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## Inconsistent Rulings Should Cause an IRA Beneficiary to Consider Alternative Inheritance Methods

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Despite the differing treatment of inherited IRAs under Federal, New York, and New Jersey law, clients may be best served to inherit IRAs in trusts or other asset protection vehicles rather than outright so as to provide an important layer of protection against the claims of the beneficiary's creditors. In a recent decision impacting inherited individual retirement accounts ("IRAs"), the bankruptcy court for the Northern District of New York has determined that inherited IRAs are not exempt from a bankruptcy trustee's reach under New York law. This case brings New York's treatment of inherited IRAs in bankruptcy in conformity with the treatment of inherited IRAs under the federal exemption, which does not allow for inherited IRAs to be exempt, but creates a conflict with New Jersey cases that have reached the opposite result.

In *In re Todd*, the court reviewed whether an IRA inherited by the debtor was exempt from the claims of her creditors under the New York state bankruptcy exemption. The debtor employed New York's state law exemptions (rather than the federal exemptions). Under New York state law, assets held in a non-self-settled trust for the benefit of a debtor are exempt from the beneficiary's creditors. The court, however, concluded that such exemption does not apply to inherited IRAs because the beneficiary of an inherited IRA maintains exclusive control over the trust.

The debtor in *Todd* argued that under New York law, assets in a qualified individual retirement account, as the term is used by the Internal Revenue Code, are exempt from the claims of the beneficiary's creditors. After finding the exemption statute ambiguous and detailing its legislative history, the court concluded that inherited IRAs do not fall into the exemption because inherited IRAs do not receive the same tax treatment as IRAs established by individuals for their own retirement because of the critical differences between an inherited IRA and an individual's own IRA.

The *Todd* decision is consistent with the United States Supreme Court's decision in *Clark v. Rameker*, which held that inherited IRAs are not exempt from the bankruptcy estate under federal law. In sharp contrast to the *Todd* and *Clark* line of cases, in *In re Andolino*, the New Jersey bankruptcy court determined that funds held in inherited IRAs are not property of the bankruptcy estate and therefore are not reachable by the beneficiary's creditors. A qualifying trust, under New Jersey law, expressly includes trusts created under the applicable section of the Internal Revenue Code. Under New Jersey law, therefore an inherited IRA is still a qualified retirement plan the Internal Revenue Code is therefore not subject to liquidation by the bankruptcy estate.

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Given the disparate treatment of inherited IRAs in New York and New Jersey, it is advisable to consider alternatives to directly inheriting IRAs. By placing IRAs in trust for the benefit of beneficiaries with creditors, beneficiaries may avoid the differing jurisdictional issues and may provide better certainty that a decedent's IRA will be protected from the claims of a beneficiary's creditors.

If you have questions about the information contained in this alert, please contact Damien Tancredi or any member of Flaster Greenberg's Bankruptcy, Financial Restructuring and Risk Management Department.

**ATTORNEYS MENTIONED**

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