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U.S. SUPREME COURT RULES INHERITED IRAS ARE NOT "RETIREMENT FUNDS" EXEMPT IN BANKRUPTCY PROCEEDINGS

On June 12, 2014, the United States Supreme Court held that funds in an inherited individual retirement account (IRA) are not "retirement funds" within the meaning of the Bankruptcy Code, and therefore such funds are not exempt from creditor claims in bankruptcy proceedings.

Ordinarily, when a debtor files for bankruptcy relief, his or her legal and equitable interests in property become part of the bankruptcy estate available to satisfy valid creditor claims. However, the Bankruptcy Code exempts debtors' interests in certain property in order to help debtors obtain a fresh start. Pursuant to 11 U.S.C. § 522(b)(3)(C), debtors are allowed to protect "retirement funds" to the extent they are held in a fund or account exempt from taxation under specified provisions of the Tax Code, such as an IRA.

According to the Court, "retirement funds" are sums of money set aside for the day an individual stops working. Consequently, the Court looked to the legal characteristics of inherited IRAs—as opposed to debtors' personal IRAs—to determine whether such accounts contain funds set aside for the day when the account owner stops working.

The Court held that three legal characteristics of inherited IRAs prevent the funds from coming within the meaning of "retirement funds." First, the owner of an inherited IRA cannot contribute additional money to the account. Second, an owner of an inherited IRA is required to withdraw funds from the account no matter how far he or she is from retiring from the workforce. Third, the owner of an inherited IRA may withdraw all of the funds in the account without incurring a penalty under the Tax Code. If inherited IRAs were exempt under the Bankruptcy Code, a debtor could obtain bankruptcy relief and immediately thereafter withdraw all funds from his or her inherited IRA to purchase a new home, take an extravagant vacation, or go on a shopping spree, even while valid creditor claims went unsatisfied in the bankruptcy proceedings. Since inherited IRAs are not "retirement funds" exempt from a debtor's estate in bankruptcy proceedings, such funds may be used to satisfy valid claims of creditors.

The Court noted that its holding is consistent with the purpose of the Bankruptcy Code's

exemptions, and balances the interests of debtors and creditors.