

NEW IRA RULES WREAK HAVOC ON TAXABLE INCOME & LEAVE INHERITED IRAS AT THE MERCY OF BANKRUPTCY CREDITORS

Comment

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I. INTRODUCTION

The volatility of our country's economic state constantly remains at the forefront of our minds.¹ Planning for retirement is one way many individuals shield themselves and their beneficiaries from the uncertainty that lies ahead.² Individual Retirement Accounts (IRAs) have become a source of tax benefits and flexibility that aid estate planners in preparing not only an individual's retirement, but also sustainability for their benefactors.³ However, two recent opinions from the United States Supreme Court and United States Tax Court make IRAs more nuanced in their practical application.⁴ Estate planners must now consider the effects of these decisions on their individual clients and assess how to restructure their estates to allow for optimal asset protection.⁵

This comment will address each decision separately, specifying the implications of the new rule interpretations for different individuals.⁶ Many factors influenced each of these court's decisions.⁷ In *Clark v. Rameker*, the Court settled an ongoing debate among jurisdictions as to whether inherited IRAs qualified as "retirement funds" that receive exclusions from bankruptcy estates.⁸ The Court held that when a beneficiary inherits an IRA, the account loses the qualities that made it a retirement fund, and thus, can no longer receive the bankruptcy exemption.⁹ From an estate planning perspective, individuals should consider alternatives to the inherited IRA as a device to

1. See generally Frank Newport, Jeffrey M. Jones & Lydia Saad, *Americans' Views on 10 Key State of the Union Proposals*, GALLUP (Jan. 23, 2015), http://www.gallup.com/poll/181256/americans-views-key-state-union-proposals.aspx?utm_source=Politics&utm_medium=newsfeed&utm_campaign=tiles (highlighting Americans' concerns with minimum wage, taxes, and unemployment).

2. Christine C. Marcks, *Achieving Retirement Security in an Era of Uncertainty: Three Important Steps*, PRUDENTIAL (2012), <http://news.prudential.com/images/20026/AchievingRetirementSecurity.pdf>.

3. See Robert J. Ruth, *Basic Retirement Planning for Lawyers*, FLA. B.J., May 1995, at 64.

4. See generally *Clark v. Rameker*, 134 S. Ct. 2242 (2014) (holding that bankruptcy creditors should not exempt inherited IRAs as retirement funds); *Bobrow v. Comm'r*, 107 T.C.M. (CCH) 1110 (2014) (holding the one-rollover-per-year rule applies to individual account holders, not individual accounts).

5. See generally Karen K. Suhre, *Clark v. Rameker: Effects on Tax-Qualified Retirement Plans*, 2014 A.B.A. Tax-CLE 0919034 (2014) (explaining the effects of the Court's decision on certain types of retirement accounts and how to protect those plans from beneficiary creditors). See also Robert Powell, *IRA Rollover Rule Stuns Advisers and Savers*, MONEY WATCH (Apr. 4, 2014, 5:00 AM), <http://www.marketwatch.com/story/ira-rollover-ruling-stuns-advisers-and-savers-2014-04-04> (advising IRA holders to plan ahead, use transfers instead of IRA rollovers, and check with their IRA custodians).

6. See *infra* Parts IV–V.

7. See *Clark*, 134 S. Ct. 2242; see also *Bobrow*, 107 T.C.M. (CCH) 1110.

8. *Clark*, 134 S. Ct. at 2243.

9. *Id.*

transfer wealth to beneficiaries, especially those who anticipate beneficiary bankruptcy.¹⁰

In *Bobrow v. Commissioner of Internal Revenue*, the tax court ruled against a previous and longtime IRS-endorsed rule regarding IRA rollovers.¹¹ Previously, the IRS rules allowed one IRA rollover per year, per one IRA account.¹² Those with more than one IRA account could theoretically rollover funds more than once per year.¹³ However, this decision tightens the reins on rollovers, changing the rule to allow only one rollover per year, *per person*.¹⁴ Though this may only affect those who have multiple IRA accounts, there is a much stronger underlying message from the courts: you cannot and should not borrow from your IRA.¹⁵

Throughout the analysis of each case, this comment will describe the estate planning and tax implications for different types of clients.¹⁶ Ultimately, this comment will provide insight and serve as a guide for an estate planner to optimally reorganize an estate based on these rulings for individuals with different needs.¹⁷ Based on the courts' reasoning, as well as the current political climate, this comment will explore predictions about where the legislature and courts will take matters involving retirement accounts, and serve as a useful tool for those individuals attempting to structure their future financial position.¹⁸

II. INDIVIDUAL RETIREMENT ACCOUNTS – THE BASICS

This section provides a basic background explanation of IRAs, and how estate planners and individuals utilize them.¹⁹ A major function of retirement accounts rests in the unique tax benefits, and this section offers a brief overview of how the Internal Revenue Code (IRC) treats these accounts.²⁰ Brief descriptions of some of the most commonly used IRA types serve as a basic foundation upon which application of certain rules will be based.²¹ IRAs receive protection from bankruptcy in some instances, which this section will address more specifically.²²

10. See *infra* Part IV.

11. *Bobrow*, 107 T.C.M. (CCH) 1110, at 4.

12. See I.R.S. Pub. 590 (2013).

13. See *id.*

14. See *Bobrow*, 107 T.C.M. (CCH) 1110, at 3.

15. Jeff Reeves, *New IRA Rollover Rules Hit Wealthiest Savers*, USA TODAY (Apr. 6, 2014, 7:04 AM), <http://www.usatoday.com/story/money/personalfinance/2014/04/06/irs-ira-rule-change-rollover/7317035/>.

16. See *infra* Part VI.

17. See *infra* Part VI.

18. See *infra* Parts IV–VI.

19. See *infra* Part II.A.

20. See *infra* Part II.B.

21. See *infra* Part II.C.

22. See *infra* Part II.D.

A. IRAs Defined

The IRC defines an IRA as a trust created for the exclusive benefit of an individual or their beneficiaries.²³ The trust must meet several requirements: an annually acceptable cash contribution, a trustee who is either a bank or individual who will follow specific guidelines, no funds invested in life insurance, nonforfeitable account interest, no comingling of assets unless in a common trust or investment fund, and compliance with the rules for distribution set forth by section 401 of the IRC.²⁴ It is a common misconception that an IRA is an investment; rather it is “just the basket in which you keep stocks, bonds, mutual funds and other assets.”²⁵ Financial institutions provide that anyone earning income under 70½ years of age may participate in an IRA.²⁶ IRAs are different from 401(k)s, but the IRC provides for a type of employer-based IRA where an employer establishes an account for the exclusive benefit of their employees; this account must meet the IRA requirements, and it supplies a separate accounting for each employee’s interest.²⁷ Not only do differences exist between IRAs and 401(k)s, but investors utilize many different types of IRAs, all with different characteristics, which this comment will later discuss.²⁸

B. Tax Treatment

Although different types of retirement accounts receive different tax treatment, many consumers generally view IRAs as savings accounts that supply tax advantages as an incentive for retirement planning.²⁹ The IRC provides that the payee of any contribution to, or distribution from, an IRA must include that amount in their gross income.³⁰ However, depending on individual circumstances, a traditional IRA may deduct the contribution from taxable income and may not tax account earnings or gains until distribution.³¹ Section 219 of the IRC allows for a yearly taxable deduction for qualified contributions and sets out the maximum deductible amount.³²

23. I.R.C. § 408(a) (2012).

24. *See id.*

25. *Ultimate Guide to Retirement*, CNN: MONEY, http://money.cnn.com/retirement/guide/IRA_Basics.moneymag/ (last visited Oct. 15, 2014).

26. Scott Holsopple, *Retirement Basics: IRA or 401(k)?*, U.S. NEWS & WORLD REPORT: MONEY (Feb. 6, 2013, 12:40 PM), <http://money.usnews.com/money/blogs/the-smarter-mutual-fund-investor/2013/02/06/retirement-basics-ira-or-401k>.

27. I.R.C. § 408(c); *see also* Holsopple, *supra* note 26 (explaining the similarities and differences between IRA and 401(k) accounts).

28. *See infra* Parts I.C.1–3.

29. I.R.S. Pub. 17 (2013).

30. I.R.C. § 408(d)(1).

31. I.R.S. Pub. 17.

32. I.R.C. § 219.

C. Types of IRA Accounts

Different types of IRAs allow individuals to make use of the account in a way that best suits their needs with respect to taxes, contributions, and distributions.³³ This section describes the basic types of accounts used though many more complex combinations may exist and remain beyond the scope of this comment.³⁴

1. Traditional IRA

As mentioned above, traditional IRAs take contributions from individuals and employers that can be both deductible and nondeductible.³⁵ Account holders subtract deductible contributions from taxable income and do not pay taxes until withdrawal from the account.³⁶ This tax deferral allows dividends, interest payments, and capital gains to grow at a much faster rate than other types of accounts.³⁷ Nondeductible contributions do not provide an immediate benefit but instead allow for a tax benefit later; withdrawals do not require payment of taxes.³⁸ Making a withdrawal from a traditional IRA before age 59½ constitutes an early withdrawal, which results in a penalty of ten percent, and factors the amount withdrawn into taxable income for that year, which constitutes a double taxation of those funds.³⁹ After age 70½, account holders must make required minimum distributions (RMDs) and can no longer make contributions.⁴⁰

2. Roth IRA

A Roth IRA, though subject to all of the same rules as a traditional IRA, has a few different characteristics.⁴¹ An individual must designate a Roth IRA as a Roth at the time they open the account.⁴² These accounts will not receive deductions for contributions but may receive tax exemptions for certain qualified distributions.⁴³ Unlike traditional IRAs, Roth IRAs can receive contributions for the entire life of the account holder and do not require minimum distributions during the owner's lifetime.⁴⁴

33. See *infra* Parts I.C.1–3.

34. See *infra* Parts I.C.1–3.

35. INDIVIDUAL RETIREMENT PLANS GUIDE ¶ 1005 (Wolters Kluwer 2015), available at 2009 WL 3925670.

36. *Id.*

37. *Ultimate Guide to Retirement*, *supra* note 25.

38. INDIVIDUAL RETIREMENT PLANS GUIDE, *supra* note 35.

39. *Id.*

40. I.R.S. Pub. 17 (2013).

41. *Id.*

42. *Id.*

43. *Id.*

44. *Id.*

3. SEP & SIMPLE IRAs

Simplified Employee Pensions (SEP) IRAs are a type of traditional IRA for small business owners and self-employed individuals that the employees hold in their name.⁴⁵ The SEP receives contributions only from the employer, maintains a higher contribution limit, and is not taxable until withdrawal.⁴⁶ A Savings Incentive Match Plan for Employees (SIMPLE) IRA has the same characteristics as the SEP, except employees may make contributions to their own account.⁴⁷ Additionally, the plan requires the employer to make a separate contribution on behalf of their employees, whether the employees make a contribution themselves or not.⁴⁸

D. IRAs in Bankruptcy

Legislators added the Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA) to the Bankruptcy Code in 2005.⁴⁹ BAPCPA attempted to create a national uniform rule regarding bankruptcy exemptions for tax-favored retirement accounts.⁵⁰ The Bankruptcy Code provides protection for certain assets like homesteads and retirement funds to allow debtors to maintain a standard of living that does not leave them reliant on the government for support.⁵¹

Retirement plan assets receive exemption if they are held by a tax-qualified retirement plan under sections 401(a), 403(b), or 457 of the IRC; or an IRA under sections 408 or 408A of the IRC.⁵² The tax-qualified plans under these sections include: qualified pension; profit-sharing and stock bonus plans created by employers for employees; tax-sheltered annuities offered by public schools and certain tax-exempt organizations that receive contributions from both employers and employees; and deferred compensation plans available to certain state and local governments and other nongovernmental entities.⁵³ Additionally, all IRAs that qualify under sections 408 including Traditional, Roths, SEPs, and SIMPLE IRAs, as well as individual retirement annuities, will receive bankruptcy protection.⁵⁴

45. *Ultimate Guide to Retirement*, *supra* note 25.

46. *Id.*

47. *Id.*

48. *Id.*

49. Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, 119 Stat. 23 (2005) (codified as amended in scattered sections of 11 U.S.C.).

50. Suhre, *supra* note 5.

51. Michael Kitces, *An Inherited IRA Is Not a "Retirement" Account for Bankruptcy Protection Under Clark v. Rameker Supreme Court Case*, NERD'S EYE VIEW (June 25, 2014), <http://kitces.com/blog/an-inherited-ira-is-not-a-reitirement-account-for-bankruptcy-protect-under-clark-v-rameker-supreme-court-case/>.

52. 11 U.S.C. § 522(b)(3)(C) (2012).

53. I.R.C. §§ 401(a), 403(b), 457 (2012).

54. *Id.* §§ 408, 408A.

Traditional and Roth IRAs receive a cumulative \$1,245,475 exemption from bankruptcy proceedings.⁵⁵ SEPs and SIMPLE IRAs receive exemption without a dollar amount limitation.⁵⁶ Rollovers from qualified plans, or sections 403(b) or 457 plans, also do not have dollar amount limitations on exemptions.⁵⁷ Rollovers from SEPs or SIMPLE IRAs may only receive a \$1,000,000 exemption.⁵⁸

III. TWO COURT DECISIONS MAKE CHANGES TO IRAS

Within the last year, both the United States Supreme Court and the United States Tax Court addressed historically disputed issues regarding IRAs.⁵⁹ This section provides a background of each case individually and the reasoning that led to the courts' ultimate decisions.⁶⁰

A. Clark v. Rameker

"In 2000, Ruth Heffron established a traditional IRA and named her daughter, Heidi Heffron-Clark, as the . . . beneficiary."⁶¹ After Heffron's death in 2001, her IRA, worth \$450,000, passed to her daughter and, thus, constituted an inherited IRA.⁶² Nine years later, the daughter, Mrs. Heffron-Clark, filed for Chapter 7 bankruptcy and sought to exempt the inherited IRA from bankruptcy creditors.⁶³ The Bankruptcy Code provides that an individual debtor may exempt retirement funds subject to the specific fund qualifications mentioned above.⁶⁴

1. Inherited IRAs

An IRA receives inherited treatment if the individual received the account by reason of death of another individual who was not the receiver's spouse.⁶⁵ Inherited IRAs differ from regular IRAs with regard to rules concerning the use, distribution, and taxation of the funds.⁶⁶ The individual

55. Richard A. Naegele, *Protection of IRA and Qualified Retirement Plan Assets After Clark v. Rameker*, A.B.A. (July 25, 2014), <http://www.wickenslaw.com/wp-content/uploads/2014/09/Handout-Protection-of-IRA-Qualified-Retirement-Plan-Assets-After-Clark-v-Rameker-8-19-14.pdf>.

56. *Id.*

57. *Id.*

58. *Id.*

59. See *infra* Parts III.A–B.

60. See *infra* Parts III.A–B.

61. Clark v. Rameker, 134 S. Ct. 2242, 2245 (2014).

62. *Id.*

63. *Id.*

64. See 11 U.S.C. § 522 (2012); see also *supra* Part II.D.

65. I.R.C. § 408(d)(3)(C)(ii) (2012).

66. James L. Boring et al., *Protection of Inherited IRAs*, 36 ACTEC L.J. 577, 582 (2010) (discussing the difference between IRAs inherited from spouses and IRAs inherited from others).

must withdraw the entire balance within five years or take annual minimum distributions, without tax penalty; additionally, the individual may never make contributions to the account.⁶⁷

An IRA inherited from a spouse has different implications than other inherited IRAs.⁶⁸ One main difference is that the spouse may make individual contributions to the IRA and essentially treat the account as his or her own.⁶⁹ The spouse must be the sole named beneficiary—a trustee named as a beneficiary makes the spousal rules inapplicable even when the spouse is the sole trust beneficiary.⁷⁰ Once the spouse elects to treat the IRA as his or her own, the regular distribution rules apply.⁷¹

Before this case, the treatment of inherited IRAs differed greatly among jurisdictions.⁷² While the majority of cases resulted in nonexempt inherited IRAs, some courts still upheld the bankruptcy exception.⁷³ The issue across jurisdictions became the means by which courts made their decisions, ultimately producing a lack of guidance for future applications of such cases.⁷⁴

2. *The Supreme Court Speaks*

The Supreme Court decided in a 9-0 decision to end the debate, holding that the law does not consider inherited IRAs to be “retirement funds,” thus concluding they should not receive treatment as such.⁷⁵ The Court gave three distinguishing factors of inherited IRAs that justify why they should not shield those accounts from bankruptcy: (1) the holder of the inherited IRA may never make contributions to the account; (2) inherited IRAs require the holder to make distributions; and (3) the holder may withdraw the full balance of the IRA account at any point in time without penalty.⁷⁶ The Court expressed concerns that “nothing about the inherited IRA’s legal characteristics would prevent (or even discourage) the individual from using the entire balance of the account on a vacation home or sports car immediately after her bankruptcy proceedings are complete.”⁷⁷ The Court

67. *See id.*

68. I.R.C. § 408(d)(3)(C)(ii)(II).

69. *See* Treas. Reg. § 1.408-8 (as amended in 2014).

70. *See id.*

71. *See id.*

72. *See* Boring et al., *supra* note 66, at 579.

73. *See id.* at 582–91; *see also In re McClelland*, No. 07-40300, 2008 WL 89901, at *1 (Bankr. D. Idaho Jan. 7, 2008) (finding an inherited IRA exempt from bankruptcy and stating the legislature did not “limit the scope of protection to retirement account owners only”). *See generally In re Nessa*, 426 B.R. 312 (B.A.P. 8th Cir. 2010) (finding the inherited IRA exempt because the account must only contain someone’s retirement funds, not the debtor’s retirement funds specifically).

74. *See* Boring et al., *supra* note 66, at 579.

75. *Clark v. Rameker*, 134 S. Ct. 2242, 2243 (2014).

76. *Id.* at 2247.

77. *Id.* at 2248.

pointed to the purpose of the Bankruptcy Code exemption provisions as balancing creditor and debtor interests, with which it suggested this decision lies in tandem.⁷⁸ Ultimately, this decision removes the protection from IRAs coming in from family members that many—especially those with bankruptcy concerns—have relied on.⁷⁹

Because the parties in *Clark* did not involve spouses, the Court's statements regarding a spouse's choice to rollover funds do not necessarily represent part of the case's holding.⁸⁰ Though not specifically, the Court seemed to imply that a spouse who elects to rollover the inherited IRA to his or her own IRA would receive bankruptcy protection.⁸¹ If the beneficiary spouse left the funds classified under an inherited IRA, the spouse would be subject to the rules set forth in *Clark*.⁸² Additionally, a surviving spouse does not necessarily have to begin taking RMDs immediately, which the Court enumerated as one of the three reasons for inherited IRA disqualification under *Clark*.⁸³

Petitioners argued that inherited IRAs have similar qualities to Roth IRAs and should receive the same qualification as retirement funds; both Roth and inherited IRAs may withdraw contributions without penalty.⁸⁴ The Court distinguished the two accounts by providing that Roth IRAs are not subject to penalty due to taxation of the funds at the time of contribution.⁸⁵ Additionally, Roth IRA holders have an incentive to use funds only upon retirement due to the capital gains and investment income pre-59½ withdrawal penalty.⁸⁶

3. State Exemption Statutes

Some states have exemptions under the Bankruptcy Code that allow in-state residents to opt out of the federal bankruptcy system.⁸⁷ If the individual chooses to claim the state rather than federal exemption, only the state's particular exemption statutes limit the debtors.⁸⁸ However, states may opt out of the federal exemption statutes altogether, which requires their citizens to follow only that state's exemption statutes and forbids the use of federal

78. *Id.* at 2247.

79. *See id.* at 2250.

80. Alson R. Martin, *Supreme Court Rules Inherited IRA Funds Not Exempt in Bankruptcy*, A.B.A., http://www.americanbar.org/content/dam/aba/administrative/real_property_trust_estate/committee/rp549000/martin_supreme_court_inherited_ira_07232014.authcheckdam.pdf (last visited Nov. 4, 2014).

81. *Id.*

82. *Id.*

83. *Id.*

84. *Clark*, 134 S. Ct. at 2250.

85. *Id.*

86. *Id.*

87. 11 U.S.C. § 522(b)(3) (2012).

88. *Id.*

exemption statutes.⁸⁹ For inherited IRAs, the statute must specifically include the term “inherited IRAs” in order for a court to definitively declare them retirement accounts.⁹⁰ Texas is one state that specifically exempts inherited IRAs from satisfaction of debts in bankruptcy.⁹¹ Other states include Alaska, Arizona, Florida, Idaho, Kansas, New York, Missouri, North Dakota, South Carolina, and Ohio, which have either exemption statutes or favorable case law that interprets inherited IRAs as retirement funds.⁹² Otherwise, courts may interpret the state statute to either include or exclude inherited IRAs.⁹³ Following *Clark*, however, courts are likely to rely on the Supreme Court interpretation and find inherited IRAs unprotected.⁹⁴

One important caveat to the state exemption rule remains prevalent and often overlooked: the debtor, rather than the deceased, receives the exemption, thus the state in which the debtor resides will determine whether the inherited funds receive the exemption.⁹⁵ This becomes problematic due to the potential for beneficiaries to move around; “trying to guess the state in which the debtor will be [a] resident when the exemption is tested might be a low-odds proposition.”⁹⁶

B. Bobrow v. Commissioner of Internal Revenue

Husband and wife, Alvan and Elisa Bobrow, each retained individual traditional IRAs as well as a joint checking account.⁹⁷ In addition to the traditional IRA, Mr. Bobrow maintained a rollover IRA and an individual checking account.⁹⁸ Over the course of four months, the couple made several distributions and repayments between their accounts.⁹⁹ The Commissioner of Internal Revenue determined a deficiency existed in the couple’s reportable income due to these distributions.¹⁰⁰ Specifically, Mr. Bobrow withdrew funds from both his traditional IRA and rollover IRA, and Mrs.

89. See 3A BANKR. SERVICE L. ED. § 29:13 (2015).

90. Boring et al., *supra* note 66, at 581.

91. TEX. PROP. CODE ANN. § 42.0021 (West 2013).

92. See ALASKA STAT. § 09.38.017 (2013); ARIZ. REV. STAT. ANN. § 33-1126(B) (2013); FLA. STAT. § 222.21 (2011); IDAHO CODE ANN. § 55-1011 (West 1999); KAN. STAT. ANN. § 60-2308 (2014); N.Y. C.P.L.R. 5205(c) (McKinney 2011); MO. REV. STAT. § 513.430 (2014); N.C. GEN. STAT. ANN. § 1C-1601(a)(9) (West 2013); OHIO REV. CODE ANN. § 2329.66(A)(10) (West 2013); S.C. CODE ANN. § 15-41-30 (2012).

93. Boring et al., *supra* note 66, at 581.

94. See *Clark v. Rameker*, 134 S. Ct. 2242, 2250 (2014).

95. Jay Adkisson, *Inherited IRA Not Exempt from Creditors in Bankruptcy, Says Sotomayor*, FORBES (June 12, 2014, 11:35 PM), <http://www.forbes.com/sites/jayadkisson/2014/06/12/inherited-ira-not-exempt-from-creditors-in-bankruptcy-says-sotomayor/2/>.

96. *Id.*

97. *Bobrow v. Comm’r*, 107 T.C.M. (CCH) 1110, at 1 (2014).

98. *Id.*

99. *Id.*

100. *Id.*

Bobrow distributed funds from her traditional IRA.¹⁰¹ The parties agreed that Mr. Bobrow transferred the funds within the designated sixty-day time period to his traditional IRA, but disagreed as to which distribution the transfer applied—the distribution from his traditional IRA or the distribution from his rollover IRA.¹⁰² An additional dispute remained as to whether Mrs. Bobrow should include partial repayment of her traditional IRA distribution in gross income due to an error on behalf of Fidelity who did not submit the repayment until sixty-one days after the distribution.¹⁰³

Ultimately, the court considered: (1) whether the petitioners should include any of the IRA distributions in gross income; (2) whether they were liable for early distributions; and (3) whether they should receive an accuracy-related penalty for their reporting deficiencies.¹⁰⁴ Essentially, the Bobrows' reliance on the one-rollover-per-year rule's separate application to each type of IRA caused the Commissioner to further inquire into these transactions.¹⁰⁵

1. Rollover Rules, Previously

The IRC provides that normal distribution requirements do not apply to distributions made from one IRA to another IRA, when the purpose of the distribution is for the benefit of the distributee within sixty days.¹⁰⁶ An individual may make only one rollover of that type in any one-year period.¹⁰⁷ Even more specifically, the IRS tried to clarify the rule through IRS Publication 590, which suggested the limitation applies on an IRA-by-IRA basis.¹⁰⁸

The actual rule language supplies general terms, making its consistency with respect to interpretation and application somewhat difficult.¹⁰⁹ The IRC states an individual does not have to include IRA distributions in their reported gross income if “the entire amount received . . . is paid into *an* individual retirement account . . . for the benefit of such individual not later than the sixtieth day after the day on which he receives the payment or distribution.”¹¹⁰

101. *Id.*

102. *Id.*

103. *Id.* at 2.

104. *Id.* at 1.

105. *Id.* at 2. Although the Bobrows' relied on the one-rollover-per-year rule, they failed to adequately cite any authority for that belief. *Id.* at 11.

106. I.R.C. § 408(d)(3)(A)(i) (2012).

107. *Id.* § 408(d)(3)(B).

108. I.R.S. Pub. 590 (2013).

109. I.R.C. § 408(d)(3)(A); *Bobrow*, 107 T.C.M. (CCH) 1110, at 12.

110. I.R.C. § 408(d)(3)(A)(i) (emphasis added).

2. Court's Holding and Reasoning

Essentially, the U.S. Tax Court held that the “an” before an individual retirement account meant only one IRA.¹¹¹ The court stated that individuals could not make a nontaxable rollover from one IRA to another IRA if they have already made a rollover from *any* of their IRAs in the preceding one-year period.¹¹² “In other words, a taxpayer who maintains multiple IRAs may not make a rollover contribution from each IRA within one year.”¹¹³ The court said the language of the statute “is not specific to any single IRA maintained by an individual but instead applies to all IRAs maintained by a taxpayer.”¹¹⁴

This means that taxpayers must include, in gross income, any previously untaxed amounts distributed from an IRA if the rollover took place in the preceding twelve months.¹¹⁵ Additionally, if the IRS or a court considers the rollover funds as an early distribution, taxpayers may be subject to a 10% early withdrawal tax on the amount included in gross income.¹¹⁶ Payment to another or to the same IRA may fall into the category of excess contributions and may receive taxation at 6% per year for as long as those funds remain in the account.¹¹⁷

This decision highlights the court hampering down on enforcement in light of the purpose for utilizing IRAs in the first place.¹¹⁸ The decision is not as much about IRA transfers as it is about the “practice of tapping into IRA money under the guise of a rollover and then having 60 days to play with it tax-free.”¹¹⁹ The purpose of this type of account is not for borrowing but for putting money away to secure funds for retirement, which the court’s decision accurately reflects.¹²⁰

This decision came as a shock to not only the Bobrows but to IRA account holders and judges who relied on IRS Publication 590, which previously stated that an individual could make one rollover within a twelve month period, per IRA account.¹²¹ Essentially, someone relying on the IRS Publication for guidance would receive a contrary ruling from the tax court with regard to more than one rollover.¹²² In an amicus curiae brief, attorneys

111. *Bobrow*, 107 T.C.M. (CCH) 1110, at 5; *see supra* Part III.B.2.

112. *Bobrow*, 107 T.C.M. (CCH) 1110, at 6.

113. *Id.* at 5.

114. *Id.* at 5.

115. *Id.*

116. *Id.*

117. *Id.*

118. *See Reeves, supra* note 15, at 15.

119. *Id.*

120. *See id.*

121. Elliot Raphaelson, *IRA Transfer vs. IRA Rollovers*, CHI. TRIB. (May 20, 2014, 8:30 PM), <http://www.chicagotribune.com/business/sns-201405202000--tms--savingsgctnzy-a20140520-20140520-story.html>.

122. *See id.*

argued that telling taxpayers, who have followed the specific guidance from the IRS, that their actions were improper undermines any confidence the public holds in our tax system.¹²³ The IRS ultimately took notice of the discrepancy and decided to change its recommendations to match the court's holding, which this comment will later discuss.¹²⁴

IV. RULES FROM *CLARK* AND *BOBROW* APPLIED

The two courts have implemented new rules regarding the treatment of inherited IRAs and rollovers.¹²⁵ However, with proper estate planning techniques and careful consideration of these rules, beneficiaries and account holders can still achieve profit maximization and protection.¹²⁶ This section describes the different ways for beneficiaries and account holders to avoid falling into pitfalls while maintaining compliance.¹²⁷

A. Rollovers and Transfers

Once a beneficiary inherits an IRA, it seems as though the easiest way to avoid implications from *Clark* would be to rollover the funds into a non-inherited IRA.¹²⁸ However, the IRC strictly forbids non-spouses from rolling over an inherited IRA into a different type of IRA or qualified plan.¹²⁹ The IRC, however, makes a distinction between rollovers and transfers.¹³⁰ Rollovers allow the individual to receive money from one of their IRAs, then redeposit the money into a new IRA within a sixty-day time period.¹³¹ A transfer occurs when a trustee of an account, rather than the IRA holder, directly deposits the funds into a new account.¹³² The difference is that the transfer does not allow the money to ever fall into the hands of the account holder in the form of a temporary loan.¹³³

Although the IRS does not allow rollovers from inherited IRAs to other IRAs, the IRC does allow transfers to these accounts.¹³⁴ Additionally, the

123. Janet Novack, *Gotcha! Tax Court Penalizes IRA Rollover That IRS Publication Says Is Allowed*, FORBES (Mar. 25, 2014, 11:47 AM), <http://www.forbes.com/sites/janetnovack/2014/03/25/gotcha-tax-court-penalizes-ira-rollover-that-irs-publication-says-is-allowed/>.

124. See *infra* Part V.B.2.

125. See *infra* Parts IV.A–F.

126. See *infra* Parts IV.A–F.

127. See *infra* Parts IV.A–F.

128. See DIANNE BENNETT ET AL., TAXATION OF DISTRIBUTIONS FROM QUALIFIED PLANS ¶ 17.08 (Thomson Reuters Tax & Accounting 2014).

129. I.R.C. § 408(d)(3)(C) (2012).

130. See BENNETT ET AL., *supra* note 128.

131. See *id.*

132. See *id.*

133. See *id.*

134. See I.R.S. Pub. 590 (2013); see also *In re Nessa* 426 B.R. 312 (B.A.P. 8th Cir. 2010) (holding that the trustee-to-trustee transfer of funds remained valid).

trustee-to-trustee transfers between IRAs do not count toward the one-rollover-per-year rule from *Bobrow*.¹³⁵ Also excluded from the twelve-month limitation are direct rollovers from a qualified plan.¹³⁶ A Treasury regulation provides that a conversion from a traditional IRA to a Roth IRA does not receive treatment as a regular rollover for the purposes of the one-year rule.¹³⁷ It is important to note that transferring funds to a non-inherited IRA still requires an individual to take the same RMDs each year—either the entire account within five years or annual distributions based on life expectancy.¹³⁸

Spouse beneficiaries, however, may rollover their inherited IRA into another IRA or qualified plan.¹³⁹ Though this option may relieve some of the consequences regarding bankruptcy, this transfer will count toward the spouse's one-rollover-per-year aggregate.¹⁴⁰ This option remains appealing for spouses since they are not subject to RMDs; spouses can also make withdrawals without penalty upon retirement age and can make contributions themselves.¹⁴¹ However, if a spouse does not comply with the one-rollover-per-year rule or does not follow the sixty-day payback requirements, the spouse will not receive the bankruptcy exemption for those rolled over funds.¹⁴²

B. Roth IRA Conversions

Estate planners should consider the exception that the one-rollover-per-year rule does not apply to Roth conversions; essentially, rollovers from traditional IRAs to Roth IRAs.¹⁴³ As previously mentioned, Roth IRAs carry many benefits including no taxation upon the withdrawal of funds.¹⁴⁴ Roth IRAs become particularly useful for clients who expect to climb into a higher tax bracket upon retirement.¹⁴⁵ As of 2013, anyone holding a traditional IRA,

135. See BENNETT ET AL., *supra* note 128; see also Rev. Rul. 78-406, 1978-2 C.B. 157 (explaining that transfers directly between trustees do not result in a "distribution" within I.R.C. § 408(d)(3)(A) because they do not fall within the direct control of the plan participant).

136. See BENNETT ET AL., *supra* note 128.

137. See *id.*; Treas. Reg. § 1.408A-4 (as amended in 2008).

138. See I.R.S. Pub. 590 (2013).

139. See Suhre, *supra* note 5.

140. See *id.*

141. See *id.*; see also Kitces, *supra* note 51 (noting the appeal for spousal beneficiaries to rollover inherited IRAs rather than leave them as inherited).

142. PETER SPERO, ASSET PROTECTION: LEGAL PLANNING, STRATEGIES AND FORMS ¶13.03 (Thomson Reuters Tax & Accounting 2014); see also *In re Patrick*, 411 B.R. 659 (Bankr. C.D. Cal. 2008) (ruling a debtor who violated the one-rollover rule by engaging in multiple rollovers could not receive the bankruptcy protection).

143. See Ed Slott, *Avoid an IRA Rollover Disaster*, FIN. PLAN. (Jan. 20, 2015, 10:28 AM), http://www.financial-planning.com/news/iras_401k/avoid-an-ira-rollover-disaster-2691690-1.html?force_pg=/News/.

144. Cyrus Shepard, *Roth IRA Conversions: Rules for 2015*, IRA SUCCESS, <http://iracontributionlimits2010.com/roth-rules/2011/10/> (last visited Jan. 22, 2015); see *supra* Part II.C.2.

145. Shepard, *supra* note 144.

401(k), or other similar retirement account remains eligible to convert that account into a Roth IRA.¹⁴⁶ The IRS requires the retirement account holder to pay federal income tax at the level of ordinary income on the funds converted from the previous account to a Roth IRA. As of 2015, convertors must pay that income tax in the year the conversion occurred.¹⁴⁷

C. Trust Accounts

One option for retirement account holders is to designate a trust as the beneficiary of the retirement account.¹⁴⁸ If an IRA is left to a third-party trust, the beneficiary will have limited access and control of the trust funds, including the inherited IRA.¹⁴⁹ If the trust meets all of the usual rules for third-party asset protection trusts, the trust funds will receive robust protection from bankruptcy.¹⁵⁰ It is important for individuals to structure the trust such that it complies with the regulations to avoid unfavorable tax treatment.¹⁵¹ At that point, the trust should allow for distributions to be stretched over the lifetime of the beneficiaries.¹⁵² Essentially, the trust will accrue the RMDs from the inherited IRA on the beneficiary's behalf, acting as a shield from creditors.¹⁵³

Receiving the extra protection from the trust comes with a downside in the form of less favorable tax treatment.¹⁵⁴ “[D]istributions that are not passed through and are held at the trust level will be reported on the trust’s tax return, and subject to compressed trust tax brackets.”¹⁵⁵ The *Clark* decision leaves holders of IRAs and their beneficiaries left to choose either more favorable tax treatment or better asset protection.¹⁵⁶ Where beneficiaries are at a high risk for bankruptcy, the unfavorable taxes might be a better pill to swallow.¹⁵⁷

Beyond negative tax implications, other downsides to naming a trust as an IRA beneficiary include laborious accounting, ongoing trust fees, and other complexities that may still leave assets unprotected from creditors.¹⁵⁸

146. *Id.*

147. *Id.* Previously, the tax requirement for Roth IRA conversions could be split over a two-year period. *Id.*

148. Kitces, *supra* note 51.

149. *Id.*

150. *Id.*

151. *Id.*; see also Treas. Reg. § 1.401(a)(9)-4 (as amended in 2004) (requiring that the trust be valid under state law, remain irrevocable, have identifiable trust beneficiaries, and have a plan administrator receive specific documentation).

152. Kitces, *supra* note 51.

153. *Id.*

154. *Id.*

155. *Id.*

156. See *id.*

157. See *id.*

158. Suhre, *supra* note 5.

IRA account holders should consider many factors before leaving their IRA to a trust: “you only get one shot to get things right and protect as much of your wealth as possible for your heirs.”¹⁵⁹

For retirement funds to receive exclusion from bankruptcy through a trust, the trust must contain an anti-alienation restriction.¹⁶⁰ A “spendthrift trust,” though not termed as such by the Bankruptcy Code, falls into this category.¹⁶¹ The spendthrift clause (or disabling restraint) makes the trust benefits legally inalienable.¹⁶² “A disabling restraint does not dictate the substantive use of trust income . . . but it does limit the temporal use of income to the singular purpose of periodic consumption.”¹⁶³ Once distribution occurs, the beneficiary may consume the funds and creditors may reach them.¹⁶⁴ The benefit of this type of trust, however, remains in the immediate asset protection upon inheritance, and the ability of the beneficiary to use the funds for their own long-term support.¹⁶⁵

Some retirement accounts fail to receive protection as a spendthrift trust because of the qualities that make the IRA “self settled” or otherwise under immense control of the individual owner.¹⁶⁶ An IRA or a self-employed individual’s qualified plan may fail for these reasons.¹⁶⁷ A good argument exists that an inherited IRA or an SEP IRA should still receive protection because they are not considered to be self-settled.¹⁶⁸ Additionally, some plans that lack employee control—like employer-funded church or government plans—may receive protection as spendthrift trusts.¹⁶⁹ The important piece to remember, however, is that before the plan can receive protection from bankruptcy as a spendthrift trust, the plan must first qualify as a trust itself.¹⁷⁰

This may seem like a relatively easy and historically utilized solution for retirement planners to avoid the fight in fending off bankruptcy

159. Jeffery Levine, *Supreme Court: Inherited IRAs Are NOT Retirement Accounts and What This Means For You*, IRA HELP (June 18, 2014), <http://www.ivahelp.com/slottereport/supreme-court-inherited-iras-are-not-reitirement-accounts>.

160. Suhre, *supra* note 5; see also 11 U.S.C. § 541(c)(2) (2012) (allowing for “[a] restriction on the transfer of a beneficial interest of the debtor in a trust that is enforceable under nonbankruptcy law”).

161. Suhre, *supra* note 5.

162. Adam J. Hirsch, *Spendthrift Trusts and Public Policy: Economic and Cognitive Perspectives*, 73 WASH. U. L.Q. 1, 2 (1995).

163. *Id.*

164. *Id.*

165. See *id.*

166. Suhre, *supra* note 5; see also *In re Goff*, 706 F.2d 574, 588 (5th Cir. 1983) (finding that allowing debtors to retain the freedom to withdraw plan assets and insulate them from creditors is against both law and equity).

167. Suhre, *supra* note 5.

168. *Id.*

169. *Id.*; see also *In re Kim*, 257 B.R. 680, 689 (B.A.P. 9th Cir. 2000) (holding that a government funded employee’s retirement account is protected from bankruptcy creditors as a spendthrift trust).

170. *Skiba v. Gould*, 337 B.R. 71, 74 (W.D. Pa. 2005).

creditors.¹⁷¹ “Thomas Jefferson created just such a trust for the benefit of one of his daughters, Martha, who married a husband who had financial difficulties.”¹⁷² The laws of each state make planning through a spendthrift provision an easy alternative that planners should use not just for IRAs but for any and all significant assets.¹⁷³ “There is nothing slick or sleazy about it, but rather it is just good planning completely sanctioned by the spendthrift laws of each state.”¹⁷⁴

D. ERISA Qualified Plans

The Employee Retirement Income Security Act of 1974 (ERISA) sets minimum standards for private industry pension plans.¹⁷⁵ Part of ERISA provides that interest in a qualified retirement plan may not be assigned or alienated.¹⁷⁶ The United States Supreme Court in *Patterson v. Shumate* found that the anti-alienation provision of ERISA fell within the Bankruptcy Code’s “applicable non-bankruptcy law” definition, such that a bankruptcy estate would not include ERISA qualified plans.¹⁷⁷ Exclusion from the bankruptcy estate prevents even going into the analysis of whether or not the plan is exempt.¹⁷⁸

After *Clark*, the anti-alienation provision of ERISA “is likely to have renewed importance as a firewall for retirement plan assets belonging to a beneficiary of a deceased plan participant.”¹⁷⁹ The section of ERISA that includes the provision, however, only applies to employee pension benefit plans—plans maintained by employers for the retirement benefit of employees.¹⁸⁰ Beneficiaries of these types of accounts may also have the ability to resist creditors through their allies—the retiree’s employer or plan administrator.¹⁸¹

E. Inherited IRAs and Other Tax-Exempt Retirement Plans: Similarities

Several other types of tax-exempt retirement accounts possess similar attributes to the inherited IRA features the Court mentioned in *Clark v. Rameker*, which implies that these retirement accounts may not qualify under

171. Adkisson, *supra* note 95.

172. *Id.*

173. *Id.*

174. *Id.*

175. Employee Retirement Income Security Act of 1974, Pub. L. No. 93-406, 88 Stat. 829 (1974) (codified as amended in 29 U.S.C. §§ 1001–1461).

176. *Id.* § 206(d).

177. Suhre, *supra* note 5; *see also* *Patterson v. Shumate*, 504 U.S. 753, 758 (1991) (finding that Congress’ use of the broad phrase suggests it did not intend to restrict exclusion).

178. *See* Martin, *supra* note 80.

179. Suhre, *supra* note 5, at 4.

180. *Id.* at 5.

181. *Id.*

the retirement funds exemption.¹⁸² The requirement that a beneficiary take RMDs from the account, even when the beneficiary has not reached retirement age, applies to tax-qualified plans, IRAs, and other types of retirement accounts.¹⁸³ A defined benefit plan may require the beneficiary to receive periodic payments over the lifetime of the beneficiary, similar to an RMD.¹⁸⁴ A qualified plan beneficiary, however, may not have the ability to necessarily withdraw the full balance of the account at any point in time.¹⁸⁵ Although this is a distinction from the account in *Clark*, courts still may not shield these types of funds from bankruptcy.¹⁸⁶

F. Inherited IRAs Outside of Bankruptcy

Creditor cases that exist outside of bankruptcy and involve IRAs become subject to state laws rather than the federal Bankruptcy Code.¹⁸⁷ The state in which the debtor is domiciled governs, and the specific exemption statutes of that state become the relevant law.¹⁸⁸ The extent to which the *Clark* decision will provide implications for creditors outside of bankruptcy remains somewhat unclear.¹⁸⁹ However, what is clear is the likelihood of courts to provide less deference to inherited IRAs than other types of retirement accounts.¹⁹⁰

One situation that can definitely provide a headache for debtors with creditors, even outside bankruptcy, involves SEPs, or SIMPLE IRAs, and ERISA.¹⁹¹ As mentioned earlier, ERISA pension plans receive anti-alienation creditor protection both inside and outside of bankruptcy.¹⁹² The protections, however, do not extend to IRAs under section 408 because an employer establishes them.¹⁹³ Additionally, other ERISA provisions preempt state law protections under the act.¹⁹⁴ This creates a problem for SEPs and

182. *Id.*; see *Clark v. Rameker*, 134 S. Ct. 2249–50 (2014).

183. Suhre, *supra* note 5; see also I.R.C. §§ 401(a)(9), 403(a)(1), 403(b)(10), 404(a)(2), 408(a)(6), 408(b)(3), 457(d)(2) (2012).

184. Suhre, *supra* note 5.

185. *Id.*

186. *Id.*

187. Naegele, *supra* note 55.

188. *Id.*

189. Michael D. Shelton, *Do Creditors Now Have Carte Blanche Access to Your Inherited IRA To Satisfy Debts?*, SMITH HAUGHEY RICE & ROEGGE (June 16, 2014), <http://www.shrr.com/do-creditors-now-have-carte-blanche-access-to-your-inherited-ira-to-satisfy-debts>.

190. *Id.*

191. See Richard A. Naegele, Mark P. Altieri & Donald W. McFall Jr., *Protection from Creditors for Retirement Plan Assets*, TAX ADVISOR (Jan. 1, 2014), http://www.aicpa.org/publications/taxadviser/2014/january/pages/naegele_jan2014.aspx.

192. See *supra* Part IV.D.

193. Employee Retirement Income Security Act of 1974, Pub. L. No. 93-406, §§ 4(B), 201, 88 Stat. 829 (1974) (codified as amended in 29 U.S.C. §§ 1003, 1051); see Naegele, Altieri & McFall Jr., *supra* note 191.

194. Employee Retirement Income Security Act of 1974, § 514(a) (codified as amended in 29 U.S.C. § 1144); see Naegele, Altieri & McFall Jr., *supra* note 191.

SIMPLE IRAs, which receive no protection under the anti-alienation provisions and remain subject to state law actions because of the lack of protection due to ERISA preemption.¹⁹⁵

V. LOOKING FORWARD: CONSEQUENCES OF COURT DECISIONS

The decisions of the Supreme Court and tax court demonstrate well-thought-out solutions to unresolved issues of confusion and misapplication with regard to retirement funds.¹⁹⁶ Interestingly, the decisions did not address some areas that will undoubtedly change as a result of the holdings.¹⁹⁷ This section overviews some of the changes that have already become clear and some of the consequences that remain to be seen.¹⁹⁸

A. Unintended Consequences of *Clark*

One of the unintended consequences of *Clark* deals with beneficiaries' ability to stretch an IRA after they inherit the funds.¹⁹⁹ Congress previously proposed legislation in 2012 that sought to end a beneficiary's ability to stretch inherited distributions beyond the five-year rule.²⁰⁰ This proposal appeared again in President Obama's recent budget proposals.²⁰¹ Limiting beneficiaries to the five-year rule would force some individuals into a higher tax bracket upon taking such large dollar amount withdrawals.²⁰² The Legislature has essentially taken the position that it does not care about the negative tax consequences for beneficiaries, claiming that the tax benefits of IRAs are meant for the retiree, not those who fall into such sudden wealth.²⁰³ This view directly aligns with *Clark* in that retirement funds take on a different function once beneficiaries inherit those funds, whether the beneficiaries use the money to aid their own retirement or to make expensive luxury purchases.²⁰⁴ This mentality calls into question whether retirement accounts will receive favorable income tax treatment after the retirement account owner's death.²⁰⁵

195. Naegele, Altieri & McFall Jr., *supra* note 191.

196. *See infra* Parts V.A–B.

197. *See infra* Parts V.A–B.

198. *See infra* Parts V.A–B.

199. Kitces, *supra* note 51.

200. *Id.*; *see also* Highway Investment, Job Creation, and Economic Growth Act of 2012, S. 2132, 112th Cong. (2012) (proposing a provision to limit inherited IRA distributions from stretching but requiring liquidation of funds within five years).

201. Kitces, *supra* note 51.

202. *Id.*

203. *See id.*

204. *Id.*

205. *See id.*

B. Bobrow Changes IRS Publications and Recommendations

After the *Bobrow* decision, the IRS released two announcements to address the change in the rule's interpretation to reflect the tax court's holding.²⁰⁶ The first announcement recognized the interpretation from *Bobrow* and indicated that the IRS would follow that interpretation, withdraw Proposed Regulation 1.408-4(b)(4)(ii), and revise future relevant IRS Publications, including Publication 590.²⁰⁷ The IRS indicated in that announcement that it would not apply the interpretation before 2015.²⁰⁸

The announcement created some confusion among practitioners and taxpayers who thought the rules themselves would go into effect in January, which set out that an individual may only make one rollover from an IRA within 365 days.²⁰⁹ The IRS cautioned that the one-year time frame would begin on the date of the distribution and would not necessarily mean an individual would be in the clear upon the next calendar year.²¹⁰ The contention was that rollovers made in 2014, technically before January 2015 and the start of the rule, would still become subject to the 365-day limitation in 2015.²¹¹

The IRS's second announcement clarified this confusion and stated that "a distribution occurring in 2014 that was rolled over is disregarded for purposes of determining whether a 2015 distribution can be rolled over . . . provided that the 2015 distribution is from a different IRA that neither made nor received the 2014 distribution."²¹² Essentially, the aggregation rule will apply to distributions from different IRAs only when both distributions occur after 2014.²¹³ However, the one-year rule does apply to the individual IRA distributions made in 2014, just as it did before the *Bobrow* decision.²¹⁴ An individual could not rollover from the same account within the same 365-day period, and that rule still remains in effect in 2015.²¹⁵

1. Example 1 – Distributions in 2014

A client has three IRA accounts—IRA 1, IRA 2, and IRA 3.²¹⁶ In November 2014, the client took a distribution from IRA 1, and in December

206. See I.R.S. Ann. 2014-32 (Nov. 10, 2014).

207. See *id.*; see I.R.S. Pub. 590-A (Jan. 13, 2015).

208. See I.R.S. Ann. 2014-32.

209. See Michael Kitces, *New Once-Per-Year IRA Rollover Rule Emerges from Bobrow v. Commissioner Tax Court Case*, NERD'S EYE VIEW (Mar. 26, 2014, 7:01 AM), <http://www.kitces.com/blog/new-once-per-year-ira-rollover-rule-emerges-from-bobrow-v-commissioner-tax-court-case/>.

210. See *id.*

211. See *id.*

212. See I.R.S. Ann. 2014-32.

213. See *id.*

214. See *id.*

215. See *id.*; see I.R.S. Pub. 590-A (Jan. 13, 2015).

216. See Slott, *supra* note 143.

2014, rolled that distribution over into IRA 2.²¹⁷ At any point in 2015, the client may take a distribution from IRA 3, because the IRS will not factor the rollover from IRA 1 in 2014 into this year's one-rollover-per-year limit.²¹⁸ However, the client cannot take a distribution to rollover from either IRA 1 or IRA 2 before the 365-day time period ends in December 2015.²¹⁹ This serves as an example of the one-rollover-per-year rule as practitioners have always viewed it—rollovers cannot be made from the same account within a one-year period.²²⁰

2. Example 2 – Distributions in 2015

For a separate example, imagine a client with all the same characteristics as the previous example with regard to the three types of IRAs.²²¹ In this example, the client made no distributions in 2014 and started 2015 with a clean slate.²²² The client takes a distribution from IRA 1 in January 2015 and rolls it over into IRA 3 in February 2015.²²³ At this point, the client may not make any further distributions or rollovers from any of the three accounts until February 2016.²²⁴

If the client does make a subsequent rollover before the 365-day limit has run, that transfer will become subject to not only a 10% penalty if the client is under the age of 59½, but another “6% penalty for every year the ineligible rollover funds remain in the account.”²²⁵ This example highlights the significance and impact of the *Bobrow* rule.²²⁶ Not only will this rule require careful behavior on behalf of retirement account holders, but it will also require strategic planning, such that account holders make the rollover they need at the most opportune time.²²⁷

As this comment has addressed, distributions turned into rollovers are a way individuals would use the funds in their retirement account to finance their immediate needs.²²⁸ Before *Bobrow*, this borrowing scheme left account holders with no major consequences if they returned the funds in time.²²⁹ Now, the question of how much they really need the money becomes

217. *See id.*

218. *See id.*

219. *See id.*

220. *See id.*

221. *See supra* Part V.B.1.

222. *See* Slott, *supra* note 143.

223. *See id.*

224. *See id.*

225. *See id.*

226. *See id.*

227. *See id.*

228. *See id.*; *see supra* Part III.B.

229. *See generally* Slott, *supra* note 143 (outlining the costs and fees associated with an ineligible IRA rollover).

much more important.²³⁰ It seems as though taking an early distribution without a rollover would ultimately eliminate some of the fees assessed with a second, ineligible rollover.²³¹ Although the individual must include the distribution in their income for which they will pay taxes and potentially receive the early distribution penalty of 10%, the money lost may actually end up amounting to less than the extra 6% fee incurred per year.²³²

VI. CONCLUSION

As seen in these two recent landmark decisions, retirement planning is complex, nuanced, and the subject of much legislative and judicial debate.²³³ Because retirement funds become so critical to sustainability, the planning and ultimate understanding of how to remain protected in the face of changing rules becomes essential.²³⁴ This comment addressed the rules, consequences, and approaches to handle the critical changes in IRAs, which the section below provides in summation.²³⁵

A. Clark v. Rameker

Rule: Inherited IRA funds do not receive protection from the beneficiary's bankruptcy creditors.²³⁶ Takeaways: (1) this rule becomes important for those passing down an IRA and those inheriting an IRA, with some exceptions like spouses, and (2) use alternative means to an inherited IRA to potentially shelter funds and maintain benefits.²³⁷ The recommendations based on this decision are summarized succinctly below.²³⁸

1. Once the inherited IRA passes to a nonspouse beneficiary, the beneficiary should use a trustee-to-trustee transfer (rather than a rollover) to move the funds to their own IRA.²³⁹ This exempts the funds from bankruptcy creditors but still requires RMDs over either the stretch or five-year time periods.²⁴⁰ Spousal beneficiaries may rollover the funds to their own account

230. *Id.*

231. *Id.*

232. *Id.*

233. See Clark v. Rameker, 134 S. Ct. 2242 (2014); Bobrow v. Comm'r, 107 T.C.M. (CCH) 1110 (2014).

234. See *Ultimate Guide to Retirement*, *supra* note 25.

235. See *supra* Parts III–IV; see *infra* Parts VI.A–B.

236. Clark, 134 S. Ct. at 2250.

237. See Robert L. Moshman, *Estate Analyst*—Clark v. Rameker: No Bankruptcy Exemption for Inherited IRA, *ULTIMATE EST. PLANNER* (July 7, 2014), <http://ultimateestateplanner.com/2014/07/07/clark-v-rameker-no-bankruptcy-exemption-for-inherited-ira/>; see Kiteces, *supra* note 51.

238. See *infra* Part VI.A.

239. See I.R.S. Pub. 590 (Jan. 1, 2013); see also *In re Nessa* 426 B.R. 312 (B.A.P. 8th Cir. 2010) (holding that the trustee-to-trustee transfer of funds remained valid).

240. See I.R.S. Pub. 590.

without using a trustee-to-trustee transfer and still protect the funds.²⁴¹ This option is especially promising for spouses who have not reached 70½ years of age but whose spouse died at an age greater than 70½, because it allows the beneficiary to delay distributions.²⁴²

2. Designate a trust as the beneficiary of the IRA instead of children or spouses, but use an experienced estate planner to execute the trust to comply with the bankruptcy rules in order to receive the benefits—i.e., make sure the trust contains an anti-alienation provision, like a spendthrift trust.²⁴³ Though this may come with less favorable tax treatment, the benefit of bankruptcy exemption might warrant having to give up a portion of the funds.²⁴⁴

3. Spend inherited IRA funds in lieu of other protected retirement assets.²⁴⁵ Though this may seem like an intuitive solution, nonspouse beneficiaries may not realize this is an option that is both permitted and prudent.²⁴⁶

B. Bobrow v. Commissioner of Internal Revenue

Rule: IRA holders may only make one rollover in the aggregate within a 365-day period, regardless of the type of account.²⁴⁷ Takeaways: (1) remain cautious and thoughtful about rollovers, and (2) carefully consider rollovers when filing tax returns for inclusion into gross income to avoid more serious consequences than paying fees.²⁴⁸ The recommendations made throughout this comment are outlined below.²⁴⁹

1. Utilize a trustee-to-trustee transfer instead of making a rollover between IRAs.²⁵⁰ These transfers do not count toward the one-rollover-per-year rule and still provide all the same benefits as a rollover.²⁵¹ Account holders may realize additional benefits from transferring to a trustee who is likely more knowledgeable with respect to moving funds between accounts.²⁵²

2. Convert a traditional IRA or other plan to a Roth IRA.²⁵³ Although taxes must be paid upon contribution to a Roth IRA, this type of rollover is

241. See Moshman, *supra* note 237.

242. See *id.*

243. Kitces, *supra* note 51.

244. See *id.*

245. See Moshman, *supra* note 237.

246. See *id.*

247. Bobrow v. Comm’r, 107 T.C.M. (CCH) 1110 (2014).

248. See *id.*

249. See *infra* Part VI.B.

250. See BENNETT ET AL., *supra* note 128; see also Rev. Rul. 78-406, 1978-2 C.B. 157 (explaining transfers directly between trustees do not result in a “distribution” within I.R.C. § 408(d)(3)(A) because they are not within the direct control of the plan participant).

251. See BENNETT ET AL., *supra* note 128; Rev. Rul. 78-406.

252. See BENNETT ET AL., *supra* note 128; Rev. Rul. 78-406.

253. Shepard, *supra* note 144.

exempt from the one-rollover-per-year rule.²⁵⁴ Use this method when circumstances make a rollover seem necessary and when paying taxes on the contribution is less than paying penalties.²⁵⁵

C. Final Thoughts

Ultimately, the concept of saving money so you can spend your last days on the golf course instead of in the office probably appeals to most people.²⁵⁶ Young people can identify with the golf course dream but do not necessarily link that goal to retirement planning because their immediate financial needs outweigh something that remains so far in the distance.²⁵⁷ For those approaching or already in retirement, that connection is not so attenuated and planning becomes much more tangible.²⁵⁸ The ultimate goal is to pay attention to things that can affect the amount of money people will have left to live off of, and try to maximize savings.²⁵⁹

The tax court and Supreme Court opinions create major consequences for an individual's ability to meet this ultimate goal.²⁶⁰ Through strategic planning and reserving IRAs for those funds that will actually remain untouched until retirement, individuals can remove the sting of these opinions for not only themselves, but their beneficiaries.²⁶¹ Although some open questions still remain with regard to certain aspects of these accounts—like how the Supreme Court really feels about spouse beneficiaries inheriting IRAs—the courts still maintain the same ultimate position about the purpose of retirement savings.²⁶² IRAs serve as a savings account for retirement, not as a savings account for everyday, or even emergency, purchases.²⁶³ If planners, account holders, and beneficiaries all keep this primary purpose at the forefront of their minds, the chance of getting burned by rules to come becomes significantly less.²⁶⁴

254. *Id.*

255. *Id.*

256. See *Save NOW For Retirement*, A.B.A., <http://www.americanbar.org/content/dam/aba/migrated/tax/taxtips4u/saveforretirementnow.authcheckdam.pdf> (last visited Jan. 23, 2015).

257. See Liz Davidson, *What Young People Need To Know About Retirement*, FORBES (July 25, 2012, 9:06 AM), <http://www.forbes.com/sites/financialfinesse/2012/07/25/what-young-people-need-to-know-about-retirement/>.

258. See *Save NOW For Retirement*, *supra* note 256.

259. See *id.*

260. See *Clark v. Rameker*, 134 S. Ct. 2242 (2014); *Bobrow v. Comm'r*, 107 T.C.M. (CCH) 1110 (2014).

261. See *supra* Parts V.A–B.

262. See *Reeves*, *supra* note 15.

263. See *id.*

264. See *id.*