



Inherited IRAs and Bankruptcy



Background

Since the enactment of the Bankruptcy Abuse Prevention and Consumer Protection Act in 2005, individual retirement accounts (IRAs) have been protected under federal law if you declare bankruptcy. The exemption was originally capped at \$1 million, but has since grown to \$1,245,475 (as of April 1, 2013) due to cost-of-living increases. (The million-dollar cap does not apply to amounts rolled over from a qualified employer plan like a 401(k)—these amounts are fully protected under federal law.)

Over the years, federal court decisions have been divided over whether or not inherited IRAs are protected under the Act. To resolve this conflict, the United States Supreme Court agreed to hear the case of *Clark v. Rameker*.

The Supreme Court's decision

On June 12, the Court decided the *Clark* case, holding that inherited IRAs are not protected "retirement funds" under federal law. The Court reached this conclusion by noting that the holder of an inherited IRA cannot invest new money in the account, can withdraw the entire balance at any time and use the funds for any reason without penalty, and must take required distributions from the account no matter how far the holder is from retirement.

So what does this mean to you? If you declare bankruptcy and hold an inherited IRA, you will not receive any protection for those assets under federal law. Whether they receive any protection from creditors at all (inside or outside of bankruptcy) will instead depend on the laws of your particular state.

Note that if you inherit an IRA from your deceased spouse, and you are the sole beneficiary, you are generally entitled to treat that IRA as your own (for example, by making an affirmative election or contributing to the account). If you do so, the IRA should not be considered an inherited IRA for bankruptcy purposes. But since the *Clark* case dealt with an IRA inherited by the IRA owner's daughter, and not a spouse, this was not specifically addressed by the Court.

Also, you should keep this ruling in mind as you name beneficiaries for your own IRAs, particularly if you intend to name someone other than your spouse as beneficiary. If creditor protection for your heirs is important to you, one option is to consider naming a spendthrift trust as your IRA beneficiary. These trusts limit your trust beneficiary's ability to control the trust funds, and provide protection from your beneficiary's creditors under the laws of most states. However, be sure to consult a qualified professional, as establishing a trust as your IRA beneficiary can have significant legal and tax implications.

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