



NATIONAL CREDIT UNION ADMINISTRATION
Washington, D.C. 20456

June 12, 1989

Office of General Counsel

GC/MM:sg
SSIC3601
89-0412

Mr. Edgar L. Wright
2123 Quail Run
Columbia, S.C. 29206

Re: Application of Statutory Lien to IRA Accounts
(Your March 29, 1989, Letter)

Dear Mr. Wright:

You have requested our opinion on whether funds in an Individual Retirement Account (IRA) are subject to a Federal credit union's ("FCU's") statutory lien authority. The real issue here is one for determination by the Internal Revenue Service ("IRS"); we can only provide you with an informal opinion. We strongly suggest that you obtain an opinion from the IRS on this matter. The available case law suggests that an FCU may be prohibited from applying its statutory lien authority against a member's IRA held in the FCU.

BACKGROUND

In 1987, the Pentagon Federal Credit Union withdrew all the funds in your IRA and used it for partial payment of your credit union loans that were in arrears. It was your understanding that your IRA ~~accounts~~ were not subject to forfeiture (due to language in the IRA Disclosure Statement provided to you by Pentagon Federal Credit Union and in the promissory note for your loan) and could not be used to satisfy your loan obligations.

ANALYSIS

The question you present is twofold. First, can an FCU impose its statutory lien on a member's IRA when the member is in arrears on his loan and second, if so, will IRA's established

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with the FCU remain qualified for purposes of the Internal Revenue Code?

Section 101(5) of the Federal Credit Union Act (12 U.S.C. § 1752(5)) defines member account to mean "a share, share certificate, or share draft account of a member of a credit union. . . ." All savings at a Federal credit union are classified as shares. Section 107(11) of the Federal Credit Union Act (12 U.S.C. §1757(11)) authorizes an FCU "to impress and enforce a lien upon the shares and dividends of any member, to the extent of any loan made to him and any dues or charges payable by him". Interpretive Ruling and Policy Statement 82-5 -- Statutory Liens, 47 Fed. Reg. 577483, 12/27/82 ("IRPS 82-5") interprets Section 107(11). It states in part that such a lien "applies to all of the members shares outstanding at the time the loan is made."

Section 408 of the Internal Revenue Code (26 U.S.C. 408) defines an IRA. Section 408(a)(4) requires that the "interest of an individual in the balance in his account is nonforfeitable." For purposes of this section, nonforfeitable means that the account has vested. Vested means that the owner has an absolute right to the account which is not contingent on some future occurrence.

In light of the nonforfeiture language in the Internal Revenue Code, the question becomes whether an account maintained as an IRA can be absorbed by the FCU under the authority of the statutory lien. There is case law which states that IRA's are not exempt from garnishment, attachment and seizure. In Bartlett Co-op. Ass'n v. Patton, 722 P.2d 551 (Kan. 1986), the court addressed the issue of whether IRA's could be garnished. The facts of the case are simple. Bartlett Cooperative Association obtained a judgment against Patton. In attempting to collect the judgment, Bartlett Cooperative Association garnished Patton's IRA in the Coffeyville State Bank. The court concluded that the IRA could be garnished for two reasons. First, the owner of an IRA has significant control over the account and can receive the invested funds before retirement by paying a penalty for early withdrawal and paying income tax on the funds. Second, unlike other sections of the Internal Revenue Code dealing with pensions, ~~section 408~~ section 408 does not contain an anti-alienation provision. The court concluded that federal law does not prohibit the garnishment of IRA's. In Re Innis, 62 B.R. 659 (Bkrcty. S.D. Cal 1986), the bankruptcy court concluded that an IRA is not exempt from the property estate, under California law. The court's reasoning was similar to that of the Patton case. The court reasoned that IRA's are not exempt because the owner of the account can withdraw the funds at any time, for any reason, merely by paying a penalty and the income tax due on the funds withdrawn.

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However, there is also case law supporting the proposition that a bank can not employ the doctrine of setoff against a debtor's IRA accounts against a debt owing the bank. The facts are similar to the above discussed cases, except that the debt is owed to the bank. In Re Dunn, 5 B.R. 156 (Bkrtcy, N.D.Tex. 1980), the court held that section 408 of the Internal Revenue Code means that the IRA cannot be forfeited to the trustee (the bank), who, as custodian, is precluded from asserting any claim against the IRA. This is because the bank would be violating its fiduciary duty, as trustee of the IRA, to act in this manner by receiving a benefit at the expense of the beneficiary. In Re McDaniel, 41 B.R. 132 (Bkrtcy, W.D.Tex. 1984), the court held that a bank, as a fiduciary of a debtor who had an IRA at the bank, is prohibited by common law and the Internal Revenue Code from asserting the right of setoff against the IRA. This is not inconsistent with a third-party's right to garnish the IRA.

There is no specific caselaw addressing the facts that you present; where an FCU uses its statutory lien authority to confiscate the funds in the IRA. A FCU's statutory lien authority is different from a bank's right to setoff and a different outcome may result. Although in our opinion it may be inappropriate to use a statutory lien in this manner, it does not clearly violate the FCU Act or NCUA Rules and Regulations. It may, however, violate the Internal Revenue Code. We are not the appropriate forum to make a determination of this issue.

The second question is whether an account maintained as IRA's qualify for tax benefits when the IRA may have a lien imposed on it by the FCU, in light of the nonforfeiture language in the Internal Revenue Code. Resolution of this issue must be determined by the IRS. Preliminary indications suggest that IRA's subject to a statutory lien still qualify for tax benefits.

Although we are concerned by the issues you raise, the problem is one that is appropriately resolved between you and the Pentagon Federal Credit Union. The matter you raise is not prohibited or regulated by the NCUA. We suggest that you consult with the IRS and a private attorney for resolution of this matter. You may wish to request a revenue ruling from the IRS.

Sincerely,



HATTIE M. ULAN
Assistant General Counsel

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