

Protecting Your Client's Estate from Beneficiary Bankruptcy

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New Rules from *Clark v Rameker*¹: The Supreme Court recently considered whether an inherited IRA is a protected retirement fund or is subject to creditor's claims asserted in an IRA beneficiary's bankruptcy. The bankruptcy exemption provided by 11 U.S.C. §522(b)(3)(C) allows debtors to protect certain funds to help meet their basic retirement needs.

The Supreme Court identified three characteristics of an inherited IRA that establish an inherited IRA is *not* objectively set aside for retirement: (i) additional money can never be contributed by the beneficiary; (ii) withdrawals can be taken regardless of the beneficiary's age; and (iii) the entire balance can be withdrawn for any purpose without penalty to the beneficiary².

IRA Beneficiary Planning: Consider whether a potential IRA beneficiary has issues with creditors that may lead to bankruptcy. If so, an alternate planning technique is to name a trust as the IRA beneficiary. A See-Through Trust ("STTrust")³ is revocable during the owner's lifetime, but becomes irrevocable upon death. When an STTrust is named as beneficiary, required minimum distributions, when received by the STTrust from the IRA, may be held as principal of the STTrust and not distributed immediately to the beneficiary. If an STTrust beneficiary seeks bankruptcy protection, the Bankruptcy Trustee could only reach those STTrust assets that the beneficiary has a right to receive, e.g., trust income.

Consequences if You Don't Plan Ahead: Without proper planning, a Bankruptcy Trustee will be able to reach the funds of the inherited IRA to pay creditors, and the inheritance intended to secure your beneficiary's future, to the extent of creditor's claims, would be lost. Owners may try to avoid *Clark* by not designating a beneficiary. If no beneficiary is designated at the time of the owner's death, the IRA will be distributed as part of the owner's estate, passing to the beneficiaries of the owner's Will, which may also be subject to creditor's claims and have additional income tax consequences.

See also similar subject: Charlie Leimberg report

¹ Clark v. Rameker, 134 S. Ct. 2242 (2014).

² *Id.* at 2247.

³ Natalie B. Choate, Life and Death Planning for Retirement Benefits, 141 (Ataxplan Publications 2011) (2010).