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wanted to share this information with you.

Inherited IRAs in Bankruptcy

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Under federal law (and under the laws of most states), retirement plans such as IRAs enjoy some protection in bankruptcy proceedings. Does that same protection apply to inherited IRAs? The issue has been disputed in many court cases in recent years with mixed verdicts. Finally, in June 2014, the U.S. Supreme Court unanimously decided that bankruptcy creditors may have access to these accounts (*Clark v. Rameker*, No. 13-299 (U.S. 6/12/14)). This ruling has implications for IRA owners as well as for the beneficiaries of such accounts.

In this case, Ruth Heffron held over \$450,000 in her IRA. If Ruth had declared bankruptcy, she probably could have kept certain IRA assets. “Allowing debtors to protect funds in traditional and Roth IRAs ensures that debtors will be able to meet their basic needs during their retirement years,” the Supreme Court noted. Keeping some assets from bankruptcy creditors helps debtors “obtain a fresh start”, reducing the chance that these debtors will be “left destitute and a public charge”.

Beneficiary Battle

Many IRAs still hold assets when the owner dies. Then, the IRA may pass to the designated beneficiary.

Here, after Ruth died, her daughter Heidi Heffron-Clark inherited the account. Nine years later, Heidi and her husband filed for bankruptcy. The couple asserted that the funds in Heidi’s inherited IRA, which now amounted to almost \$300,000, should be exempt from creditors’ claims.

In such cases, debtors have prevailed some of the time. Retirement funds held in tax-exempt retirement accounts are protected in bankruptcy, some courts have ruled, and the funds in an Individual Retirement Account remain retirement funds even after they pass to a beneficiary and are held in an inherited IRA.

Other courts, including the one ruling on Heidi’s case, found that funds in an inherited IRA are no longer retirement funds because the funds are not specifically set

aside for use by the beneficiary in retirement. Thus, they are not protected in bankruptcy. Heidi and her husband appealed to the Supreme Court, which upheld the ruling against them.

In favoring the creditors in this case, the Supreme Court gave several reasons why funds held in an inherited IRA are not funds set aside for retirement purposes. First, a beneficiary can't contribute to an inherited IRA. An individual can put money into a Roth or traditional IRA via annual contributions or direct transfers or rollovers from other retirement accounts. Indeed, various tax incentives encourage such contributions.

As its second reason, the Court noted that beneficiaries are required to take minimum distributions from inherited IRAs, even if they are many years from retirement. Traditional IRA owners face required distributions only after age 70½, when they are likely to be retired, and Roth IRA owners never have to withdraw funds. Finally, the Court noted that “the holder of an inherited IRA may withdraw the entire balance of the account at any time – and use it for any purpose – without penalty”. Traditional and Roth IRA owners, on the other hand, generally are subject to penalties for early withdrawals before age 59½.

Points To Consider

After this decision, people who declare bankruptcy can't expect to protect inherited IRAs from creditors. Therefore, IRA owners should review their choice of IRA beneficiaries. If a future bankruptcy filing by a beneficiary is a concern, you might designate an irrevocable trust as the beneficiary of your IRA and name your human heir as the trust beneficiary. Such a procedure may increase the chance that the IRA will enjoy protection in bankruptcy.

Moreover, surviving spouses who inherit an IRA from the other spouse might be affected by this decision. A spousal beneficiary “may roll over the IRA funds into his or her own IRA, or he or she may keep the IRA as an inherited IRA”, the Supreme Court observed. Once the IRA has been rolled over into the surviving spouse's own IRA, it probably will be protected in bankruptcy.

Still, some spousal beneficiaries choose to keep the account as an inherited IRA. That's often the case if the survivor intends to take withdrawals before age 59½ and wants to avoid a 10% early withdrawal penalty. The Supreme Court's decision does not include whether an inherited IRA held by a surviving spouse would get bankruptcy protection, but all of the reasons cited to disallow such protections – no future contributions, required minimum distributions at any age, no penalties for early distributions – apply to inherited IRAs held by a surviving spouse. Therefore, any widow or widower who is considering leaving a deceased spouse's IRA as an inherited IRA might discuss creditor protection issues with a knowledgeable attorney.

Finally, you should keep in mind that the Supreme Court's decision applies to bankruptcy cases, not other types of creditors' claims. In non-bankruptcy litigation, state law usually will determine whether inherited IRAs are protected from creditors. Some states specifically protect inherited IRAs, but most states have not passed relevant legislation. Again, you should consult with counsel if this is a concern.

For more information on how this Supreme Court ruling affects you and your retirement accounts, please contact our office at 262-634-6659 and we would be happy to schedule a free conference. In this meeting, we can discuss if you need to take action and what we can do for you to protect your retirement accounts for future generations.

**“Those Who Plan Ahead Win.
Those Who Don’t Plan Ahead Lose.”**

This article is for informational purpose only and is not intended as legal advice. It is recommended that you call Timothy P. Crawford for a free conference to discuss your situation in more detail. Attorney Crawford can be reached at 1-262-634-6659. Please refer to this article when you call.

*Attorney Timothy P. Crawford is a Nationally Board Certified Elder Law Attorney (CELA). He has been Board Certified by the National Elder Law Foundation which has been approved as the Sole Certifying Organization for Elder Law Attorneys by the American Bar Association.

**Timothy P. Crawford was invited to join the Council of Advanced Practitioners (CAP) of the National Academy of Elder Law Attorneys (NAELA) in August of 2005. CAP is a small group of premier elder law attorneys, all of whom have been members of NAELA for at least 10 years, are certified as elder law attorneys by the National Elder Law Foundation, and are AV rated by Martindale Hubbell, a service that provides an independent rating of the quality of attorneys, as one of the top attorneys in the nation.

Attorney Timothy P. Crawford has been selected as a Fellow of NAELA. Fellow is the highest honor bestowed by the Academy. Selection as a Fellow signifies that his peers recognize the lawyer as a model for others and as an exceptional lawyer and leader.

Attorney Timothy P. Crawford has a superb rating of 10 out of 10 with A V V O.

A V V O has awarded to Attorney Timothy P. Crawford the A V V O Client’s Choice Award.

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