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LOUIS KRAVITZ & ASSOCIATES INC

Information Release

July 2005

New Law Provides Further Protection for Pension Assets in the event of Bankruptcy

One of the many attractive features of retirement plans is that the benefits are protected from creditors in the event of bankruptcy. Unfortunately, some plans are not eligible for this protection and in other cases the extent of the protection is questionable. For example, assets held in IRAs receive no protection under federal law although in some cases they are protected (or partially protected) under various state laws.

This will all change on October 17, 2005, when the new Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA") goes into effect.

Which Plans Will Be Protected Under the New Law?

The new law provides clearly defined protection from creditors for the following kinds of retirement plans:

- √ Qualified retirement plans under Internal Revenue Code Section 401, which include defined benefit plans such as cash balance plans and defined contribution plans such as 401(k) plans and profit sharing plans
- √ 403(b) plans
- √ Governmental and exempt organization plans under Code Section 457
- √ Traditional IRAs
- √ SIMPLE Plans and SEPs
- √ Roth IRAs

With the exception of IRAs, there is no limit on the amount of assets that can be protected in the event of bankruptcy. IRA assets attributable to an individual's own contributions to an IRA are subject to a $1,000,000 limit. This limit does not apply to IRA assets attributable to employer contributions (including employee 401(k) contributions) rolled over or transferred from eligible employer sponsored plans listed above. For example, if you transfer $1,000,000 from a profit sharing plan to an IRA and that amount grows, with investment income, to $1,500,000, the full $1,500,000 is protected from creditors.

Planning Tip: In order not to have rollovers and transfers counted against the $1,000,000 limit, IRA owners will need to establish and maintain records to distinguish between regular IRA contributions and the amounts rolled over or transferred from another plan. Alternatively, rollovers and transfers could be kept in a separate IRA and not commingled with contributory IRAs.

How will a plan be judged as one which is "Qualified"?

Any plan that has received a favorable determination letter from the Internal Revenue Service will be presumed to be a qualified plan. Plans that do not have favorable determination letters must demonstrate that:

- √ Neither the IRS nor a court has made a prior determination that the plan is not qualified under Section 401 of the Code, and either
- √ The plan is in substantial compliance with Section 401, or
- √ The plan is not in substantial compliance with Section 401 but the debtor is not materially responsible for that failure.

In Summary—The New Law Reinforces one of the major advantages of retirement plans.

The new law will continue to protect retirement plan assets from creditors in bankruptcy proceedings. It will also extend the protection to situations not covered by the prior law. Asset protection is one of the many advantages of qualified retirement plans. If you have any questions, please contact your Kravitz consultant.

Louis Kravitz & Associates, Inc. is the largest firm of retirement consultants headquartered in California. We specialize in the design, implementation and administration of virtually every type of retirement plan. Our consultants, actuaries and other specialists have the experience and ability to make certain your retirement plans are properly designed, meet your needs and operate to your satisfaction. We have been dedicated to providing high quality service since our firm was founded in 1977.