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INHERITED RETIRMENT FUNDS ARE NOT CREDITOR EXEMPT

Chapter 815 of the Wisconsin Statutes provides that certain personal assets are exempt from judgment creditors, and these exemptions can be claimed by individuals when they file federal bankruptcy. Likewise, the federal Bankruptcy Code [11 U.S.C. Section 522(d)] also provides an alternative set of exemptions that the individual can claim instead of using the Wisconsin set. Both sets generally provide for the right of individuals to retain their retirement funds (subject to some limitations) exempt from their creditors in bankruptcy. Section 815.18(3)(j), Stat.; 11 U.S.C. Section 522(d)(12).

There has been a recent local decision, however, denying such exempt status to an inherited IRA (whether originally-formed as an IRA, or a Rollover IRA set up when the decedent withdrew from a company-sponsored retirement plan) under the Wisconsin exemptions. In re Kirchen, Bankr. E.D. Wis. Case No. 04-29434. The bankruptcy trustee in that case successfully established that inherited retirement funds did not meet the requirement under Chapter 815 that the account be a fund for the retirement of the owning debtor, and therefore was not exempt. He directed the IRA issuer to pay out the funds to him to distribute to Kirchen's creditors.

Common definitive language under the Wisconsin law ("on account of … age") is a similar element needed for qualifying such account under the federal exemption set, so undoubtedly a similar ruling will occur if the claim of exemption of an inherited account is presented to local bankruptcy courts under that set. By extension, inherited pension funds (including 401k's) are also at risk.

While under our Wisconsin marital property law, an inherited IRA or retirement fund would not be eligible to collection efforts of many creditors of the other spouse, it is still liable for debts incurred in support of the marriage (if all other assets have been exhausted) and for the liabilities of the recipient spouse. These positions may be overruled by higher courts, but for now, they pose a problem that might be avoided by planning steps that a prudent recipient of an inherited retirement funds can take. For more information and to discuss such planning steps, contact Russell C. Brannen, Jr.