

August 26, 2009 – Is your IRA Safe From Creditors?

As we plan for retirement, many of us are accumulating assets in IRA accounts. With the decline of the traditional pension plan, IRA accounts are becoming one of our most important sources of retirement income. With the financial issues facing many Americans growing larger by the day, it is important to know if our IRA accounts are safe from creditors. The good news is, yes, IRA's are safe from creditors.

The Supreme Court ruled in 2008 that IRA owners receive the same Federal Creditor Protection as pensions, 401(k)'s, Social Security and other benefits tied to age, illness, and disability that are given protection under the federal bankruptcy law.

Prior to this ruling, IRA's were covered under state laws which varied from state to state on the amount and type of coverage provided. This inevitably led to much confusion about how IRA assets would be considered in a bankruptcy proceeding.

The case came before the Supreme Court in 2008 due to a lower court ruling against IRA protection based on the faulty assumption that since investors can make withdrawals at any time from their IRA's, that they should be treated like normal savings accounts which are not protected from creditors under bankruptcy law. The Supreme Court reasoned that IRA's are benefits tied to a person's age under the Federal Statute because a 10% early withdrawal tax penalty is imposed if a person makes withdrawals prior to age 59 ½.

Prior to this ruling, those with little to no state IRA protection were given protection under a federal bankruptcy law established in 2005 that gave up to \$1 million in IRA creditor protection. This is in comparison to the other qualified plan accounts listed above that had unlimited protection.

The ruling comes when IRA assets are near \$3 trillion and have for many become their most significant retirement asset. Defined benefit pension plans (such as the old GM retirement pension plan) are being eliminated by many employers around the country.

In 2004, 74% of Fortune 100 companies offered a traditional defined benefit plan. According to a survey by Watson Wyatt in 2009, for the 1st time, the majority of Fortune 100 companies are no longer offering the old defined benefit pension plan and are offering new salaried employees only one type of retirement plan: a 401(k) or similar defined contribution plan.

The defined benefit pension plan will likely continue to decline in popularity as it can provide a big drag on a company's cash flow when stock market declines like we had in 2008 deplete a company's pension assets to below federal guidelines. Poor investment performance of the assets in a defined pension plan will force companies to make contributions into their defined benefit plans instead of using these funds to grow the business.

To discuss any questions or concerns you have regarding your retirement plan, contact Dave Fulkerson at dave@davefulkerson.com or 248.670.9823.

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