REAL PROPERTY, PROBATE AND TRUST LAW SECTION
WHITE PAPER

CLARIFICATION OF IRA TREATMENT BY §222.21(2)(c), FLA. STAT.

I. SUMMARY

The proposed amendment to Section 222.21(2)(c) of the Florida Statutes is to clarify that the interest of a beneficiary in an inherited individual retirement account (IRA) is exempt from the claims of the owner's, beneficiary's and participant's creditors. Although the existing statutory provisions and purpose are clear, at least two Florida courts have misread the statute and ignored the intent of the Florida Legislature when it originally enacted the statute in 1987.

II. CURRENT SITUATION

A. The Statute Was Intended to Exempt the Interest of a Beneficiary of an Inherited IRA

Section 222.21 of the Florida Statutes was enacted in 1987[1]. Subsequent enacted amendments do not affect this legislative proposal. The applicable portions of the statute currently provide as follows:

> "(2)(a) Except as provided in paragraph (d), any money or other assets payable to an owner, a participant, or a beneficiary from, or any interest of any owner, participant, or beneficiary in, a fund or account is exempt from all claims of creditors of the owner, beneficiary, or participant if the fund or account is:". . .
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> (c) Any money or other assets that are exempt from claims of creditors under paragraph (a) do not cease to qualify for exemption by reason of a direct transfer or eligible rollover that is excluded from gross income under s. 402(c) of the Internal Revenue Code of 1986.

[Provisions in the statute, providing that the creditor protection inures to the benefit of the persons described above as long as the fund or account is tax-qualified, are omitted.]

The statute was intended to ensure that the creditor protection features of a qualified plan created under the Internal Revenue Code (hereafter the "Code"), which include a spendthrift clause to implement the anti-alienation rules of Section 401(a)(13) of the Code, also applied to single owner/participant plans.[2]

There was a concern that bankruptcy courts were permitting creditors to attach single owner/participant plans on the theory that the plan, which was required to have a spendthrift provision, was a self-settled trust that, then and now, does not defeat claims of the settlor's creditors. The statute was enacted to make clear that *all* plans would be exempt, even if there were a single owner/participant.

One of the original drafters, who testified before the Florida House and Senate, stated that the intent of the word "beneficiary" under the statute was to mean *any* beneficiary, including not only the person who, as the owner of the IRA, could be thought (albeit incorrectly) to be its beneficiary, but also a beneficiary of an inherited IRA after the owner's death. A *Florida Bar Journal* article co-authored by the same drafter soon after the statute was enacted notes that the legislation was intended to "protect from creditors interests in *all* types of tax qualified retirement plans (including . . . individual retirement accounts)."[3] (Emphasis added.) The legislation used the word "beneficiary" with no qualifiers. The drafters and the Florida legislature could certainly have denied or limited protection afforded to beneficiaries. Neither did so.

In 2005, the statute was amended to respond to certain changes in the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA"). One of the consistent themes of BAPCPA was to change the term "ERISA qualified" to "tax qualified." BAPCPA made it clear that the intent, from the standpoint of the federal government, was to exempt these types of accounts and assets so long as they maintain "tax qualified" status.

An inherited IRA that is administered properly by a qualified custodian would meet the requirement of "tax qualified." Subparagraph (c) was added to the Statute, stating in part that "[a]ny money or other assets that are exempt from claims of creditors under paragraph (a) do not cease to qualify for exemption by reason of a direct transfer or eligible rollover that is excluded from gross income . . . " This language was added to clarify that those tax-qualified funds could be rolled over or transferred between accounts without losing the protection intended to be afforded by the statute.

No change was made to the Statute regarding beneficiaries, owners, or participants. In fact, the Florida Session Law staff analysis states that the change "is made because technically the owner of an IRA is neither a beneficiary nor a participant in the account."[4] It is clear that the term "beneficiary" as used in the statute means something different from the terms "owner" and "participant."

B. Courts Have Misapplied the Statute

(1) *Robertson v. Deeb*

In *Robertson v. Deeb,* 16 So. 2d 936 (Fla. 2d D.C.A. 2009), the Second District Court of Appeals concluded that the interest of a beneficiary or owner of an inherited IRA was not an exempt asset protected from creditors under the terms of Florida Statues Section 222.21.

In *Robertson*, the custodian of an IRA whose owner was deceased informed the owner's son, as the named beneficiary, that there were two options with respect to the distribution of his father's IRA. The first option would be to transfer his father's IRA into an "inherited IRA", which would require that the son take required minimum distributions[5] based on his remaining life expectancy, with the ability to withdraw more than the minimum distributions without a penalty. The second option would be to keep the IRA in his late father's titled account and take distributions over 5 years without penalty.[6] The beneficiary chose the first option. The funds were properly transferred from his late father's IRA into an inherited IRA by way of an account to account transfer, and properly titled "Richard Robertson, Beneficiary, Harold Robertson, Decedent RBC Capital Markets, Custodial IRA."

The issue before the court was whether Richard Robertson's interest in the inherited IRA was exempt from garnishment by his creditors. The trial court held that it was not exempt because the "account became Robertson's property and no longer qualified for the same exemptions from taxation."[7] Further, the trial court determined that Robertson's inherited IRA was "not like an IRA in terms of taxing and penalty tax for early withdrawal and things of that nature."

On appeal, Richard Robertson argued that under Florida Statutes Section 222.21(2)(a) he was a "beneficiary" of a "fund or account" and, therefore, that his beneficial interest in the inherited IRA was exempt from creditors' claims. The Second District Court of Appeals disagreed, concluding that because the IRA was an inherited IRA it was not exempt.

The Second District Court of Appeals determined that the statute did not "exempt the money or assets at issue"[8] unless such amounts were maintained in the *original* "fund or account." The court determined that the inherited IRA was a *different* fund or account that was "created when the original fund or account passes to a beneficiary upon the death of the participant."[9] The court also reasoned that the availability of the creditor exemption for the IRA was a function of the fund's tax-exempt status.[10] Once the IRA was transferred to an inherited IRA upon the death of the original owner, the Second District Court of Appeals concluded that the tax-exempt status of the original account changed and the exemption vanished.

The strand of the Second District Court of Appeals' analysis that draws a distinction between the original and subsequent funds or accounts is an incorrect interpretation of the statute. Section 222.21(2)(a) of the Florida Statute by its terms makes the interest of *any* beneficiary – without qualification – exempt. If, as the *Robertson* court reasoned, an IRA is not exempt because it "passes to a beneficiary upon the death of the participant," the word "beneficiary" in Section 222.21(2)(a) of the Florida Statutes would become superfluous. The Florida legislature meant to protect the interests of *all* beneficiaries in inherited IRAs; courts in this state do not have the power to arbitrarily ignore or constructively delete statutory provisions.

The Second District Court of Appeals' distinction between the tax status of the original and the inherited IRA is similarly misguided (and largely incorrect). The court noted that while inherited IRAs are exempt from taxes until distributions are made to the beneficiary, beneficiaries of inherited IRAs are required to take distributions. What the court did *not* note is that, generally, the original owner also is required to take minimum annual distributions upon reaching age 70 ½, that beneficiaries of inherited IRAs also are required to take minimum annual withdrawals from an inherited IRA, and that both "owner IRAs" and inherited, beneficiary-type IRAs are exempt from federal income taxes under the same federal statutory provisions. If the *Robertson* court's "tax classification" analysis were correct, then no beneficiary could ever have a protected interest in an inherited IRA, making the use of the term "beneficiary" in Florida Statutes Section 222.21(2)(a) a nullity.

(2) *In Re Ard*

In *In re Ard*, Case No. 8:09-bk-22280-KRM, Chapter 7, WL3400368 (Brkrtcy. M.D.Fla) (August 18, 2010), the Bankruptcy Court for the Middle District of Florida concluded that a Chapter 7 debtor's interest in her father's inherited IRA was not exempt from creditors claims. The Bankruptcy Court noted a handful of decisions in courts applying the laws of other states, and conceded that "the outcome of each of these cases turned on the particular language of each states' laws applicable to the exemption of IRAs." *Id.* Nevertheless, the *Ard* court ignored the language in the Section 222.21 of the Florida Statutes and followed the reasoning of *Robertson,* concluding that the funds in the original IRA did not retain the same tax exempt status after being transferred to the debtor's inherited IRA.

III. ANALYSIS

The proposal would clarify Florida Statutes Section 222.21(2)(c) by adding a provision stating an IRA that is exempt in the hands of the owner under Section 222.21(2)(a) continues to be exempt if the original IRA is transferred to an inherited IRA. Because the term "inherited IRA" is sometimes used imprecisely, the statutory provision defines the term with reference to the definition of "inherited IRA" in the Internal Revenue Code.

The proposal is intended to override the incorrect results reached by the courts in *Robertson* and *Ard,* and to ensure that the intent of the Florida Legislature to exempt the interests of a beneficiary in an inherited IRA from the beneficiary's creditors, is given effect.

IV. FISCAL IMPACT ON STATE AND LOCAL GOVERNMENTS

The proposal does not have a fiscal impact on state or local governments.

V. DIRECT IMPACT ON PRIVATE SECTOR

The proposal will not have a direct economic impact on the private sector.

VI. CONSTITUTIONAL ISSUES

There appear to be no constitutional issues raised by this proposal.

VII. OTHER INTERESTED PARTIES

Other interested parties include The Florida Bankers Association, and the Tax and Business Law Sections of The Florida Bar.

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[1] Fla. Laws Ch. 87-375, § 1
[2] *See* E. Jackson Boggs and Steven K Barber, *New Florida Statute Protects Retirement Plan Assets for Claims of Creditors*, 61 FLA. B.J. 51 (Nov.1987).
[3] *Id*. at 52
[4] Fla. Staff Analysis S.B. 660 (3/22/05)
[5] *Id.*
[6] *Robertson*, 16 So. 3d at 937
[7] *Id*. at 938
[8] *Id.*
[9] *Id.*
[10] *Id.* at 939