

Licensed:
Florida
Connecticut
Rhode Island

Marc J. Soss, JD, LL.M

mjs@fl-estateplanning.com
www.fl-estateplanning.com



INHERITED IRA'S ARE NOT CREDITOR EXEMPT IN BANKRUPTCY

EXECUTIVE SUMMARY:

Section 222.21(2)(a) of the Florida Statutes protects "money or other assets payable to an owner, a participant or a beneficiary" from garnishment if held in a fund or account maintained as an Individual Retirement Account ("IRA"). To qualify, the IRA must be exempt from taxation under the Internal Revenue Code.

The same creditor protection does not apply to an *inherited* IRA. The Second District Court of Appeals in *Robertson v. Deeb*, (2D08-6428) found that when an IRA is distributed to its beneficiary, upon the death of the account owner, its tax exempt status changes. The court went on to hold that the legislative intent of exempting individual retirement accounts, to allow debtors to preserve assets designated for retirement, would not be served by protecting an inherited IRA too.

FACTS:

Background:

In *Robertson v. Deeb*, the creditor (Deeb) obtained both a judgment and writ of garnishment against Robertson on an unpaid promissory note. In response to the writ, RBC Wealth Management ("RBC") identified an inherited IRA with cash and securities. Robertson claimed the inherited IRA was exempt from garnishment pursuant to section 222.21(2)(a) of the Florida Statutes.

Robertson argued reliance on an RBC letter informing him of his rights to the IRA and options (an inherited IRA or distributions pursuant to the "five year death rule") as its beneficiary.

The trial court found that section 222.21(2)(a) was not applicable to an inherited IRA and denied the claim of exemption. The court held that "[i]t is not an IRA. It

is not like an IRA in terms of taxing and penalty for early withdrawal and things of that nature, so I don't think that's what [the legislature] meant."

COMMENT:

Section 408 of the Internal Revenue Code ("IRC") provides that an IRA is exempt from income tax until a distribution is taken by the account owner. IRA owners are also required to take distributions (subject to limitations), may roll over his or her account and incur a ten percent penalty for early account withdrawals. Section 222.21(2)(a) of the Florida Statutes further provides that an account's tax exempt status determines its exemption from garnishment.

In contrast, upon the IRA owner's death the tax exempt status of the inherited account changes. Account distributions become exempt from any early withdrawal penalty (I.R.C. § 72(q)(2)) and the inherited account loses its entitlement to rollover treatment (I.R.C. § 408(d)(1)).

Case Law:

In reaching its ruling the court relied upon the prior bankruptcy court decisions of *In re Taylor*, No. 05-93559, (Bankr. C.D. Ill. May 9, 2006); *In re Kirchen*, 344 B.R. 908, 914 (Bankr. E.D. Wis. 2006); and *In re Greenfield*, 289 B.R. 146, 150 (Bankr. S.D. Cal. 2003). The case law evolved from the United States Bankruptcy Court case of *In re Sims*, 241 B.R. 467, 470 (Bankr. N.D. Okla. 1999) in which a chapter 7 debtor claimed an inherited IRA as an exempt asset.

In ruling on the bankruptcy court trustee and creditors objections, the bankruptcy court interpreted an Oklahoma statutory provision that exempted "*any interest in a retirement plan or arrangement qualified for tax exemption purposes under present or future Acts of Congress . . . only to the extent that contributions by or on behalf of a participant were not subject to federal income taxation to such participant at the time of such contributions.*". The court held that an inherited IRA was not a vehicle to defer taxation on income in order to preserve money for retirement and not entitled to creditor exempt status. This conclusion has been subsequently reaffirmed in the cases.

Appellate Decision:

On appeal, the Second District Court of Appeals addressed the issue of whether an IRA loses its tax exempt status under section 222.21(2)(a) upon the death of the original account owner. While acknowledging that section 222.21(2)(a) provides

for exemption from "all claims of creditors of the . . . beneficiary," in reaching its conclusion the court reaffirmed that "inherited IRAs are not entitled to the exemption set forth in section 222.21(2)(a), Florida Statutes (2008)" which is limited to the "original fund or account."

The court further emphasized that section 222.21(2)(a) did not specifically exempt inherited IRAs, which are separate funds or accounts created when the original fund or account passes to its beneficiary upon the death of the original participant.

The court concluded that

"[t]he purpose of the . . . Legislature in exempting individual retirement accounts is to allow debtors to preserve assets which have been earmarked for retirement in the ordinary course of the debtor's affairs. Such a purpose would not be served by upholding [the beneficiary's] request to keep his interest in the IRA as exempt."

In order to properly advise a client it is not only important to know about all of his or her retirement accounts, but each account's history.

Federal Bankruptcy courts have determined that inherited IRA's are not exempt from creditor claims. This knowledge may dramatically impact a client's future planning options.