



ALASKA TRUST & ESTATE PROFESSIONALS

An Alaska Non-Profit Corporation
Keeping Alaska the #1 Planning Jurisdiction

RESPONSE TO HB 405 AND HB 406

Alaska Trust & Estate Professionals (ATEP) appreciates the opportunity to respond to HB 405 and HB 406, which were introduced in the Alaska House of Representatives on April 4, 2022. We understand and appreciate the intent behind these bills – to prevent bad actors from using Alaska trusts for nefarious purposes. Our response is focused on (1) aligning our shared objectives; (2) outlining our concerns with the language and consequences of the bills as drafted; and (3) providing potential alternative changes in law to achieve the same result.

Common Uses of Trusts by Alaskans

While the intent of the legislation is honorable, we need to consider the overall effect of this legislation on Alaskans who regularly use trusts to protect their families. The following situations illustrate common uses of trusts for Alaskan families that likely will be completely discouraged if HB 405 and HB 406 are enacted.

- Parents commonly create trusts for their children after death, which often will continue on as the children become adults and then continue on for further generations. These trusts protect children.
- Spouses often create trusts for their surviving spouses and their families. Trusts are common in blended families, created to “keep the peace” between a surviving spouse and children from a prior marriage. Spousal trusts also are created to protect surviving spouses, help elderly spouses manage their affairs, and defer estate tax until the death of the surviving spouse.
- There are various types of charitable trusts, where an individual receives an annuity from the trust for a period of time and then a charity receives the corpus after the end of the time period (or vice versa). Charitable trusts can provide tremendous support to our communities.
- Supplemental needs trusts or special needs trusts are quite common and necessary to protect the property of disabled Alaskans. Trusts are created to preserve public benefits for vulnerable adults and children – third party special needs trusts created by family members for a special needs beneficiary as well as first party Medicaid income qualifying trusts (Miller Trusts) and first party Medicaid qualifying asset trusts created by the beneficiary for the beneficiary's assets. The reporting requirements of HB 405 create a tremendous burden on those families who simply are trying to protect their vulnerable family members.

For the reasons explained below, HB 405 and HB 406 will affect regular Alaskans and discourage them from using trusts entirely. The bills fly in the face of hundreds of years of established trust law – not just Alaska law – and likely trusts will become a last resort at best.

Rendering A Trust Invalid Causes Tremendous Harm

HB 405 and HB 406 carry a general theme – if a settlor, trustee, or beneficiary fails to comply with one of the new requirements, then the trust becomes invalid, ineffective, or unenforceable. Our existing state law does not have any specific requirements for how to create a trust; rather, we rely on hundreds of years of established legal principles and property rights for the creation of trusts. We have serious concerns about any legislation that would render a trust invalid, unenforceable, or ineffective under Alaska law.

Constitutional Concern

First, there may be a constitutional issue. The Alaska Supreme Court has explained that a trust is a fiduciary relationship with respect to property. The trustee of the property is held to equitable duties to deal with the property for the benefit of another person, which arises as a result of a manifestation of an intention to create the trust. *In re Last Will & Testament of Tamplin*, 48 P.3d 471, 473 (Alaska 2002). Creation of a trust involves transfer of the legal and equitable title to property. The U.S. Supreme Court has held that the right to transfer property, like the right to devise property by will and the right to otherwise alienate property, is a “stick” in the constitutionally protected “bundle of rights” over property. *Hodel v. Irving*, 481 U.S. 704, 716 (1987) (right to transfer property by Will); *Lucas v. S.C. Coastal Council*, 505 U.S. 1003, 1031 (1992) (right to “essential use” of land); *Loretto v. Teleprompter Manhattan CATV Corp.*, 458 U.S. 419, 435-36 (1982) (right to possess, use, exclude, and dispose); *Andrus v. Allard*, 444 U.S. 51, 65-66 (1979) (right to possess, exclude, dispose, transport, donate or devise). Accordingly, a property owner’s right to transfer property to a trust is a protected property interest under the Fourteenth Amendment to the U.S. Constitution. We would need more time to fully analyze the potential constitutional issues, but we are concerned about such a restriction on a person’s constitutional right to transfer property.

Effect on Property Rights

Second, the effect of this proposed legislation on beneficiaries’ property rights raises significant questions. We have identified the following initial questions:

- What does it mean for a trust that otherwise is valid, effective, and enforceable, to become invalid, ineffective, or unenforceable? Does the trust terminate?
- What if property already has been transferred to a trustee before anyone realizes that compliance with HB 405 or HB 406 has not been satisfied?
- If the trust terminates, who receives the property in the trust?
 - Many trusts are what we call “discretionary trusts” that have numerous beneficiaries. For example, a grandparent may create a trust for his or her child and grandchildren. If the trust is no longer valid, does the trustee distribute the property to the child? To the grandchildren? To one grandchild?

- What if the child was only supposed to receive income from the property, and at the child's death, a charity was supposed to receive the corpus of the property? Does the charity now lose its property interest?
- Using the example with the charity, suppose the trust created an annuity for an individual for a term of years, with the property distributed to the charity after the term. Both the individual and charity are beneficiaries. If the trust terminates, does the individual now receive the property and the charity is deprived? Or does the charity receive the property and the individual is deprived?
- If the trust becomes valid or enforceable again, then what does that mean? Do the beneficiaries have to return their distributions? How does anyone know the trust has returned to valid status? What are the tax results? Are the beneficiaries now considered "transferors" for gift and estate tax purposes? If so, the results would be absolutely destructive.
- What happens to creditors of the trust if the trust is no longer valid, effective, or enforceable? Is the trust relieved of its obligations? Is the obligation (like a promissory note) accelerated? What about creditor rights?

In light of the complex nature of trusts, blanket invalidity, unenforceability, or ineffectiveness would wreak havoc on beneficial interests, impair the dispositive intent of trust settlors in ways that cannot be anticipated, cause tremendous opportunity for litigation, and harm Alaskan beneficiaries, both individual and charitable.

Unforeseen Tax Consequences

Third, rendering a trust invalid under state law could cause many potential harmful federal tax results.

- A trust may have qualified for a charitable deduction, or a federal estate tax marital deduction, or as a "Qualified Subchapter S Trust" (QSST) that may hold interests in an S corporation, or may have some other tax attribute that would be lost if the trust became invalid, ineffective, or unenforceable.
- Other examples are trusts designed to hold inherited IRAs or court-approved settlement trusts, and they could have unforeseen consequences as a result of termination.
- Take a marital trust as an example. Suppose a husband dies and leaves his property in trust for his wife in a "qualified terminable interest property" (QTIP) trust, which is a special type of trust designed to qualify for the estate tax marital deduction. The IRS may consider the Alaska law and determine that, because the QTIP trust has the potential to become unenforceable, it does not qualify for the federal estate tax marital deduction. In that event, it is entirely possible that there could be estate tax at the husband's death – which would deprive the widow of property needed for her support.

- As another example, if a QSST election is lost, a trust could cause a corporation to lose its status as an S corporation and create a multitude of tax problems.

Neither HB 405 nor HB 406 should include a result that a trust becomes invalid, ineffective, or unenforceable under state law, as doing so is likely to cause significant harm to individual Alaskans and the charitable organizations that support our communities.

Specific Comments to HB 405

In addition to our concern about blanket invalidity, we have specific comments about the proposed language in HB 405. Our comments are divided by topic.

Corporate Transparency Act Issues

HB 405 appears to emulate portions of the Corporate Transparency Act (“CTA”), which Congress enacted in an effort to reduce money laundering through business entities. The CTA requires “reporting companies” to submit periodic reports to the Department of the Treasury’s Financial Crimes Enforcement Network (“FinCEN”). Subject to some exceptions, a reporting company is any “corporation, limited liability company, or other similar entity that is . . . created by the filing of a document with a secretary of state or a similar office under the law of a State[.]” 31 U.S.C. § 5336(a)(11)(A). Although the final reporting requirements have not yet been fixed by regulation, the CTA requires that reports include information about “beneficial owners” of reporting companies, which is broadly defined to include anyone who owns 25% or more of a reporting company or anyone who exercises substantial control over company decisions.

We are unclear as to the overall application and extent of the desired connection between the CTA and Alaska trusts in HB 405 and HB 406. We have thought of three potential interpretations, all three of which are problematic.

- Is HB 405 trying to characterize trusts as “reporting companies” under the CTA? The current general interpretation of the CTA is that trusts fall outside the CTA definition of reporting companies. Trusts have long been considered “relationships,” not entities. *See Americold Realty Tr. v. ConAgra Foods, Inc.*, 136 S. Ct. 1012, 1016 (2016) (“Traditionally, a trust was not considered a distinct legal entity”); 76 Am. Jur. 2d *Trusts* § 2 (“A trust is not a legal entity.”). If the intent of HB 405 is to characterize Alaska trusts as reporting companies, then Alaska trusts would be required to report to FinCEN as if they were LLCs or corporations. Alaska would be the only state that requires trusts to report to FinCEN. The requirement would be a severe extension beyond what is required by federal law. Importantly, the overall burden on Alaskans with trusts will be so tremendous that families will be discouraged from using trusts at all.
- Is HB 405 only trying to require parties to comply with the CTA to the extent required by the CTA? Trusts can be beneficial owners, and to the extent a trust is a beneficial owner of a reporting company, then the trustee is required to provide the

information required by any other beneficial owner. If the intent of HB 405 is only to require compliance with federal law, that is a much more limited interpretation. However, it is unusual to have a state law that says only that people have to comply with federal law. What is the purpose? To the extent a trust is a beneficial owner of a reporting company under the CTA, of course the trustee (or anyone else required under the CTA) will have to follow federal law. In addition, the failure to comply under the CTA would generate penalties under the CTA but would not render the reporting entity invalid; as explained above, invalidity, unenforceability, and ineffectiveness of an Alaska trust cannot be a result.

- Is the intent of HB 405 to create a new Alaska-based version of the CTA? A duplicate FinCEN? If so, why? Will settlors, trustees, and beneficiaries need to file updated establishment documents with the state? How frequently must trust establishment documents be filed? What would prevent a settlor or trust protector from changing the trustee immediately after filing an establishment document? This requirement will have a complete chilling effect on the creation of trusts in Alaska by both Alaskans and non-Alaskans.

In addition to the interpretative questions raised above, we have additional CTA-related concerns regarding HB 405.

- Lines 24-25 of HB 405 place CTA compliance requirements not on the trust, but on individual settlors, trustees, and beneficiaries. It is unclear whether any failure to comply with the CTA must relate to the actual trust. If a settlor, trustee, or beneficiary fails for any reason to comply with the CTA in their own separate business dealings, it seems as though Lines 18-19 and 24-25, read in conjunction, could render the trust ineffective and unenforceable. It would seem possible that a discretionary beneficiary's failure to file required reports with FinCEN in matters unrelated to the trust may nevertheless render the entire trust ineffective and unenforceable. Please see our general discussion about rendering trusts invalid, ineffective, or unenforceable.
- We are aware of no mechanism that allows the federal government to terminate reporting companies that fail to file reports under the CTA. FinCEN may impose civil or criminal penalties on those who fail to report under the CTA, but they cannot terminate noncompliant reporting companies. HB 405 would go beyond what even the CTA is trying to accomplish. If this is the goal, then Alaska trusts would be uniquely susceptible to reporting errors.
- The CTA is so new that final regulations, forms, and other information necessary to file reports are not yet publicly available. HB 405 could prove to be an unwelcome surprise to settlors, trustees, and beneficiaries who do not closely monitor legislative developments. Additionally, HB 405, because it is coming before final regulations, may not be consistent with the CTA.

Protection of Children and Incapacitated Persons

HB 405 does not distinguish between beneficiaries based on age. Does the establishment document require the disclosure of information on minor children? Why do Alaskan children pose a threat and need to have their names included in such a database? At the very least, children need to be protected from unnecessarily having their personal information added to databases. The CTA specifically exempts individuals under the age of eighteen from beneficial owner reporting requirements. Compelling the disclosure of information about minor children when federal law does not would be troubling and could increase the risk of compliance failures.

What if a settlor or beneficiary is incapacitated and has a legal guardian or agent under a durable power of attorney? Does that agent or guardian now have to provide information on its own behalf as well as for its principal? If that agent or guardian is included on the Specifically Designated Nationals and Blocked Persons List, is the trust invalidated?

Traps for Unwary Alaskans

Line 18 of HB 405 says that “[a] trust does not become effective or enforceable until the trust complies with this section.” This result is a drastic departure from the current requirement to register trusts with the court. The failure to register a trust with the court does not have any impact on the validity, effectiveness, or enforceability of the trust. There likely are an untold number of Alaskans who have created trusts and failed to register simply because they were unaware of the duty to register with the court. This occurrence is certain to continue. Rendering their trusts invalid would be injurious to Alaskans who are not familiar with the added registration requirement. As outlined above, this result would punish Alaskans who simply are trying to get their affairs in order for their families.

One of the challenges for many Alaskans is access to competent legal counsel, whether financial or geographical. Our laws and rules give leeway to Alaskans who try to do their own estate planning. For example, our statutes allow holographic or handwritten wills. As another example, the Alaska Court System website has “DIY” probate forms for Alaskan estate administrations (<https://courts.alaska.gov/shc/probate/probate-forms.htm>). The dramatic consequences of inadvertent compliance failures with HB 405 would make trusts inaccessible to Alaskans without the engagement of legal counsel.

Loss of Privacy for Alaskans

One of the reasons to use trusts in estate planning is to preserve a family’s privacy. A person’s last will and testament becomes public record during probate – a trust remains private. Many Alaskans wish to keep their family and financial affairs private – not for nefarious purposes – but because they value privacy and do not want the public to know their personal business. Even though Line 20 of HB 405 says that the trust establishment document is private, the existence of this new rule may deter people from creating trusts in Alaska (and instead create trusts in other states) due to the mere perception of a lack of privacy.

Definitional Questions

Line 14 of HB 405 requires identification of “the beneficiary.” Trusts can have many beneficiaries, some of whom are not ascertainable at the time of the creation of the trust. Further, many if not most times there are current beneficiaries and future beneficiaries – which ones count here? It is unclear how to comply with the statute.

Line 15 of HB 405 requires the identification of “the applicant for the establishment of the trust.” There is no definition of applicant, and this concept does not exist in AS 13.06-13.36. We do not know what this means. In a probate administration, there is an “applicant” who files an application to be appointed as personal representative; however, that situation seems out of context here. The CTA uses this term – is that what the language means?

Other Scenarios That Raise Questions

What will happen if the trustee changes? It is common for a trustee to resign and a new trustee to be appointed throughout the lifecycle of a trust. Is a new trust establishment document required?

What if a new beneficiary is born or added to a trust? Or what happens if one beneficiary’s interest terminates and another interest begins, such as the example above with the charitable trust? Is a new trust establishment document required?

It is common for a single trust instrument to allow the establishment of additional trusts. Would a trust instrument that permits division of trusts at a certain age, or that allows the establishment of separate trusts for generation-skipping transfer tax purposes, fail unless someone filed establishment documents for each trust created thereunder?

How would trusts created by operation of law satisfy the requirements of HB 405? We anticipate that litigants in a wide range of matters would attempt to use HB 405 to challenge the availability of resulting trusts and constructive trusts, which are not meaningfully manipulable by bad actors. By limiting the availability of resulting trusts and constructive trusts, this legislation may deny recovery to wronged parties.

Lines 21–23 say that “the department may release the information in a trust establishment document to the United States Department of Treasury.” Who decides whether the information will be released? Will it be released at the Commissioner’s discretion? Will the Department of Commerce volunteer the information to the federal government? Will the information be provided only at FinCEN’s request?

Specific Comments to HB 406

Section 1. Please see our comments above about rendering a trust invalid. Furthermore, the triggering event for a trust to become invalid raises additional questions.

- Suppose a trust has three individual beneficiaries and one charitable beneficiary. If one of those beneficiaries is listed on the Specifically Designated Nationals (SDN) and Blocked Persons List, why do the other beneficiaries suffer as well? Are beneficiaries deprived of

their property rights because of the actions of another beneficiary? All of our questions above about trust invalidity apply here.

- What is the result if a trustee, settlor, or beneficiary is included in the SDN list, and then is removed from the list? Does the trust become valid again? What does that mean? What if a person is mistakenly included on the SDN list? Same questions.
- There is no distinction for different types of beneficiaries. Suppose a trust provides for a surviving spouse during her lifetime, and at the spouse's death, she has the power to redirect the assets (this is called a power of appointment). If she refrains from directing the assets, then the remaining assets are distributed to her children. A child has no vested interest in the trust unless the mother refrains from exercising her power. Suppose that child is included in the SDN list? Does the mother's trust now fail?

Section 2. We have numerous practical questions and concerns.

- How is the Recorder's Office expected to comply with this requirement? Will the Recorder now have access to and be required to search every name through the database? What is the cost to Alaska?
- How does the Recorder's Office comply with regards to conveyances to entities such as LLCs or corporations? For example, a conveyance to ABC Inc. – does the Recorder need the names of all officers, owners, board members, etc.?
- Does this rule apply to easements and deeds of trust? Does this rule apply to UCC documents?
- The fact that the Recorder cannot record the transfer does not mean the transfer did not occur; it does not mean that the grantee does not have an enforceable property right. What effect will this statute have on a property transfer that is unrecorded?
- What safeguards would protect individuals who are not included in the SDN list, but who have names in common with individuals who are on the list? Names often are not unique. How is the Recorder's Office supposed to resolve whether a person actually is included in the list or simply has the same name as another person in the list?
- According to HB 405, a trust does not become effective or enforceable until it files the establishment document. At the same time, an establishment document is purportedly not a public record. How can the trustee prove the enforceability of the trust without showing proof of this private record? And if a trust is not enforceable, is a deed to the trustee of a non-enforceable trust a nullity? Please again see our comments about enforceability.

Chilling Effect on Thriving Trust Industry in Alaska

HB 405 and HB 406 will have a complete chilling effect on the creation and use of Alaska trusts, which will decimate an entire industry. The Alaska trust industry includes banks, attorneys, accountants, financial advisors, insurance agents, other professionals, and all the businesses supported by them.

This industry has made significant, wide-ranging economic benefits to Alaska. In 2021, the McDowell Group conducted an independent study on the economic impact of trusts in Alaska. The results were revealing: the trust industry supported about 260 jobs and roughly \$21.6 million in labor income to the Alaska economy in 2019 – and it has continued to grow. It also greatly benefits financial institutions such as Alaska community banks, which receive substantial deposits from these entities that they can use for loans to Alaskans. Alaska will lose jobs and revenue if the trust industry disappears.

Alaska has built a client-centric industry that presents a truly unique offering, founded on trust, pun intended. Chief importance to us is our ethics and that all of our relationships are founded on integrity. The industry has thoughtful, ongoing processes in place, such as comprehensive due diligence processes, to combat potential fraud or misconduct. These practices help ensure that we only provide services to those families that meet the high standards of regulators, community members, and that which we hold for ourselves.

Potential Alternatives

ATEP supports the well-meaning goal of preventing bad actors from using Alaska trusts for nefarious purposes. As a complete alternative to the language of HB 405 and HB 406, ATEP proposes the ideas below to accomplish the same, or close to the same, goal without the concerns raised above.

Please keep in mind that we have not had time to fully vet these proposals. ATEP members usually spend months creating proposed legislation. Here, we have had only a single week, and therefore not enough time to fully analyze the effects of our ideas below. We are providing them as a starting point for further discussion.

First, Alaska law can be changed to prohibit someone from serving as a trustee if that person is on the Specifically Designated Nationals (SDN) and Blocked Persons List. Suggestions as to how to accomplish this prohibition include the following:

- AS 13.36.071 can add a section that prohibits a trustee from accepting the trusteeship while that person is named on the SDN list.
- AS 13.36.074 can add a section that requires that any trustee named on the SDN list to resign, and give a third party (maybe a beneficiary) the right to remove a trustee who is on the SDN list without seeking court intervention.

Second, a new statute can be created that prohibits a trustee from making a distribution to a beneficiary while the beneficiary is named on the SDN list. There must be an exception to prevent disqualification from a marital deduction, charitable deduction, or other specific tax attribute that is needed to remain in place. For example, to qualify for an estate tax marital deduction, a QTIP trust is required to pay all income to the surviving spouse. A potential prohibition on distribution – even if it never happens – can result in the loss of the marital deduction and incur tax. Our decanting statute already has exclusion language that may be helpful here – see

AS 13.36.158(i)(5). One potential solution is to apply the restriction only to discretionary distributions; however, we need more time to vet the idea.

About ATEP

Alaska Trust & Estate Professionals (ATEP) is a non-profit organization dedicated to the creation and betterment of Alaskan law pertaining to all trusts and estates held and administered in the State of Alaska. ATEP's primary focus is the creation of innovative legislation and the continuous improvement of existing Alaska Statutes that govern trusts and estates. ATEP seeks to improve administrations for Alaskans while giving Alaska a competitive edge as a premier trust and estate planning jurisdiction. ATEP achieves these goals through the efforts of its membership base of dedicated practitioners, professionals, and academics that contribute their time and expertise for the benefit of Alaska's trust and estate laws. ATEP is committed to the education of Alaska's fiduciary, trust, and estate planning professionals.