

ESTATE PLANNING**THE U.S. SUPREME COURT HOLDS THAT INHERITED IRAS ARE NOT EXEMPT IN BANKRUPTCY**by *Eric Gregory*

On June 12, 2014, the United States Supreme Court unanimously held in *Clark v. Rameker Trustee* that funds in an individual retirement account ("IRA") inherited from someone other than the bankrupt debtor's spouse are not "retirement funds" within the meaning of the United States Bankruptcy Code and are, therefore, available to pay creditors of the debtor-heir.

Background

Under the Bankruptcy Code, certain retirement plans are designated as "excluded" from the bankruptcy estate, which means that individuals can keep them. These include "retirement funds to the extent that those funds are in a fund or account that is exempt from taxation under Section [...] 408 of the Internal Revenue Code." Internal Revenue Code section 408 relates to IRAs.

Clark Case

The issue in *Clark* was whether the debtor could protect her mother's IRA that she had inherited upon her mother's death. The Internal Revenue Code treats IRAs inherited from a non-spouse differently from IRAs inherited from a spouse.

Justice Sonia Sotomayor, writing for the Supreme Court, upheld a 7th Circuit of Appeals decision, holding that the change in status of the account to a non-spouse inherited IRA makes it less like a "retirement fund" and more like a pool of money that could be used for any purpose. In summary, there was nothing preventing an individual who has emerged from bankruptcy from using the IRA assets "on a vacation home or a sports car immediately after the bankruptcy proceedings are complete."

Inherited IRAs lack many attributes common in retirement accounts. For example, the beneficiary of an inherited IRA is prohibited from rolling funds over to their own IRA and from adding their own funds to the IRA.

Takeaway

This holding creates the risk that IRA money left to heirs will not be protected from creditors if the beneficiaries have financial difficulty.

It is important to remember that inherited IRAs may be subject to claims in non-bankruptcy proceedings as well. Under laws in states like Arizona, Texas and Florida, inherited IRAs are specifically protected from creditors. Most states, however, are silent on this issue.

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