

How to Protect an IRA From Heirs' Creditors

When a person declares bankruptcy, an individual retirement account (IRA) is one of the assets that is beyond the reach of creditors, but what about an IRA that has been inherited? Resolving a conflict between lower courts, the U.S. Supreme Court recently (and unanimously) ruled that funds held in an inherited IRA are *not* exempt from creditors in a bankruptcy proceeding because they are not really retirement funds. *Clark v. Rameker* (U.S., No. 13-299, June 13, 2014).

This ruling has significant estate planning implications for those who intend to leave their IRAs to their children. If the child inherits the IRA and then declares bankruptcy sometime in the future, as a result of the Supreme Court ruling the child's creditors could take the IRA funds.

Fortunately, there is a way to still protect the IRA funds from a child's potential creditors. The way to do this is to leave the IRA not to the child but to a "spendthrift" trust for the child, under which an independent trustee makes decisions as to how the trust funds may be spent for the benefit of the beneficiary. However, the trust cannot be a traditional revocable living trust; it must be a properly drafted IRA trust set up by an attorney who is familiar with the issues specific to inherited IRAs.

The impact of the Supreme Court's ruling may be different in some states, such as Florida, that specifically exempt inherited IRAs from creditor claims. As Florida attorney Joseph S. Karp explains in a recent blog post, Florida's rule protecting inherited IRAs will bump up against federal bankruptcy law, and no one knows yet which set of rules will prevail. While a debtor who lives in Florida could keep a creditor from attaching her inherited IRA, it is

unknown whether that debtor would succeed in having her debts discharged in bankruptcy while still retaining an inherited IRA. We will have to wait for the courts to rule on this issue. In the meantime, no matter what state you are in, the safest course if you want to protect a child's IRA from creditors is to leave it to a properly drafted trust.

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