inherited iras ARE NOT PROTECTED FROM CREDITORS ESTATE PLANNING WITH IRAS


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The Supreme Court Ruling

On June 12, 2014, the United States Supreme Court ruled that inherited IRAs are not "retirement funds" within the meaning of the federal bankruptcy exemption for retirement funds. In making its decision, the court distinguished inherited IRAs from IRAs established and held by the owner who originally deposited the funds.

This court decision has a significant impact on anyone owning IRAs and hoping to pass such assets to their heirs as protected assets. While the owner of the IRA will continue to have asset protection during his or her life, the beneficiary of the IRA will generally not have such protection.

Some Strategies for IRA owners

Surviving Spouses. A spouse who inherits an IRA can treat the IRA as an inherited IRA or can roll the IRA over. Given the ruling by the Supreme Court in the Clark case, a surviving spouse should consider rolling the assets of an inherited IRA into his or her own IRA and postponing distributions until she turns age 70 ½ to achieve asset protection. If the surviving spouse is under age 59 ½, the disadvantage is that withdrawals prior to age 59 ½ will be subject to penalty.

Trust Options. There are two common types of trusts that are typically used for IRAs. The key issues in deciding on the best type of trust to be beneficiary of an IRA are income tax issues and asset protection planning concerns.

For purpose of allowing a trust beneficiary to stretch out IRA distributions as long as possible, a conduit trust might be used. Such a trust directs the trustee to take at least the minimum required distribution from the IRA each year and to distribute that amount to the beneficiary. The distributions, and corresponding income tax cost, can be "stretched" over the life expectancy of the trust beneficiary in a properly designed conduit trust.

From an income tax perspective, the conduit trust is a great option. The approach is less desirable from an asset protection perspective. In many states, creditors are allowed to attach distributions that a beneficiary has a right to receive from a trust. To the extent that the trustee of a conduit trust is required to distribute the minimum required distribution, such distribution could be subject to creditors. Following the Supreme Court ruling, the conduit trust, designed as a spendthrift trust, will likely be better than simply having an inherited IRA. The inherited IRA can be attached in bankruptcy. It is unlikely that a creditor can attached an IRA directed to a conduit trust.

A second type of trust that can be used as a beneficiary of an IRA is an accumulation trust. In an accumulation trust, the trustee has the discretion to make distributions from the IRA based on standards established by the settlor of the trust. Distributions to beneficiaries are not mandatory. While the accumulation trust is not as beneficial as the conduit trust from an income tax perspective, the trust has the ability to offer more in terms of asset protection.

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