



Inherited IRAs, Bankruptcy and Estate Planning

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The general purpose of the United States Bankruptcy Code (the “Code”) is to assist in the resolution of situations where a person’s debts and obligations exceed their assets or their ability to pay their creditors. However, there are also decisions made in the Code regarding what assets should be protected from the claims of creditors, such as a person’s home or retirement accounts.

One source of “retirement” funds that many individuals have come to possess is an IRA inherited from a family member. In June 2014, the United States Supreme Court held in *Clark v. Rameker* that an inherited IRA failed to meet the criteria for a “retirement account” that warranted protection under the federal exemptions allowed in the Code. The Court’s reasoning was that an inherited IRA lacks the characteristics of a traditional retirement account. For example, an individual cannot invest additional funds into an inherited IRA and can withdraw funds at any time for any purpose without penalty to the beneficiary.

While this decision was a tremendous blow to debtors in some states, North Carolina was an exception. North Carolina General Statutes §1C-1601(a)(9) specifically includes inherited IRAs or similar accounts as exempt from the claims of creditors. Because the Code allows debtors to choose between either their federal or state exemptions when filing bankruptcy, North Carolina debtors can still protect those assets through bankruptcy. The potential trade-off is that there may be other assets that could be lost due to choosing the state exemptions as opposed to the federal exemptions.

However, the issue raises potential planning opportunities in the context of estate planning. If an individual has a significant IRA that would otherwise have beneficiaries scattered across different states, do those states have similar protections? If not, the solution could be the use of a specialized trust to serve as the beneficiary of the IRA. While the specific requirements of such a trust are beyond the scope of this article, a trust could be used in such a way as to protect some or all of the inherited IRA for the benefit of the beneficiary or beneficiaries.

These types of trusts require very detailed and specialized language, along with a thorough discussion of the tax and non-tax consequences of using a trust to serve as the beneficiary. A trust of this type is not for everyone and a careful and informed decision must be made after weighing all of the pros and cons in each particular case. If you believe your circumstances would warrant the use of a trust, we would be happy to discuss the issue with you.