



# ERISA ALERT

## BULLETIN

April 11, 2005

## ***Rousey v. Jacoway: The Supreme Court Extends Bankruptcy Protection to IRAs, or Does It?***

Individual retirement accounts or annuities (IRAs) are now afforded protection in bankruptcy. At least, that's what the U.S. Supreme Court seemed to say in *Rousey v. Jacoway*, issued on April 4. But don't get too excited. Despite press reports to the contrary, the new ruling doesn't fully exclude IRAs from bankruptcy estates—which means that the protections given to ERISA plans in the Court's *Patterson v. Shumate* decision have not been extended to IRAs.

### ***Discussion***

The debtors argued that §522(d)(10)(E) of the Bankruptcy Code protected their IRA assets from the claims of their creditors. That section applies to protect "retirement assets" if three tests are met:

- 1) The right to receive the payment is from a "stock bonus, pension, profit sharing, annuity, or similar plan or contract."
- 2) The right to receive payment is "on account of illness, disability, death, age, or length of service."
- 3) The right to receive payment is withheld from the bankruptcy estate only to the extent that it is "reasonably necessary to support" the debtor and/or his or her dependents.

Since the application of the third test was not before the Supreme Court in *Rousey*, the Court focused on whether the first two tests were met. In ruling that the first test was met, the Court found IRAs to be "similar plans or contracts within the meaning of Section 522(d)(10)(e)." The Court then found the second test was met because the 10 percent penalty imposed for distributions from an IRA prior to age 59-1/2 is a "substantial barrier" to early withdrawal and, thus, provides "a right to payment on account of age." The third test was remanded to the Court of Appeals for a determination. In order to fully exempt their IRA from their bankruptcy estate, the Rouseys will now have to prove that their IRA funds are "reasonably necessary to support" themselves and their dependents.

### ***What Do You Need to Understand about this Case?***

*Rousey* does not stand for the proposition that IRAs are completely exempt from the debtor's bankruptcy estate. Rather, the

third leg of the three-part test means that an IRA is exempt only to the extent the funds are reasonably necessary for the support of the debtor and his or her dependents. If only two-thirds of the IRA funds are necessary for support, the remaining third is not eligible for the exemption and, therefore, remains subject to the claims of creditors as part of the bankruptcy estate. This means that the *Rousey* decision is of limited value to wealthy IRA holders.

*Rousey* is irrelevant to IRA holders who live in states that preclude debtors from using the Section 522(d) exemptions. The ruling is also irrelevant to IRA holders who live in states that provide debtors with the option of applying state rather than federal exemptions, and the state exemptions are broader. In addition, *Rousey* does not change existing law for states like California, where IRAs are already exempt from the claims of creditors to the extent reasonably necessary to support the IRA holder and his or her dependents. (See California Code of Civil Procedure, Section 704.115.)

You should continue to take great care in deciding whether to rollover assets from an ERISA plan to an IRA. This is because neither the *Rousey* case nor any state laws provide protection from creditors equal to the absolute exclusion extended to ERISA plans under the Bankruptcy Code and *Patterson*.

Finally, if you or your client is facing insolvency or bankruptcy and there is a question as to whether your retirement plan is an "ERISA-qualified plan" as described in *Patterson* and, thus, entitled to full asset protection under the Bankruptcy Code, then you should retain competent ERISA counsel to review the plan and advise you in this regard.

If you have any questions regarding the issues raised in this bulletin, please contact one of our ERISA attorneys:

<b>C. Frederick Reish</b>	<i>FredReish@Reish.com</i>
<b>Bruce L. Ashton</b>	<i>BruceAshton@Reish.com</i>
<b>Martin M. Heming</b>	<i>MartyHeming@Reish.com</i>
<b>Nicholas J. White</b>	<i>NickWhite@Reish.com</i>
<b>Nicholas J. Waddles</b>	<i>NickWaddles@Reish.com</i>
<b>Stephanie L. Bennett</b>	<i>StephanieBennett@Reish.com</i>