



ED SLOTT'S IRA ADVISOR

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Tax & Estate Planning for Your Retirement Savings

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GUEST IRA EXPERT:
Denise Appleby,
CISP, CRC, CRPS®,
CRSP, APA, M.J.
Appleby Retirement Consulting Inc.

Appleby's Top 10 Reasons Why a Small Business Owner 401(k) Is a Great Retirement Savings Solution

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Join the Retirement Planning Conversation



Court Rules Inherited 401(k) Accounts Are Protected in Bankruptcy

In 1992, the U.S. Supreme Court ruled that 401(k) and other company plan benefits covered under the Employee Retirement Income Security Act (ERISA) are protected from bankruptcy creditors. In 2014, the Supreme Court said that inherited IRAs are **not** protected from creditors. *But what happens when a person inherits a 401(k) (instead of an IRA) and then files for bankruptcy?* One court recently ruled that ERISA protection takes precedence, and inherited 401(k) funds are shielded in bankruptcy.

Background

When an individual files for bankruptcy, all of the property included in that bankruptcy estate can be reached by creditors, except for certain property that is exempted from the estate. [The Bankruptcy Code, in § 541](#), dictates which of the person's property is included in the bankruptcy estate. Another section of the [Code, § 522](#), lists the items that, while technically part of the estate, can be exempted. Among those items are "retirement funds," including IRAs, Roth IRAs, SEP and SIMPLE IRAs, and 401(k), 403(b) and 457(b) plans. For IRAs and Roth IRAs (but not SEP or SIMPLE IRAs), bankruptcy protection is limited to a dollar amount that is adjusted for inflation

every three years (\$1,362,800 in 2021). Company plan accounts rolled over to IRAs maintain 100% protection and are not counted towards this limit.

Another potential source of bankruptcy creditor protection comes from ERISA. Most, but not all, company retirement plans are covered by ERISA. Solo 401(k) plans, the Thrift Savings Plan, and certain 403(b) and 457(b) plans are not. ERISA-covered plans must not allow benefits to be paid to anyone other than participants or beneficiaries (the "anti-alienation provision"). ERISA creditor protection is iron-clad, with exceptions only for qualified domestic relations orders (QDROs) and IRS tax levies. By contrast, IRAs are not covered by ERISA, so their owners cannot benefit from ERISA creditor protection.

Before 1992, it was not clear whether the ERISA anti-alienation provision applies in bankruptcy. In [Patterson v. Shumate, 504 U.S. 753 \(1992\)](#), the U.S. Supreme Court settled the matter by ruling that an ERISA plan participant's benefits are excluded from his bankruptcy estate. Under § 541(c)(2) of the Bankruptcy Code, property that has a restriction on its transfer is excluded from the bankruptcy estate, as long as the restriction can be enforced under a law separate from the Bankruptcy Code.

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