No. 13-299

IN THE

Supreme Court of the United States

BRANDON C. CLARK AND HEIDI K. HEFFRON-CLARK,
Petitioners,

v.

WILLIAM J. RAMEKER, TRUSTEE, ET AL.,
Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF OF THE NATIONAL ASSOCIATION OF CONSUMER BANKRUPTCY ATTORNEYS AS AMICUS CURIAE IN SUPPORT OF PETITIONERS

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TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES iii

INTEREST OF AMICUS CURIAE 1

SUMMARY OF ARGUMENT 2

ARGUMENT 4

I. CONGRESS INTENDED AND DRAFTED THE RETIREMENT FUNDS EXEMPTION TO BE STRAIGHTFORWARD AND BROAD 4

A. The Bankruptcy Estate And Exemptions 5

B. In Protecting Retirement Savings, Congress Rejected Limitations Established Under State Law And In Prior Court Decisions 7

C. The Plain Language Of The Retirement Funds Exemption Is Entirely Consistent With Congress's Intent To Establish A Uniform Exemption For All Types Of Tax-Favored Retirement Plan Assets 10

TABLE OF CONTENTS—*Continued*

Page

II. THE COURT OF APPEALS' DECISION BELOW INJECTS UNCERTAINTY INTO THE SCOPE OF THE RETIREMENT FUNDS EXEMPTION AND OPENS THE DOOR TO A HOST OF PRACTICAL PROBLEMS. 13

CONCLUSION 16

TABLE OF AUTHORITIES

Page(s)

Cases:

Burlingham v. Crouse,
228 U.S. 459 (1913) 5

Hamilton v. Lanning,
560 U.S. 505 (2010) 8

Hartford Underwriters Ins. Co. v. Union Planters Bank, N.A.,
530 U.S. 1 (2000) 11

In re Barshak,
106 F.3d 501 (3d Cir. 1997)..............................9

In re Chilton,
674 F.3d 486 (5th Cir. 2012) 11, 12-13

In re Clark,
711 F.2d 21 (3d Cir. 1983).............................10

In re Clark,
714 F.3d 559 (7th Cir. 2013) 12, 13, 14

In re Goldman,
192 B.R. 1 (D. Mass. 1996).............................10

In re Kulp,
949 F.2d 1106 (10th Cir. 1991) 9

In re Nessa,
426 B.R. 312 (B.A.P. 8th Cir. 2010)..............11

TABLE OF AUTHORITIES—*Continued*

Page(s)

Lamie v. United States Trustee,
540 U.S. 526 (2004) 11

Owen v. Owen,
500 U.S. 305 (1991) 6

Patterson v. Shumate,
504 U.S. 753 (1992) 5

Rousey v. Jacoway,
544 U.S. 320 (2005) 6

Schwab v. Reilly,
560 U.S. 770 (2010) 1

Taylor v. Freeland & Kronz,
503 U.S. 638 (1992) 6

United States Aid Funds, Inc. v. Espinosa,
559 U.S. 260 (2010) 1

Constitutional Provisions and Statutes:

U.S. Const., art. I, § 8, cl. 4 ....2, 5

11 U.S.C. § 362(b)(19) 8

11 U.S.C. § 522 2

11 U.S.C. § 522(b)(1) 6

11 U.S.C. § 522(b)(3)(A) 6

TABLE OF AUTHORITIES—*Continued*

Page(s)

11 U.S.C. § 522(b)(3)(B) 6

11 U.S.C. § 522(b)(3)(C) 2, 6, 8, 11

11 U.S.C. § 522(b)(4) 8

11 U.S.C. § 522(b)(4)(C) 3, 12, 16

11 U.S.C. § 522(d)...6

11 U.S.C. § 522(d)(1), (2), (3), (6), (8), (11)(D) 6

11 U.S.C. § 522(d)(12) 2, 8, 11

11 U.S.C. § 522(n) 10

11 U.S.C. § 523(a)(18) 8

11 U.S.C. § 541(a)...5

11 U.S.C. § 541(b)...5

11 U.S.C. § 541(c)(2)...5

11 U.S.C. § 704(a)(1) 7

11 U.S.C. § 1322(f) 8

11 U.S.C. § 1325(a)(4) 7

11 U.S.C. § 1325(b)(5) 8

26 U.S.C. § 72(t)(2)(A)(ii) 15

26 U.S.C. § 72(t)(2)(B)...15

26 U.S.C. § 408(d)(3) 11-12

26 U.S.C. § 408(e)(1) 12

42 Pa. Con. Stat. Ann. § 8124(b)(1)(ix)(1997) 9

TABLE OF AUTHORITIES—*Continued*

Page(s)

H.R. REP. No. 95-595, at 117 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963 6

H.R. REP. No. 109-31(I), pt.1 at 63-64 (2005).............9

144 Cong. Rec. S10508-01 (Sept. 17, 1998)................9

144 Cong. Rec. S10596-01 (Sept. 18, 1998)................8

Pub. L. No. 109-8, 119 Stat. 23, § 224 (2005).............9

IRS Publication 590, at 94..14

INTEREST OF AMICUS CURIAE

The National Association of Consumer Bankruptcy Attorneys, or NACBA, is a non-profit organization of more than 3,500 consumer bankruptcy attorneys practicing throughout the country. Incorporated in 1992, NACBA is the only nationwide association of attorneys organized specifically to protect the rights of consumer bankruptcy debtors.

Among other things, NACBA works to educate the bankruptcy bar and the community at large on the uses and misuses of the consumer bankruptcy process. NACBA also advocates for consumer debtors on issues that cannot be addressed adequately by individual member attorneys. NACBA has filed amicus briefs in this Court in several cases involving the rights of consumer debtors. *See, e.g.*, *Schwab v. Reilly*, 560 U.S. 770 (2010); *United States Aid Funds, Inc. v. Espinosa*, 559 U.S. 260 (2010).

The resolution of the question presented in this case is of substantial importance to NACBA. The Bankruptcy Code permits individual debtors to exempt from their bankruptcy estate certain property which either Congress or a State's legislature has deemed worthy of special protection, thereby putting that property beyond the reach of the trustee and creditors. In consumer bankruptcy cases, exemptions serve the overriding purpose of helping individual debtors obtain a fresh start. In 2005, Congress enacted a broad, uniform exemption for all types of tax-favored, retirement plans to eliminate uncertainty then existing in the law around the country. The uniformity and clarity that Congress achieved with the new statutory language has been muddied by the court of appeals decision below, and its judicial carve out for "inherited IRAs" from the

exemption. The decision injects uncertainty into the scope of the retirement fund exemption and opens up a host of practical problems upon which NACBA has a unique perspective.[1]

SUMMARY OF ARGUMENT

I. Through the Bankruptcy Clause of the U.S. Constitution, Congress is given the power to adjust debtor-creditor relationships. U.S. CONST., art. I, § 8, cl. 4. In furtherance of that power, Congress determines, among other things, what property a debtor may shield from his creditors in bankruptcy. *See* 11 U.S.C. § 522. Congress has determined that this protected, or exempt, property is fundamental to the debtor's fresh start provided by bankruptcy law.

At issue in this case is an exemption enacted by Congress in 2005, which allows bankruptcy debtors to keep, free of creditors' claims, "retirement funds to the extent that those funds are in a fund or account that is exempt from taxation under section 401, 403 408, 408A, 414, 457, or 501(a) of the Internal Revenue Code of 1986." 11 U.S.C. §§ 522(b)(3)(C), 522(d)(12). Congress enacted this exemption in order to provide a uniform exemption for all types of tax-favored retirement plan assets in bankruptcy. The exemption is both straightforward and broad. It has only two requirements: 1) the funds must be re-

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[1] No counsel for a party authored this brief in whole or in part, and no person or entity other than NACBA, its members, and its counsel made any monetary contribution toward the preparation or submission of this brief. Petitioner's written consent for the submission of this brief is on file with the Clerk of the Court. A letter of consent from the Respondent accompanies the brief.

tirement funds, and 2) the funds must be in an account exempt from taxation under certain sections of the Internal Revenue Code. Further, Congress has specified that the direct transfer (*i.e.*, a trustee-to-trustee transfer) of funds from one tax-exempt account to another tax-exempt account does not disqualify the funds from exemption. 11 U.S.C. § 522(b)(4)(C). Moreover, nothing in the transfer provision requires that the transferee account be maintained for the debtor's retirement or that the debtor must have herself saved the funds in the account in contemplation of retirement.

Here, the retirement funds of Ruth Heffron were in an IRA—one of the enumerated types of tax-exempt accounts listed in the statute. Upon Ruth's death, those funds passed to her beneficiary and daughter, Heidi Heffron-Clark. The funds were subsequently moved to another tax-exempt account via a trustee-to-trustee transfer. In Heidi's later bankruptcy, she properly exempted these funds because they squarely fit within the requirements for exemption set forth by Congress.

II. The decision of the court of appeals below creates unnecessary limitations and practical difficulties in the application of an exemption that Congress was at pains to broaden and clarify. To determine whether funds are "retirement funds," the court created and applied varying tests related to the debtor's retirement status, the source of funds, the necessity for minimum distributions, and the applicability of tax penalties for withdrawals. By inventing these tests for determining whether funds are "retirement funds," the decision of the court of appeals opens up a Pandora's Box of litigation that destroys the efficiency created by the objective statutory presumption written by Congress.

ARGUMENT

I. CONGRESS INTENDED AND DRAFTED THE RETIREMENT FUNDS EXEMPTION TO BE STRAIGHTFORWARD AND BROAD.

In the 2005 amendments to the Bankruptcy Code, Congress enacted, among other things, a package of provisions designed to expand protection for tax-favored retirement plans. Included in these provisions is a uniform exemption, applicable to all individual debtors, for retirement funds in certain tax-exempt accounts. The exemption shields these funds and makes them unavailable to the bankruptcy trustee or creditors. The exemption has only two requirements: 1) the funds must be retirement funds, and 2) the funds must be in an account exempt from taxation under certain sections of the Internal Revenue Code. Funds transferred directly (*i.e.*, in a trustee-to-trustee transfer) from one tax-exempt account to another tax-exempt account are not disqualified from the exemption.

Here, the funds at issue fit squarely within the exemption. Ruth Heffron placed retirement funds into an Individual Retirement Account ("IRA"), one of the enumerated types of tax-exempt accounts listed in the statute. Ruth named her daughter, Heidi Heffron-Clark, as the IRA beneficiary. Upon Ruth's death, the funds in the IRA passed to Heidi, and were subsequently transferred via a trustee-to-trustee transfer into an enumerated tax-exempt account belonging to Heidi. Because the transfer did not disqualify the funds from exemption, Heidi, the transferee, properly claimed them as exempt in her chapter 7 bankruptcy case. Nothing in the Bankruptcy Code requires that the transferee account be maintained for Heidi's retirement or that

Heidi must have herself saved the funds in the account in contemplation of her retirement.

A. The Bankruptcy Estate And Exemptions.

Bankruptcy law reflects a balancing act in which Congress has established the rules for adjusting debtor-creditor relationships. The importance of this regime to the national welfare, and the delicacy of the task, are suggested by the Framers' assignment to Congress of the power to "establish . . . uniform Laws on the subject . . ." U.S. CONST., art. I, § 8, cl. 4. The two main purposes of bankruptcy are to provide a fresh start to the debtor and to facilitate the fair and orderly repayment of creditors to the extent possible. *See Burlingham v. Crouse*, 228 U.S. 459, 473 (1913). To achieve these dual goals, the Bankruptcy Code first creates a bankruptcy estate upon commencement of a case. 11 U.S.C. § 541(a). Section 541(a) defines the bankruptcy estate and contains an expansive definition of property that includes all debtors' legal or equitable interests in property whether tangible or intangible, real or personal.

Some property, however, is specifically excluded from becoming property of the estate. 11 U.S.C. § 541(b). For example, property in a trust that cannot be transferred to any other person is excluded from the bankruptcy estate. 11 U.S.C. § 541(c)(2). This Court has held that debtors' interests in pension plans subject to the Employee Retirement Income Security Act of 1974 (ERISA) are not property of the bankruptcy estate, because benefits provided under such plans may not be assigned or alienated. *Patterson v. Shumate,* 504 U.S. 753 (1992).

Other property initially considered part of the bankruptcy estate may be removed from the estate through the exemption process. *See Taylor* v. *Freeland & Kronz*, 503 U.S. 638, 642 (1992) (Bankruptcy Code "allows the debtor to prevent the distribution of certain property by claiming it as exempt"). Exemptions serve the overriding purpose of helping the debtor to obtain a fresh start by maintaining essential property. *See* H.R. REP. No. 95-595, at 117 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6078 (purpose of this scheme is to provide "adequate exemptions and other protections to ensure that bankruptcy will provide a fresh start."); *Rousey v. Jacoway*, 544 U.S. 320, 322, 325 (2005). In some states the debtor is given a choice between using either the state exemptions or the federal exemptions. Section 522(d) lists the exemptions available under the federal exemption scheme. These include among other things a certain amount of equity in the debtor's home or vehicle, household furnishings, tools of the debtor's trade, unmatured life insurance policies, and personal injury claims. 11 U.S.C. § 522(d)(1), (2), (3), (6), (8), (11)(D).

Some states, as authorized by the Code, have "opted-out" out of the federal bankruptcy exemption scheme. *See* 11 U.S.C. § 522(b)(1); *Owen* v. *Owen*, 500 U.S. 305, 308 (1991). In those states debtors must choose exemptions under state law. In addition, the Bankruptcy Code permits debtors choosing state law exemptions to exempt certain retirement funds, to exempt property held as tenants by the entireties, and to use any other federal nonbankruptcy law exemption. 11 U.S.C. § 522(b)(3)(A), (B), (C).

Exempt property is removed from the bankruptcy estate and shielded from administration by the trustee. In chapter 7, the trustee may sell prop-

erty of the estate that is not exempt and distribute the proceeds to creditors in accordance with the priorities set forth in the Bankruptcy Code. *See* 11 U.S.C. § 704(a)(1) (the trustee shall collect and reduce to money property of the estate); § 507 (setting forth priorities for distribution); § 726 (setting forth order of distribution). In chapter 13, where unsecured creditors must be paid at least as much through a debt adjustment plan as they would receive in a chapter 7, the debtor may need to pay an amount equal to the value of non-exempt property into her plan if she wants to retain that property. 11 U.S.C. § 1325(a)(4).

As the current Bankruptcy Code reflects, Congress has specifically considered and resolved a variety of issues relating to exemptions, including the nature and scope of permissible exemptions, the States' role in defining them, and the procedures for claiming and objecting to exemptions. That is, in fulfillment of its assigned Constitutional duty, Congress has already made the difficult choices regarding exemptions, balancing the economic harm that exemptions visit on creditors with the need to provide the debtor a fresh start.

B. In Protecting Retirement Savings In Bankruptcy, Congress Rejected Limitations Established Under State Law And In Prior Court Decisions.

The exemption at issue in this case was enacted as part of the 2005 amendments to Bankruptcy Code, and it applies to, "retirement funds to the extent that those funds are in a fund or account that is exempt from taxation under section 401, 403 408,

408A, 414, 457, or 501(a) of the Internal Revenue Code of 1986." 11 U.S.C. § 522(b)(3)(C). This exemption was part of a broader package of provisions in the 2005 amendments that protected tax-qualified retirement plans. *See* 11 U.S.C. §§ 362(b)(19), 522(b)(3)(C), (b)(4), (d)(12), 523(a)(18), 1322(f). Section 362(b)(19) excepts from the automatic stay withholding from the debtor's income for repayment of loans from tax-qualified accounts. Section 522(b)(3)(C) and 522(d)(12) have identical language, which is at issue in this case, and protect retirement funds in certain tax-exempt accounts. Section 522(b)(4) establishes a presumption in favor of exemption when the retirement fund has received a favorable determination from the Internal Revenue Service, and also applies the exemption to certain transfers from one tax-exempt account to another. Section 523(a)(18) excepts from discharge retirement plan loans. Finally, section 1322(f) limits the ability of a debtor to alter the terms of a retirement plan loan in a chapter 13 plan and specifies that funds used to repay those loans are not "disposable income" for purposes of the chapter 13 projected disposable income test. 11 U.S.C. § 1325(b)(5); *see Hamilton v. Lanning*, 560 U.S. 505 (2010) (discussing the projected disposable income test in chapter 13).

All of these sections have their origins in an amendment to the Consumer Bankruptcy Reform Act of 1998, known as the "Hatch Amendment." *See* H.R. 3150, 105th Cong. (1998); 144 Cong. Rec. S10596-01 (Sept. 18, 1998) (Amendment 3600: Protection of Retirement Savings). The purpose of the amendment was straightforward and broad. According to Senator Hatch, one of the co-sponsors of the amendment, the statutory language was designed to:

"Provide a uniform exemption for all types of tax-favored qualified pension plan assets in bankruptcy including Roth IRAs whose status under current bankruptcy law is uncertain, protect retirement assets that are in the process of being rolled over into a new qualified plan, and protect loans from pension funds in bankruptcy." 144 Cong. Rec. S10508-01 (Sept. 17, 1998). Approval of the amendment was unanimous, *see id.*, and the language of the amendment carried through seven more years of congressional debate on bankruptcy reform virtually unchanged, and was finally enacted as part of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, 119 Stat. 23, § 224 (2005).

With the 2005 amendment to the Bankruptcy Code, Congress expanded the protection for tax-favored retirement plans by providing standard federal exemptions to supplement the patchwork of state law exemptions that sometimes did not suffice to exempt IRAs from a debtor's estate. *See* H.R. REP. No. 109-31(I), pt.1 at 63-64 (2005) (intent to "expand the protection for tax-favored retirement plans or arrangements that may not be already protected" under the Code, or other state or federal law.) For example, just prior to the Hatch Amendment, the Pennsylvania exemption statute allowed the debtor to exempt only $15,000 in rollover contributions from an employee benefit plan to an IRA. 42 Pa. Con. Stat. Ann. § 8124(b)(1)(ix)(1997); *In re Barshak*, 106 F.3d 501 (3d Cir. 1997) (debtor could exempt only $15,000 of $71,134 of rolled over funds). Under Colorado law, debtors were permitted to exempt 75% of the entire balance in their IRA account. *See In re Kulp*, 949 F.2d 1106, 1108 (10th Cir. 1991). A debtor in Massachusetts was able to exempt up to seven

percent of his income within five years before he filed for bankruptcy. *See In re Goldman*, 192 B.R. 1 (D. Mass. 1996). All of the varied state law protections were supplemented by the uniform federal exemption, which effectively established a floor, but not a ceiling, for retirement fund exemptions. Also abrogated by the new federal exemption were cases such as *In re Clark*, 711 F.2d 21 (3d Cir. 1983), which held that the exemption of funds in a Keogh retirement plan depended on whether the debtor at the time of the petition was receiving, or was eligible to receive, distributions (*i.e*, whether the debtor had reached the age of 59½). In creating a uniform exemption for all types of tax-qualified retirement plans, Congress included no limitations based on the debtor's age, the debtor's income, the debtor's current use of the funds, the debtor's contemplated use of the funds, or the debtor's actual use of the funds. But, where Congress did desire a limitation, it imposed one expressly. Thus, the protection granted in bankruptcy to any individual debtor's IRAs has an aggregate cap of $1,245,475. 11 U.S.C. § 522(n) (originally $1 million, the amount is adjusted every three years for inflation). This amount can be increased if the interest of justice so require. *Id.*

C. The Plain Language Of The Retirement Funds Exemption Is Entirely Consistent With Congress's Intent To Establish A Uniform Exemption For All Types Of Tax-Favored Retirement Plan Assets.

"'[W]hen the statute's language is plain, the sole function of the courts—at least where the disposition required by the test is not absurd—is to en-

force it according to its terms.'" *Lamie v. United States Trustee*, 540 U.S. 526, 534 (2004), *quoting Hartford Underwriters Ins. Co. v. Union Planters Bank, N.A.*, 530 U.S. 1, 6 (2000). The text of the statute here is not only plain and dispositive, it is also consistent with Congress's intent to create a uniform exemption for all types of tax-exempt retirement plans. Section 522(b)(3)(C) exempts "retirement funds to the extent that those funds are in a fund or account that is exempt from taxation under section 401, 403 408, 408A, 414, 457, or 501(a) of the Internal Revenue Code of 1986." As the Fifth Circuit Court of Appeals in *In re Chilton*, 674 F.3d 486 (5th Cir. 2012), correctly recognized when construing the parallel requirements of section 522(d)(12), the statute imposes only two requirements before a debtor may claim the exemption: "(1) the amount the debtor seeks to exempt must be retirement funds; and (2) the retirement funds must be in an account that is exempt from taxation under one of the provisions of the Internal Revenue Code set forth therein." *Id.* at 488, *citing In re Nessa*, 426 B.R. 312, 314 (B.A.P. 8th Cir. 2010). In *Chilton*, the court recognized that the debtor's inherited IRA satisfied both statutory conditions. 674 F.3d at 489-90. The funds were retirement funds in a tax-exempt account and those funds were transferred directly to another tax-exempt account. That ended the matter, as it should here.

There is no dispute that the funds in question in this case were in one of the specified accounts while Ruth Heffron, Heidi Heffron-Clark's mother, was alive. Nor is there any legitimate dispute that the funds were transferred, by means of a lawful and appropriate trustee-to-trustee transaction, into one of those specified accounts after the IRA passed to Heidi as the result of her mother's death. *See* 26

U.S.C. § 408(d)(3) (inherited IRA may be transferred via a direct trustee-to-trustee transfer without tax consequences). The transfer did not affect their exempt status under the Bankruptcy Code. 11 U.S.C. § 522(b)(4)(C). Moreover, the funds at issue remained in that tax-qualified transferee account as of the date of the filing of the petition.

Furthermore, there is no dispute that the money contained in the transferee account constituted "retirement funds" when that money was originally deposited into the IRA. The court of appeals, however, denied Heidi's exemption because it decided that the money contained in the transferee account did not constitute *Heidi's* "retirement funds." That is, according to the court of appeals, the retirement funds in the IRA of Ruth Heffron, debtor's mother, ceased to be anyone's "retirement funds" upon her death. *In re Clark,* 714 F.3d 559, 561 (7th Cir. 2013).

The court of appeals' view is inconsistent with the plain language of the statute. Nothing in the transfer provision, 11 U.S.C. § 522(b)(4)(C), requires that the account into which the funds are transferred be one established or maintained for the debtor's retirement, or that the funds in that account necessarily have been saved by the debtor in contemplation of her retirement. All that the statute requires is that the transferee account be one that is "exempt from taxation under" certain Internal Revenue Code provisions. Heidi's account, into which her late mother's retirement funds were transferred, is in fact tax exempt under these provisions of tax law. In this case, the transferee account is tax exempt under 26 U.S.C. § 408(e)(1), which expressly provides that "[a]ny individual retirement account is exempt from taxation..." *See Chilton*, 674 F.3d at

489. Funds held in a transferee account do not lose their original status as "retirement funds" under federal law due to the transfer from one tax-exempt account to another.

II. The Court Of Appeals' Decision Below Injects Uncertainty Into The Scope Of The Retirement Funds Exemption And Opens The Door To A Host Of Practical Problems.

In reaching its decision, the court of appeals below used several litmus tests for determining whether funds were "retirement funds." The first test relates to the source of the funds and the reason the funds were set aside. The second test considers restrictions on withdrawals. The third test looks at limitations on distributions. Each test was applied by the court of appeals to a single factual scenario that produced a result consistent with the court's ultimate holding. That holding carves out an exception, for non-spouse, inherited IRAs, to the broad exemption language Congress enacted.

The court of appeals stated that an IRA "by which a person provides for his or her own retirement" meets the "retirement fund" requirement. *Clark*, 714 F.3d at 560. That is, if the debtor is the source of the funds set aside and the reason for setting aside the funds is to provide for the debtor's retirement then the funds are "retirement funds." However, applying this source and reason test to an IRA inherited by a spouse would result in funds that are not exempt because the surviving spouse was not necessarily the source of the funds and the funds were not set aside to support the surviving spouse's retirement. Therefore, the court of appeals applied a

different test to this factual scenario, stating that the money remains "retirement funds" because the surviving spouse cannot withdraw any of the money before age 59½ without paying a penalty tax. *See id*. For all other inherited IRAs, the court of appeals held that the determinative question was whether money could be held in the account until the current owner retires, and concluded that non-spouse inherited IRAs are "not savings reserved for use after their owners stop working." *Clark*, 714 F.3d at 562. From a practical perspective, it is impossible to know which test to apply in other factual scenarios. This can be illustrated with a few examples.

- Debtor is 62 years old and retired when his 85-year old father's IRA passes to him on account of his father's death. There is no question that the funds in the inherited IRA will be used to support the debtor in retirement since he has already stopped working. Under the court of appeals' first test—the source/purpose test—the funds would not be exempt because though used by the debtor for retirement, the debtor was not the source of the funds. However, under the court of appeals' third test—whether funds could be held in the account until the current owner retires—the inherited IRA would be exempt.

- Debtor is 45 years old and has inherited an IRA from her mother. Every year she takes the minimum distribution required by the Tax Code based on her projected life expectancy. *See* IRS Single Life Expectancy Table, IRS Publication 590, at 94. She files for bankruptcy at age 50. Based on her minimum required distribution, a significant amount would still be in the account when she plans to retire at age 70, perhaps more than was in the account initially. Since she plans to use as much of the account

as possible to support her retirement, the court of appeals interpretation leaves entirely unclear whether she can exempt all the funds, a portion of the funds equivalent to what she expects to use in retirement, or none of the funds.

• Debtor is 58 years old and searching for employment, or in the alternative contemplating retirement. Three years ago her spouse died. As the beneficiary of her deceased spouse's IRA, she elected to transfer the funds into an inherited IRA (beneficiary) account instead of her own IRA account. As a result, she is able to take distributions without penalty. *See* 26 U.S.C. § 72(t)(2)(A)(ii). Because there is no penalty, does her inherited IRA account now become nonexempt under the court of appeals' decision?

• Debtor is 71 years old and employed. The debtor is required to take minimum distributions from his IRA account, as would be the case with most other types of tax-favored retirement accounts. The court of appeals' decision suggests that the debtor's retirement funds would not be exempt because, like Heidi Heffron-Clark, the debtor must take minimum distributions, which are used for current consumption.

• Debtors filed a chapter 13 case and exempted their retirement funds in IRA accounts. During their five-year plan, debtors experienced medical problems for which they had to pay $4,500 out-of-pocket for medical expenses. Debtors take a penalty-free distribution from their IRA to pay for these medical expenses. *See* 26 U.S.C 72(t)(2)(B). Because the funds were not actually used for retirement purposes, the court of appeals' formula creates uncertainty as to whether the chapter 13 trustee would be

able to seek a modification of the debtors' chapter 13 plan claiming that the $4,500 is a non-exempt asset or is income.

Affirmance of the court of appeals decision would unnecessarily open a Pandora's Box of litigation around the term "retirement funds." Under the decision of the court of appeals whether funds constitute "retirement funds" depends on a host of factors including the debtor's age, retirement status (retired or not), minimum distribution requirements, the applicability of tax penalties, and whether the funds are actually used for retirement purposes. Congress enacted the retirement funds exemption specifically to eliminate this same panoply of questions and limitations that existed under state law and prior court decisions. Furthermore, the efficiency created by the presumption that retirement funds are exempt if the fund has received a favorable determination from the Internal Revenue Service would be lost. 11 U.S.C. § 522(b)(4)(C). At bottom, the reasoning used by the court of appeals is unworkable in practice and stands in stark contrast to the simplicity of the exemption, as written by Congress, and as recognized by the appellate courts in other circuits. It creates uncertainty in the application of a statute that has plain meaning.

CONCLUSION

The judgment of the court of appeals should be reversed.

Respectfully submitted,

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