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SPECIAL ESTATE PLANNING BULLETIN

Creditor Protection for IRAs Payable to Trusts

We frequently advise clients as to proper beneficiary designations for different types of assets, especially in the context of funding a revocable living trust (RLT). A recent court case, *Commerce Bank N.A. v. Bolander* (2007 WL 1041760), addressed the creditor protection afforded Individual Retirement Accounts (IRAs) that name a RLT as beneficiary. Although the case is from Kansas and not directly controlling in Tennessee or other states, the extension of the underlying principles could affect some of you.

In the case, the decedent executed a RLT in 1998, and a Last Will and Testament (will) in 2002. At death, the will was admitted to Probate in order to transfer assets that were titled in the decedent's sole name. However, the decedent had over $200,000 in two different IRAs naming the RLT as beneficiary that were not subject to the Probate Court administration. After the will was admitted to probate, the estate advised the court that the estate was insolvent because it contained more debt than assets subject to the Probate Court administration. The estate argued that the IRAs were exempt from any creditors of the decedent during lifetime pursuant to statute and therefore should not be reachable by a creditor after death.

Although the court agreed that the decedent's IRAs were not subject to creditors during lifetime, the court found that the IRAs were subject to creditors after death because the beneficiary of the IRAs was a RLT. The estate claimed that a RLT becomes irrevocable upon the death of the settlor and therefore should not be subject to creditors. However, the court relied on a Kansas statute stating that the property of a trust that was revocable at the settlor’s death is subject to the claims of the settlor’s creditors. The state of Tennessee has a similar statute. The court specifically noted that the exemption from creditors was a right the decedent was entitled to during lifetime but did not survive death.

In the past, we have often instructed clients to name a RLT as either the primary or contingent beneficiary of IRAs or other retirement plans. This court case is an example that naming a RLT as a beneficiary of an IRA could transmute an asset that was previously exempt from a decedent's creditors while living to one that is subject to the claims of creditors after death. However, this terrible result can be avoided with proper planning. By naming an irrevocable trust, such as a Retirement Benefits Trust, as the beneficiary of an IRA or other retirement plan, you can make certain that the creditor protection given to those plans during your lifetime will continue after death. If you would like additional information on the proper beneficiary designations on these accounts or would like to discuss the potential solutions to this potential problem in more detail, please contact our office.