

HEB

449

Alaska State Legislature

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House Of Representatives

House District 33

House Bill 449

"An Act relating to certain individual retirement accounts."

SPONSOR: Representative Gene Therriault

SPONSOR STATEMENT:

Under the Alaska Exemptions Act, retirement plans are protected from creditor claims. However, it does so by listing each type of retirement plan by reference to the Internal Revenue Code section governing that plan. HB 449 will expand the list to include the newly created Roth IRA.

The 1997 Taxpayer Relief Act passed by Congress created the Roth IRA account under Internal Revenue Code section 408A. Contributions and earnings from traditional IRAs can be rolled over into a new Roth IRA. However, when the rollover is done, the taxes must be paid on the capital gains realized. To soften this potential tax bite, Congress has allowed all of the the taxable income stemming from rollovers done in 1998 to be spread over a four year period.

This is a great opportunity to convert all future IRA account earnings into tax-free income and spread the current tax bite over four years. However, those Alaskans who take advantage of this are removing their assets from the list of those protected under state law.

This option is available only during 1998. Beginning in 1999, distributions from regular IRA accounts that are rolled into Roth IRAs will be fully taxed in the year of the rollover. In order for Alaskans to maintain their protection while taking advantage of this opportunity legislation must be passed this session.

Walsh Kelliher & Sharp

A Professional
Corporation

January 30, 1998

The Honorable Gene Therriault
119 North Cushman
Fairbanks, AK 99701

Dear Mr. Therriault:

We need your help to sponsor a bill which will benefit many Alaskans. Specifically we need you to sponsor a bill to amend Alaska statute 09.38.017 to include Internal Revenue Code Section 408A.

The Alaska statutes provide various "homestead" type exemptions, listing the amounts and types of assets which may not be attached by creditors. The Alaska statute specifically exempts retirement plan interests from creditor claims. Unfortunately, it does so by listing each type of retirement plan by reference to the Internal Revenue Code section governing that type of plan. Individual Retirement Accounts (IRA's) are described and governed by Internal Revenue Code Section 408. When Congress made changes to IRA's in 1997 they did so by adding the changes to a new section, IRC 408A. However by definition, 408A is a separate code section and currently is not included in the definition of retirement plans listed as exempt in A.S. 09.38.017.

The 1997 Taxpayer Relief Act created the Roth IRA account under code section 408A. This section will allow taxpayers to make nondeductible contributions to a Roth IRA and then later take all distributions from the account tax free subject to certain specified conditions. These qualified distributions must be included in gross income but, for 1998 only, the distributions will be taken into income over four years rather than the customary one year. This is a great opportunity to convert all future IRA account earnings into tax free income and spread the current tax bite over four years. This option is available only during 1998. Beginning in 1999 distributions from regular IRA accounts that are rolled into Roth IRAs will be fully taxed in the year of the rollover.

Because of the unique opportunity available in 1998 to spread these distributions over four years, it is imperative that legislation be passed as soon as possible in 1998 giving Roth IRA's the same creditor protection as regular IRA's and all other retirement plans. In many cases IRA accounts represent a person's major retirement savings. While a Roth IRA is a great tax planning tool it would be unwise to convert creditor protected assets into unprotected assets.



Mr. Gene Theirrault
January 30, 1998
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Roth IRA's are not allowed to high income individuals. This is a provision which was intended by Congress to benefit the low and middle income taxpayer. As such it will have broad appeal to many Alaskans.

We are concerned that many people will be converting their existing IRA's to Roth IRA's without knowing that they are removing these assets from the list of those protected under state law. The popular press and many financial advisors who are not familiar with Alaska's creditor protection law will be advising taxpayers to start or convert to Roth IRA's.

We need legislation now. The window of opportunity will have passed come January 1, 1999 when those same distributions will become taxable all in one year instead of four years. Please take steps to amend the A.S. 09.38.017(e)(3) (copy enclosed) as soon as possible.

If you need any further information please let me know.

Sincerely,

Walsh, Kelliher and Sharp, APC



Kevin J. Walsh, CPA

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'Roth IRA' May Lack Protection From Creditors

By James L. Dam

The popular new Roth IRA has a serious danger -- it may not be protected from creditors, experts tell *Lawyers Weekly USA*.

This is true for two reasons:

- Many state statutes that protect IRAs refer to Sect. 408 of the Tax Code. Roth IRAs are covered by Sect. 408A. Section 408A is *not* a subsection of Sect. 408, but stands alone as a separate section, says Seymour Goldberg of Garden City, N.Y., author of *J.K. Lasser's How to Pay Less Tax on Your Retirement Savings* and apparently the first person to discover this problem.
- Some state statutes that protect IRAs don't protect "non-deductible contributions" to an IRA or the earnings on those contributions. With a Roth IRA, *all* contributions are non-deductible, says Natalie Choate of Boston, author of *Life and Death Planning for Retirement Benefits*.

It appears that 24 states have the first of these two problems and 10 have the second, including five that have both.

In those states, the potential lack of protection will be a major factor in deciding whether to convert a regular IRA to a Roth IRA, says Goldberg.

For example, a doctor in a high-risk practice probably won't want to convert, he says.

Anybody who faces a high risk of being sued "should think twice about it," says Gideon Rothschild, an estate planning attorney in New York.

Clients may want to wait until the end of 1998 before converting, since they won't lose much by waiting, and by the end of the year their state's statute may have been amended, suggests New York estate planning attorney Bruce Steiner.

Most states will probably amend their laws to correct these problems, lawyers say. But of course that won't happen

immediately, and there's no guarantee it will happen at all.

If a state's statute isn't amended by the end of 1998, the client could face a dilemma. That's because a client who waits to convert until Jan. 1, 1999 will lose a special tax break that allows the income generated by the conversion to be spread out over four years for tax purposes.

Of course, if a client's IRA is just a small portion of his or her overall wealth, protection from creditors is probably not an issue, notes Steiner. For example, it probably wouldn't be an issue if the client has a \$20,000 IRA and \$3 million of other assets.

It probably isn't an issue if a client is just looking to set up a Roth IRA and make annual contributions, instead of converting an existing IRA, says Marvin Rotenberg, national director of retirement services at BankBoston.

Roth IRAs became available on Jan. 1, 1998. Apart from the asset protection issue, they have a number of tax advantages over regular IRAs that make them a much better deal for many people. These advantages were discussed in detail at 97 LWUSA 733; [Search words for LWUSA Archives: Juggle and Grapes.](#)

'A Fighting Issue'

It's not absolutely clear that a Roth IRA won't be protected from creditors even if your state has one of the "problem" statutes.

If a statute refers to Sect. 408, there's an argument that it impliedly covers Roth IRAs under Sect. 408A, says James Caher of Eugene, Ore., who has written two books on bankruptcy law.

This argument is supported by language in Section Sect. 408A which defines "Roth IRA" by referring to Sect. 7701(a)(37) of the Tax Code, which in turn refers to Sect. 408, says Noel Ice of Fort Worth, Texas, the author of an IRA planning manual.

If a statute covers only deductible contributions and their earnings, there's an argument that money rolled over from a regular IRA to a Roth IRA is covered because the original contributions to the regular IRA were deductible, says Goldberg.

However, whether Roth IRAs are covered will "certainly be a fighting issue that creditors can raise and possibly win on," says Caher.

What the Statutes Say

Most of the states provide some creditor-protection to regular IRAs, although the level of protection varies a lot.

In general, they exempt the IRA assets and payments from attachment, execution or garnishment by creditors of the IRA owner or beneficiaries.

Some states limit the exemption to a dollar amount; others limit it to an amount "reasonably necessary for the support" of the debtor and his or her dependents. Some say the exemption doesn't apply to debts for child or spousal support.

The 24 states that refer specifically to Sect. 408 typically do so with language such as that in Florida's statute, which covers only "a retirement or profit-sharing plan that is qualified under S. 401(a), S. 403(a), S. 403(b), S. 408, or S. 409 of the Internal Revenue Code."

They go beyond providing that the plans covered *include* plans under Sect. 408, says Goldberg.

The 10 states that limit protection to deductible contributions (and earnings on those contributions) generally say they don't protect contributions that weren't "exempt from federal income tax" or that "exceeded the deductible amount allowed under Sect. 408." Some also say this limitation doesn't apply to amounts that weren't deductible because they were rolled over to the IRA from another IRA.

However, the language in the statutes varies greatly, and the effect of it on the protection of Roth IRAs may vary even more, lawyers say.

The Federal Exemption

In a number of states, a debtor who goes bankrupt can choose between the state's exemptions and those in the Bankruptcy Code. And the Code has an exemption (Sect. 522(d)(10)(E)) that some courts have said protects regular IRAs, although others have disagreed.

If a court has held that the exemption covers regular IRAs, it will probably say that it also covers Roth IRAs, because the language in the exemption is broad enough to cover both, says Boston bankruptcy attorney Mark DeGiacomo.

The exemption covers a "stock bonus, pension, profitsharing, annuity, or similar plan or contract."

The courts that have held that this exemption covers regular IRAs have focused on the phrase "similar plan or contract," says DeGiacomo.

However, the federal exemption allows a debtor to keep only as much as is "reasonably necessary for the support of the debtor and any dependent of the debtor." So even if it covers Roth IRAs, it may not be much help.

The States That Have a 'Problem' Statute

Here are the state exemption statutes covering IRAs and other retirement benefits, listed according to whether they appear to have one, both or neither of the problems that may cause Roth IRAs to be

unprotected:

States That Refer to Sect. 408

Alaska: Alaska Stat. Sect. 09.38.017.
Arizona: Ariz. Rev. Stat. Ann. Sect. 33-1126(C).
Connecticut: Conn. Gen. Stat. Sect. 52-321a.
Delaware: Del. Code Ann. tit. 10, Sect. 4915.
Florida: Fla. Stat. Ann. Sect. 222.21.
Hawaii: Haw. Rev. Stat. Sect. 651-124.
Idaho: Idaho Code Sect. 55-1011.
Kansas: Kan. Stat. Ann. Sect. 60-2308.
Minnesota: Minn. Stat. Sect. 550.37.
Missouri: Mo. Rev. Stat. Sect. 513.430.
Nebraska: Neb. Rev. Stat. Sect. 25-1563.01.
Nevada: Nev. Rev. Stat. Sect. 21.090(1)(q).
New York: N.Y. Civ. Prac. L. & R. Sect. 5205(c).
North Dakota: N.D. Cent. Code Sect. 28-22-03.1(3).
Oregon: Or. Rev. Stat. Sect. 23.170.
Tennessee: Tenn. Code Ann. Sect. 26-2-104.
Utah: Utah Code Ann. Sect. 78-23-5(1).
Virginia: Va. Code Ann. Sect. 34-34.
Washington: Wash. Rev. Code Sect. 6.15.020.

States That Protect Only Deductible Contributions

Arkansas: Ark. Code Ann. Sect. 16-66-220.
Indiana: Ind. Code Sect. 34-2-28-1.
Kentucky: Ky. Rev. Stat. Ann. Sect. 427.150(2)(f).
Oklahoma: Okla. Stat. tit. 31, Sect. 1(A)(20).
Texas: Tex. Prop. Code Ann. Sect. 42.0021.

States With Both Problems

Louisiana: La. Rev. Stat. Ann. Sects. 20-33(1) and 13-3881(D).
Maryland: Md. Code Ann. Cts. & Jud Proc. Sect. 11-504(h).
Michigan: Mich. Comp. Laws 600.6023.
Pennsylvania: 42 Pa. Cons. Stat. Sect. 8124.
Rhode Island: R.I. Gen. Laws Sect. 9-26-4.

States With Neither Problem

These are the remaining states. They vary greatly as to the protection they give to regular IRAs -- some may give none. But all appear to give the same protection (or lack thereof) to Roth IRAs that they give to regular IRAs.

(Some refer to Sect. 408, but just say that they cover retirement plans *including* plans under Sect. 408.)

Alabama: Ala. Code Sect. 19-3-1(b).
California: Cal. Stat. Sect. 704.115.
Colorado: Colo. Rev. Stat. Sect. 13-54-102.
District of Columbia: D.C. Code Ann. Sect. 15-503.
Georgia: Ga. Code Ann. Sect. 44-13-100.
Illinois: Ill. Rev. Stat. ch. 735, para. 5/12-1006.

Iowa: Iowa Code Sect. 627.6.
Maine: Me. Rev. Stat. Ann. tit. 14, Sect. 4422(13)(E).
Massachusetts: Mass. Gen. L. ch. 235, Sect. 34A.
Mississippi: Miss. Code Ann. Sect. 85-3-1.
Montana: Mont. Code Ann. Sect. 31-2-106(3).
New Hampshire: (No exemption statute).
New Jersey: N.J. Stat. Ann. Sect. 25:2-1(b).
New Mexico: N.M. Stat. Ann. Sect. 42-10-1 and 42-10-2.
North Carolina: (No exemption statute).
Ohio: Ohio Rev. Code Ann. Sect. 2329.66(A)(10).
South Carolina: S.C. Code Ann. Sect. 15-41-30.
South Dakota: (No exemption statute).
Vermont: Vt. Stat. Ann. tit. 12, Sect. 2740(19)(J).
West Virginia: W. Va. Code Sect. 38-10-4.
Wisconsin: Wis. Stat. Sect. 815.18(3)(j).
Wyoming: Wyo. Stat. Sect. 1-20-110.

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