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COURT FINDS IRAS EXPOSED TO CREDITORS IN BANKRUPTCY

The general rule in a federal individual bankruptcy is that IRAs and other qualified retirement assets are protected and such assets are not subject to the claims of the individual's creditors. However, in the case of Ernest W. Willis v. Deborah Menotte, Red Reef, Inc. the US Court of Appeals found an exception to that rule. In the Willis case the debtor used his IRA in a way that technically disqualified it for income tax purposes in 1994 and 1997. However, the IRS never caught the technical violations and the statute of limitation ran as to the IRS' claims. In 2007 Mr. Willis filed for a Chapter 7 Bankruptcy, long after the technical violations occurred. Nonetheless, the Bankruptcy Court and the US Court of Appeals ruled that the statute of limitation that applies for tax purposes had no relevance for bankruptcy purposes and the debtors $1.5 million of IRA assets were exposed to creditors. The lesson that should be taken from this is that the statutory rules that create the tax and bankruptcy favored status of these IRAs and retirement accounts must be followed very carefully.