Take-Away: An *exempt* asset is no longer exempt when it is held in the hands of its owner.

Background: In the past we have covered from time-to-time Michigan's exempt property statute, regarding assets like IRAs, Roth IRAs, and life insurance cash surrender values which are exempt from creditor claims. We have also covered how the Employee Retirement Income Security Act (ERISA) protects qualified plan accounts from a plan participant's creditor claims. These statutes are designed to provide protection to the asset-owner to assure that income will be available to the account or asset owner in retirement. However, that statutory protection from creditor claims is not absolute in some circumstances. In addition, the presence of an exemption in the statute can be misleading. For example, under Michigan's exempt property statute as it is currently written and construed by courts, **only one IRA is exempt from creditor claims.** In addition, even though the title is held in the name of 'IRA', and inherited IRA is not protected from creditor claims against the IRA's designated beneficiary. [A handful of states have extended creditor *exempt* status to inherited IRAs, but not Michigan yet.] These limits of protection afforded to retirement assets and life insurance proceeds was recently reaffirmed in a Michigan Court of Appeals decision;

In re Estate of Jennifer L. Fowler, Michigan Court of Appeals, No. 365600 (July 18, 2024)

Facts: The facts are admittedly strange. Helen had four children. Helen was diagnosed with dementia and lived in assisted living. One of Helen's daughters, Jennifer, took Helen from assisted living to Jennifer's home. There, Jennifer fatally shot Helen and herself. Another daughter of Helen, named as Personal Representative, filed a wrongful-death action against Jennifer's estate, and a jury awarded damages to Helen's estate for $557,105 for lost society and companionship. With interest, at the time of trial that judgment was about $625,000.

Declaratory Judgement: Helen's estate then filed a claim against Jennifer's estate for the value of the wrongful death claim. Jennifer's Trust then filed a declaratory judgment action to determine what assets of the Trust could be used to satisfy the Helen's estate judgment. Jennifer had through her employment life insurance, a death benefit in the amount of $438,385 that was paid to Jennifer's Trust. Jennifer also participated in a 401(k) plan through her employment (with DTE Electric), a stock savings plan. That Savings & Stock Plan also named Jennifer's Trust as her designated beneficiary. That qualified plan contained the following provision: **(5) Death of Beneficiary.** ***If a Beneficiary who is entitled to receive payments from the Trust Fund dies before receiving all payments due, any remaining benefit shall be paid to the Beneficiary's estate in a lump sum.***

Dispute: Jennifer's Trust took the position that both the life insurance proceeds that it received (actually the death benefit was paid into the probate by Met Life) and the 401(k) balance were exempt under the Michigan Trust Code [MCL 700.7605(2)] which provides, in part:

1. *The property of a trust over which the settlor has the right without regard to the settlor's mental capacity, at his or her death, either alone or in conjunction with another person, to revoke the trust and revest principal in himself or herself is subject to all of the following, but only to the extent that the settlor's property subject to probate administration is insufficient to satisfy the following expenses, claims, and allowances: (a) the administration expenses of the settlor's estate; (b) An enforceable and timely presented claim of a creditor of the settlor, including a claim for the settlor's funeral and burial expenses; (c) Homestead, family and exempt property allowances.*
2. *A trust established as part of, and all payments from an employee annuity described in section 403 of the internal revenue code, an individual retirement account described in section 408 of the internal revenue code, ...or a retirement or other plan that is qualified under section 401 of the internal revenue code, shall not be considered to be a trust described in subsection (1).*

With respect to the life insurance proceeds, Jennifer's Trust argued that the life insurance proceeds did not become property *until* after Jennifer's death, and thus they were not subject to MCL 700.7605(1).

Probate Court: The court found that Jennifer's 401(k) account was not available to pay her creditors under ERISA. The probate court also held that the Met Life death benefit was available to satisfy the judgment obtains by Helen's estate.

Court of Appeals: The court on appeal affirmed the probate court's decision that the life insurance death benefit was available to satisfy the judgment obtained by Helen's estate. This court reversed the probate court on the availability of Jennifer's 401(k) account, finding that it, too, could be attached and taken to apply towards Helen's estate's judgment.

401(k) Availability: The Savings & Stock Plan provided that after Jennifer's death, any remaining funds were to be paid to fund her estate in a lump sum if there was no surviving beneficiary.

"Any remaining funds after Jennifer's death converted to a lump-sum payment. This asset no longer involved a retirement account administered by DTE. Upon the sum-sum conversion, the funds were no longer part of the Savings & Stock Plan subject to federal regulations for retirement accounts. For this reason, the probate court erred by ruling that MCL 700.6505(2) applied to prohibit Helen's estate from reaching the lump-sum payment of the remaining 401(k) account funds… ERISA's anti-alienation provision only obligates protecting benefits up to the point of payment. Once a pension plan has sent payments to the beneficiary, relinquishing control over the payments, attachment of those funds by a creditor does not involve the alienation of the benefits… A different result occurs if funds are diverted before they are paid out…[t]hat protection is lost once the beneficiary receives the funds… ERISA is intended to protect retirement assets, but the lump-sum payment due Jennifer's trust can no longer be considered a retirement account."

Consequently, to the extent that the assets in Jennifer's estate were insufficient to satisfy her debts, the 401(k) account paid in a lump sum to her trust were funds that became available to satisfy Helen's estate judgment.

IRA Availability: While not on point with the facts of the *Fowler* case, the Court of Appeals cited at length a Kansas court decision that found that while IRA assets were exempt under a comparable statute to Michigan's exempt property statute, those IRA assets made payable to the IRA owner's trust can also be reached by the account owner's creditors after death, since that 'statutory exemption is not transferrable and disappears on the death of the settlor, citing the Michigan case *In re Vary Estate, 401 Mich 340 (1977)* (dealing with Social Security benefits) noting that "*exemption is a protection that does not survive the individual. It is a person protection which dies with the beneficiary.*"

Life Insurance Proceeds: Under Michigan statute life insurance proceeds intended to provide for a decedent's dependents may be exempt from the claims of the decedent-insured's creditors. [MCL 500.2207(1) and (2).] However, with respect to Jennifer's Trust, none of the named beneficiaries of her trust was a dependent of Jennifer's.

"The purpose behind MCL 500.2207(1) is to shield from creditors insurance policies procured to protect an insured's dependents. MCL 500.2207(2) extends the

> exemption to other policies obtained under legitimate circumstances…Thus, MCL 500.2207(2) does not allow an insured to obtain coverage on his or her own life and shield the policy proceeds from the insured's creditors… Jennifer's trust cannot avoid the requirements of MCL 500.2207(2) by arguing that Jennifer's trust is a separate entity…Jennifer could have named the individual beneficiaries of her trust as direct beneficiaries of the life insurance policy to avoid this asset from being subject to her creditor claims, but she did not do so."

Conclusion: While Michigan follows a fairly broad exempt property statute when it comes to IRAs, and ERISA's spendthrift limitation is designed to preserve retirement assets for the retiree by all preempting state laws on retirement plan accounts, when those retirement assets come into the hands of the beneficiary on the account owner's death, the statutory exemption simply disappears. Hence, an inherited IRA is not protected from creditor claims of either the account owner or the account beneficiary under the current form of Michigan's e*xempt property* statute. Add while a 401(k) account is protected from the account owner's creditors, that lasts only so long as the assets remain inside the 401(k) account; once the 401(k) account assets are distributed to the account owner (or its beneficiary on the account owner's death) 'all bets are off.' As for life insurance proceeds, naming a trust as the beneficiary of the policy apparently will only work if the trust's beneficiaries are the insured's dependents. In sum, many of these assets are protected from creditor claims, but only up to a point, since the exemption dies with the account owner.