

## RETIREMENT ACCOUNT PROTECTION

### House Bill 5648 as introduced First Analysis (3-24-98)

**Sponsor: Rep. Judith Scranton**  
**Committee: Commerce**

#### ***THE APPARENT PROBLEM:***

Michigan is one of many states that has not changed its statute to protect the new Roth Individual Retirement Account (IRA) from creditors when court judgments such as bankruptcies are executed. In contrast and under current law, one regular IRA is protected from creditors after a declaration of bankruptcy.

Some argue that just as a regular IRA is protected during bankruptcy, so, too, should the new Roth IRA be protected. They further argue that *all* retirement accounts and retirement annuities should be protected in the event of personal bankruptcy.

#### ***THE CONTENT OF THE BILL:***

House Bill 5648 would amend those provisions of the Revised Judicature Act that list the kinds of property that are protected from creditors in the execution of any judgment. Currently, an individual retirement account or individual retirement annuity, as defined in section 408 of the Internal Revenue Code, is protected. House Bill 5648 would protect all individual retirement accounts and individual retirement annuities as defined in section 408, and section 408a, of the Internal Revenue Code. (Section 408a of the Internal Revenue Code was added as part of the federal Taxpayer Relief Act of 1997, and provides for a new type of individual retirement account, known as the "Roth IRA".)

MCL 600.6023

#### ***BACKGROUND INFORMATION:***

Roth IRAs. The federal Taxpayer Relief Act of 1997 created a new kind of individual retirement account (IRA), called the Roth IRA, which first became available to contributors on January 1, 1998.

A worker with earnings can start a Roth IRA by depositing \$2,000 a year (\$4,000 for a married couple). A taxpayer qualifies for the full contribution amount if single with an adjusted gross income up to \$95,000, or married with income up to \$150,000.

With the new Roth IRA, a depositor does not get a tax deduction for the money put in, but the earnings that accumulate can be taken tax free, as long as the account is held for at least five years, and the depositor is at least 59½ years old, or disabled, or taking up to \$10,000 in earnings to buy a first home.

Generally, with a regular IRA, a depositor's money is tax-deferred but not tax-free; depositors pay taxes when they withdraw their money. Because of the tax advantages, people with regular IRAs have been encouraged to consider conversions to the new Roth IRAs. A depositor can qualify for a conversion if his or her adjusted gross income is \$100,000 or less, married or single.

According to financial planners, a roll-over to a Roth IRA is not tax free, since the money converted must be reported as taxable income. However, if a depositor switches to a Roth IRA in 1998, he or she can spread the income and the tax over four years. For a conversion after 1998, all the tax would be due at once.

One disadvantage to the Roth IRA (both for those who start one anew, and for those who convert a regular IRA), is that many states have not changed their statutes to protect the Roth IRA from creditors when court judgments are executed. In contrast, a regular IRA is protected from creditors after a declaration of bankruptcy.

Related legislation. House Bill 5612 and Senate Bill 856, both on the House calendar, would protect a Roth IRA from creditors during bankruptcy (in the same way that a regular IRA is now protected).

House Bill 5612 and Senate Bill 856 are identical to each other.

**FISCAL IMPLICATIONS:**

Fiscal information is not available.

**ARGUMENTS:**

***For:***

Under the Revised Judicature Act certain types of properties are protected against court-ordered judgments to collect assets, including qualified pension plans and IRAs. Since the federal Taxpayers Relief Act of 1997 now allows persons to deposit funds in a new type of IRA, the Roth IRA, simple fairness requires that the protection against judgments also be extended to the Roth IRA.

Current law protects only one individual retirement account or one annuity from creditors. Many proponents of the legislation expressed a preference that *all* retirement accounts and annuities--regular and Roth--be protected from creditors.

***Against:***

This legislation seems to reward personal bankruptcy. The number of personal bankruptcies reached a record high last year in the United States.

**POSITIONS:**

There are no positions on the bill.

Analyst: J. Hunault

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■This analysis was prepared by nonpartisan House staff for use by House members in their deliberations, and does not constitute an official statement of legislative intent.