

Pennsylvania Superior Court: No Creditor Protection for Inherited IRAs

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Under longstanding Pennsylvania law, retirement savings vehicles like individual retirement accounts (IRAs), 401(k) and 403(b) accounts, pensions, and employee stock ownership plans (ESOPs) are generally exempt from creditor claims. 42 Pa.C.S. § 8124(b)(1) prohibits judgment creditors from attaching or executing upon funds in such accounts, with some exceptions. Since the statute does not mention inherited IRAs, there has been uncertainty about whether they are afforded the same protection. Last January, the Superior Court of Pennsylvania resolved this ambiguity by finding that inherited IRAs are categorically different than IRAs and are therefore vulnerable to creditor claims.

IRA owners can and should designate beneficiaries to receive the account after death, thereby creating "inherited IRAs" owned by the beneficiaries. Inherited IRAs are subject to different rules than IRAs created during one's lifetime. Under the 2019 SECURE Act, inherited IRAs must be drawn down within ten years of the original owner's death unless the beneficiary is an "eligible designated beneficiary," *i.e.*, a surviving spouse, a disabled or chronically ill individual, an individual not more than ten years younger than the original owner, or a child of the original owner who has not reached the age of majority. If the beneficiary of the original IRA is a trust or other entity, it must be fully distributed within five years (with some exceptions, of course).

In *Jones v. McGreevy*, 2022 PA Super 8 (1/11/2022), Debtor owed money to Creditor after failing to make payments under a purchase agreement. Creditor sued Debtor and obtained a judgment in his favor. Creditor then attempted to collect on the judgment by garnishing Debtor's various accounts, including an inherited IRA from Debtor's father. In defense, Debtor claimed the inherited IRA was exempt from execution under section 8121(b)(1). After a bench trial, the court agreed with Debtor and ordered the banks to unfreeze his assets.

Since the court could find no prior Pennsylvania case law regarding the exemption of inherited IRAs, the Superior Court looked to the U.S. Bankruptcy Code for guidance. Like Pennsylvania, 11 U.S.C. § 522 exempts certain "retirement funds" from the reach of creditors. The Code is also silent about inherited IRAs.

In *Clark v. Rameker*, a 2014 U.S. Supreme Court case, the debtor declared bankruptcy and attempted to shield his inherited IRA from creditor claims. The Court was asked to resolve a split between two federal courts of appeal: the Seventh Circuit ruled that inherited IRAs are not protected "retirement funds" while the Fifth Circuit came to the opposite conclusion. *In re Clarke*, 714 F.3d 559 (7th Cir. 2013); *In re Chilton*, 674 F.3d 486 (5th Cir. 2012).

Retirement funds are exempt because they are designed to "ensure that debtors will be able to meet their basic needs during their retirement years." *Clark*, 573 U.S. 122, 129 (2014). Early withdrawal penalties discourage accountholders from accessing IRA funds prior to retirement. There are no penalties for withdrawing funds from inherited IRAs (besides paying income taxes on the distribution). On the contrary, many (if not most) post-SECURE Act inherited IRAs must be completely withdrawn within ten years. The Court found inherited IRAs to be closer in kind to checking accounts. For these reasons, the Court unanimously ruled that assets held in inherited IRA accounts are not "retirement funds" subject to the bankruptcy exemption and may be distributed to creditors under a bankruptcy plan.

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Although the Bankruptcy Code and Pennsylvania debt collections laws are unrelated, the *Jones* court found the two statutes have a shared purpose: both seek to satisfy creditors while also protecting debtors from being "left destitute and a public charge" by exempting retirement assets from execution. *Jones*, 2022 PA Super at 34 (quoting *Clark*, 573 U.S. at 129 n.3). On the other hand, inherited IRAs "represent an opportunity for current consumption, not a fund of retirement savings." *Id.* (quoting *Clark*, 714 F.3d at 562). The Pennsylvania Superior Court applied the rule from *Clark*, holding that inherited IRAs are not exempt from creditor claims under 42 Pa.C.S. § 8124(b)(1).

If you have questions or would like more information, please contact Andrew J. Barron (barrona@whiteandwilliams.com; 215.864.7167) or another member of the Tax and Estates Group.

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