

# *The Bankler Report*

July 24, 2014

## INTRODUCTION

The Supreme Court, with a unanimous opinion, held that an inherited IRA does not qualify for a bankruptcy exemption. **Therefore, these assets are NOT PROTECTED FROM CREDITORS in bankruptcy.**

### **Background.**

Under Bankruptcy Code §522(b)(3)(C), a debtor may exempt amounts that are both (1) "retirement funds," and (2) exempt from income tax under one of several specified Internal Revenue Code provisions, including Code Sec. 408, which provides a tax exemption for IRAs.

### **Facts.**

In 2001, Heidi Heffron-Clark inherited her deceased mother's traditional IRA, as sole beneficiary. The IRA was worth about \$450,000, and Heidi and her husband Brandon (the Clarks) elected to take monthly distributions from the IRA.

In 2010, the Clarks filed a bankruptcy petition under Chapter 7 of the Bankruptcy Code. In their petition, the Clarks sought to exempt the inherited IRA, then worth about \$300,000, from their bankruptcy estate. The bankruptcy trustee and the Clarks' unsecured creditors objected, arguing that the funds held in the inherited IRA were not "retirement funds" within the meaning of the Bankruptcy Code, and so could not be exempted from the bankruptcy estate under that provision. The bankruptcy court agreed, finding that inherited IRAs don't hold "anyone's" retirement funds, because the funds are not set aside for retirement needs, nor are they distributed upon retirement.

The bankruptcy court's decision was appealed to a federal district court, which reversed the decision and held that the inherited IRA did qualify for the exemption. This decision was again appealed, this time to the Seventh Circuit, which found that the bankruptcy court had gotten it right, and that the Clarks' inherited IRA did not qualify for the exemption.

### **Split among Circuit Courts.**

The Seventh Circuit's decision was at odds with an earlier holding by the Fifth Circuit, so the Supreme Court agreed to hear the case to resolve the split among the Circuit Courts.

### **Conclusion.**

Justice Sotomayor, on June 12, 2014, delivered the opinion for a unanimous court, stating that "text and purpose" of the Bankruptcy Code provided that funds held in inherited IRAs are not "retirement funds" for purposes of the Bankruptcy Code exemption.