

## WEALTH TRANSFER & SUCCESSION PLANNING ALERT

6/19/14

### U.S. Supreme Court Finds Inherited IRAs Not Protected in Bankruptcy

On June 12, 2014, the Supreme Court unanimously upheld a Seventh Circuit decision that said inherited IRAs do not enjoy the protections of IRAs in bankruptcy proceedings.

The petitioner in *Clark v. Rameker*, Trustee, Hedi Heffron-Clark, inherited an IRA worth about \$300,000 in 2001. In October 2010, the Clarks filed voluntary joint bankruptcy and claimed an inherited IRA under the Section 522 exemption, to which the bankruptcy trustee and creditors objected. The district court ruled that inherited IRAs are exempt because they retain their character as retirement funds, but the U.S. Court of Appeals for the Seventh Circuit reversed that ruling.

The Court's analysis turned on key legal distinctions between inherited IRAs and those that you set up and fund yourself, either through annual contributions or by rolling over assets from a company plan.

In the unanimous opinion written by Justice Sonia Sotomayor, the Supreme Court agreed with the Seventh Circuit: "the possibility that some investors may use their inherited IRAs for retirement purposes does not mean that inherited IRAs bear the defining legal characteristics of retirement funds. Were it any other way, money in an ordinary checking account (or, for that matter, an envelope of \$20 bills) would also amount to "retirement funds" because it is possible for an owner to use those funds for retirement."

Several features make inherited IRAs unique and suggest that they are not retirement assets, the Court noted. Unlike IRA owners, inheritors can't put additional funds into the account, and they can take out money at any time without penalty. In fact, generally, non-spousal IRA heirs must either withdraw the entire account balance within five years of the original owner's death, or take out a calculated minimum amount each year, starting by Dec. 31 of the year after the IRA owner died.

The ruling will likely affect some families' estate planning decisions. Some families will decide to bequeath their IRA assets through trusts, which could shield them from bankruptcy settlements but would also involve more paperwork, costs and complexity. Even before the Court's decision, that was a popular strategy to protect IRA assets from creditors. However, complex rules govern this approach and pitfalls abound. So clients are advised not to do this without help from advisors who are experts in the field.

For further information, please contact any of the following Roetzel attorneys:

**Steven Cox**

330.849.6714 | [scox@ralaw.com](mailto:scox@ralaw.com)

**Brian McAvoy**

239.649.2722 | [bmcavoy@ralaw.com](mailto:bmcavoy@ralaw.com)

**Erika Haupt**

614.723.2037 | [ehaupt@ralaw.com](mailto:ehaupt@ralaw.com)

**David Strosnider**

312.582.1688 | [dstrosnider@ralaw.com](mailto:dstrosnider@ralaw.com)

**Lisa Lipman**

239.213.3863 | [llipman@ralaw.com](mailto:llipman@ralaw.com)

**Joe Zaks**

239.649.2720 | [jzaks@ralaw.com](mailto:jzaks@ralaw.com)