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IRA's and Income Tax and Creditor Protection Planning

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Dedon on Estate Planning

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Besides the equity in their homes, **many Americans** have most of their wealth in their **qualified retirement assets**. Retirement assets often are held in IRA's, as employees rollover 401(k)'s and other retirement accounts into one or more IRA's. How to protect and pass the IRA assets to descendants is a complex topic.

Regarding income tax issues, IRA's grow income tax free over an owner's lifetime. Upon death, the IRA balance can be subject to both estate and income tax. How the income tax is treated to the beneficiary differs significantly on whether the beneficiary is a surviving spouse, a child, a trust or a charity. The income tax consequences to the beneficiary are huge - depending on the beneficiary choice, there may be no income tax; or the income tax may be spread out over a lifetime; or the income tax may need to be paid within a short period of time, such as 5-years. Not many tax professionals understand these rules, much less the IRA owners.

Regarding protecting IRA assets, IRA's and other qualified retirement assets also enjoy creditor protection, meaning if the owner is sued or files bankruptcy, the IRA may be a protected asset. The protection can arise under federal and state law. Here again, there is a great deal of misinformation and confusion regarding exactly what kind of IRA may or may not be asset protected. The Courts are still deciding asset protection issues pertaining to IRA assets, including the U.S. Supreme Court.

A June 12, 2014 Supreme Court decision, **Clark v. Rameker**, held that an "inherited IRA" was not a protected retirement fund under federal law. The Clark case dealt with an IRA inherited by the IRA owner's daughter. The daughter was not able to protect the IRA from her own creditors.

Thus, when it comes to IRA's and creditor protection, similar to IRA's and income tax treatment, the planning becomes paramount. For example, would Clark have been decided differently if the beneficiary was a surviving spouse who rolled the IRA to his/her own IRA? Probably. What if Mom had directed her IRA to a spendthrift trust for her daughter? The IRA would likely have been protected. Does state law matter? Yes.

Planning for IRA's will continue to be a critical and evolving area of the law.