CREDITOR PROTECTION IN IDAHO FOR RETIREMENT PLANS AND IRAs AFTER *CLARK v. RAMEKER*

Prepared by
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CREDITOR PROTECTION IN IDAHO OUTSIDE OF BANKRUPTCY

Creditor Protection in Idaho for Retirement Plans and IRAs

For debtors who have not filed for bankruptcy, creditor protection for Retirement Plans and IRAs is based on ERISA, the Internal Revenue Code, case law, and state law.

Creditor protection for Retirement Plans and IRAs "***outside***" of Bankruptcy requires that you classify them into one of 3 categories before you can determine what creditor protection is available:

Category #1: ERISA Retirement Plans subject to Title I;

Category #2: ERISA Retirement Plans not subject to Title I;

Category #3: Non-ERISA Retirement Plans

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ERISA RETIREMENT PLANS
Category #1
(Subject to Title I of ERISA)

DEFINED BENEFIT PLANS, PROFIT SHARING PLANS, EMPLOYEE STOCK OWNERSHIP PLANS, 401(k) PLANS, CERTAN 403(b) PLANS, MONEY PURCHASE PENSION PLANS, AND ELECTING CHURCH PLANS

ERISA RETIREMENT PLANS
Category #2
(Not subject to Title I of ERISA)

SEP IRAs
and
SIMPLE IRAs

NON-ERISA RETIREMENT PLANS
Category #3
(Not subject to ERISA)

CERTAIN 403(b) PLANS, GOVERNMENT PLANS, NON-ELECTING CHURCH PLANS, AND SELF-EMPLOYED PLANS COVERING ONLY THE OWNER AND/OR HIS SPOUSE

TRADITIONAL IRAs
and
ROTH IRAs

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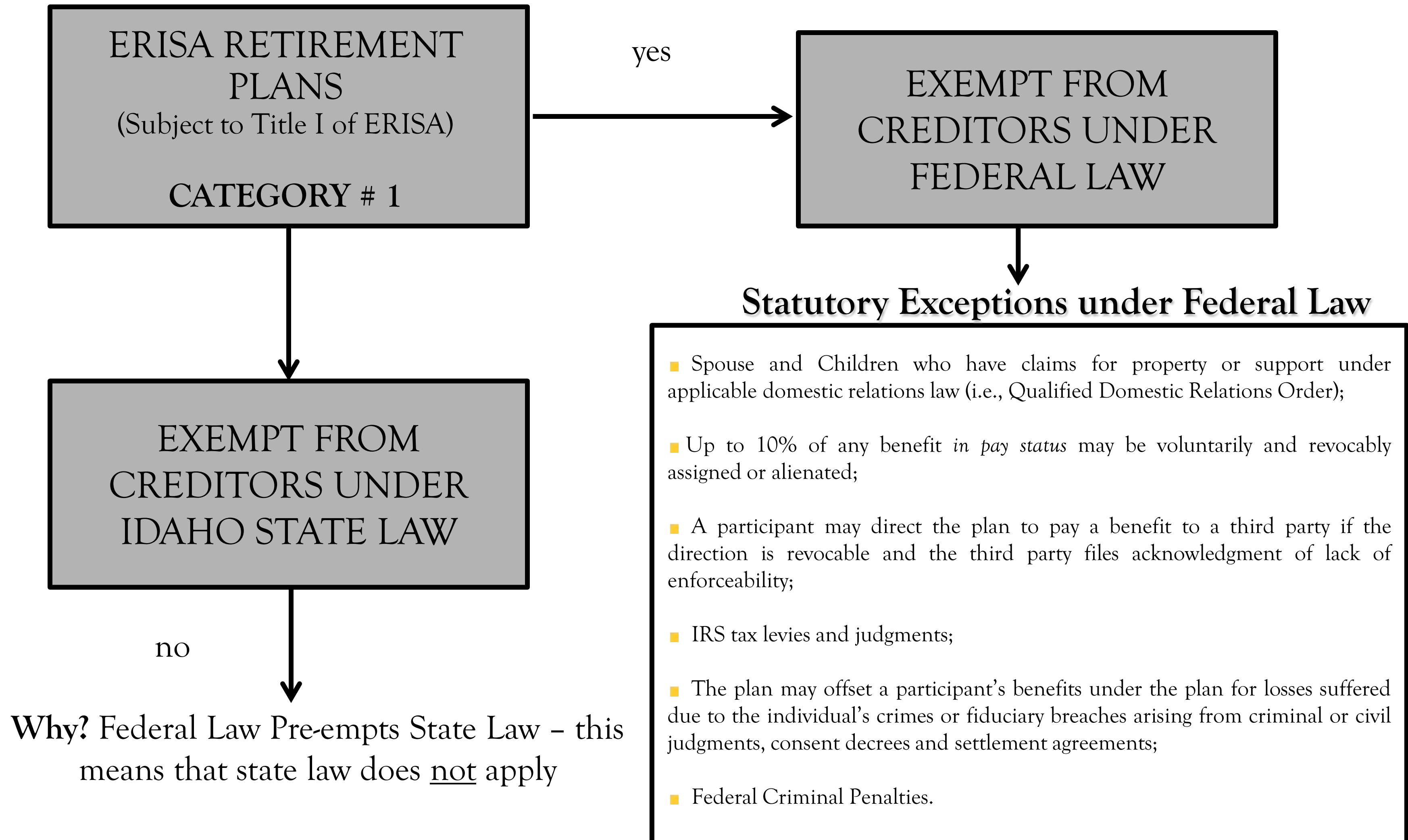

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Category # 1

ERISA Plans subject to Title I of ERISA

The Employee Retirement Income Security Act of 1974, or ERISA, is a federal law that sets minimum standards for pension plans provided by ***private employers*** to employees.

To be an ERISA covered plan, the underlying plan must constitute a "pension plan" under ERISA. Such a plan is any "plan, fund or program which is established or maintained by an employer … that provides retirement income to employees." ERISA Section 3(2)(A).

Title I of ERISA requires that a "pension plan" provide that benefits under the plan may not be assigned or alienated. ERISA Section 206(d)(1). The Internal Revenue Code buttresses ERISA by providing that a retirement plan will not attain "**qualified status**" unless it provides that benefits may not be assigned or alienated. I.R.C. Section 401(a)(13)(A).

For an ERISA covered plan to be deemed "**qualified**" for tax purposes, the plan must meet certain qualification requirements under I.R.C. Section 401(a), including, but not limited to, minimum standards for participation, vesting, funding, nondiscrimination, reporting, disclosure, and fiduciary duties.

ERISA Section 514(a) provides that the provisions of ERISA supersede state laws insofar as such laws relate to employee benefit plans. The ERISA anti-alienation provisions of Title I and the preemption provisions combine to make state attachment and garnishment laws inapplicable outside of bankruptcy to ERISA-covered retirement plans subject to Title I of ERISA (i.e., ERISA-qualified plans).

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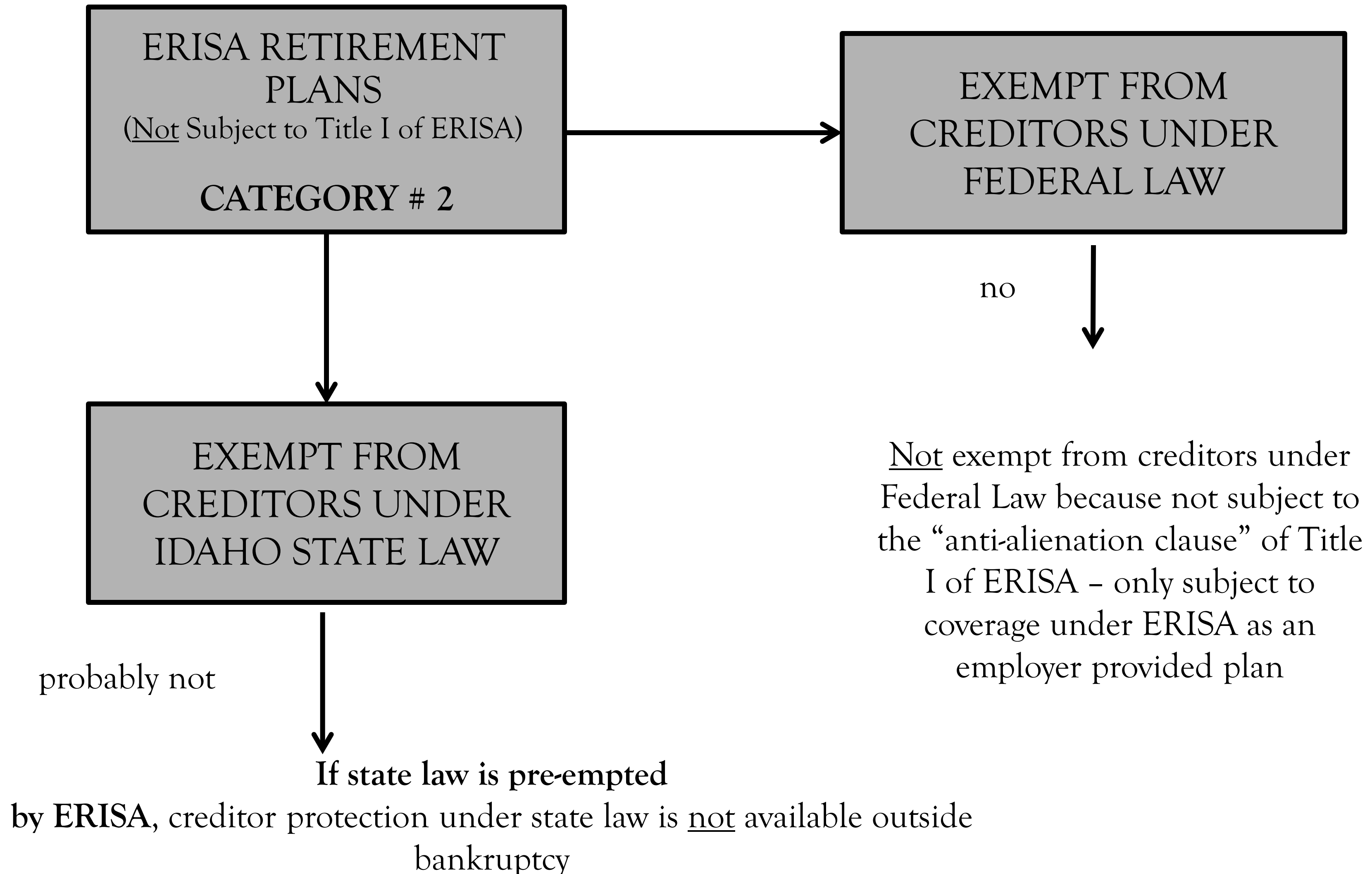

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Category # 2

ERISA Plans <u>not</u> subject to Title I of ERISA

The Department of Labor and the U.S., Tenth Circuit Court of Appeals, in *Garratt v. Walker*, 164 F. 3d 1249 (10th Cir. 1998) have held that an employer sponsored SEP or SIMPLE IRA are ERISA pension plans due to "*the employer involvement*" in such arrangement. However, the anti-alienation protections provided by Title I of ERISA do <u>not</u> extend to an IRA arrangement under Code Section 408 even if the IRA is an employer sponsored SEP or SIMPLE IRA. ERISA Sections 4(b) and 201.

ERISA Section 514(a) provides that the provisions of ERISA supersede state laws insofar as such laws relate to employee benefit plans. The ERISA anti-alienation provisions and preemption provisions combine to make state attachment and garnishment laws inapplicable to an individual's retirement benefits under an ERISA-covered employee benefit plan <u>outside</u> of bankruptcy.

Thus, the SEP and SIMPLE IRA is in a quandary <u>outside</u> of bankruptcy – this IRA is deemed an ERISA pension plan but has no ERISA anti-alienation protection, and being an ERSA pension plan, any state law protecting the funds may be preempted by ERISA and such accounts may be open to attachment under state law actions. The U.S. Sixth Circuit case of *Lampkins v. Golden*, 28 Fed. Appx. 409 (6th Cir. 2002) appears to have adopted this position when it ruled that a Michigan statute exempting SEPs and IRAs was <u>preempted</u> by ERISA and, therefore, a SEP-IRA was subject to garnishment.

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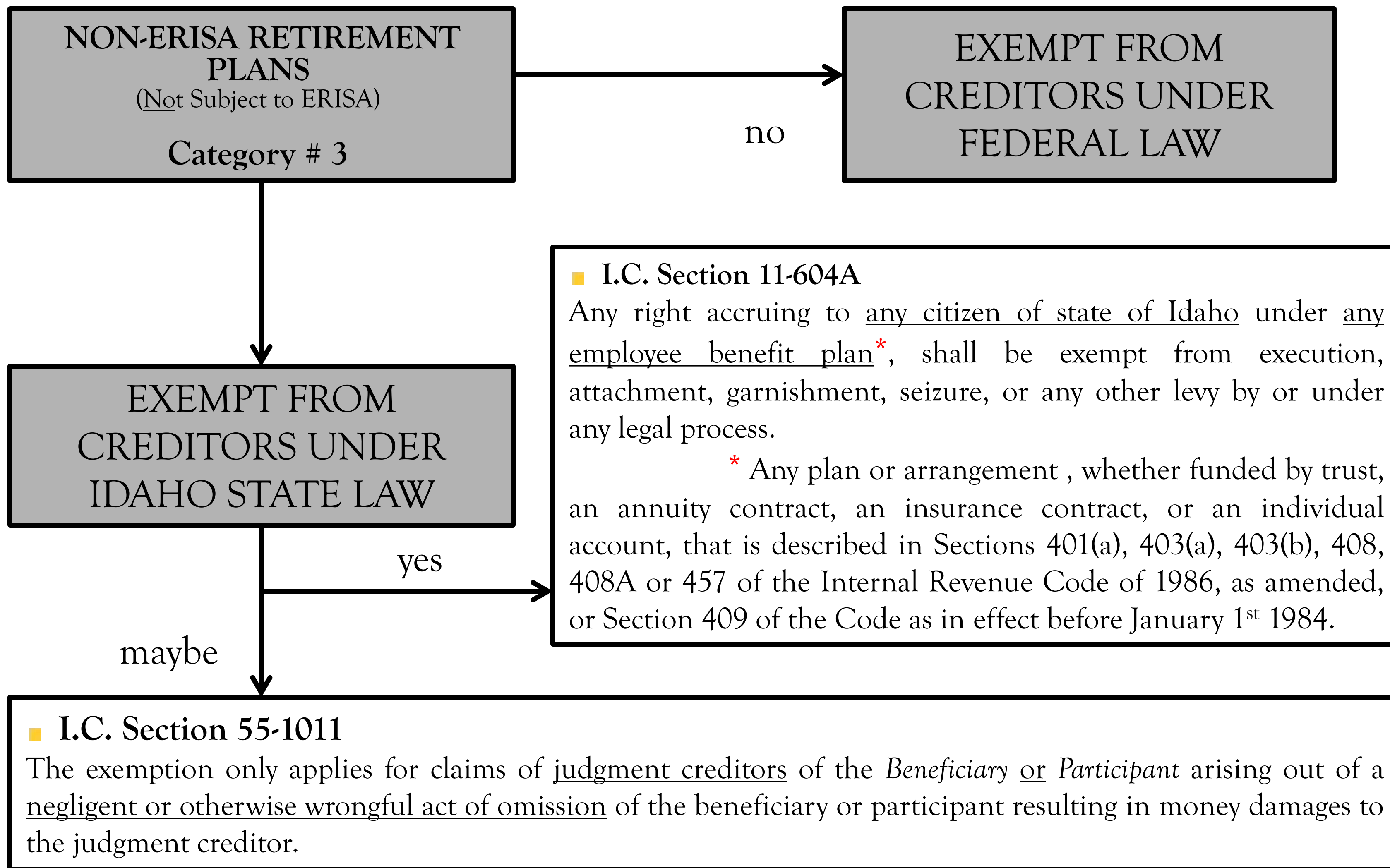

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Category # 3

Types of Non-ERISA Plans

Non-ERISA plans are not subject to ERISA and therefore exempt, if at all, only under state law. Examples of such plans include certain 403(b) plans, governmental plans, non-electing church plans, qualified plans that benefit only the business owner and/or the owner's spouse, and individually created and funded Traditional and Roth IRAs.

403(b) plans

A 403(b) Plan can be established by public schools, 501(c)(3) tax-exempt organizations, and churches. ERISA applies to "employer sponsored retirement plans." However, under long-standing Department of Labor Regulations, an employer can avoid ERISA if it "*limits its involvement*" with the plan. By appropriately limiting employer involvement, the 403(b) plan is considered voluntary by employees, and the tax-sheltered annuity contracts and custodial accounts funding the 403(b) plan are viewed as contractual arrangements between individual employees and the insurance companies and mutual funds providing the investment.

403(b) Plans - continued

For example, an employer can take steps to ensure the 403(b) plan keeps its tax-preferred status, and provide verifying information to plan investment providers, without crossing the line and becoming a "sponsoring employer."

Most 403(b) plans that only receive employee salary-deferral contributions can fit easily into either category: an ERISA plan subject to the anti-alienation requirement in Title I of ERISA (Category #1) or a Non-ERISA plan (Category #3). However, if a plan receives any employer contributions, then the plan is automatically subject to ERISA, unless the employer is a governmental entity or a church, in which case there is a separate exemption under ERISA Sections 4(b)(1) and 4(b)(2), 29 U.S.C. Sections 1003(b)(1) and (b)(2).

That being the case, if a 403(b) plan is subject to ERISA, state law as it relates to such 403(b) plans is preempted by ERISA outside of bankruptcy. On the other hand, if a 403(b) plan is not subject to ERISA, state law is **not** preempted by ERISA. In such a case, one must look solely to state law, such as I.C. Section 11-604A, to determine what creditor protection exists for 403(b) plans outside of bankruptcy.

CREDITOR PROTECTION IN IDAHO OUTSIDE OF BANKRUPTCY

Church Plans

Church plans are also exempt from ERISA under Section 4(b)(2), 29 U.S.C. Section 1003(b)(2). In general, a church plan is a plan established and maintained by a Church or by a convention or association of Churches that is exempt from tax under I.R.C. Section 501. Church plans are defined in ERISA Section 3(33) and I.R.C. 414(e).

Church plans are exempt from ERISA, unless an election is made to have ERISA coverage. The election once made is irrevocable. I.R.C. Section 410(d).

Accordingly, if a Church plan elects to be subject to ERISA, state law as it relates to such Church plan is preempted by ERISA. On the other hand, if a Church plan has not elected to be subject to ERISA, state law exemption statutes are **not** preempted by ERISA. In such a case, one must look solely to state law, such as I.C. Section 11-604A, to determine what creditor protection exists for Church plans outside of bankruptcy.

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Governmental Plans

Governmental plans are also exempt from ERISA under Section 4(b)(1), 29 U.S.C. Section 1003(b)(1). "A governmental plan is a plan established or maintained for its employees by the government of the United States, by the government of any State or political subdivision thereof, or by any agency or instrumentality of any of the foregoing."

A plan is considered governmental if it was "established by an entity falling within the confines of the aforementioned definition or if it is currently maintained by such entity." *Smith v. Regional Transit Authority*, 827 F. 3d 412 (2016). A governmental plan, unlike a church plan, may not elect to be subject to ERISA.

That being the case, state law as it relates to such governmental plans is **not** preempted by ERISA outside of bankruptcy. In such cases, one must look solely to state law, such as I.C. Section 11-604A, to determine what creditor protection exists for governmental plans outside of bankruptcy.

CREDITOR PROTECTION IN IDAHO OUTSIDE OF BANKRUPTCY

Employer Sponsored Plans that Benefits only the Owner and/or Spouse

ERISA defines a pension plan as any "plan, fund or program which…provides retirement income to employees." ERISA Section 3(2)(A). Therefore, a plan that does not benefit any ***common-law employees*** is not an ERISA pension plan.

Case law and Department of Labor Regulations have held that a plan that benefits only an owner and/or spouse are not ERISA plans thus voiding the anti-alienation protections generally afforded to ERISA plans. 29 CFR Section 2510.3-3(b); DOL Advisory Opinion 99-04A; *In re Watson*, 192 B.R. 238 (Feb., 1998, Nevada), affd. 22 EBC 1091 (9th Circuit 1998).

However, in *Yates v. Hendon*, 124 S. Ct. 1330 (March 2, 2004), the U.S. Supreme Court held that the working owner of the business could qualify as a "participant" in a pension plan covered by ERISA if the plan included one or more employees other than the business owner and his or her spouse. In such cases, the business owner and his or her spouse are afforded the same protection under ERISA that is available to any other participant of an ERISA plan.

In other words, if the plan does not include one or more employees other than the business owner and his or her spouse, Idaho state exemption statutes, such as I.C. 11-604A(4), are **not** preempted by ERISA and are applicable outside bankruptcy.

CREDITOR PROTECTION IN IDAHO OUTSIDE OF BANKRUPTCY

IRAs and Roth IRAs

As noted earlier, ERISA defines a "pension" plan under its jurisdiction as any "plan, fund or program which is established or maintained by an employer… that provides retirement income to employees." ERISA Section 3(2)(A). Unlike SEP and Simple IRAs which are considered ERISA employer sponsored plans, IRAs and Roth IRAs are individually created and funded accounts and consequently are not considered ERISA pension plans.

In addition, ERISA Section 201(6) specifically provides that individual retirement accounts are not subject to the "anti-alienation provision of Title I of ERISA. 29 U.S. C. Section 1051(6).

That being the case, state law as it relates to such IRAs is **not** preempted by ERISA. In such cases, one must look solely to state law to determine what creditor protection exists for IRAs outside of bankruptcy.

In Idaho, in the case of *In re Skaar*, 98.1 I.B.C.R. 13 (Bankr. D. Idaho 1998), the court held that an **IRA** which qualifies under Section 408 is exempt as an "**employee benefit plan**" as that term is defined under I.C. Section 11-604A. Likewise, in the case of *In re Gregory Allen McClelland and Debra Jean McClelland*, 2008 W L 89901 (Bankr. D. Idaho 2008), the court held that a debtor's **inherited IRA** was exempt from attachment by creditors under I.C. Section 11-604A. While the cases cited above are bankruptcy cases, the decisions are applicable outside of a bankruptcy as well.

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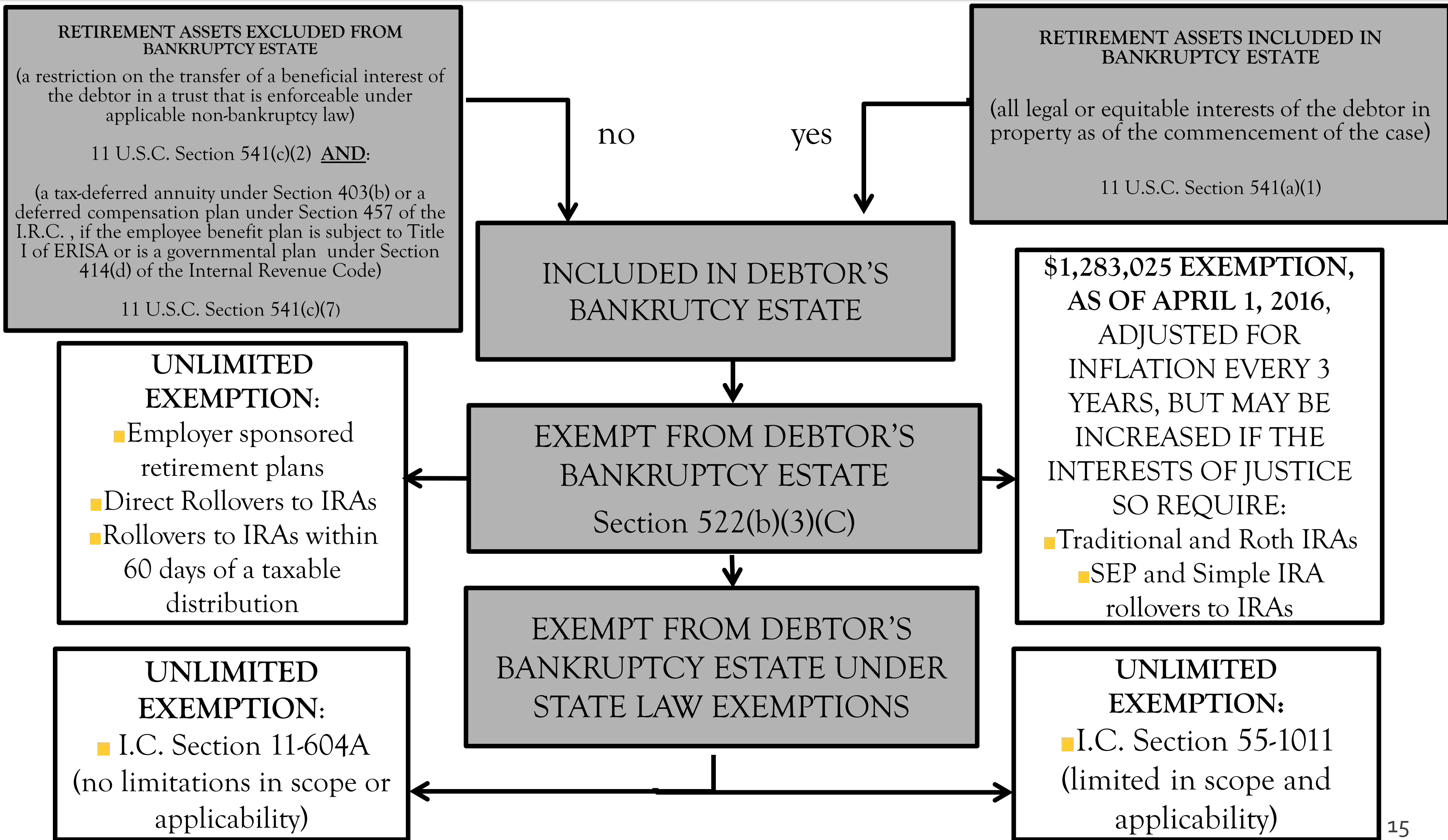

CREDITOR PROTECTION IN IDAHO INSIDE BANKRUPTCY

Creditor Protection for Retirement Plans and IRAs in Bankruptcy

The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA) was enacted April 20, 2005, and became effective for Bankruptcies filed after October 17, 2005.

Debtor's Bankruptcy Estate

Assets can be protected from creditors of a debtor's bankruptcy estate in two ways: (1) the assets can be excluded from the debtor's bankruptcy estate or (2) the assets can be exempted from a debtor's bankruptcy estate.

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Assets Excluded from a Debtor's Estate

A bankruptcy estate is considered to be "*all legal or equitable interests of the debtor in property*" 11 U.S.C. Section 541(a)(1). However, if an asset is not considered a part of the bankruptcy estate in the first place, then it is, in effect, an excluded asset. An ERISA plan is an example of an excluded asset. ERISA is applicable to employer sponsored retirement plans, including all types of defined benefit plans, 401(k) plans, certain 403(b) plans, profit-sharing plans, and money purchase pension plans.

ERISA states that retirement benefits under employer-sponsored retirement plans "*may not be assigned or alienated*." 29 U.S.C. Section 1056(d)(1). This is important because in defining what is or is not included in the bankruptcy estate, federal law states that a "*restriction on the transfer of a beneficial interest of the debtor in a trust that is enforceable under applicable non-bankruptcy law*" is enforceable under the Bankruptcy Code, so the benefits are not part of the debtor's bankruptcy estate. 11 U.S.C. Section 541(c)(2). The restriction on the transfer of a beneficial interest of the debtor in a trust under ERISA's anti-alienation provision is analogous to a spendthrift trust provision under applicable non-bankruptcy law.

CREDITOR PROTECTION IN IDAHO INSIDE BANKRUPTCY

Enforceable Non-Bankruptcy Law Restriction on the Transfer of a Debtor's Assets held in Trust under Section 541(c)(2)

In 1992, the United States Supreme Court declared in *Patterson v. Shumate*, 504 U.S. 753 (1992), that the ERISA "anti-alienation" rules do, in fact, constitute an enforceable non-bankruptcy law restriction on the transfer of a debtor's assets held in trust, thereby causing employer plan assets subject to ERISA's anti-alienation clause, of Title I of ERISA, to be excluded from the debtor's bankruptcy estate. In *Patterson v. Shumate*, **Article 16.1 of the Plan** contained the anti-alienation provision required for qualification as a ERISA-qualified pension plan under Section 206(d)(1) of ERISA, 29 U.S.C. Section 1056(d)(1). The Court apparently coined the phrase "ERISA- qualified plan" to describe the plan's dual status as both tax-qualified and ERISA-covered.

In the years following the decision in *Patterson v. Shumate*, the question of whether a debtor's interest in funds held in a retirement plan or IRA is an excludible asset from the debtor's bankruptcy estate was frequently litigated as an issue arising under Section 541(c)(2), the section which excludes from "property of the bankruptcy estate" funds held in trusts where under applicable non-bankruptcy law the debtor's interest was inalienable. These court cases focused on what is an ERISA-qualified pension plan under *Patterson v. Shumate* and in particular: (1) whether the retirement plan or IRA was held in a "trust," (2) how much "control" the debtor had over the retirement plan or IRA assets, and (3) whether the anti-alienation rules could be satisfied if the "statute" contained such a provision as opposed to the plan document.

Enforceable Restriction on the Transfer of a Debtor's Interest under Section 541(c)(2) – Split in the Circuits

Currently, there is a split in the federal circuits on the issue as to whether the restriction on transfer must be included in the pension plan provisions creating the trust under Section 541(c)(2). The Third Circuit in *Orr v. Yuhas* (In re Yuhas), 104 F.3rd 612 (3rd Cir. 1997) held that a New Jersey statute, N.J.S.A. Section 25:2-1(b), exempting from creditors' claims any property held in a qualifying trust and any distributions made from a qualifying trust constituted a restriction on transfer that was enforceable under non-bankruptcy law. The court concluded that, under 11 U.S.C. Section 541(c)(2), the statute restriction was enforceable in bankruptcy; therefore, the IRA was not property of the bankruptcy estate. Likewise, the Eleventh Circuit reached a similar result in *Meehan v. Wallace* (In re Meehan), 102 F.3rd 1209 (11th Cir. 1997). There, the court held that Georgia statute, O.C.G.A. Section 18-4-22(a) imposed a restriction on the transfer by garnishment. The debtor's interest in the IRA was excluded from the bankruptcy estate.

However, in *Lowenschuss v. Selnick* (In re Lowenschuss), 171 F3d 673, 683 (9th Cir. 1999), the Ninth Circuit court acknowledged that it was creating a split in the circuits when it reached the opposite conclusion. In that case, the court determined that a pension plan that did not qualify under ERISA was property of the bankruptcy estate. It held that in order for a debtor's beneficial interest in a pension plan to be excluded from the estate, the plan, as opposed to the transfer restriction set forth in Section 8124(b) of the Pennsylvania Consolidated Statutes, must contain a transfer restriction and that transfer restriction must be enforceable under state or federal law. See also *In re Zott*, 225 B.R. 160,164 (Bankr. E.D. Mich. 1998).

CREDITOR PROTECTION IN IDAHO INSIDE BANKRUPTCY

Exclusion from the Bankruptcy Estate under Section 541(c)(2) for Anti-alienation Provision in I.C. Section 11-604A

(2) The right of any person to a pension, annuity, or retirement allowance or disability allowance, or death benefits, or any optional benefit, or any other right accrued or accruing to any **citizen of the state of Idaho** under any ***employee benefit plan***, and any fund created by the benefit plan or arrangement, shall be exempt from execution, attachment, garnishment, seizure, or any other levy by or under any legal process whatever…

(4) For purposes of this section, the term "***employee benefit plan***" means…

(b) Any plan or arrangement, whether funded by a trust, an annuity contract, an insurance contract, or an individual account, that is described in sections 401(a), 403(a), 403(b), 408, 408A or 457 of the Internal Revenue Code of 1986, as amended, or section 409 of the Internal Revenue Code as in effect before January 1, 1984….

(5) An employee benefit plan shall be deemed to be a ***spendthrift trust***, regardless of the source of funds, the relationship between the beneficiary and the trustee or custodian of the plan, or the ability of the debtor to withdraw, borrow, or otherwise become entitled to benefits from the plan before retirement (Emphasis added.).

Exclusion from the Bankruptcy Estate under Section 541(c)(2) for Anti-alienation Provision in I.C. Section 11-604A - Continued

The Idaho Bankruptcy Court, in the case of *In re Mark Petruzzelli*, __ B.R. __ (Bkrtcy. D. Idaho 2004), held that a deferred compensation plan under IRC Section 457 that contained an anti-alienation provision in the plan document, as required by ERISA, 29 U.S.C. Section 1056(d)(1), was not property of the bankruptcy estate under Section 541(c)(2). In this case, the Idaho Bankruptcy Court was not required to address the issue of whether the anti-alienation provision could be contained in the exemption statute as opposed to the plan document.

However, the Idaho Bankruptcy Court did cite, in a footnote to the decision, the case of *Meehan v. Wallace* (In re Meehan), 102 F. 3d 1209 (11th Cir. 1997), holding that the Section 541(c)(2) exclusion is not lost merely because it was state law, not debtor's IRA document, that contained the applicable restriction on transfer, and rejecting the argument that debtor's ability to withdraw funds from her IRA subject to a penalty tax brought the funds within the estate.

Since the Idaho Bankruptcy Court was citing *Meehan v. Wallace* to support a different issue raised in the case (i.e., debtor's control over the assets), the Idaho Bankruptcy Court has not directly addressed the issue of whether the anti-alienation provision set forth in the state statute, I.C. 11-604(A), as opposed to the plan document, is an excludible asset of the bankruptcy estate in light of the 9th Circuit decision in the case of *Lowenschuss v. Selnick*, 171 F3d 673, 683 (9th Cir. 1999), which held to the contrary.

CREDITOR PROTECTION IN IDAHO INSIDE BANKRUPTCY

BAPCPA Added Section 541(c)(7) to the Bankruptcy Code

BAPCPA added Section 541(c)(7) to allow debtor's in bankruptcy to exclude from the bankruptcy estate: (i) a tax-deferred annuity under Section 403(b) of the Internal Revenue Code of 1986 or (ii) a deferred compensation plan under Section 457 of the Internal Revenue Code of 1986, if the employee benefit plan is subject to Title I of ERISA or is a governmental plan under Section 414(d) of the Internal Revenue Code.

Collier on Bankruptcy notes that "[u]nder prior law.. The question of whether a debtor's interest in funds held in a pension plan was frequently litigated as an issue arising under Section 541(c)(2), the section which excludes from "property of the estate" funds held in trusts where under applicable non-bankruptcy law the debtor's interest was inalienable." 5-541 Collier on Bankruptcy-15th Edition Rev. P 541.22C (footnotes omitted). Collier's notes that the 2005 amendments "probably will eliminate much of the need for litigation about some portions of the funds held in pension and other welfare-benefit plans, i.e., amounts withheld from wages by employers for, and amounts received by employers from employees for payment as, contributions to, enumerated types of employee-benefit plans." Id. (footnotes omitted).

CREDITOR PROTECTION IN IDAHO INSIDE BANKRUPTCY

Assets Exempt from the Debtor's Estate

In addition to excluded assets, the Bankruptcy Abuse Prevention and Consumer Protection Act also provides for exemptions for certain assets of a debtor, thereby making them unavailable to creditors and allowing them to remain the property of the debtor. 11 U.S.C. Section 522. There are two distinct sets of exemptions that may apply to a debtor under the Bankruptcy Code. The first are federal exemptions, and the second are state exemptions.

All states may use the federal exemptions. 11 U.S.C. Section 522(b). However, the states are also given the opportunity to "opt out" of the federal exemptions and instead design their own list of exemptions that will be applicable to debtors domiciled in their state. Section 522(b)(2). Once a state has opted out of the federal exemptions, a debtor who is a resident of that state must use that state's exemptions. This requirement of choosing between the federal and state exemptions is often referred to as the anti-stacking clause of the Bankruptcy Code. 522(b)(1). As will be explained later in this presentation, BAPCPA created an exception to the anti-stacking clause of the Bankruptcy Code for retirement plans and IRAs.

CREDITOR PROTECTION IN IDAHO INSIDE BANKRUPTCY

Federal Exemptions under the Bankruptcy Code

Prior to the enactment of BAPCPA, Section 522(d)(10) allowed debtor's in state's that did not "opt out" of the federal exemptions to obtain a limited amount of creditor protection for retirement plans in bankruptcy.

Section 522(d)(10) exempts, to the "**extent reasonably necessary for support of the debtor and any dependent of the debtor**," a pension and profit sharing plan, or a "similar plan or contract." The U.S. Supreme Court, in *Rouse v. Jacoway*, 125 S. Ct. 1561 (2005), held that IRAs meet this definition because they are considered a similar plan or contract as a pension or profit sharing plan. However, with the enactment of BAPCPA, this decision is of limited value because of the addition of a new federal exemption in bankruptcy that is available to those debtor's who are eligible to use the **federal exemptions** in bankruptcy under their state law. The new exemption, set forth in Section 522(d)(12), is not limited, like Section 522(d)(10), to the "*extent reasonably necessary for the support of the debtor and any dependent of the debtor*."

In addition to the new exemption set forth in Section 522(d)(12), a second new exemption, set forth in Section 522(b)(3)(C), is available to those debtor's who may only use the **state exemptions** in their state. Section 522(b)(3)(C) is "**identical**" to Section 522(d)(12). Both exemptions are designed to provide enhanced creditor protection for employer sponsored retirement plans and IRAs in bankruptcy for debtor's claiming under either the federal exemptions or the state exemptions.

CREDITOR PROTECTION IN IDAHO <u>INSIDE</u> BANKRUPTCY

The Sections 522(b)(3)(C) and 522(d)(12) Exemptions

Sections 522(b)(3)(C) and 522(d)(12) exempt "**retirement funds**" if such funds are in an account that is exempt from tax under I.R.C. Sections 401, 403, 408, 408A, 414, 457 or 501(a), subject to any dollar limitation in Section 522(n). The U.S. Supreme Court held in *Clark v. Rameker*, 134 S. Ct. 2242 (2014), that the phrase "retirement funds" does <u>not</u> include an inherited IRA. This holding is based on the fact that the holder of an inherited IRA: (1) cannot contribute additional funds to the account; (2) are required to take distributions from the account regardless of age; and (3) can withdraw the entire balance of the account regardless of age and use the funds for any purpose without a 10% premature penalty.

The Section 522(n) dollar limitations distinguish between **employer sponsored retirement plans** <u>and</u> **IRAs**. Employer sponsored retirement plans, including defined benefit plans, profit sharing plans, money purchase pension plans, 403 plans, 457 plans, SEP IRAs, Simple IRAs, solo 401(k) plans, and owner-only plans, now enjoy ***unlimited protection*** under the Bankruptcy Code. This unlimited protection extends to direct rollovers from qualified plans to IRAs and to rollovers to an IRA that occur within sixty day after a taxable distribution.

However, the unlimited protection does <u>not</u> apply to Traditional IRAs and Roth IRAs established by the account owner with regular contributions. Under BAPCPA, creditor protection for Traditional IRAs and Roth IRAs is ***limited to*** $1,283,025, as of April 1, 2016, adjusted for inflation every three years, but that amount may be increased "if the interests of justice so require." Similarly, unlike the unlimited protection for a rollover from a qualified plan to an IRA, a rollover from a SEP or Simple IRA to an IRA is limited to $1,283,025, as of April 1, 2016, adjusted for inflation every three years.

CREDITOR PROTECTION IN IDAHO INSIDE BANKRUPTCY

Implications of a Favorable IRS Determination Letter under Sections 522(b)(3)(C) and 522(d)(12) Exemptions

Under BAPCPA, if a favorable IRS determination letter for a qualified plan is in effect as of date of filing of the bankruptcy petition, the retirement funds are presumed to be exempt from the estate of the debtor.

However, if the retirement funds are in a retirement plan that has not received a favorable determination letter, then under BAPCPA these funds are protected in bankruptcy if the debtor can demonstrate that:

a. neither the IRS nor a court has made a determination that the plan is not qualified, **and**

b. i. the plan is in substantial compliance with the Internal Revenue Code, **or**

ii. the plan is not in substantial compliance but the debtor is not materially responsible for the failure.

11 U.S.C. 522(b)

CREDITOR PROTECTION IN IDAHO INSIDE BANKRUPTCY

Planning Considerations under Sections 522(b)(3)(C) and 522(d)(12) Exemptions in Bankruptcy – Applicable to States with limited Creditor Protection Statutes and those that have not "opted out" of the Federal Exemptions

- ✓ Employer sponsored retirement plans should review the tax-qualified status of their retirement plan before filing for bankruptcy to that they can utilize any IRS self-correction procedures to correct plan defects prior to filing for bankruptcy;

- ✓ Employer sponsored retirement plans using prototype plan documents (IRS issues an opinion letter) that are sponsored by banks, brokerage firms, mutual funds, insurance companies and other organizations should apply for an IRS determination letter prior to filing for bankruptcy to ensure that the qualified plan is subject to the "presumption" of exemption from the bankruptcy estate;

- ✓ Under BAPCPA, tracking rollover funds from employer sponsored plans (other than SEP IRAs and Simple IRAs) to IRAs becomes important to preserve the unlimited creditor protection in bankruptcy;

- ✓ Rollover funds from retirement plan assets should not be commingled with Traditional IRA and Roth IRA contributory accounts to ensure maximum creditor protection under BAPCPA.

CREDITOR PROTECTION IN IDAHO INSIDE BANKRUPTCY

State Exemptions Available in Idaho in Bankruptcy

Pursuant to Idaho Code Section 11-609, Idaho has chosen to "opt out" of the federal exemptions, and its law specifically precludes a debtor's use of the federal exemption scheme. *In re Almgren* 2007 W L 4285373 (Bankr. D. Idaho 2007). As a result, prior to BAPCPA, Idaho debtors were limited to the exemptions allowed by Idaho state law. *In re Skaar*, 98.1 I.B.C.R. 13, 13 (Bankr. D. Idaho 1998).

Prior to the enactment of BPCPA, three federal court of appeals decisions, including a case from the 5th Circuit, the 8th Circuit, and the 11th Circuit held that Section 514(d) of ERISA saves such state law exemptions from pre-emption in bankruptcy. *In re Dyke*, 943 F. 2d 1435 (5th Cir. 1991); *In re Vickers*, 954 F. 2d 1426 (8th Cir. 1992); *In re Schlein*, 8 F. 3d 745 (11th Cir. 1993). In other words, these courts have held that ERISA does not pre-empt the state law exemptions in bankruptcy because the federal bankruptcy code specifically authorizes a state to "opt-out" of the federal exemptions.

However, as previously noted, BAPCPA changed the bankruptcy law protection for retirement benefits by providing new retirement plan rules that apply regardless of whether a state uses the federal exemption scheme or its own state exemptions. *In re Hamlin*, 465 B.R. 863 (B.A.P. 9th Cir. 2012). Further, the United States Bankruptcy Court for the District of Arizona held, in a minute entry order for a matter taken under advisement, in the case of *In re Kristi Lynn Pacheco*, Case No. 2:14-bk-07173-EPB (8/24/2015), that if the state law exemptions provide greater protection for retirement plan assets and IRAs than the federal exemption under Section 522(b)(3)(C), then the state law exemptions will apply (holding that "inherited IRAs" are exempt under Arizona Revised Statute Section 33-1126(B)).

Accordingly, in Idaho, an "opt-out" state, a debtor in bankruptcy may utilize the state exemptions for retirement plans and IRAs that are set forth in Idaho Code Sections 55-1011 and 11-604A and the federal exemption for retirement plans and IRAs set forth in Section 522(b)(3)(C), whichever provides greater protection.

CREDITOR PROTECTION IN IDAHO INSIDE BANKRUPTCY

Idaho Exemptions More Expansive than Federal Exemptions

The state of Idaho has two separate state exemption statutes that are applicable to retirement plans and IRAs.

The first exemption statute is set forth in Idaho Code Section 55-1011. This statute provides an exemption for claims of *judgment creditors* of the "beneficiary or participant" arising out of a *negligent or otherwise wrongful act or omission* of the beneficiary or participant resulting in money damages to the judgment creditor. This statute is limited in scope and applicability to many debtor's in bankruptcy.

The second exemption statute is set forth in Idaho Code Section 11-604A. This statute is very broad and applicable to any debtor in Idaho who is seeking to exempt retirement plans and IRAs from the reach of creditors. This statute provides an "**unlimited exemption**" for all retirement plans and IRAs in bankruptcy. In addition, unlike the federal exemption statute, "**inherited IRAs**" also receive an "**unlimited exemption**" in bankruptcy. *In re Gregory Allen McClelland and Debra Jean McClelland,* 2008 W L 89901 (Bankr. D. Idaho 2008). See also *In re Kristi Lynn Pacheco*, Case No. 2:14-bk-07173-EPB (8/24/2015).

Accordingly, in Idaho, a debtor will rely upon the more expansive state exemption statute, set forth in Idaho Code Section 11-604A, to "exempt" retirement plans and IRAs in bankruptcy as opposed to the federal exemption statute that is available to a debtor in Idaho under Section 522(b)(3)(C).

CREDITOR PROTECTION IN IDAHO <u>INSIDE</u> BANKRUPTCY

Planning Considerations in Idaho for Residents seeking Creditor Protection in Bankruptcy for Retirement Plans and IRAs

Due to the unlimited exemption in bankruptcy for retirement plans and IRAs in Idaho, planning considerations should focus on the possibility that an Idaho resident (or their beneficiary) may move to another state with less creditor protection:

✓ Rollovers from employer sponsored retirement plans (other than SEP IRAs and Simple IRAs) to an IRA should be rolled over into a separately designated IRA account, such as a "Conduit IRA", for <u>tracking purposes</u> to preserve the unlimited creditor protection in bankruptcy for rollovers under BAPCPA;

✓ Rollover funds from retirement plan assets should <u>not</u> be commingled with Traditional IRA and Roth IRA contributory accounts to ensure maximum creditor protection under BAPCPA;

✓ After *Clark v. Rameker*, an estate planner should consider naming an irrevocable trust with a "spendthrift clause" in the trust agreement as the beneficiary of the inherited IRA as opposed to naming the non-spouse beneficiary outright. The trust agreement would need to be drafted as a "see-through trust" under Treas. Reg. 1.401(a)(9)-4, Q&A-5 to allow the trust beneficiary to use their life expectancy for minimum required distribution purposes. The benefit of such planning is that the trust beneficiary could <u>exclude</u> the inherited IRA held in trust for their benefit from the bankruptcy estate under 11 U.S.C. Section 541(c)(2).