragraph c bolded above). That does not mean that bankruptcy might not in some instances stay, stall or thwart such a levy – that's a different issue altogether.

The following are from the recently amended Internal Revenue Manual, available online (**bold inserted by this author**). It is not a failure of due process if the IRS fails to follow the IRM, but it "serves as the single, official source of IRS 'instructions to staff' relating to the administration and operation of the Service."[233]

Part 5. Collecting Process
Chapter 11. Notice of Levy
Section 6. Notice of Levy in Special Cases

5.11.6 Notice of Levy in Special Cases
5.11.6.2 (01-22-2010)
Funds in Pension or Retirement Plans

1. These instructions cover money accumulated in a pension or retirement plan, as well as Individual Retirement Arrangements (IRAs). They do not deal with levying retirement income. See section IRM 5.11.6.1 above. Also see Delegation Order 5-3 (Rev-1) at IRM 1.2.44.3.(23)c.
2. There are many employer and self-sponsored retirement vehicles that are **not exempt from levy**. These plans include, for example:
- Qualified Pension, Profit Sharing, and Stock Bonus Plans under ERISA
- IRAs
- Retirement Plans for the Self-Employed (such as SEP-IRAs and Keogh Plans)
3. Because these retirement vehicles provide for the taxpayer's future welfare, levy on the assets in a retirement account (as contrasted with income from the account) after following the procedures set forth below.

Note:

On January 1, 2000, a new exception to the 10 percent additional tax on early distributions from retirement plans was added to the Internal Revenue Code. If an account is levied upon, the taxpayer does not owe the 10 percent additional tax. **Because of the levy exception to the 10 percent additional tax, occasionally taxpayers may ask the Service to levy the funds in the retirement accounts. Even though the taxpayer may be able to voluntarily withdraw money in a lump sum from a retirement account and apply it to the outstanding tax liability, do not levy on retirement assets at the request of the taxpayer**. Instead, follow the procedures set forth below.

Note:

An imminent CSED, alone, does not justify levying on retirement assets. Levying on assets in retirement accounts requires application of the procedures set forth below.

4. The first step in deciding whether to levy on a retirement account is to determine what property, retirement assets and non-retirement assets, is available to collect the liability. If there is property other than retirement assets that can be used to collect the liability, or if a payment agreement

[233] IRM pt. 1.11.2.1.1(1) (Apr. 1, 2007)

can be reached, consider these alternatives before issuing a levy on retirement accounts. Also consider the expense of pursuing other assets as well as the amount to be collected.

5. The second step in deciding whether to levy on a retirement account is to determine whether the taxpayer's conduct has been flagrant. **If the taxpayer has not engaged in flagrant conduct, do not levy on retirement accounts**. Deciding whether the taxpayer has engaged in flagrant conduct must be done on a case-by-case basis. Keep in mind, however, extenuating circumstances may exist that mitigate the taxpayer's flagrant conduct.

6. The following are some examples of flagrant conduct.

Example:

Taxpayers whose failure to pay is based on frivolous arguments which are listed in Notice 2008–14, IRB 2008–4 page 310, or subsequent updates. See IRB 2008–4 at http://www.irs.gov/pub/irs-irbs/irb08-04.pdf .

Example:

Taxpayers who continue to make voluntary contributions to retirement accounts while asserting an inability to pay an amount that is owed.

Caution:

Where a tax liability has been discharged in bankruptcy, the IRS may continue to have a valid tax lien on certain retirement assets that existed prior to the bankruptcy. See IRM 5.11.6.2(14). Voluntary contributions made to such retirement assets after the bankruptcy petition was filed are not considered flagrant.

Example:

Taxpayers who contributed to retirement accounts during the time period the taxpayer knew unpaid taxes were accruing.

Example:

Taxpayers convicted of tax evasion for the tax debt.

Example:

Taxpayers assessed with a fraud penalty for the tax debt.

Example:

Taxpayers assisting others in evading tax.

Example:

Taxpayers with liabilities based on illegal income.

Example:

Taxpayers who are in business and pyramiding unpaid trust fund taxes

Example:

Individual taxpayers who are accumulating unpaid income taxes over multiple tax periods.

Example:

Taxpayers against whom the Trust Fund Recovery Penalty has been asserted on more than one occasion.

Example:

Taxpayers who have demonstrated a pattern of uncooperative or unresponsive behavior, e.g., failing to meet established deadlines, failing to attend scheduled appointments, failing to respond to revenue officer attempts to contact. In such cases, determining alternatives and the taxpayer's dependence on the money in the retirement accounts (final step) may not be possible, so a levy may need to be served without making those determinations.

Example:

Taxpayers who have placed other assets beyond the reach of the government, e.g., sending them outside the country, concealing them, dissipating them, or transferring them to other people.

Example:

Taxpayers with jeopardy or termination assessments subject to collection.

7. The final step in deciding whether to levy on retirement assets is to determine whether the taxpayer depends on the money in the retirement account (or will in the near future) for necessary living expenses. If the taxpayer is dependent on the funds in the retirement account (or will be in the near future), do not levy the retirement account. In determining whether the taxpayer depends on the money (or will in the near future), use the standards in IRM 5.15, *Financial Analysis,* to establish necessary living expenses. Use the life expectancy tables in Publication 590, Individual Retirement Arrangements (IRAs), to estimate how much can be withdrawn annually to deplete the retirement account in the taxpayer's remaining life. Also, consider any special circumstances in the taxpayer's specific situation, such as extraordinary expenses or additional sources of income that will be available to pay expenses during retirement.

8. The taxpayer may be able to withdraw money in a lump sum from a plan. If the taxpayer has the right to do so, a levy can reach that right. However, remember that a levy only reaches the taxpayer's present rights.

Example:

The taxpayer has $10,000 in a plan but can only withdraw it later. The taxpayer may have a present right to the money, although it can not be withdrawn immediately. A levy may reach that right, but the money can be not paid over until the taxpayer can withdraw it. At that time, there may be $30,000 in the plan. Without a new levy, though, only $10,000 could be paid over.

Example:

The taxpayer has money in a plan. The terms of the plan do not allow for any lump sum withdrawal. The plan provides a right in the future to receive monthly payments, but the taxpayer has not paid into it long enough yet to qualify for any future payments. A notice of levy attaches nothing, because the taxpayer has no present property rights.

9. The notice of levy form says it does not attach money in pension or retirement plans. When levying on these funds, sign the notice of levy in the block to the left of, "Total Amount Due."

10. Have the SB/SE Director, Collection Area approve the notice of levy by signing the form as the Service Representative or see IRM 5.11.1.2.4, *Managerial Approval*, for methods to secure managerial approval.

11. Consider discussing the case with the Employee Plans Group before issuing the levy. Their advice, as well as advice from AIQ - Advisory and Associate Area Counsel, may be needed to determine the present right to property. Often, a levy is served before the taxpayer's precise rights are determined. Try to get a copy of the plan instruments as soon as possible to determine the taxpayer's interests in the plan.

12. When money is withdrawn from a retirement account, the taxpayer may be liable for income tax on the withdrawal. If the taxpayer is less than $59^1/_2$ years old, a 10 percent additional tax on early distributions may be assessed. However, the taxpayer is not liable for the 10 percent additional tax on early distributions if the money was withdrawn because of a notice of levy served on the retirement account. There may, however, still be income tax owed for the amount withdrawn.

13. Send Letter 3257 (DO) with the notice of levy and Letter 3258 (DO) with the taxpayer's copy of the notice of levy. These letters state the withdrawal is not subject to the tax on early distributions, even if the taxpayer is under $59^1/_2$ years old. These letters are available as macros on the Integrated Collection System.

14. **Retirement accounts that are <u>exempted</u> or <u>excluded</u> from the bankruptcy estate are still subject to being levied to collect taxes that are discharged in bankruptcy, where a Notice of Federal Tax Lien was filed before bankruptcy. Retirement accounts that are <u>excluded</u> from the bankruptcy estate are still subject to being levied to collect taxes that are discharged in bankruptcy, where no Notice of Federal Tax Lien was filed prior to bankruptcy; however a valid statutory lien is required.** Consider a levy on the retirement accounts if there is no other property that survived the bankruptcy.

See IRM 5.19.17.4, *Exempt, Excluded, or Abandoned Property,* for guidance in determining if the retirement account is exempt or excluded.

Note:

In this situation, the NFTL attaches to only the taxpayer/debtor's property or rights to property held as of the bankruptcy petition date. However, the lien is not limited to the value of the property as of the petition date. **Its attachment relates to any appreciation or diminution of such assets**. The federal tax lien does not attach to retirement account contributions made on or after the bankruptcy petition date. Care must be taken to limit collection to only the bankruptcy pre-petition account value. Consult with AIQ-Insolvency or Counsel prior to issuing levies on exempted or excluded retirement accounts for assistance in determining the account value the levy attaches.

Note:

Retirement accounts that are exempt from the bankruptcy estate are not subject to being levied to collect taxes that are discharged in bankruptcy where no Notice of Federal Tax Lien was filed prior to bankruptcy. See IRM 5.19.7.4(1), for details regarding exempt assets.

XIV. Fraudulent Transfer (UFTA) Issues

We will not have time to go over this section in detail. But it is important to at least vaguely understand the **distinction between common fraud and a fraudulent transfer under UFTA.** Black's Law Dictionary defines fraud is a "knowing misrepresentation of the truth or concealment of a material fact to induce another to act to his detriment." Fraud under the UFTA, however, is a completely different concept from criminal fraud or the definition above. Ohio's Uniform Fraudulent Transfer Act is found at R.C. § 1336.01 et seq.

Ignore the normal meaning of fraud when analyzing fraudulent conveyance law. A fraudulent conveyance under the UFTA may occur without any tortious intent, misrepresentation or concealment by the debtor. Even "rich" people may be "insolvent" for UFTA analysis, because exempt assets would not be considered. And a "creditor" for UFTA need not have achieved a judgment or even filed suit.[234] The federal government is not bound by state UFTA statute of limitations.[235]

While it is unlikely (but not impossible) that creditors would seek to void small retirement plan contributions from salary, the same may not be said to a large contribution to an insurance policy or NQ annuity. Similarly, contributions to defined benefit plans or even 529 plans can easily be six figures.

To protect IRAs, qualified plans, annuities and insurance, consider:

- Should a client make rollovers via check or trustee to trustee transfer?
  (Consider the recent case of *Robertson v. Deeb* – ***always*** *use the latter*)
- Could a Roth conversion be a fraudulent transfer?
- How do Crummey withdrawal rights and hanging powers jeopardize an ILIT where beneficiary has creditor issues?[236]

[234] *Stein v. Brown*, 18 Ohio St.3d 305 (1985)
[235] See discussion at *U.S. v Levine*, 73 F.Supp 2d 853 (N.D. Ohio 1999) – debtors placed all their assets into irrevocable trust, court held that SOL did not apply to sovereign and lien was placed years later, **after** SOL had run
[236] For my recommendation, see Mikel article

XV. Disclaimer Issues

Surprisingly, the fraudulent transfer issues discussed above are also relevant in considering qualified disclaimers as a method whereby a beneficiary of accounts discussed herein may avoid creditors. This technique is discussed in many national articles and textbooks.

Most states allow disclaimers to defeat a disclaimant's creditors.[237] Note that federal bankruptcy cases rely on state property law regarding the effect of disclaimers. State law defines what rights exist, but federal law will determine whether those rights amount to a property interest.[238] What constitutes a transfer and whether it is complete may be a matter of federal bankruptcy law (since it is defined in the statute).

Remember that Medicaid or other government benefit legislation may have its own rules – a disclaimer that may not be a transfer of property under state law may still be an "improper transfer" causing a disqualification period for government benefits.[239]

Many states have addressed this by statute. Note that some states, such as Minnesota and Florida, bar the disclaimer by statute if the disclaimant is insolvent.[240] An important exception is when a federal tax lien has already attached to the property prior to the disclaimer, in which case federal law will trump state law.[241]

Therefore, to protect executors, trustees and custodians, it may be a good idea to investigate or at least get an affidavit from the disclaiming beneficiary as to whether 1) a disclaiming beneficiary is subject to federal tax liens (actually, the best query would be to ask about the triggers that cause the tax liens to apply, since laypeople may not know they have a tax lien against them) and 2) whether the disclaimant is insolvent and/or knows of any pending or even potential claims against them.

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237 See, e.g., *In re Costas*, No. 06-16520 (9th Cir. 2009), interpreting Arizona law, *In re Simpson*, 36 F.3d 450 (5th Cir 1994), interpreting Texas law, *In re Achison*, 925 F.2d 209 (7th Cir. 1991), *In re Laughlin* (5th Cir. 2010), interpreting Louisiana law, *Slocum v. Estate of Martin*, 666 N.E.2d 411 (1996), interpreting Indiana law. Both *Costas* and *Laughlin* are after the Supreme Court's federal tax lien preemption decision in *Drye*. See also the Uniform Disclaimer of Property Interest Act, §6, available online at www.uniformlaws.org. Ohio recently amended its statute to overrule case law and is now consistent with the majority relation back states. Ohio R.C. §5815.36(N)

238 *Drye v. U.S.*, 528 US 49 (1999)

239 See, e.g. Ohio's Medicaid rule at O.A.C. §§5160:1-3- 07

240 See, e.g., Florida's F.S. §739.402 which states a disclaimer is barred if the "disclaimant is insolvent."` F.S. §739.102 defines insolvent for disclaimer purposes to mean that the person's debts exceed the assets (including exempt assets) and "the person is generally not paying his or her debts as they become due."

241 *Drye v. U.S.*, 528 US 49 (1999)

XVI. Medicaid/Government Benefit Issues

Just because ERISA or state law provides extensive creditor protection does not mean that such plans are not considered as a "resource" when determining Medicaid or other eligibility.[242] IRAs, insurance and annuities are similar, although there may be differences in calculating resources for "income streams", such as annuitized annuities, which is beyond the scope of this outline.

The government is not really a "creditor" unless and until it pays benefits. However, fraudulent transfer law can easily be applied to "Medicaid planning" involving gifts of assets.[243] Such cases will no doubt increase. See the companion fraudulent transfer CLE outline on some of the UFTA cases in this area.

Moreover, as discussed in the above section, disclaimers of property can be improper transfers for Medicaid benefit purposes.[244]

If the ERISA plan or other assets were not declared to authorities, then you have much bigger problems than creditor issues, you potentially have criminal fraud charges. An Ohio attorney in Toledo was recently disbarred for assisting a client in Medicaid fraud.[245]

Also remember 529 plans (and similarly, education IRAs (nka Coverdell Education Savings Accounts), which we think of as already gifted or "unavailable" and "outside" of the taxable estate for estate tax purposes or protected from creditors are not necessarily unavailable resources for Medicaid or other benefit calculations. A 529 plan is typically set up with the grantor as owner and kids, grandkids etc as "beneficiaries". Some may overlook the fact that the owner can name themselves as beneficiary and otherwise get such funds out, albeit with a 10% penalty if not used for education. Thus, such funds may be considered "available resources", similar to retirement plans.[246] If the children or grandchildren were made owner, then the 5 year lookback for improper transfers would presumably apply.

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[242] See *Houghton ex rel. Houghton v. Reinertson*, 382 F.3d 1162 (10th Cir. 2004), 20 CFR § 426.120, §426.1201
[243] See recent Hamilton County, 1st District Case of *Montgomery Care Center, Inc. v. Poulias* (2009), where a mother's transfer of assets to her son disqualified her from Medicaid but was a fraudulent transfer as to her anticipated creditor, which was the nursing home, not the government. A similar finding from a recent Clark County case, *Masonic Health Care v. Finley*, 176 Ohio App.3d 529 (2nd Dist. 2008), where an elderly mom gifted her Lebanon home and over $150,000 in assets to 3 kids but stiffed health care providers.
[244] See, e.g. Ohio's Medicaid rule at O.A.C. §§5160:1-3- 07. Google your state's Medicaid Manual and "Transmittal 64"
[245] *Toledo Bar Assn v. Cook*, 2007-Ohio-3253
[246] 20 CFR § 426.120, §426.1201

XVII. Liability for Advisors

ACTS

Helping a client with typical estate and financial planning transfers involving insurance, IRAs, annuities and qualified plans will not typically involve liability for the advisor. Although there is potentially advisor liability for aiding and abetting contempt of court, money laundering, tax fraud, bankruptcy fraud, Medicaid fraud, wire fraud, mail fraud, obstruction of justice, R.I.C.O. or other statutes, these are usually underhanded attempts to help a client HIDE money or transactions.[247] I could find no case in the entire annotated Uniform Fraudulent Transfer Act of an attorney (or other advisor) incurring liability for aiding and abetting fraudulent transfers that were not subject to some other statute. There are Florida cases which absolved attorneys from conspiracy/aiding charges for mere UFTA transfers.

OMISSIONS

What if a client could have legitimately put funds into an IRA, annuity, insurance or qualified plan that is better protected, yet faults **you** the advisor for **failing** to advise him of this? Can a client sue for malpractice? It is unlikely that an average CPA or financial advisor or even an attorney would be found negligent for failing to address this, unless they held themselves out as having special knowledge or addressing this area.

However, many attorneys, and increasingly other advisors, now do themselves out as practicing or addressing "asset protection" as part of their planning. The term is on many advisors' marketing material and websites. In many regards, rightfully so, since insurance, annuities, trusts, retirement plans, etc are all in some aspects risk management and asset protection tools. But how far does this responsibility extend? Attorneys should be careful to exclude such planning from the scope of representation agreement unless the client is willing to pay the attorney to address this (mea culpa – I never did in my representation agreements while in private practice). If it is unclear what the client is paying for the advisor to address, failure to exploit or at least consider increasing use of simple retirement plan funding, Roth conversions, insurance, Coverdell, 529 plans, irrevocable trusts, LLCs etc to better protect assets may be actionable.

[247] See, e.g., *Morganroth – Law Firm Sued for Advice to Debtor*, Jay Adkisson, Steve Leimberg's Asset Protection Planning Newsletter #32 (2003), dealing a blow to attorneys who helped John DeLorean **hide** assets

XVIII. Conflicts of Laws

"The local law of the forum determines the methods by which a judgment of another state is enforced."[248]

- Restatement 2nd, Conflict of Laws, §99

"Enforcement measures do not travel with the sister state judgment as preclusive effects do; such measures remain subject to the evenhanded control of forum law."[249]

This section might be subtitled, "sneaky ways for a creditor to get around the protections outlined in the prior seventeen sections". Conflicts between interstate laws may severely curtail protection for insurance, annuities, IRAs, education IRAs or other type accounts that rely on state rather than ERISA or other federal protections. Taken together with the gaping holes in ERISA protection, one might easily conclude that the only true protection for the different accounts noted herein is under the protective umbrella of the bankruptcy court (assuming one would qualify for discharge).

Ohio creditors and debtors are involved in most of the cases cited herein. Cases from other states usually concerned *only* that state's laws. But let's take a look at how the various state protections and analysis may falter under the disjointed weight of interstate issues. John Stewart, a retired Columbus professional, takes a summer road trip with family to Washington, D.C. While driving in West Virginia, he accidentally causes a terrible accident, which leads to a $4 million judgment, in excess of his $1 million insurance. Retired, he is comforted by the fact that he has $1 million socked away in a Roth IRA. Until, that is, he receives a writ of garnishment on the IRA from the West Virginia court. Possible?

Consider the application of the similar case of *Clark v. Wilbur*:[250] In 1995, Dudley Allen and John Wilbur, Florida residents, lost a case and had a $6 million judgment entered against them jointly in West Virginia. In post-judgment discovery, it was determined that they owned

> "(1) Wilbur--(a) Peak Retirement Individual Retirement Account (IRA) (valued at approximately $ 40,000); (b) Charles Schwab IRA (valued at approximately $ 18,000); and (c) a beach house in Ponte Vedra, Florida (valued at approximately $ 1,000,000); (2) Allen--(a) Merrill Lynch IRA (valued at approximately $ 2,500); (b) Mass Mutual IRA Annuity (valued at over $ 100,000); and (3) Clark--Life USA IRA Annuity (valued at approximately $ 38,000)."

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[248] Restatement 2nd, Conflict of Laws, §99 (1969)
[249] *Baker by Thomas v. Gen. Motors Corp.*, 522 U.S. 222, 235, 118 S. Ct. 657 (1998).
[250] *Clark v. Wilbur*, 913 F. Supp. 463 (S.D. WV, 1996)

The question for the court became – which state's laws should apply to the motion for order to compel delivery of the above assets? Defendants claimed that Florida law should apply, of course, as it would exempt the above assets. Held – West Virginia law applied because:

> "The mandate requiring resort to the law of the state where the district court is held applies to questions relating to whether assets are exempt from collection. See, e.g., *Chicago, Rock Island & Pac. Ry. Co. v. Sturm*, 174 U.S. 710, 717, 43 L. Ed. 1144, 19 S. Ct. 797 (1899) (stating "exemption laws are . . . part of the remedy and subject to the law of the forum"); *Johns v. Rozet*, 826 F. Supp. 565, 567 (D.D.C. 1993); *Pallante v. Int'l Venture Invs., Ltd.*, 622 F. Supp. 667, 668 (N.D. Ohio 1985)(stating "generally . . . questions of exemption are determined solely by the laws of the forum"); *Marine Midland Bank v. Surfbelt*, *Inc*., 532 F. Supp. 728, 729 (W.D. Pa. 1982) (stating "the law of the forum governs questions of exemption"); 11 Thomas J. Goger et al., Federal Procedure § 31:21 (1982)."[251]

End Result?

> "The Court ORDERS as follows:
>
> 1. That, with respect to the property located at 837 Ponte Vedra Boulevard, Ponte Vedra Beach, Florida, Defendant Wilbur shall deliver a deed for such to Plaintiff assigning all of his right, title and interest in the property to Plaintiff, subject only to the West Virginia homestead exemption;
>
> 2. That, with respect to the Merrill Lynch IRA, Wilbur's Charles Schwab IRA, and the Peak Retirement Account (to the extent it contains assets other than annuities), Defendants Allen and Wilbur are ORDERED to convert these assets to cash and to withdraw the cash from their IRA accounts and, net of applicable tax penalties, deliver such cash to Plaintiff; and
>
> 3. That with respect to the Peak Retirement Account (to the extent it contains annuities), the Massachusetts Mutual IRA Annuity and the Life USA IRA Annuity, Defendants Wilbur, Allen and Clark shall surrender such annuities for their cash value and deliver such cash, net of any applicable tax penalties, to Plaintiff."

Might there have been better arguments to be made? (Defendants proceeded pro se in the above case). Perhaps. Bankruptcy may have been a good option for the defendants here. However, this brings up significant holes in state law protections that are just as disturbing as the holes in ERISA

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[251] *Id*. at 467

protection. Consider the above re: DAPT protections!

Creditors can often proceed in multiple states, and they can exploit gaps between coverage by various states, some of which provide no protection to non-residents.[252] Creditors may also proceed against a bank branch in a creditor-friendly state different from the debtor's residence, and such multi-state gaps are another reason why debtors may favor bankruptcy.[253]

Do not assume that what seems like unfair discrimination against non-residents is unconstitutional under the equal privileges and immunities clause or under the equal protection clause of the 14th Amendment. Is it fair for a state to permit its residents to protect their IRAs, 403bs, insurance or 529 plans from garnishment, but not non-residents? No, of course not. But is it legal and Constitutional? Probably so. It is hardly invoking a fundamental right, like voting or due process. The court will ask whether the provisions (such as protections for retirement plans, homestead, etc) are rationally related to substantial regulatory interest of the state. Rationally related is not a hard hurdle to overcome. Thus, a state is permitted to charge substantially more fees for out-of-state residents; this is Constitutional.[254]

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252 See cases in Section II, footnotes 13 and 14, state comparison chart
253 E.g. *Triffin v. Community Nursery & Preschool LLC*, *2011 WL 6030076 (N.J. Super. 2011)
254 *Baldwin v. Fish & Game Commission*, 436 U.S. 371 (1978)

XIX. Conclusions

Retirement Plans

SEP-IRAs, Keogh, HR-10 and potentially 403(b)s and SIMPLE IRAs have **inferior** protection under Ohio and many other states' law than a traditional IRA. Similarly any other qualified plan that would otherwise be subject to ERISA, such as safe harbor 401(k)s and profit sharing plans, where the owner and/or spouse/partners are the *only* participants, are also inferior under Ohio and many other states' law than an ordinary IRA. Remember, a failing business may well lose employees (who roll their accounts into IRAs) to the point where only husband and/or wife are left in the plan – losing ERISA protection and possibly Ohio protection as well under a *Lampkins* rationale.[255] Strongly consider rolling these plans over to IRAs if possible. See chart below:

[255] See *Lowenschuss v. Selnick*, 117 F.3d 673 (9th Cir. 1999) where such attrition eviscerated ERISA protection.

ROLLOVER CHART

9/3/2009

Roll From	Roll To: Roth IRA[1]	IRA (traditional)	SIMPLE IRA	SEP-IRA	457(b)	Qualified Plan[4] (pre-tax)	403(b) (pre-tax)	Designated Roth Account (401(k) or 403(b))
Roth IRA	YES	NO	NO	NO	NO	NO	NO	NO
IRA (traditional)	YES[2]	YES	NO	YES	YES	YES	YES	NO
SIMPLE IRA	YES[2], after two years	YES, after two years	YES	YES, after two years	YES[3] after two years	YES, after two years	YES, after two years	NO
SEP-IRA	YES[2]	YES	NO	YES	YES[3]	YES	YES	NO
457(b)	YES[2], after 12/31/07	YES	NO	YES	YES	YES	YES	NO
Qualified Plan[4] (pre-tax)	YES[2], after 12/31/07	YES	NO	YES	YES[3]	YES	YES	NO
403(b) (pre-tax)	YES[2], after 12/31/07	YES	NO	YES	YES[3]	YES	YES	NO
Designated Roth Account (401(k) or 403(b))	YES	NO	NO	NO	NO	NO	NO	Yes, if a direct trustee to trustee transfer

[1]Subject to income limits until December 31, 2009
[2]Must include in income
[3]Must have separate accounts
[4]Qualified Plans include, for example, Profit-Sharing, 401(k), Money Purchase, Defined Benefit plans
For more information regarding retirement plans and rollovers, visit Tax Information for Retirement Plans Community.

Other instances where ERISA plans may be *inferior* to state law protections may be when the pension or other plan is mandatorily receiving payments (say, RMDs or pension). Recall that tracing the protection of the payments to other accounts outside the plan is not available, except to the extent available under Ohio law, and we have no analogous case extending the *Bresnahan* and *Daugherty* cases after *Lampkins* (i.e. would a court, interpreting §2329.66(A)(10)(b), trace that protection and even if it does, would it only protect to the extent "necessary for support").

If someone has spousal support or child support claims, ERISA protection may be superior to state law IRA protection, since Ohio specifically exempts these creditors from its statute, though QDROs may be used to attach ERISA benefits.

Additionally, recall that for state/local tax claims, ERISA protection is superior to state law protections for IRAs (indeed, any state sanctioned protections). Thus, if there could be lingering state tax claims out there (such as contingent responsible party debts), keep such funds in ERISA accounts, or even, if the plan permits, roll other retirement accounts into such plans. Ditto for potential claims arising in other states (see Section XVIII discussion).

Debtors in plans subject to the above loopholes can file bankruptcy to conceivably benefit from expanded coverage under BAPCPA that exempts all of these plans on near-equal footing. However, bankruptcy discharge is more difficult than previously under the new act, bankruptcy has other negatives (effect on credit, effect on contracts, LLC/LP interests, expanded fraudulent transfer statute, etc) and this should probably not be counted on without rigorous examination. For instance, if one does not qualify for Chapter 7 discharge (and many now do not, based on income or other factors), social security and retirement benefits (even ERISA protected and excluded from the bankruptcy estate) are counted for determining the ability to repay under Chapter 13.

Consider maxing out such plans, including Roth 401(k), Roth 403(b) and even Roth conversions (including potentially conversions to Roth IRAs, provided the employee is eligible through an in service distribution, separation from service, etc). Paying from after tax funds or paying the conversion tax from unprotected accounts reduces the amount unprotected and *increases* the percentage of assets protected. Roth conversions are unlikely to be considered a fraudulent transfer.[256] As discussed in the separate outline on the UFTA, the definition of an "asset" under the UFTA usually excludes such protected assets (although this may or may not be different in states that do not fully protect IRAs).

Roth conversions may also save estate taxes, particularly in states with a separate estate tax scheme (state estate taxes are NOT eligible for the §691(c) deduction) – the deduction is reduced for those using a standard deduction or subject to Pease limitations, since it would be an itemized deduction subject to phase out. Beware – there are a handful of states that do NOT provide the same protection for Roth IRAs as for traditional IRAs (See the 50 state chart and discussion in Section II regarding the potential "age" loophole for Roth IRAs in Ohio).

Of course, all of the above (as well as use of annuities/insurance) are subject to the modified adage of "don't let the asset protection tail wag the financial, investment and estate planning dog".

[256] See, e.g., recent case of *In re Middendorf*, 381 BR 774 (Bankr. D. Kan. 2008) and *Wittmann v. Weir*, 1990 WL 63072 (Bankr. D. Kan. 1990), holding that payment of capital gains taxes from sale just prior to filing bankruptcy was neither preferential nor fraudulent transfer subject to set-aside. See also, *In re Stern*, 317 F.3d 1111 (9th Cir. 2003), where the court found that a debtor's transfer of a $1.4 million IRA to a qualified plan just prior to filing was NOT a fraudulent transfer.

IRAs are often superior vehicles from a flexibility of investment perspective.

For "downstream" planning, consider leaving retirement plan assets in a trusteed IRA, or to a separate IRA trust that prohibits payment of probate estate debts (although mere apportionment of taxes should not be an issue).[257] The trusteed IRA with appropriate restricted beneficiary designation has the unique capability in that the beneficiary/debtor may get not only state/federal protection for IRAs, but, more importantly, third-party spendthrift trust law protection, and through that, 541 bankruptcy exclusion.[258] This would require, of course, the IRA owner to place restrictions on the beneficiary's withdrawal rights similar to any other third party created spendthrift or discretionary trust.

Annuities and Insurance

As discussed, ordinary annuities should not be touted as an asset protected vehicle, at least under Ohio law (unless purchased for a third party and contributor retains no benefits). If a client moves to a debtor friendly state such as Florida this may be different.

Insurance fares better under Ohio law, and the law in many other states. It is unclear whether "pushing the envelope" with such plans makes any difference. Adding so much cash that the policy becomes a Modified Endowment Contract (MEC) should be similarly protected – and this "overfunding" may merit consideration. Recall that a MEC gets the same income tax free death benefit, but has less advantageous tax rules for lifetime withdrawals. In many cases, this would be a minor issue that taxpayers could live with. Although this protects more "cash" from creditors, courts may not see it as abusive since a MEC hampers lifetime withdrawals and looks less like an ordinary investment than other products with more extensive "lifetime" benefits. Like any contributions, this could be subject to UFTA for transfers made after a claim is pending or just prior to bankruptcy – but Ohio statutes have some very unique protections for life insurance in that regard. See the Ohio insurance funding case in the separate UFTA outline.

Insurance is unique among the assets discussed herein in that it can also be easily transferred to LLCs or Irrevocable Life Insurance Trusts (ILITs) during lifetime.

529 Plans and Coverdell ESAs

Rarely discussed is the ability in 529 plans to name oneself as beneficiary (also, the reasons why

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[257] For pros and cons of using standalone or separate trusts for this purpose, see *Using Standalone or Separate Trusts Solely to Receive Retirement Benefits*, J. Retirement Planning, November/December 2007 by this author

[258] See generally, *Trusteed IRAs: An Elegant Estate Planning Option*, Trusts and Estates Sept 2009 and *Contrasting Conduit Trusts, Accumulation Trusts and Trusteed IRAs*, J. Retirement Planning, May-June 2007, by this author

a trust should be owner or at least contingent owner). In some respects, this enables people to use 529 plans as de facto domestic asset protection trusts with the added benefit of tax deferral, but without the taint and uncertainty. I do not advocate overuse in this manner, and of course, there is a 10% penalty and tax on gain for withdrawals not made for education. However, for those with legitimate reason to use a 529 plan, the potential access and asset protection is surely an added benefit.

Appendix A

(bold and/or italics inserted by author **** denotes deleted sections not discussed herein)

R.C. §2329.66 Property that person domiciled in this state may hold exempt

(A) Every person who is domiciled in this state may hold property exempt from execution, garnishment, attachment, or sale to satisfy a judgment or order, as follows:

******

(6)(a) The person's interest in a beneficiary fund set apart, appropriated, or paid by a benevolent association or society, as exempted by section 2329.63 of the Revised Code;

(b) The person's interest in **contracts of life or endowment insurance or annuities**, as exempted by section 3911.10 of the Revised Code;

(c) The person's interest in a policy of **group insurance or the proceeds of a policy of group insurance**, as exempted by section 3917.05 of the Revised Code;

(d) The person's interest in money, benefits, charity, relief, or aid to be paid, provided, or rendered by a fraternal benefit society, as exempted by section 3921.18 of the Revised Code;

(e) The person's interest in the portion of benefits under policies of sickness and accident insurance and in lump sum payments for dismemberment and other losses insured under those policies, as exempted by section 3923.19 of the Revised Code.

******

(10)(a) Except in cases in which the person was convicted of or pleaded guilty to a violation of section 2921.41 of the Revised Code and in which an order for the withholding of restitution from payments was issued under division (C)(2)(b) of that section or in cases in which an order for withholding was issued under section 2907.15 of the Revised Code, and only to the extent provided in the order, and except as provided in sections 3105. 171, 3105.63, 3119.80, 3119.81, 3121.02, 3121.03, and 3123.06 of the Revised Code, the person's right to a **pension, benefit, annuity, retirement allowance, or accumulated contributions, the person's right to a participant account in any deferred compensation program offered by the Ohio public employees deferred compensation board**, a government unit, or a municipal corporation, or the person's other accrued or accruing rights, as exempted by section 145.56, 146.13, 148.09, 742.47, 3307.41, 3309.66, or 5505.22 of the Revised Code, and the person's right to benefits from the Ohio public safety officers death benefit fund;

(b) Except as provided in sections 3119.80, 3119.81, 3121.02, 3121.03, and 3123.06 of the Revised Code, the person's right to receive a **payment under any pension, annuity, or similar plan or contract**, not including a payment from a stock bonus or profit-sharing plan or a payment included in division (A)(6)(b) or (10)(a) of this section, on account of illness, disability, death, age, or length of service, **to the extent reasonably necessary for the support of the person and any of the person's dependents**, except if all the following apply:

(i) The plan or contract was established by or under the auspices of an insider that employed the person at the time the person's rights under the plan or contract arose.

(ii) The payment is on account of age or length of service.

(iii) The plan or contract is not qualified under the "Internal Revenue Code of 1986," 100 Stat. 2085, 26 U.S.C. 1, as amended.

(c) Except for any portion of the assets that were deposited for the purpose of evading the payment of any debt and except as provided in sections 3119.80, 3119.81, 3121.02, 3121.03, and 3123.06 of the Revised Code, the person's right in the assets held in, or to receive any payment under, **any individual retirement account, individual retirement annuity, "Roth IRA," or education individual retirement account** that provides benefits by reason of illness, disability, death, or age, to the extent that the assets, payments, or benefits described in division (A)(10)(c) of this section are attributable to any of the following:

(i) **Contributions of the person** that were less than or equal to the applicable limits on deductible contributions to an individual retirement account or individual retirement annuity in the year that the contributions were made, whether or not the person was eligible to deduct the contributions on the person's federal tax return for the year in which the contributions were made;

(ii) **Contributions of the person** that were less than or equal to the applicable limits on contributions to a Roth IRA or education individual retirement account in the year that the contributions were made;

(iii) **Contributions of the person** that are within the applicable limits on rollover contributions under subsections 219, 402(c), 403(a)(4), 403(b)(8), 408(b), 408(d)(3), 408A(c)(3)(B), 408A(d)(3), and 530(d)(5) of the "Internal Revenue Code of 1986," 100 Stat. 2085, 26 U.S.C.A. 1, as amended.

(d) Except for any portion of the assets that were deposited for the purpose of evading the payment of any debt and except as provided in sections 3119.80, 3119.81, 3121.02, 3121.03, and 3123.06 of the Revised Code, the person's right in the assets held in, or to receive any payment under, any **Keogh or "H.R. 10" plan** that provides benefits by reason of illness, disability, death, or age, **to the extent reasonably necessary for the support of the person and any of the person's dependents**.

*****

(17) Any other property that is **specifically exempted from execution, attachment, garnishment, or sale by federal statutes** other than the "Bankruptcy Reform Act of 1978," 92 Stat. 2549, 11 U.S.C.A. 101, as amended;

§3911.10 Proceeds exempt from claims of creditors

All contracts of **life or endowment insurance or annuities upon the life of any person**, or any interest therein, which may hereafter mature and which have been taken out for the benefit of, or made payable by change of beneficiary, transfer, or assignment to, **the spouse or children, or any persons dependent upon such person**, or an institution or entity described in division (B)(1) of section 3911.09 of the Revised Code, or any creditor, or to a **trustee for the benefit of such spouse, children, dependent persons**, institution or entity, or creditor, **shall be held, together with the proceeds or avails of such contracts, subject to a change of beneficiary if desired, free from all claims of the creditors of such insured person or annuitant**. Subject to the statute of limitations, the amount of any premium upon such contracts, endowments, or annuities, paid in fraud of creditors, with interest thereon, shall inure to their benefit from the proceeds of the contracts, but the company issuing any such contract is discharged of all liability thereon by the payment of its proceeds in accordance with its terms, unless, before such payment, written notice is given to it by a creditor, specifying the amount of the claim and the premiums which the creditor alleges have been fraudulently paid.

§ 3923.19. Exemption of insurance and similar benefits from attachment

(A) Benefits under **all policies of sickness and accident insurance are not liable to attachment or other process**, or to be taken, appropriated, or applied by any legal or equitable process or by operation of law, **either before or after payment of the benefits**, to pay any liabilities of the person insured under any such policy to the extent that the benefits are reasonably necessary for the support of the debtor and any dependents of the debtor. When a policy provides for a lump sum payment because of a dismemberment or other loss insured, the payment is exempt from execution by the insured's creditors.

(B) (1) A payment under a stock bonus, pension, profitsharing, 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 person who is the beneficiary of the plan or party to the contract and any dependents of the person, is not liable to attachment or other process, or to be taken, appropriated, or applied by any legal or equitable process or by operation of law, **either before or after payment of the benefits**, to pay any liabilities of the person unless all of the following apply:

(a) The plan or contract was established by or under the auspices of an insider that employed the person at the time the person's rights under the plan or contract arose.
(b) The payment is on account of age or length of service.
(c) The plan or contract does not qualify under section 401(a), 403(a), 403(b), or 408 of the Internal Revenue Code of 1986, 100 Stat. 2085, 26 U.S.C. 1, as amended.

(2) When a plan or contract provides for a lump sum payment because of a dismemberment or other loss covered by the plan or contract, the payment is exempt from execution by the person's creditors.

Appendix B

11 USC § 522 Exemptions

(sections relating to protecting retirement plans and assets discussed herein **bolded** by author, some sections not discussed herein are deleted and replaced with ***)

SUBCHAPTER II - DEBTOR'S DUTIES AND BENEFITS

(a) In this section -

(1) "dependent" includes spouse, whether or not actually dependent; and

(2) "value" means fair market value as of the date of the filing of the petition or, with respect to property that becomes property of the estate after such date, as of the date such property becomes property of the estate.

(b)(1) Notwithstanding section 541 of this title, **an individual debtor may exempt from property of the estate the property listed in either paragraph (2) or, in the alternative, paragraph (3) of this subsection**. In joint cases filed under section 302 of this title and individual cases filed under section 301 or 303 of this title by or against debtors who are husband and wife, and whose estates are ordered to be jointly administered under Rule 1015(b) of the Federal Rules of Bankruptcy Procedure, one debtor may not elect to exempt property listed in paragraph (2) and the other debtor elect to exempt property listed in paragraph (3) of this subsection. If the parties cannot agree on the alternative to be elected, they shall be deemed to elect paragraph (2), where such election is permitted under the law of the jurisdiction where the case is filed.

(2) Property listed in this paragraph is property that is specified under subsection (d), unless the State law that is applicable to the debtor under paragraph (3)(A) specifically does not so authorize.

(3) Property listed in this paragraph is--

(A) subject to subsections (o) and (p), any property that is exempt under Federal law, other than subsection (d) of this section, or State or local law that is applicable on the date of the filing of the petition at the place in which the debtor's domicile has been located for the 730 days immediately preceding the date of the filing of the petition, or if the debtor's domicile has not been located at a single State for such 730-day period, the place in which the debtor's domicile was located for 180 days immediately preceding the 730-day period or for a longer portion of such 180-day period than in any other place;

If the effect of the domiciliary requirement under subparagraph (A) is to render the debtor ineligible for any exemption, the debtor may elect to exempt property that is specified under subsection (d).

(B) any interest in property in which the debtor had, immediately before the commencement of the case, an interest as a tenant by the entirety or joint tenant to the extent that such interest as a tenant by the entirety or joint tenant is exempt from process under applicable nonbankruptcy law; and

(C) retirement funds to the extent that those funds are in a fund or account that is exempt from taxation under section 401, 403, 408, 408A, 414, 457, or 501(a) of the Internal Revenue Code of 1986.

(4) {{NOTE: Applicability.}} For purposes of paragraph (3)(C) and subsection (d)(12), the following shall apply:

(A) If the retirement funds are in a retirement fund that has received a favorable determination under section 7805 of the Internal Revenue Code of 1986, and that determination is in effect as of the date of the filing of the petition in a case under this title, those funds shall be presumed to be exempt from the estate.

(B) If the retirement funds are in a retirement fund that has not received a favorable determination under such section 7805, those funds are exempt from the estate if the debtor demonstrates that--

(i) no prior determination to the contrary has been made by a court or the Internal Revenue Service; and

(ii)(I) the retirement fund is in substantial compliance with the applicable requirements of the Internal Revenue Code of 1986; or

(II) the retirement fund fails to be in substantial compliance with the applicable requirements of the Internal Revenue Code of 1986 and the debtor is not materially responsible for that failure.

(C) A direct transfer of retirement funds from 1 fund or account that is exempt from taxation under section 401, 403, 408, 408A, 414, 457, or 501(a) of the Internal Revenue Code of 1986, under section 401(a)(31) of the Internal Revenue Code of 1986, or otherwise, shall not cease to qualify for exemption under paragraph (3)(C) or subsection (d)(12) by reason of such direct transfer.

(D)(i) Any distribution that qualifies as an eligible rollover distribution within the meaning of section 402(c) of the Internal Revenue Code of 1986 or that is described in clause (ii) shall not cease to qualify for exemption under paragraph (3)(C) or subsection (d)(12) by reason of such distribution.

(ii) A distribution described in this clause is an amount that--

(I) has been distributed from a fund or account that is exempt from taxation under section 401, 403, 408, 408A, 414, 457, or 501(a) of the Internal Revenue Code of 1986; and

(II) to the extent allowed by law, is deposited in such a fund or account not later than 60 days after the distribution of such amount.

(c) Unless the case is dismissed, property exempted under this section is not liable during or after the case for any debt of the debtor that arose, or that is determined under section 502 of this title as if such debt had arisen, before the commencement of the case, except -

(1) a debt of a kind specified in paragraph (1) or (5) of section 523(a) (in which case, notwithstanding any provision of applicable nonbankruptcy law to the contrary, such property shall be liable for a debt of a kind specified in section 523(a)(5));

(2) a debt secured by a lien that is -

(A)(i) not avoided under subsection (f) or (g) of this section or under section 544, 545, 547, 548, 549, or 724(a) of this title; and

(ii) not void under section 506(d) of this title; or

(B) a tax lien, notice of which is properly filed;

(3) a debt of a kind specified in section 523(a)(4) or 523(a)(6) of this title owed by an institution-affiliated party of an insured depository institution to a Federal depository institutions regulatory agency acting in its capacity as conservator, receiver, or liquidating agent for such institution; or

(4) a debt in connection with fraud in the obtaining or providing of any scholarship, grant, loan, tuition, discount, award, or other financial assistance for purposes of financing an education at an institution of higher education (as that term is defined in section 101 of the Higher Education Act of 1965 (20 U.S.C. 1001)).

(d) The following property may be exempted under subsection (b)(2) of this section:

(1) The debtor's aggregate interest, not to exceed $15,000 in value, in real property or personal property that the debtor or a dependent of the debtor uses as a residence, in a cooperative that owns property that the debtor or a dependent of the debtor uses as a residence, or in a burial plot for the debtor or a dependent of the debtor.

(2) The debtor's interest, not to exceed $2,400 in value, in one motor vehicle.

(3) The debtor's interest, not to exceed $400 in value in any particular item or $8,000 in aggregate value, in household furnishings, household goods, wearing apparel, appliances, books, animals, crops, or musical instruments, that are held primarily for the personal, family, or household use of the debtor or a dependent of the debtor.

(4) The debtor's aggregate interest, not to exceed $1,000 in value, in jewelry held primarily for the personal, family, or household use of the debtor or a dependent of the debtor.

(5) The debtor's aggregate interest in any property, not to exceed in value $800 plus up to $7,500 of any unused amount of the exemption provided under paragraph (1) of this subsection.

(6) The debtor's aggregate interest, not to exceed $1,500 in value, in any implements, professional books, or tools, of the trade of the debtor or the trade of a dependent of the debtor.

(7) Any unmatured life insurance contract owned by the debtor, other than a credit life insurance contract.

(8) The debtor's aggregate interest, not to exceed in value $8,000 less any amount of property of the estate transferred in the manner specified in section 542(d) of this title, in any accrued dividend or interest under, or loan value of, any unmatured life insurance contract owned by the debtor under which the insured is the debtor or an individual of whom the debtor is a dependent.

(9) Professionally prescribed health aids for the debtor or a dependent of the debtor.

(10) The debtor's right to receive -

(A) a social security benefit, unemployment compensation, or a local public assistance benefit;

(B) a veterans' benefit;

(C) a disability, illness, or unemployment benefit;

(D) alimony, support, or separate maintenance, to the extent reasonably necessary for the support of the debtor and any dependent of the debtor;

(E) a payment under a stock bonus, pension, profitsharing, 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, unless -

(i) such plan or contract was established by or under the auspices of an insider that employed the debtor at the time the debtor's rights under such plan or contract arose;

(ii) such payment is on account of age or length of service; and

(iii) such plan or contract does not qualify under section 401(a), 403(a), 403(b), or 408 of the Internal Revenue Code of 1986.

(11) The debtor's right to receive, or property that is traceable to -

(A) an award under a crime victim's reparation law;

(B) a payment on account of the wrongful death of an individual of whom the debtor was a dependent, to the extent reasonably necessary for the support of the debtor and any dependent of the debtor;

(C) a payment under a life insurance contract that insured the life of an individual of whom the debtor was a dependent on the date of such individual's death, to the extent reasonably necessary for the support of the debtor and any dependent of the debtor;

(D) a payment, not to exceed $15,000, on account of personal bodily injury, not including pain and suffering or compensation for actual pecuniary loss, of the debtor or an individual of whom the debtor is a dependent; or

(E) a payment in compensation of loss of future earnings of the debtor or an individual of whom the debtor is or was a dependent, to the extent reasonably necessary for the support of the debtor and any dependent of the debtor.

(12) Retirement funds to the extent that those funds are in a fund or account that is exempt from taxation under section 401, 403, 408, 408A, 414, 457, or 501(a) of the Internal Revenue Code of 1986.

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(n) For assets in individual retirement accounts described in section 408 or 408A of the Internal Revenue Code of 1986, other than a simplified employee pension under section 408(k) of such Code or a simple retirement account under section 408(p) of such Code, the aggregate value of such assets exempted under this section, without regard to amounts attributable to rollover contributions under section 402(c), 402(e)(6), 403(a)(4), 403(a)(5), and 403(b)(8) of the Internal Revenue Code of 1986, and earnings thereon, shall not exceed $1,000,000 in a case filed by a debtor who is an individual, except that such amount may be increased if the interests of justice so require.

11 USC § 541 - Property of the estate

(a) The commencement of a case under section 301, 302, or 303 of this title creates an estate. Such estate is comprised of all the following property, wherever located and by whomever held:
(1) Except as provided in subsections (b) and (c)(2) of this section, all legal or equitable interests of the debtor in property as of the commencement of the case.
****
(5) Any interest in property that would have been property of the estate if such interest had been an interest of the debtor on the date of the filing of the petition, and that the **debtor acquires or becomes entitled to acquire within 180 days** after such date—
(A) by bequest, devise, or inheritance;
(B) as a result of a property settlement agreement with the debtor's spouse, or of an interlocutory or final divorce decree; or
(C) as a beneficiary of a life insurance policy or of a death benefit plan.
(6) Proceeds, product, offspring, rents, or profits of or from property of the estate, except such as are earnings from services performed by an individual debtor after the commencement of the case.
(7) Any interest in property that the estate acquires after the commencement of the case.
(b) Property of the estate does not include—
(1) any power that the debtor may exercise solely for the benefit of an entity other than the debtor;
****
(5) funds placed in an **education individual retirement account (as defined in section 530(b)(1)** of the Internal Revenue Code of 1986) **not later than 365 days before** the date of the filing of the petition in a case under this title, but—
(A) only if the designated beneficiary of such account was a child, stepchild, grandchild, or stepgrandchild of the debtor for the taxable year for which funds were placed in such account;
(B) only to the extent that such funds—
(i) are not pledged or promised to any entity in connection with any extension of credit; and
(ii) are not excess contributions (as described in section 4973(e) of the Internal Revenue Code of 1986); and
(C) in the case of funds placed in all such accounts having the same designated beneficiary not earlier than 720 days nor later than 365 days before such date, only so much of such funds as does not exceed $5,000;
(6) funds used to purchase a tuition credit or certificate or contributed to an account in accordance with **section 529(b)(1)(A)** of the Internal Revenue Code of 1986 under a qualified State tuition program (as defined in section 529(b)(1) of such Code) not later than 365 days before the date of the filing of the petition in a case under this title, but—
(A) only if the designated beneficiary of the amounts paid or contributed to such tuition program was a child, stepchild, grandchild, or stepgrandchild of the debtor for the taxable year for which funds were paid or contributed;
(B) with respect to the aggregate amount paid or contributed to such program having the same designated beneficiary, only so much of such amount as does not exceed the total contributions permitted under section 529(b)(6) of such Code with respect to such beneficiary, as adjusted beginning on the date of the filing of the petition in a case under this title by the annual increase or decrease (rounded to the nearest tenth of 1 percent) in the education expenditure category of the Consumer Price Index prepared by the Department of Labor; and
(C) in the case of funds paid or contributed to such program having the same designated beneficiary not earlier than 720 days nor later than 365 days before such date, only so much of such funds as does not exceed $5,000;
(7) any amount—
(A) withheld by an employer from the wages of employees for payment as contributions—
(i) to—

(I) an **employee benefit plan that is subject to title I of the Employee Retirement Income Security** Act of 1974 or under an employee benefit plan which is a governmental plan under section 414(d) of the Internal Revenue Code of 1986;
(II) a **deferred compensation plan under section 457** of the Internal Revenue Code of 1986; or
(III) a tax-deferred annuity under section 403(b) of the Internal Revenue Code of 1986; except that such amount under this subparagraph shall not constitute disposable income as defined in section 1325 (b)(2); or
(ii) to a health insurance plan regulated by State law whether or not subject to such title; or
(B) received **by an employer from employees for payment as contributions—**
(i) to—
(I) an **employee benefit plan** that is subject to title I of the Employee Retirement Income Security Act of 1974 or under an employee benefit plan which is a governmental plan under section 414(d) of the Internal Revenue Code of 1986;
(II) a deferred compensation plan under **section 457** of the Internal Revenue Code of 1986; or
(III) a **tax-deferred annuity under section 403(b)** of the Internal Revenue Code of 1986; except that such amount under this subparagraph shall not constitute disposable income, as defined in section 1325 (b)(2); or
(ii) to **a health insurance plan** regulated by State law whether or not subject to such title;
****

(c)
(1) Except as provided in paragraph (2) of this subsection, an interest of the debtor in property becomes property of the estate under subsection (a)(1), (a)(2), or (a)(5) of this section notwithstanding any provision in an agreement, transfer instrument, or applicable nonbankruptcy law—
(A) that restricts or conditions transfer of such interest by the debtor; or
(B) that is conditioned on the insolvency or financial condition of the debtor, on the commencement of a case under this title, or on the appointment of or taking possession by a trustee in a case under this title or a custodian before such commencement, and that effects or gives an option to effect a forfeiture, modification, or termination of the debtor's interest in property.

(2) **A restriction on the transfer of a beneficial interest of the debtor in a trust that is enforceable under applicable nonbankruptcy law is enforceable in a case under this title.**

(d) Property in which the debtor holds, as of the commencement of the case, **only legal title and not an equitable interest**, such as a mortgage secured by real property, or an interest in such a mortgage, sold by the debtor but as to which the debtor retains legal title to service or supervise the servicing of such mortgage or interest, becomes property of the estate under subsection (a)(1) or (2) of this section only to the extent of the debtor's legal title to such property, but not to the extent of any equitable interest in such property that the debtor does not hold.
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Appendix C

§222.21 **Exemption of pension money and certain tax-exempt funds or accounts from legal processes.**—

(1)Money received by any debtor as pensioner of the United States within 3 months next preceding the issuing of an execution, attachment, or garnishment process may not be applied to the payment of the debts of the pensioner when it is made to appear by the affidavit of the debtor or otherwise that the pension money is necessary for the maintenance of the debtor's support or a family supported wholly or in part by the pension money. The filing of the affidavit by the debtor, or the making of such proof by the debtor, is prima facie evidence; and it is the duty of the court in which the proceeding is pending to release all pension moneys held by such attachment or garnishment process, immediately, upon the filing of such affidavit or the making of such proof.

(2)(a)Except as provided in paragraph (d), any money or other assets payable to an owner, a participant, or a beneficiary from, or any interest of any owner, participant, or beneficiary in, a fund or account is **exempt from all claims of creditors of the owner, beneficiary, or participant** if the fund or account is:

1.Maintained in accordance with a master plan, volume submitter plan, prototype plan, or any other plan or governing instrument that has been preapproved by the Internal Revenue Service as exempt from taxation under **s. 401(a), s. 403(a), s. 403(b), s. 408, s. 408A, s. 409, s. 414, s. 457(b), or s. 501(a) of the Internal Revenue Code of 1986, as amended, unless it has been subsequently determined that the plan or governing instrument is not exempt from taxation in a proceeding that has become final and nonappealable**;

2.Maintained in accordance with a plan or governing instrument that has been determined by the Internal Revenue Service to be exempt from taxation under s. 401(a), s. 403(a), s. 403(b), s. 408, s. 408A, s. 409, s. 414, s. 457(b), or s. 501(a) of the Internal Revenue Code of 1986, as amended, unless it has been subsequently determined that the plan or governing instrument is not exempt from taxation in a proceeding that has become final and nonappealable; or

3.Not maintained in accordance with a plan or governing instrument described in subparagraph 1. or subparagraph 2. if the person claiming exemption under this paragraph proves by a preponderance of the evidence that the fund or account is maintained in accordance with a plan or governing instrument that:

a.Is in substantial compliance with the applicable requirements for tax exemption under s. 401(a), s. 403(a), s. 403(b), s. 408, s. 408A, s. 409, s. 414, s. 457(b), or s. 501(a) of the Internal Revenue Code of 1986, as amended; or

b.**Would have been in substantial compliance with the applicable requirements for tax exemption under s. 401(a), s. 403(a), s. 403(b), s. 408, s. 408A, s. 409, s. 414, s. 457(b), or s. 501(a) of the Internal Revenue Code of 1986, as amended, but for the negligent or wrongful conduct of a person or persons other than the person who is claiming the exemption under this section.**

(b)It is not necessary that a fund or account that is described in paragraph (a) be maintained in accordance with a plan or governing instrument that is covered by any part of the Employee Retirement Income Security Act for money or assets payable from or any interest in that fund or account to be exempt from claims of creditors under that paragraph.

(c)Any money or other assets or any interest in any fund or account that is exempt from claims of creditors of the owner, beneficiary, or participant under paragraph (a) **does not cease to be exempt after the owner's death by reason of a direct transfer or eligible rollover that is excluded from gross**

income under the Internal Revenue Code of 1986, including, but not limited to, a direct transfer or eligible rollover to an inherited individual retirement account as defined in s. 408(d)(3) of the Internal Revenue Code of 1986, as amended. This paragraph is intended to clarify existing law, is remedial in nature, and shall have retroactive application to all inherited individual retirement accounts without regard to the date an account was created.

(d)Any fund or account described in paragraph (a) is not exempt from the claims of an alternate payee under a qualified domestic relations order or from the claims of a surviving spouse pursuant to an order determining the amount of elective share and contribution as provided in part II of chapter 732. However, the interest of any alternate payee under a qualified domestic relations order is exempt from all claims of any creditor, other than the Department of Revenue, of the alternate payee. As used in this paragraph, the terms “alternate payee” and “qualified domestic relations order” have the meanings ascribed to them in s. 414(p) of the Internal Revenue Code of 1986.

(e)This subsection applies to any proceeding that is filed on or after the effective date of this act.

Appendix D

Inherited IRAs In The Courts – Chart by Michigan attorney Sal LaMendola				
Date	**Case Name**	**Jurisdiction**	**Amount**	**Result for Beneficiary***
8.30.2010	Weilhammer[259] (Mother to Son)	California Bankruptcy Court	Undisclosed	**Win** ** **S/F2**
8.18.2010	Ard[260] (Father to Daughter)	Florida Bankruptcy Court	$25,000	**Loss S**
6.18.2010	Tabor[261] (Mother to Daughter)	Pennsylvania Bankruptcy Court	$105,102	**Win F2**
6.7.2010	Klipsch[262] (Father to Son)	Indiana Bankruptcy Court	$56,137	**Loss S**
4.18.2010	Kuchta[263] (Mother to Daughter)	Ohio Bankruptcy Court	$7,259	**Win** ** **S/F2**
3.5.2010	Chilton[264] (Mother to Daughter)	Texas Bankruptcy Court	$170,000	**Loss F1**
1.11.2010	Nessa[265] (Father to Daughter)	Minnesota Bankruptcy Court	Undisclosed	**Win/Win F1**
8.14.2009	Robertson[266] (Father to Son)	Florida Court of Appeals	$75,372	**Loss/Loss S**
9.30.2008	Mullican[267] (Mother to Son)	Texas Bankruptcy Court	$112,885	**Loss S**
1.7.2008	McClelland[268] (Aunt to Niece)	Idaho Bankruptcy Court	Undisclosed	**Win S**
4.30.2007	Jarboe[269] (Mother to Son)	Texas Bankruptcy Court	$46,467	**Loss S**
4.6.2007	Commerce Bank[270] (Mother to Revocable Trust)	Kansas Court of Appeals	$212,546	**Loss S**
7.7.2006	Kirchen[271] (Mother to Son)	Wisconsin Bankruptcy Court	$283,893	**Loss S**
5.9.2006	Taylor[272] (Aunt to Niece)	Illinois Bankruptcy Court	$43,633	**Loss S**
7.21.2004	Navarre[273] (Mother to Son)	Alabama Bankruptcy Court	$7,800	**Loss S**
1.31.2003	Greenfield[274] (Father to Daughter)	California Bankruptcy Court	$67,099	**Loss S**
11.23.1999	Sims[275] (Father to Son)	Oklahoma Bankruptcy Court	$57,869	**Loss S**

"S" = Decided under state IRA exemption statute.

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[259] *In re Weilhammer*, 2010 Bankr. LEXIS 2935 (Bankr. S.D. Cal. 2010) (Unpublished)
[260] *In re Ard*, 435 B.R. 719 (Bankr. M.D. Fla. 2010)
[261] *In re Tabor*, 2010 Bankr. LEXIS 2051 (Bankr. M.D. Tenn. 2010)
[262] *In re Klipsch*, 2010 Bankr. LEXIS 1845 (Bankr. S.D. Ind. 2010)
[263] *In re Kuchta*, 434 B.R. 837 (Bankr. N.D. Ohio 2010)
[264] *In re Chilton*, 426 B.R. 612 (Bankr. E.D. Tex. 2010)
[265] *In re Nessa*, 426 B.R. 312 (B.A.P. 8th Cir. 2010)
[266] *Robertson v. Deeb*, 16 So. 3d (Fla. 2d DCA 2009)
[267] *In re Mullican*, 2008 Bankr. LEXIS 3938 (Bankr. E.D. Tex. 2008)
[268] *In re McClelland*, 2008 Bankr. LEXIS 41, 2008 WL 98801 (Bankr. D. Idaho 2008)
[269] *In re Jarboe*, 365 B.R. 717 (Bankr. S.D. Tex. 2007)
[270] *Commerce Bank, N.A. v. Bolander*, 154 P.3d 1184, 2007 WL 1041760 (Unpublished)
[271] *In re Kirchen*, 344 B.R. 908 (Bankr. E.D. Wisc. 2006)
[272] *In re Taylor*, 2006 Bankr. LEXIS 755, 2006 WL 1275400 (Bankr. C.D. Ill. 2006)
[273] *In re Navarre*, 332 B.R. 24 (Bankr. M.D. Ala. 2004)
[274] *In re Greenfield*, 289 B.R. 146 (Bankr. S.D. Cal. 2003)
[275] *In re Sims*, 241 B.R. 467 (Bankr. N.D. Okla. 1999)

"F1" = Decided under 11 U.S.C. 522(d)(12) (federal IRA exemption for debtors who choose federal exemptions).
"F2" = Decided under 11 U.S.C. 522(b)(3)(C) (federal IRA exemption for debtors who choose (or who must choose) state exemptions).
*Where two entries are shown, the second indicates the win or loss on appeal.
**Court analyzed both S and F2 and indicated that result would have been a loss under S alone.

SPEAKER BIO

After receiving his *Juris Doctor* from the Northwestern School of Law of Lewis and Clark College, Ed went on to complete his masters degree in tax law (*LL.M.*) at Capital University in Columbus and his MBA from Xavier University. He practiced as Of Counsel in the area of estate planning at the Cincinnati law firm of Furnier, Flagel & Thomas, LLP and had his own solo law practice in Springboro, Ohio. Ed is now a Wealth Specialist concentrating in estate planning and tax matters for Key Private Bank Family Wealth clients nationwide as well as Director of Wealth Transfer Planning and Tax Strategies. He is married and lives in Springboro with his wife and two daughters.

On the Bar level, Ed is a certified specialist through the Ohio State bar Association in Estate Planning, Probate and Trust Law. He is the recently outgoing Chair of the Dayton Bar Association's Estate Planning, Trust and Probate Committee. Ed is also a Certified Financial Planner (CFP®) and Registered Financial Consultant (RFC®) and has passed Level 1 of the Certified Financial Analyst exam. He is an approved as a non-public arbitrator for the Financial Industry Regulatory Agency (FINRA). He confines his practice with Key Private Bank to working with high net worth individuals and their attorneys, accountants and financial advisors in conjunction with KeyBank's financial planning, investment management, trust services and wealth management teams nationwide.

Ed is a frequent speaker at continuing legal education courses and financial conferences. Recent Articles include: "*Contrasting Conduit Trusts, Accumulation Trusts and Trusteed IRAs*" in the Journal of Retirement Planning in May/June 2007, "*Ensuring the Stretch*" July/August 2007 Journal of Retirement Planning and "*Separate or Standalone Trusts as IRA Beneficiaries*", in the October/November 2007 issue of the CCH Journal of Retirement Planning, and *Trusteed IRAs: An Elegant Estate Planning Option*, September 2009 Trusts and Estates.