



Fact Sheet

PENSION ACTION CENTER, GERONTOLOGY INSTITUTE
McCORMACK GRADUATE SCHOOL OF POLICY AND GLOBAL STUDIES

Protecting Your Retirement Savings from Potential Creditors

State and federal laws provide strong protections to New England residents to shield their retirement savings from creditors. The particular protections available depend on whether you have filed for bankruptcy, how your retirement savings are kept, and where you live.

Brief Introduction to Bankruptcy.

There are two main means available to an individual filing for bankruptcy. The first, referred to as Chapter 7, is designed for individuals in financial difficulty who do not have the ability to pay their existing debts. If you file for Chapter 7, you may claim certain of your property as exempt under either federal or state law but a trustee may have the right to take possession of your non-exempt assets and distribute the proceeds from the sale of such non-exempt assets among your creditors. Although the ultimate purpose of filing Chapter 7 is to have your debts discharged, meaning that you no longer owe anything to your creditors, there are certain debts that cannot be discharged and limitations on how much you can earn and still qualify for debt discharge under Chapter 7. In general, an individual or family earning more than the average in their state may not be eligible for Chapter 7.

The second main means available to an individual filing for bankruptcy is referred to as Chapter 13, which is designed for debtors with regular income who would like to pay all or part of their debts in installments over a period of time. Under Chapter 13, you will have to propose a plan to repay your creditors and after such repayments are completed, your debts will be discharged although certain debts cannot be discharged. Note, however, that there are limits on eligibility for Chapter 13 related to the size and nature of debts. In general and as may be amended by the Bankruptcy Code, an individual or family with more than \$360,475 in so-called unsecured debt (such as medical and credit-card bills) or more than \$1,081,400 in so-called secured debt (such as car and mortgage payments) cannot file for Chapter 13.

What Protections are Available if You Have Filed for Bankruptcy?

Federal Bankruptcy Law:

Whether in Chapter 7 or 13, federal bankruptcy law, in certain circumstances, bars creditors from reaching your retirement assets held in the most common forms of retirement savings, such as 401(k) funds, pension plans, employee stock-ownership plans, and tax-sheltered annuity plans (referred to herein as an “Exempt Fund”).¹ Amounts directly rolled over from an Exempt Fund to a traditional or Roth IRA are also protected.² However, this protection under the Bankruptcy Code only extends to the first \$1,171,650 (as adjusted every three years) held in a non-rollover IRA or Roth IRA, as well as amounts held in a SEP Plan or SIMPLE IRA (collectively referred to herein as an “Individual Account”).³ Because these protections are provided by federal law, they are available to residents of every state.⁴ A glossary of retirement plan terms, with definitions, is provided at the end of this brochure.

¹ 11 U.S.C. § 522(d)(9)(E)11; U.S.C. § 522(d)(12).

² 11 U.S.C. § 522(b)(4)(C) (exempting transfers); 11 U.S.C. § 522(b)(4)(D) (exempting rollovers).

³ 11 U.S.C. § 522(n).

⁴ Among New England states, only Maine has opted out of the federal exemption scheme. See, e.g., *In re Davenport*, 443 B.R. 231 (Bankr. D. Me. 2011). But its residents can still access the federal retirement-savings exemptions through 11 U.S.C. § 522(b)(3)(C).

Example 1. Frank, a resident of Connecticut, filed for bankruptcy under Chapter 7. His assets were sold and he received a discharge of his debts. At the end of his bankruptcy, the \$75,000 he had saved in his 401(k) plan remained untouched by his former creditors.

Money already distributed to you from an Exempt Fund may also be protected, to the extent that you need the distributions to cover your living expenses.⁵ A bankruptcy judge will look to your other sources of income—for example, whether you are employed—in deciding whether to shield distributions from an Exempt Fund from your creditors. The judge will look at all the facts and circumstances in making this decision.

Example 2. Laverne, who lives in New Hampshire, filed for bankruptcy under Chapter 7 after retiring. Upon retirement she began to receive a monthly pension payment equal to \$2,500 per month. The bankruptcy judge in her case ruled that the pension payments could not be reached by her creditors, as they were Laverne's sole source of income.

It is important to know that if you owe money for back taxes, the Internal Revenue Service can seize your retirement assets, even those assets held in an Exempt Fund, to satisfy your unpaid tax bill. This is important because IRS liabilities are not generally dischargeable in bankruptcy. If you owe unpaid federal income taxes and have any type of deferred compensation or retirement plan, you should obtain legal advice from an attorney to avoid inadvertently exposing your retirement savings to IRS enforcement for past tax obligations.⁶

State Exemptions Under Bankruptcy:

A further consideration in the decision to file bankruptcy is the election of federal or state exemptions.⁷ Under federal bankruptcy law, a debtor may elect to avail himself or herself of exemptions set forth in the federal bankruptcy law or of the state where the debtor's domicile is located within a certain amount of time before the filing of bankruptcy.⁸ This election of exemptions is required and a debtor may not pick and choose between exemption schemes.

Maine, Massachusetts and Vermont have state statutes that differ from federal bankruptcy laws with regard to the protection afforded amounts held in an Individual Account in bankruptcy. The protections under these state exemptions are less favorable to the debtor than are the federal protections.

Federal Bankruptcy Law – Individual Accounts are exempt up to the first \$1,171,650.

Maine - Individual Accounts are exempt up to the greater of \$15,000 or amount reasonably necessary for support of self and dependents.

Massachusetts – Individual Accounts are exempt with the exception of amounts deposited during the five years prior to the individual filing for bankruptcy. This does not apply to amounts directly rolled over or transferred in a plan-to-plan transfer.

Vermont - Individual Accounts are exempt with the exception of amounts deposited during the one year prior to the individual filing for bankruptcy.]

If You Have Not Filed for Bankruptcy, Are Your Retirement Assets Protected From Creditors?

Even outside of bankruptcy your retirement assets held in an Exempt Fund are protected from creditors, other than the IRS or pursuant to a court's ordering payment of alimony, child support, or both—a so-called qualified domestic-relations order ("QDRO").

Example 3. Cheryl, who lives in Massachusetts, has \$5,000 in an employee stock-ownership plan. She is ordered to pay \$100 each month to her ex-husband after they divorce. Cheryl does not do so, and her husband sues her to recover his spousal-support payments. Because she does not have enough money to make the payments, a judge orders the payments to be taken out of her employee stock-ownership plan.

⁵ 11 U.S.C. 522(d)(10)(E).

⁶ I.R.C. § 401(a)(13)(B).

⁷ 11 U.S.C. § 522(b)(2)-(3).

⁸ 11 U.S.C. § 522(b)(3).

But what about funds that have been contributed directly by you to an Individual Account or funds that you have transferred to an Individual Account through a direct rollover or plan-to-plan transfer? Are these assets still exempt under federal law? The answer is no, because you have not filed for bankruptcy and are therefore outside the scope of federal law protections.

Nevertheless, state law may offer protections to shield your retirement assets from creditors. The specific protection available will depend on in which state you live. Similarly, state law will determine whether creditors can reach distributions from Exempt Funds and payments from Individual Accounts that have already been made to you.

What are the Applicable State Laws?

The following table summarizes the state law protections afforded your retirement assets held in an Individual Account under state law. The purpose of these laws is to allow the person who owes debts to keep the basic necessities of life, such as clothing, food, certain cash and often a car, in order to remain a productive member of society. Exempt property is unreachable regardless of whether the debt is valid and owed. It is unreachable even if the creditor holds a valid state court judgment and execution. Remember, assets held in an Exempt Fund remain protected under the federal law.

STATE	EXEMPTION FOR AMOUNTS HELD IN AN INDIVIDUAL ACCOUNT	EXEMPTION FOR AMOUNTS DISTRIBUTED FROM AN INDIVIDUAL ACCOUNT OR EXEMPT FUND	EXCEPTIONS
Connecticut	100% exclusion for Individual Accounts.	100% exclusion for amounts distributed from Individual Account or Exempt Fund in retirement.	Exemption does not apply if convicted of a crime and ordered to make restitution, or have order concerning divorce or QDRO.
Maine	Individual Accounts are exempt up to the greater of \$15,000 or amount reasonably necessary for support of self and dependents.	Amounts distributed from Individual Account are exempt up to the greater of \$15,000 or amount reasonably necessary for support of self and dependents. Amounts distributed from Exempt Fund are exempt to extent reasonably necessary for support of self and dependents.	Exemption is not applicable if contribution is deemed to be a fraudulent transfer.
Massachusetts	Individual Accounts are exempt except for amounts great than 7% of your total income during the 5 years prior to entry of a judgment. Amounts directly rolled over or deposited as plan-to-plan transfer are exempt.	Subject to the limits of the prior column, amounts distributed from an Exempt Fund or Individual Account are exempt.	Exemption does not apply if convicted of a crime and ordered to make restitution, or have order concerning divorce or QDRO.
New Hampshire	100% exclusion for Individual Accounts.	100% exclusion for amounts distributed from Individual Account or Exempt Fund in retirement.	Exemption is not applicable if contribution is deemed to be a fraudulent transfer.
Rhode Island	100% exclusion for Individual Accounts.	100% exclusion for amounts distributed from Individual Account or Exempt Fund in retirement.	Amounts contributed in excess of IRS maximums are not exempt.
Vermont	100% exclusion for Individual Accounts.	100% exclusion for amounts distributed from Individual Account or Exempt Fund in retirement.	If the state child-support office is a creditor, then only the first \$5,000 in an Individual Account is exempt.

A. For Connecticut Residents

If you live in Connecticut, state law generally provides full protection for your retirement assets held in an Individual Account. However, if you are convicted of a crime and ordered to make restitution or there is an order concerning divorce, separate maintenance or child support, your creditors can recover money from you held in an Individual Account.

Example 4. Jerry, who lives in Connecticut, has \$50,000 in a Roth IRA. He fails to make his car payments, and the bank that loaned him money sues to recover the payments owed. A court will not force him to make these payments from funds in his Roth IRA.

If you have already retired, Connecticut law also provides full protection to amounts that have been distributed to you from an Exempt Fund or paid to you from an Individual Account.⁹

Example 5. Maria, a retiree who also lives in Connecticut, receives a \$2,000 distribution each month from her 401(k) plan. Her car mechanic, whom she owes \$5,000, sues to collect on this debt. The mechanic will not be able to reach her monthly distributions.

B. For Maine Residents

In Maine, amounts held in or distributed from an Individual Account are automatically protected up to \$15,000, or to the extent reasonably necessary for the support of yourself and your dependents, whichever is greater. So that, if you have more than that amount saved a court will look to whether you need the savings to support yourself and your dependents. In making that determination, the court will look at your living expenses, income, age, health, and other savings.¹⁰ The exception to this general rule is if a contribution to the Individual Account is deemed to be a fraudulent transfer under the Uniform Fraudulent Transfer Act; that is, the debtor transfers money to an Individual Account for the purpose of protecting his assets from the reach of creditors.

Example 6. Karen, who lives in Maine, has \$20,000 in a traditional IRA. She is married, has no children, and owns her home and car. However, she owes her dentist \$5,000 but does not have enough to pay him from her savings. The dentist sues to recover this money, and a judge orders her to pay the \$5,000 out of her IRA.

Similarly, Maine law provides protection for monies kept in, or paid to you from, any Exempt Fund to the extent reasonably necessary to support yourself and your dependents.¹¹

C. For Massachusetts Residents

Amounts held by Massachusetts residents in an Individual Account are protected from creditors, with the exception of amounts greater than 7% of your total income during the five years prior to a judgment having been entered against you. Amounts directly rolled over or transferred to an Individual Account in a plan to plan transfer are generally 100% protected. If you are convicted of a crime and ordered to make restitution or there is an order concerning divorce, separate maintenance or child support, your creditors can recover money from you held in an Individual Account whatever the source of the funds (i.e., directly deposited by you or rolled over in a direct rollover or plan-to-plan transfer).¹²

Example 7. Susan, who lives in Massachusetts, has contributed \$1,000 per year to her IRA for the past 20 years. On December 31, 2010, Susan retired and rolled over in a direct rollover to her IRA the balance in her 401(k) account from her former employer. On June 1, 2011, Susan filed for Bankruptcy.

⁹ Conn. Gen. Stat. § 52-321a.

¹⁰ *Steelstone. Indus. v. McCrum*, 785 A.2d 1256, 1258 (Me. 2001) (“McCrum could have made a prima facie showing that the IRA qualified for exemption by presenting evidence addressing some or all of the following factors: (1) debtor’s present and anticipated living expenses; (2) debtor’s present and anticipated income from all sources; (3) debtor’s (and debtor’s dependents’) age; (4) debtor’s (and debtor’s dependents’) health; (5) debtor’s ability to work and earn a living; (6) debtor’s training, job skills and education; (7) other available assets, including exempt assets; (8) debtor’s ability (and opportunity) to save for retirement; (9) debtor’s (and debtor’s dependents’) special needs; (10) liquidity of other assets; and (11) financial obligations that will survive bankruptcy.”).

¹¹ Me. Rev. Stat. Ann. tit. 14, § 4422(13).

¹² Mass. Gen. Laws Ann. ch. 235, § 34A.

Susan is unmarried and does not have any convictions or judgments against her. The amounts directly rolled over from her 401(k) plan are exempt from her creditors. Also, the amounts contributed to her IRA for the 15 years prior to her declaring insolvency are exempt from her creditors. However, her creditors are able to attach the \$1,000 per year that she contributed to her IRA in each of the 5 years prior to her declaring insolvency

Example 8. Brian, who lives in Massachusetts, has \$20,000 in an IRA. He causes an automobile accident and is charged with reckless driving. He is also ordered to pay his victim's costs. Brian, who is otherwise unable to pay these costs, is ordered to pay them out of the funds in his IRA.

Subject to the foregoing, Massachusetts law also provides full protection to retirement savings that have been distributed to you from an Exempt Fund, or paid to you from an Individual Account, if you have already retired.

D. For New Hampshire Residents

Generally, if you are a New Hampshire resident, your state law exempts amounts held in an Individual Account from collection efforts by creditors. It also protects distributions made to you in retirement from an Exempt Fund and payments from an Individual Account. The exception to this general rule is if a contribution to the Individual Account is deemed to be a fraudulent transfer under the Uniform Fraudulent Transfer Act.

See Examples 4 and 5.

E. For Rhode Island Residents

Savings held by Rhode Island residents in an Individual Account, including amounts directly rolled over or transferred in a plan-to-plan transfer, are shielded from creditors. State law also protects amounts that you have already received as distributions from an Exempt Fund or payments from an Individual Account. However, amounts contributed to an Individual Account in excess of the maximum allowable contribution set forth by the IRS are not exempt (i.e., for 2011 the maximum allowable IRA contribution is \$5,000, or \$6,000 if you are 50 years of age or older).

See Examples 4 and 5.

F. For Vermont Residents

Amounts held by Vermont residents in an Individual Account are protected from creditors. However, if the state child-support office is among your creditors, only the first \$5,000 you hold in an Individual Account will be exempted.

Example 8. Alice, who lives in Vermont, has \$20,000 in a traditional IRA. She owes \$10,000 to her daughter's father in child-support payments. Because she is otherwise unable to make these payments, she is ordered to make them using funds from her IRA.

Subject to the foregoing, Vermont law also provides full protection to amounts held in or distributed to you from an Exempt Fund, or paid to you from an Individual Account, if you have already retired.¹⁶

What Should You Do If You Are Considering Bankruptcy?

Individuals considering bankruptcy should speak with a legal professional and receive advice specific to their own situations. However, there are three general propositions that, while not legal advice, you should note if you are considering bankruptcy.

First, remember that the discussion above only applies to funds that are currently kept in retirement accounts or that are distributed to you because you are already in retirement. If you were to withdraw funds from a 401(k) plan or take a loan against your pension, these protections will not apply. Accordingly, you should not take money from your retirement funds to pay down debt if you think you will file for bankruptcy in the future

¹³ Mass. Gen. Laws Ann. ch. 235, § 34A.

¹⁴ N.H. Rev. Stat. Ann. § 511:2 XIX.

¹⁵ R.I. Gen. Laws § 9-26-4.

¹⁶ Vt. Stat. Ann. tit. 12, § 2740(16).

Second, if you have retired, you should consider keeping your distributions from an Exempt Fund, or payments from an Individual Account like an IRA, in a separate bank account. This is because a bankruptcy judge may be more willing to exempt the funds if they are easily identifiable as retirement funds.

Third, the laws discussed above are unavailable if any foul play is found in connection with your retirement savings. For example, if you have intentionally contributed more to a retirement account than the law allows or have moved funds into a retirement account in hopes of shielding them from creditors (i.e., a fraudulent transfer), these protections generally will not apply. Accordingly, you should not attempt to “hide” or “shield” your savings in a retirement account in advance of filing for bankruptcy.

Appendix: Definitions of Types of Qualified Retirement Accounts.

401(k) Plan. A 401(k) plan is a type of retirement plan governed by section 401(k) of the Internal Revenue Code. Employees are permitted to save for their retirement by electing to contribute a portion of their compensation on a pretax basis to the 401(k) plan. Amounts contributed to a 401(k) plan, and any earnings thereon, are taxed at the time of distribution to the employee. Employers may contribute in the form of matching or profit-sharing contributions.

403(b) Tax-Sheltered Annuity (TSA) Plan. A TSA plan is a retirement plan, similar to a 401(k) plan, offered by public schools and certain tax-exempt organizations.

Defined-Benefit Plan. A defined-benefit plan is a type of plan in which an employer pays a fixed monthly benefit generally dependent on the employee’s retirement age and length of service.

Direct Rollover. A tax-free transfer of cash or other property made directly from an individual’s 401(k) plan into an Individual Account on account of the individual no longer be eligible to participate in the 401(k) plan.

Employee Retirement Income Security Act of 1974 (ERISA). ERISA is the principal law regulating retirement and employee benefit plans in the United States. The primary goal of ERISA is to create statutory protections for participants and beneficiaries in such plans. Title I of ERISA governs the protection of participant rights. Title II of ERISA governs jurisdictional issues. Through the establishment of the Pension Benefit Guaranty Corporation (PBGC), Title IV of ERISA protects participants and beneficiaries against the loss of pension benefits in the event a plan terminates with insufficient assets to pay benefits.

Employee Stock-Ownership Plan (ESOP). An ESOP is a retirement plan that invests in the sponsoring corporation’s stock.

Exempt Fund. As used in this brochure, Exempt Fund means a 401(k) fund, pension plan, employee stock-ownership plan, or 403(b) tax-sheltered annuity plan.

Individual Account. As used in this brochure, Individual Account means an IRA, Roth IRA, Simple IRA, or SEP Plan.

Individual Retirement Account (IRA). An IRA is a type of self-directed retirement vehicle that permits an individual to set aside money each year. Deposits are tax deductible and the investment earnings in the account are not taxable until withdrawn.

Plan-to-Plan Transfer. A transfer of cash or other property from an individual’s 401(k) plan into an Individual Account. A plan-to-plan transfer differs from a direct rollover because the assets are distributed directly to the individual and the individual then contributes the funds to an Individual Account. Transfers made within 60-days of receipt by the individual are tax exempt.

Roth IRA. A Roth IRA is a type of individual retirement account. Contributions to a Roth IRA are not tax deductible, but qualified distributions from a Roth IRA are made tax free. The benefit of a Roth IRA is that a participant may grow his or her wealth tax free. To contribute to a Roth IRA an investor’s annual income must be below a designated threshold amount.

Savings Incentive Match Plan for Employees (SIMPLE) IRA. A SIMPLE IRA is an IRA-based plan that gives small employers a simplified method to make contributions toward their employees’ retirement and their own retirement.

Under a SIMPLE IRA plan, employees may choose to make salary reduction contributions and the employer makes matching or non-elective contributions.

Simplified Employee Pension (SEP) Plan. A SEP Plan provides employers with a simplified method to make contributions toward their employees' retirement and, if self-employed, their own retirement. Contributions are made directly to an IRA or TSA Plan.