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## ***Davis & Company, CPA's, CVA's***

The Supreme Court recently ruled that creditors may not seize individual retirement accounts in bankruptcy proceedings. This ruling offers asset protection in the shadow of bankruptcy reform which is attempting to curb bankruptcy abuse by changing who can qualify for bankruptcy, how much debt has to be repaid and to whom debt must be repaid.

The decision was based on the facts that IRAs provide a right to receive payment on account of age, and IRAs are similar plans or contracts to those enumerated and listed in the Bankruptcy Code.

The Supreme Court stated that the ten percent tax penalty applicable to funds withdrawn from IRAs before the accountholder turns 59 1/2 effectively prevented the debtors from accessing the entire balance of their IRAs. The Court pointed out that, because the ten percent penalty is removed upon the attainment of age 59 1/2, the right of the debtors to their entire IRA account balances was a "right to payment on account of age." The Court added that the ten percent penalty, which it characterized as "substantial," indicated that Congress intended it to be a deterrent to early withdrawal of IRA funds.

The Supreme Court found the debtors' IRAs to be similar to the types of plans listed in the Bankruptcy Code because IRAs, like the listed plans, provide income that is a substitute for wages earned. The Court gave three reasons for the similarity to other listed plans:

1. Withdrawals prior to age 59 1/2 would be subject to a ten percent tax penalty.
2. The IRA funds would be tax-deferred until the year of distribution, at which time the funds would be treated for tax purposes as income.
3. The IRA minimum distribution requirements provide that the latest the distributions could begin was in the calendar year after the year in which the accountholder turns 70 1/2. If the funds were not withdrawn by that time, they would be subject to a 50% tax penalty, which, the Court stated, was designed to ensure that IRA beneficiaries would use their IRA funds during their retirement years.

## **Individual Retirement Account Basics**

The popularity of contributing to IRA plans has diminished over the years due to 401(k) plans and other similar employer sponsored plans. However, many taxpayers favor rolling over their pension or 401(k) plan to an IRA upon retirement or separation of service

Current tax law provides for a deduction for a contribution to a Traditional IRA provided that the taxpayer or the taxpayer's spouse is not a participant in another qualified plan. If the taxpayer or spouse is a participant in another plan, the deductibility of a Traditional IRA is limited based on income levels.

However, non-deductible contributions are still permitted. In fact, the amount that can be contributed increases to \$4,000 per taxpayer for years 2005 through 2007. For 2008, the contribution limit will increase to \$5,000, and will be indexed for inflation each year thereafter.

Catch-up contributions are available for taxpayers over 50. The amount of additional contribution is \$500 for 2005, and \$1,000 for 2006 and years thereafter. And non-working spousal IRAs contributions can be deducted if certain income levels are not exceeded.

IRAs still serve a useful purpose for tax, retirement and asset protection planning.