The California "Private Retirement Plan"

Jay D. Adkisson, JD

[Editor's Note: I invited [Jay D. Adkisson, JD](), a well-known "asset protection" attorney and author of "[Asset Protection: Concepts & Strategies]()" to write this guest post after a comment he made to a previous post about "Private Retirement Plans" as an asset protection strategy in California, which is [one of the most toxic states for physicians]()due to low reimbursement, high cost of living, high tax rate, and high cost of malpractice in some of its cities. It turns out California is also not great from an asset protection standpoint, but there is one interesting aspect of California, a "private retirement plan" which he discusses below. We have no financial relationship. As with any other post on this blog, this is for informational and entertainment purposes only, and doesn't constitute legal, accounting, or financial advice. In other words, Mr. Adkisson is an attorney, but he isn't YOUR attorney.]

California has some of the most creditor-friendly and debtor-unfriendly laws in the United States. The Homestead Exemption is a meager $50,000 for an individual, $75,000 for a couple, and $150,000 for the elderly and handicapped, which would barely cover the plot for a mailbox in many California cities.

Life insurance is exempt only to the tune of $9,700 and annuities have no protection at all in California.

The Private Retirement Plan

There is, however, one bright light for persons desiring asset protection planning in the Golden State. California Code of Civil Procedure Section 704.115 provides a complete exemption for the assets of "private retirement plans". So what is a "private retirement plan"? Section 704.115(a)(1) defines it quite unhelpfully as a "private retirement plan" – thanks for nothing. Fortunately, opinional case law has developed in California to essentially define a "private retirement plan" as a plan, managed by a trustee or custodian, that is meant to provide retirement benefits to a privately-employed individual. In other words, a California business owner (let's say a physician with a medical practice), can set up a private retirement plan where the funds will be paid by the practice into the trust, and held for the physician's retirement. So long as those funds stay in the plan, they are exempt from the physician's creditors. Even when the funds come out of the plan, they stay protected from the physician's creditors under other California law, so long as they are kept separate and not commingled with other funds.

Must Be An Official Plan

The California Courts have focused on the word "plan". The key here is to have a comprehensive "plan" for retirement. Just indiscriminately depositing money into one's account will not cut it. Instead, there must be plan documents, a schedule or formula of payments to be made into the plan, a trustee or custodian to hold the money according to the plan documents, a schedule or formula of payments to be made from the plan when the physician retires, and some other requirements. Once the money is in the plan, the money can be invested – but not returned sub rosa [*lawyer-speak for "secretly"- ed*] to the physician by way of loans, etc.

Unlimited Contributions

Due to a historic anomaly, there is no statutory limit to how much money can be contributed to a private retirement plan, so long as the money is contributed according to the set schedule or formula, and bears some actuarial relationship to how much and when the money will be paid to the physician in retirement.

Beware Community Property Issues

Note that due to California’s community property regime, the money in the private retirement plan would very likely be considered community property unless the spouses agree that it will be one or the other’s separate property. Unless the couple have a pre- or post-nuptial agreement that divides the community property into separate property, the best practice is probably to have the private retirement plan hold the money half for one spouse, and half for another.

Main Benefit Is Asset Protection

The bottom line is that money is removed from the physician’s practice, and therefore is no longer available to the creditors of the practice, and the money in the private retirement plan (and when it comes out, as discussed above) is not available to the physician’s personal creditors either.

Qualified vs Non-qualified

Private retirement plans can also be tax-qualified plans, meaning that the physician would get a deduction for contributions to the plan. However, some types of qualified plans have a limited exemption, meaning that only a certain amount of money may be protected, and thus great care must be undertaken when a private retirement plan attempts to be organized as a qualified plan. Also, if the private retirement plan is a qualified plan, then plan benefits cannot be paid before age 59.5 without penalty, and required minimum distributions must begin by age 70.5. Further, the private retirement plan that is a qualified plan may also have to include other employees and not discriminate.

If the private retirement plan is structured not to be a qualified plan, then there is no deduction for contributions to the plan, but there will be no penalties for early withdrawal prior to age 59.5, no mandatory distributions that must start at age 70.5, and no need to include other employees – discrimination is allowed. Notably, a non-qualified private retirement plan can run alongside a qualified plan (whether that qualified plan is a private retirement plan or not). Payments from a non-qualified plan at retirement may be made lump-sum, as opposed to annuitized, or even taken as tax-free loans for up to the full amount of the cash in plan during retirement.

Because of the uncertainty in the statutory law regarding private retirement plans, it is almost always going to be better to have an attorney familiar with this peculiar legal animal to draft the plan documents, arrange any necessary actuarial calculations, and keep an eye on it during the lifetime of the plan. For California business owners and professionals, private retirement plans can be an effective and cost-beneficial method of legally shielding assets under established California law, and potentially a very significant amount of assets.

What do you think? Do you live in California? Would you consider using a private retirement plan? Comment below!