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***Court Holds That Debtor-Indemnitor
Cannot Claim Exemption in Inherited IRA***

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In a case of first impression, the United States Bankruptcy Court for the Northern District of New York held that a debtor’s inherited IRA is property of the debtor’s bankruptcy estate and is not exempt from creditors. The recent decision in *In re Todd*, No. 15-11083 (Bankr. N.D.N.Y. March 23, 2018) provides reassurance to parties extending credit, such as sureties, that a New York-based debtor or indemnitor cannot shield an inherited IRA from his or her creditors.

In *Todd*, the debtor was an individual indemnitor subject to joint and several liability to a surety under a general indemnity agreement. With the surety having asserted the largest claim against her bankruptcy estate, the debtor claimed an exemption in her most significant asset, an inherited IRA that she had inherited from her deceased mother. The debtor elected to claim her exemption under the New York state exemption statute, N.Y. C.P.L.R. § 5205 (the “Exemption Statute” or “Section 5205”). Had she claimed her exemption under the federal bankruptcy code, the United States Supreme Court’s 2014 decision in *Clark v. Rameker*, 573 U.S. ___, 134 S. Ct. 2242, 189 L.Ed.2d 157 (2014) would have definitively resolved that an inherited IRA is not exempt under the federal bankruptcy code. However, no court had ever decided whether an inherited IRA may be claimed as exempt under the New York state Exemption Statute.

The bankruptcy court’s denial of the debtor’s claimed exemption was principally premised on two holdings: (i) an inherited IRA is not held in trust, as required by Section 5205(c)(1); and (ii) an inherited IRA is not “qualified as an individual retirement account” under Section 5205(c)(2). The exemption provided for under Section 5205(c)(1) is reserved for, most relevantly, “all property while held in trust for a judgment debtor.” The bankruptcy court held that the debtor could not avail herself of the exemption set forth in Section 5205(c)(1) because the debtor maintains exclusive control of the inherited IRA, with the unfettered ability to withdraw funds at any time, for any reason, and without penalty.

Section 5205(c)(2) provides an exemption for, among other things, an account “which is qualified as an individual retirement account” under Section 408 of the Internal Revenue Code, 26 U.S.C. § 408 (“Section

408”). Noting that neither Section 5205 nor Section 408 defines the word “qualified,” the court determined that Section 5205 is ambiguous, and looked to the legislative history. The legislative history definitively established that the purpose of Section 5205(c)(2) is to protect individuals’ accounts established for their retirement. The court determined that a holding that inherited IRAs are “qualified” under Section 5205(c)(2) would betray the legislature’s intent to protect individuals’ savings for their retirement because: (i) the funds in inherited IRAs are traceable only to the decedents that established the IRAs; (ii) inherited IRAs cannot be used to save for retirement because the holder is precluded from contributing to them; (iii) funds in inherited IRAs may be accessed at any time without penalty; and (iv) inherited IRA holders are compelled to withdraw money from the accounts. The Todd court noted that other state legislatures, such as those in Alaska, Arizona, Florida, Missouri, North Carolina, Ohio, and Texas, have amended their state exemption statutes to explicitly provide an exemption for inherited IRAs. New York’s legislature has not done so.

The *Todd* decision is a noteworthy win for surety underwriters issuing bonds to contractors with New York-based indemnitors, and claims professionals pursuing indemnity from New York-based indemnitors. Given the proliferation of individual retirement accounts over the past few decades, it has become increasingly common for an indemnitor to possess an inherited IRA among their various assets. With the recent issuance of the *Todd* decision, it is now clear that a New York-based indemnitor may not shield an inherited IRA from his or her creditors.

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Kevin S. Brotspies Esq. is Of Counsel in the Construction, Fidelity & Surety Department at McElroy, Deutsch, Mulvaney & Carpenter, LLP.

Adam R. Schwartz, Esq. is a Partner in the Construction, Fidelity & Surety Department at McElroy, Deutsch, Mulvaney & Carpenter, LLP.

John W. Morris, Esq. is a Partner in and Chair of the Construction, Fidelity & Surety Department at McElroy, Deutsch, Mulvaney & Carpenter, LLP.

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