



**Financial Services, LLC**

250 Commercial Street  
Suite 3005-G  
Manchester, New Hampshire 03101  
Tel: 603-641-1010  
Fax: 603-641-0707  
e-mail: [fdemaio@jtdfinancial.com](mailto:fdemaio@jtdfinancial.com)  
[www.jtdfinancial.com](http://www.jtdfinancial.com)

## **Less Protection for Inherited IRAs**

*They are no longer exempt from creditors & bankruptcy proceedings.*

Provided by Frank DeMaio\*

**A SCOTUS ruling raises eyebrows.** On June 12, 2014, the Supreme Court ruled 9-0 that assets held within inherited IRAs by non-spousal beneficiaries do not legally constitute “retirement funds.” Therefore, those assets are not protected from creditors under federal bankruptcy statutes.<sup>1,2</sup>

This opinion may have you scratching your head. “IRA” stands for Individual Retirement Arrangement, right? So how could IRA assets fail to qualify as retirement assets?

**Here is the background behind the decision.** In 2010, a Wisconsin resident named Heidi Heffron-Clark filed for Chapter 7 bankruptcy. In doing so, she listed an inherited IRA with a balance of around \$300,000 as an exempt asset. No doubt this seemed reasonable: the Bankruptcy Abuse Prevention and Consumer Protection Act provided a cumulative \$1 million inflation-adjusted bankruptcy exemption for both traditional IRAs and Roth IRAs in 2005.<sup>3</sup>

So under BAPCPA, wasn't that \$300K in inherited IRA funds held by Ms. Heffron-Clark creditor-protected? Her creditors, the bankruptcy trustee and the Wisconsin bankruptcy court all thought not. That wasn't surprising, as bankruptcy trustees have issued numerous challenges to the exemption status of inherited IRAs since BAPCPA's passing.<sup>3</sup>

*Clark v. Rameker* made it all the way to the country's highest court, and boiled down to one question: is an inherited IRA a retirement account, or not?

The Supreme Court rejected the idea that a retirement account for one individual automatically becomes a retirement account for the individual who inherits it. It made that stand based on three features of inherited IRAs:

---

\* Registered Principal Offering Securities through UNITED PLANNERS' FINANCIAL SERVICES OF AMERICA, A Limited Partnership. Member: FINRA, SIPC. JTD Financial Services and United Planners' are not affiliated.

\*\* The beneficiary of an inherited IRA can draw down all of the IRA balance at any time and use the money for anything without any penalty. Compare that to the original IRA owner, who will face penalties for (most) IRA distributions taken before age 59½.

\*\* Typically, beneficiaries of inherited IRAs must start to take required minimum distributions (RMDs) in the year after they inherit the IRA; it doesn't matter how old they are when that happens. They could be 68 years old, they could be 8 years old – age doesn't factor into the RMD rules.

\*\* Unlike the original IRA owner, the beneficiary of an inherited IRA can't contribute to that account – another strike against the contextualization of an inherited IRA as a retirement fund.<sup>3</sup>

All this gave the high court a basis for its decision.

**Do IRA funds that pass to surviving spouses remain creditor-protected?** It would seem so. Frustratingly, the Supreme Court didn't tackle that question in its ruling. IRAs inherited from spouses are still presumably exempt from federal bankruptcy laws, and if a surviving spouse rolls over inherited IRA assets into an IRA of his or her own, the resulting enlarged IRA is presumably still defined as a retirement account. Oral arguments heard in *Clark v. Rameker* may help to reinforce this view; the bankruptcy trustee's lawyer emphasized the differences between Ms. Heffron-Clark's inherited IRA and one inherited from a decedent.<sup>3</sup>

**State laws may save some inherited IRA assets.** If a non-spousal beneficiary inherits an IRA and lives in Alaska, Arizona, Florida, Missouri, North Carolina, Ohio or Texas, state law is on his or her side. In those states, bankruptcy exemption statutes shelter inherited IRAs.<sup>2</sup>

**What if the heir lives elsewhere?** That could pose a problem. If an IRA owner fails to play defense, the IRA assets could one day be at risk if a non-spousal beneficiary inherits them.

Designating a trust as the IRA beneficiary isn't the only option here, but it certainly has merit. The hitch is that putting an IRA into a trust is rather involved. Trusts also come with fees, paperwork and complexity, and the non-spousal beneficiary of the IRA assets should have some financial literacy.<sup>1</sup>

In the case of a traditional IRA, a Roth conversion might be an option worth examining. (The conversion would have to happen during the original owner's lifetime.) Another option: some of the IRA balance could be spent on life insurance which could be left to a trust; life insurance proceeds are tax-free, and a life insurance policy is much more suited to inclusion in a trust than a traditional or Roth IRA.<sup>2</sup>

**The bottom line?** If you fear that the heir(s) to your IRA might face bankruptcy proceedings someday, talk with a financial or legal professional about your options. If state law won't protect those assets, a trust might be wise.

---

Frank DeMaio, CPF®, CFA® is a Registered Representative offering securities through UNITED PLANNERS' FINANCIAL SERVICES OF AMERICA, a Limited Partnership, Member FINRA, SIPC. Frank may be reached at 603-641-1010 or [fdemaio@jtdfinancial.com](mailto:fdemaio@jtdfinancial.com). JTD Financial Services and United Planners' are not affiliated.

This material was prepared by MarketingPro, Inc., and does not necessarily represent the views of the presenting party, nor their affiliates. This information has been derived from sources believed to be accurate. Please note - investing involves risk, and past performance is no guarantee of future results. The publisher is not engaged in rendering legal, accounting or other professional services. If assistance is needed, the reader is advised to engage the services of a competent professional. This information should not be construed as investment, tax or legal advice and may not be relied on for the purpose of avoiding any Federal tax penalty. This is neither a solicitation nor recommendation to purchase or sell any investment or insurance product or service, and should not be relied upon as such. All indices are unmanaged and are not illustrative of any particular investment.

**Citations.**

1 - [blogs.marketwatch.com/encore/2014/06/12/scotus-inherited-iras-not-retirement-accounts/](http://blogs.marketwatch.com/encore/2014/06/12/scotus-inherited-iras-not-retirement-accounts/) [6/12/14]

2 - [tinyurl.com/n9g4acw](http://tinyurl.com/n9g4acw) [7/13/14]

3 - [theslottreport.com/2014/06/supreme-court-inherited-iras-are-not.html](http://theslottreport.com/2014/06/supreme-court-inherited-iras-are-not.html) [6/18/14]