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REWRITING THE ODDS

INSIDE THIS ISSUE

SOUTH DAKOTA LEGISLATIVE UPDATE	2
E-STATE OF HOCKEY	2
UPDATED TRUST CODE PROVIDES NEW OPTION FOR MINNESOTA LITIGANTS	3
BANKRUPTCY AND INHERITED IRAS: THE IMPACT OF <i>CLARK V. RAMEKER</i>	5

SOUTH DAKOTA LEGISLATIVE UPDATE

SETH A. NIELSEN

The South Dakota Legislature continues to be on the forefront of innovation with respect to its trust laws. House Bill No. 1039, which was signed by the Governor on February 18, amended the state's directed trust statutes to include a new trust-related position, titled "family advisor." These new statutory provisions allow a settlor or the court to authorize a designated family advisor to consult with or advise a fiduciary on various matters, and to take other action, including removal and appointment of trustees, trust advisors, or members of any investment or distribution committee.

Despite the broad authority South Dakota has entrusted to this role, a family advisor is not a fiduciary and is not obligated to take any action at all. Further, any action taken is not subject to a "reasonableness standard" and is subject to judicial review only if the family advisor acts dishonestly or with an improper motive. Effective as of July 1, 2016, this new family advisor role is codified at S.D.C.L. §55-1B.

E-STATE OF HOCKEY



The Robins Kaplan Estate and Trust Group is going to watch the Minnesota Wild play the Colorado Avalanche in St. Paul on November 19, 2016. We have a limited number of tickets to our suite available for our loyal readers. Call Denise Rahne at 612-349-8433 if you are interested in joining us.



UPDATED TRUST CODE PROVIDES NEW OPTION FOR MINNESOTA LITIGANTS¹

DENISE S. RAHNE

For nearly three decades, the Minnesota Legislature made no significant changes to its trust laws—but a change has finally come. Effective January 1, 2016, the Legislature amended Minnesota's existing trust law to better align with the Uniform Trust Code (UTC). One of the key changes departs from Minnesota's traditional *in rem* framework as a sole option for jurisdiction, offering instead a first-of-its-kind system in which petitioners elect either *in rem* or *in personam* jurisdiction. This article examines the background of this significant change, specifics of the new approach, and the potential impact on trust litigants and their lawyers.

BACKGROUND OF REVISIONS TO MINNESOTA TRUST CODE

The Uniform Law Commission promulgated the UTC to fill gaps in state-specific trust laws and make the rules uniform across the nation. The Commission also aimed to provide a more complete model upon which to structure trust law and thereby better enable lawmakers and lawyers to understand, codify, and disseminate their states' laws on trusts. Very few states, however, have enacted the UTC without modifications because of radical differences in states' legislatures and judiciaries.

Thirty-two states, now including Minnesota, have adopted some variation of the UTC since its introduction by the Commission in 2000. Although Minnesota had its own statutory framework for issues surrounding the law of trusts and trust litigation, the UTC provides a more comprehensive and detailed model upon which the state now bases its trust code. The Minnesota Legislature passed the bill enacting the revised Minnesota Trust Code in its 2015 session, replacing many sections of Chapter 501B of the Minnesota Statutes. This new version of the Minnesota Trust Code is codified in Chapter 501C of the Minnesota Statutes and marks Minnesota's first large-scale alteration of its trust laws since 1989—a change that will have a direct impact on trust litigation in Minnesota.

Before the adoption of the new jurisdiction provision, the basis of jurisdiction for trust proceedings in Minnesota, unlike most other states, was exclusively *in rem*. See Minn. Stat. § 501B.24 (2014) (repealed 2015). Under this framework, Minnesota courts had jurisdiction over the property in the trust and could enter judgment solely against the property in question. This restrictive *in rem* requirement led to binding decisions on any claim related to the trust, including any future claims of potentially interested parties. *In rem* jurisdiction also allowed interested parties to obtain ongoing court supervision of the trust. But perhaps most significantly, *in rem* jurisdiction required publication of a notice of the order for hearing, and the court's orders were binding on all interested parties given reasonable notice of the order.

MINNESOTA'S NEW STATUTORY FRAMEWORK

The newly adopted jurisdiction provision of the Minnesota Trust Code, codified at Minn. Stat. § 501C.0201, provides the option for *in personam* jurisdiction in judicial proceedings. This amendment introduced an alternative to the previous *in rem* jurisdiction requirement, allowing more flexibility in trust litigation while preserving Minnesota's unique *in rem* jurisdiction as an option.

A party can now elect either *in rem* or *in personam* jurisdiction at the outset of a trust proceeding. Minn. Stat. § 501C.0201(c). This amendment requires petitioners to specify whether they are invoking *in rem* or *in personam* jurisdiction; otherwise, the court defaults to *in rem* jurisdiction. Unlike *in rem* jurisdiction, *in personam* jurisdiction grants the court authority to enter a decision against a person, rather than property. This amendment eliminates the need for publication of notice if petitioners choose *in personam* jurisdiction.

Although this new provision has caused a stir in the Minnesota legal community, it may not drastically transform the landscape of trust litigation because there are benefits and drawbacks to either proceeding choice. *In rem* jurisdiction, because of its binding decisions, provides petitioners with a sense of finality. As seen under the previous law, however, this option may raise privacy concerns because it requires the petitioner to publish notice in a legal newspaper in the county where the case is filed, as set forth in Minn. Stat. § 501C.0203.

By contrast, *in personam* jurisdiction allows the involved parties to keep the trust matter private because petitioners can individually serve all interested parties without publishing notice. Unlike *in rem* jurisdiction, *in personam* proceedings do not bind all interested parties, nor do they provide the perceived comfort of ongoing court supervision over the trust. Ultimately, this means that a court's order will have little, if any, effect on interested parties who were not given the opportunity to appear. In trust cases with a large or undetermined number of beneficiaries, it may be impossible to identify and serve all potentially interested parties.

CHOOSING BETWEEN PRIVACY AND FINALITY

The tension between the desire for privacy and the desire for finality presents a unique issue in Minnesota, since it is the only state that permits petitioners to choose between *in rem* and *in personam* jurisdiction. Compare Minn. Stat. §§ 501C.0201–.0208 (Supp. 2015), with Unif. Trust Code §§ 201–04. This distinct quality makes it difficult to look to other jurisdictions to assess the likely impact of this change in the broader context of trust proceedings. The ultimate conclusion, however, is clear: A petitioner's decision to elect an *in rem* or *in personam* proceeding will depend on their needs, the nature of the trust, their role in litigation, and whether they place greater value on privacy or finality.

Despite this change to the Minnesota Trust Code, *in rem* proceedings will likely remain the preferred option, especially for trusts with multiple beneficiaries, because *in rem* jurisdiction provides the most conclusive way to avoid future claims from other potential beneficiaries. It also remains the only option for a party who wishes to submit the trust to the court's continuing supervision.

Although this amendment may not prompt immediate, far-reaching changes in trust proceedings, it is difficult to deny that the change will provide opportunities for creative lawyering and will increase the importance of sound legal guidance as clients make the choice between *in rem* and *in personam* jurisdiction.

1. This is the third article in our series examining various aspects of the newly enacted Minnesota Trust Code.



BANKRUPTCY AND INHERITED IRAS: THE IMPACT OF *CLARK V. RAMEKER*

JAMES P. MENTON, JR. AND KEVIN D. MEEK

The U.S. Supreme Court in *Clark v. Rameker* held that an inherited individual retirement account was not “retirement funds” within the meaning of the Bankruptcy Code and therefore was available to creditors in a bankruptcy. This article addresses the decision, later limiting cases, and some practical considerations for estate planning attorneys.

BACKGROUND

When an individual debtor files for bankruptcy, his or her “legal or equitable interests ... in property” become property of the bankruptcy estate. 11 U.S.C. § 541(a)(1). To facilitate the debtor obtaining a fresh start, the Bankruptcy Code allows debtors to exempt from the estate limited interests in certain kinds of property. Among such property is “retirement funds to the extent those funds are in a fund or account that is exempt from taxation” under certain Internal Revenue Code provisions. Among the types of accounts enumerated in the Internal Revenue Code sections is an inherited individual retirement account (IRA).

Prior to 2014, courts were split as to whether an IRA inherited by a bankruptcy debtor is exempt from the bankruptcy estate. Some courts held that inherited IRAs qualify as “retirement funds” within the meaning of the Bankruptcy Code because they were retirement funds of the initial owner at an earlier point in time. See *Chilton v. Moser (In re Chilton)*, 674 F.3d 486 (5th Cir. 2012); *In re Thiem*, 443 B.R. 832, 843 (Bankr. D. Ariz. 2011). Some courts held that to qualify as “retirement funds” within the meaning of the Bankruptcy Code, the funds must be retirement funds in the hands of the debtor or the debtor’s spouse. See *In re Heffron-Clark*, 714 F.3d 559 (7th Cir. 2013).

CLARK V. RAMEKER

In *Clark v. Rameker*, 134 S. Ct. 2242 (2014), the beneficiary-wife and her husband filed for relief under chapter 7. They identified an IRA from the wife’s mother as an asset exempt from the bankruptcy estate under 11 U.S.C. § 522(b)(3)(C). The bankruptcy trustee objected to the claimed exemption, arguing that the funds in the inherited IRA were not “retirement funds” of the debtors and should therefore be available to pay the debtors’ debts.

The Supreme Court said that funds that were held in an inherited IRA are not “retirement funds” within the meaning of 11 U.S.C. § 522(c)(3), reasoning, in part, that inherited IRAs are not retirement funds because

of three attributes: Holders of an inherited IRA (1) may never invest additional money in the account; (2) are required to withdraw money from such account irrespective of how many years they may be from retirement; and (3) may withdraw the entire balance of the account at any time without penalty.

SUBSEQUENT CASES LIMITING CLARK

Several cases after *Clark* have limited the Supreme Court's holding to just the Bankruptcy Code and allowed exemption and/or exclusion of inherited IRAs under applicable state law. See *In re Norris*, 550 B.R. 271 (Bankr. D.N.J. 2016); *In re Andolino*, 525 B.R. 588 (Bankr. D.N.J. 2015); *In re Pacheco*, 537 B.R. 935 (Bankr. D. Ariz. 2015). These cases indicate that, in the context of exemptions for states that have opted out of the federal exemption scheme, the Supreme Court's holding in *Clark* may be considered only persuasive authority.

In *Norris* and *Andolino*, an individual debtor claimed an exemption in an inherited IRA. The chapter 7 trustee objected in each case, citing *Clark*. In each case, the bankruptcy court held that the debtor's interest in the inherited IRA was excluded from her bankruptcy estate under New Jersey law. In doing so, the bankruptcy courts relied on N.J.S.A. 25:2-1(b) and the Third Circuit's pre-*Clark* decision in *Orr v. Yuhas* (*In re Yuhas*), 104 F.3d 612 (3d. Cir. 1997).

Addressing *Clark*, the bankruptcy court in *Norris* held that *Clark* was "of limited applicability to this case" but noted the tension between its decision and the Supreme Court:

We would be remiss if we did not comment on how this ruling conflicts with the significant policy concerns outlined in *Clark v. Rameker*. Though decided in the context of bankruptcy exemptions versus property of the estate ... The determination that an inherited IRA is not property of the estate has the potential to similarly provide a "free pass" to debtors in this district. It is difficult to envision a reasonable policy explanation for such a result. Nevertheless, stare decisis provides instruction for interpretation of the Statute as set forth herein.

In re Norris, 550 B.R. at 278.

In each case, the bankruptcy court held that the debtor's interest in the inherited IRA was excluded from her bankruptcy estate

At least one bankruptcy court within the Ninth Circuit has adopted a similar holding as *Norris* and *Andolino*. See *Pacheco*, *supra*. In *Pacheco*, the Bankruptcy Court for the District of Arizona allowed the debtor's claimed exemption of her interest in an IRA she inherited from her ex-husband under Arizona law, A.R.S. § 33-1126, which provides:

Any money or other assets payable to a participant in or beneficiary of, or any interest of any participant or beneficiary in, a retirement plan under § 401(a), 403(a), 403(b), 408, 408A or 409 or a deferred compensation plan under § 457 of the United States internal revenue code ["I.R.C."] of 1986, as amended, whether the beneficiary's interest arises by inheritance, designation, appointment or otherwise, is exempt from all claims of creditors of the beneficiary or participant.

The court held that: (1) the Arizona statute was not preempted by 11 U.S.C. § 522; and (2) the debtor's interest in the inherited IRA was exempt under the Arizona statute. The court reasoned that, as an opt-out state, Arizona limits the applicability of *Clark*:

The problem with applying the holding in *Clark v. Rameker* to this case is that the only issue presented was whether section 522(b)(3)(C) applies to inherited IRAs by nonspouses. It did not address Arizona's exemption statute and certainly did not address preemption. Arizona's exemption law may allow a debtor to keep more than he or she could under the Bankruptcy Code, but there are many exemptions under various state laws that allow debtors to retain more of their assets than they could under federal law. That is a choice Congress has allowed states to make.

In re Pacheco, 537 B.R. at 940.

No post-*Clark* decision in California has been found addressing whether the relevant California statute, Civil Procedure Code section 703.140(b)(10)(E), permits exemption of a debtor's interest in an inherited IRA, or outright exclusion of interest from the debtor's estate. In cases decided prior to *Clark*, however, bankruptcy courts in California have held that the section did not apply to inherited IRAs. See *In re Greenfield*, 289 B.R. 146 (Bankr. S.D. Cal. 2003); *Diamond v. Trawick (In re Trawick)*, 497 B.R. 572, 589 (Bankr. C.D. Cal. 2013). These cases suggest that, at least in California, inherited IRAs are non-exempt and not excluded from the bankruptcy estate.

PRACTICAL CONSIDERATIONS

In response to *Clark*, estate planning attorneys may want to consider, for example, having a spendthrift trust designated as the beneficiary of the IRA rather than the heir directly. In addition, if a state has opted out of the federal bankruptcy exemptions, and if a state exemption statute specifically exempts inherited IRAs, those exemptions arguably should still apply in the debtor's bankruptcy. The *Norris*, *Andolino*, and *Pacheco* decisions support this result. Whether those decisions represent a trend remains to be seen, as is whether federal courts in California and other jurisdictions will directly address the potential limits of *Clark*. Needless to say, estate planning and bankruptcy attorneys would be well advised to stay current of legal developments and decisions in this area.



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