

**ALASKA STATE LEGISLATURE  
JOINT MEETING  
HOUSE JUDICIARY STANDING COMMITTEE  
SENATE JUDICIARY STANDING COMMITTEE**

February 7, 2002

2:07 p.m.

**HOUSE MEMBERS PRESENT**

Representative Norman Rokeberg, Chair  
Representative John Coghill  
Representative Kevin Meyer

**HOUSE MEMBERS ABSENT**

Representative Scott Ogan, Vice Chair  
Representative Jeannette James  
Representative Ethan Berkowitz  
Representative Albert Kookesh

**SENATE MEMBERS PRESENT**

Senator Robin Taylor, Chair  
Senator John Cowdery  
Senator Johnny Ellis

**SENATE MEMBERS ABSENT**

Senator Dave Donley, Vice Chair  
Senator Gene Therriault

**OTHER LEGISLATORS PRESENT**

Representative Lisa Murkowski

**COMMITTEE CALENDAR**

OVERVIEW AND UPDATE OF ALASKA TRUST LAW

**PREVIOUS ACTION**

No previous action to record

**WITNESS REGISTER**

DOUGLAS J. BLATTMACHR, President  
Chief Executive Officer (CEO)

Alaska Trust Company  
1029 West Third Avenue, Suite 601  
Anchorage, Alaska 99501-1981

POSITION STATEMENT: Presented information regarding Alaska's trust laws.

RICHARD S. THWAITES, JR., Attorney  
733 West 4th Avenue, Suite 401  
Anchorage, Alaska 99501

POSITION STATEMENT: Assisted with the presentation regarding Alaska's trust laws.

### **ACTION NARRATIVE**

TAPE 02-12, SIDE A [House JUD tape]  
Number 00.01

CHAIR ROBIN TAYLOR called the joint meeting between the House Judiciary Standing Committee and the Senate Judiciary Standing Committee to order at 2:07 p.m. Present at the call to order from the Senate Judiciary Standing Committee were Senators Taylor, Cowdery, and Ellis. Present at the call to order from the House Judiciary Standing Committee were Representatives Rokeberg and Coghill. Representative Meyer arrived as the meeting was in progress. Representative Murkowski was also in attendance.

CHAIR TAYLOR announced that the committees would hear an overview and update from the Alaska Trust Company regarding Alaska's trust laws. He remarked that Alaska, via legislation sponsored by various legislators over the last five or six years, has gone through a transition of updating and modernizing its trust laws, with the goal being to make Alaska a more attractive community for securing and investing assets. He noted that some of the issues to be discussed will include: the effects of the various pieces of legislation, whether the legislation is beneficial, whether it did anything for the state, and "how is it going today in the real world - what effect did we have."

Number 01.58

DOUGLAS J. BLATTMACHR, President, Chief Executive Officer (CEO), Alaska Trust Company, thanked the committees for the opportunity to present information regarding Alaska's trust laws. He said:

Starting in 1996, we first tried to get some legislation through, and finally were successful in 1997 with your ... support, [which we] greatly appreciate.... The two pieces of legislation really revolutionized the trust industry throughout the country. [A lot of states] started realizing that [they] needed to modernize their trust laws, and a number of states have tried to piggyback on what Alaska has done. Particularly Delaware [has] copycatted a number of things we did ...; [as did] Rhode Island ...; [and] so has Nevada. So there's more states doing similar things. Fortunately, Alaska still is the preeminent jurisdiction; there's things we can do that no other state allows, [and] we've done a number of pieces of legislation. ...

Why did we first come to Alaska to change the rule? Well, partly [it] was because [of] personal reasons: I'd lived in Alaska and wanted to get back; my brother - who practiced law in Alaska [as] a New York City estate-planning attorney - ... loves Alaska, so we really wanted to do it. We were familiar with Alaska statutes and the professionals, and the professionals kept indicating they wanted institutions to be more focused on Alaska and [were asking], "How could we modernize our laws." And also because Alaska had a very favorable environment: it had no state income tax on trusts or estates. So that was also positive.

Number 03.32

MR. BLATTMACHR continued:

The question has been [asked], "Has it been successful," and we feel it has been very successful, particularly since we've been doing this for less than five years. And what we're going to give you is just information [that] our small company knows about; we know the other institutions have benefited directly, but we really can't say exactly how much.... We're just really talking about ours, [but] I think you can [infer] that there's been a lot greater breadth of [the] positive. One of the positive developments that Alaska has really seen [is that it is viewed] as a very innovative and progressive state [regarding] its [trust and estate] laws, and it is considered by most estate planning professionals as the leading

jurisdiction [in which] to consider setting up your trusts or estates.

Some of the positive have been that we have created seven fulltime positions - five of them are born-and-raised Alaskans; we pay a corporate income tax; we put hundreds of thousands of dollars into the local economy each year ...; and we have on deposit in local institutions tens of millions of dollars that has come from outside of Alaska that wouldn't have been deposited [otherwise]. So local banks have participated, and we have had over 700 clients come to Alaska to use Alaska services.... That's just what we've done; we know other trust companies and banks have also got some [business], and some people have gone to individuals instead of professionals. So it's been, we think, successful.

The professionals in Alaska have benefited, both in getting increased business from working with clients from outside of Alaska but also bringing these benefits to Alaskans. And I think it should be important to realize that all the things that can get done can benefit Alaskans also; they probably have the biggest benefit. Although unfortunately our population is small, ... on a practical basis they really benefit as much as anybody who comes here from California, New York, or Texas. [Certified public accountants (CPAs)] have increased business; insurance agents have; stockbrokers - they've gotten accounts moved here from individuals who want to have some of their assets here to take advantage of these great trust laws.

Number 05.27

MR. BLATTMACHR:

As I said, Alaskans have benefited quite directly from this legislation, and one of my colleagues, Mr. Thwaites, will talk about some of the examples he has [regarding] some of his clients [who] have really benefited directly from this. With the changes we made in the trust legislation, and combining that with some modifications to the state premium tax, ... the state [has] received ... at least \$700,000 of the traditional state premium tax on life insurance that

it wouldn't have received without these modifications. So there's been an increase in corporate income tax; there's been an increased revenue from people using our LLCs [limited liability companies] and LPs [limited partnerships] - so there's been increased filing; and some of the insurance companies we've dealt with are seriously looking at Alaska to set up subsidiaries. We think all of these are positives.

We think it important that this has really [just] happened within five years, with no financial outlay from the state, ... except for your support and we greatly do appreciate it. ... One of the questions we hear sometimes is, "Gosh, we've passed so much legislation and you guys are coming back again, why do you need to come back?" ... Part of the reason is that a number of these things we're doing are geared towards [Internal Revenue Service (IRS)] rules and regulations. So if [the] IRS makes a change, many times we need to change the current legislation to make sure that [it's] still effective.

Other states now are starting to realize that they've got to modernize their rules and come into ... modern society, and so they're changing rules. And sometimes they come up with better ideas, so we're saying, "Gee, if they've got a better idea, maybe we should incorporate it to continue to have Alaska be competitive if not the leading jurisdiction." And then just sometimes fine-tuning the legislation; sometimes we've done things and some of the other lawyers will look and say, "Well, you know, I'm not exactly sure if you've really accomplished what you set out to do," or "It's not clear enough for me." So many times we're coming back [saying], "Let's clarify that this is what it was meant to do, so there's no ambiguity about what the purpose of the legislation was.

Number 07.19

MR. BLATTMACHR went on to say:

We think that the future is extremely bright for Alaska; we think it's just a beginning for [a] fledgling financial-services industry to attract more and more business, and we think we're getting more

every year. We're getting more and more clients coming here, [and] more and more attorneys [are] using us throughout the country, because ... one of the advantages Alaska has [is that] it has no current state income tax on trusts in the state. So our (indisc.--coughing) strongly recommend ..., if the state decides to do an income tax, that you seriously consider not taxing trusts and estates [of] nonresidents, because what will happen is [that] they will go to another jurisdiction that doesn't have a tax on foreign trusts, such as New York, New Jersey, Delaware, [or] South Dakota.

New York, New Jersey, and Delaware have an income tax, but they exempt trusts from nonresidents because they realize nobody's going to come to their state. So we strongly recommend this because what will happen, unfortunately, is that all this business - 99 percent of all the business we've attracted - will leave the state within one year because they're just going to say, "We're not going to pay a state income tax; there are other states that have many of the things that Alaska has and [so] why should we do that." So, that's just part of our concern, because we're just starting ... to see all the fruits of all the hard work. It has really been [within] the last two years that we've really seen this influx and people starting to use Alaska - and giving increased revenue directly to the state and indirectly to residents of the state and businesses.

Number 08.57

MR. BLATTMACHR concluded:

And, again, we greatly appreciate your support in the past and hope we can count on it in the future. For information [purposes], in [members' packets there is] a little pamphlet that we put together that gives a brief explanation of each piece of legislation and what it does, kind of as a summary. And then we've put together three articles that have been published nationally that ... talk about the three major functions of what legislation has been done. The first one talks about the ... [Alaska Trust Act], then we ... have one that talks about how the changes with the limited partnership and LLC statute integrates

[with] this trust legislation, and then [there is] an article about how the Alaska Community Property Trust works and the advantages for both Alaskans and non-Alaskans.

SENATOR COWDERY noted that Mr. Blattmachr had mentioned with regard to the income tax that [it] would have an effect on the attraction to Alaska and had explained why. He asked how much revenue these trusts put into state coffers, and how much revenue might be generated for state coffers over the next five to ten years assuming that the state remains free of an income tax.

MR. BLATTMACHR said that just from his company, he is aware of at least \$700,000 generated from life insurance premiums, but is not sure how much revenue the state has gotten from increased filing of limited partnerships and LLCs. He ventured a guess, however, that the state has probably gotten \$1 million of additional revenue. He cited the fact that his company has a lot of deposits in banks, which has probably increased their profits and are thus they are paying higher state corporate taxes, and noted again that his company also generates business for other businesses in the state. He posited that his company probably puts \$700,000 a year into the local economy, and that [this amount] will continue to grow. He opined that in five years, there should be "a number of millions of dollars" generated at minimal, if any, cost to the state.

Number 10.50

MR. BLATTMACHR, in response to a question regarding states that exempt nonresidents from income tax on trusts, said that "South Dakota is one of our competitors for some of this, and they don't have a state income tax at all." But a number of states, such as Delaware and New York, do have a state income tax but don't tax nonresident trusts or estates, he added. He mentioned that because it had the biggest trust industry, New York used to get the majority of business in the '50s, '60s, and '70s, but because it didn't modernize its trust laws, very little business from nonresidents is now coming its way. He also mentioned that now residents of New York are realizing that they can set up trusts in New Jersey, Delaware, or Alaska and avoid paying a state income tax; as a result New York is seriously considering exempting its residents from income tax on trusts.

SENATOR COWDERY asked what would happen to trusts that had already been established by residents should Alaska begin to tax trusts.

MR. BLATTMACHR said that it would be hard to predict. He surmised, however, that some people might decide to move the situs of their trusts in order to avoid an income tax. He noted that those with bigger trusts would have more of an incentive to move their trusts and would probably be advised to do so by their attorneys.

Number 13.48

RICHARD S. THWAITES, JR., Attorney, noting that he specializes in estate and gift tax law, said that after passage of the Community Property Act, he drafted a community property agreement for one of his clients. He also noted that this is not a complicated agreement for Alaskan residents - merely one page - though it can result in a 40-50-page document for nonresidents. In an effort to illustrate how a community property agreement works, he recounted the following example:

We had a family that was in the Palmer area, [and] they had a lot of property acquired - originally as homesteaders - [and] the value of that property has increased over ... time. In this situation, [the] mom developed an illness and passed away last year, and as a result of having done the community property agreement, there was probably somewhere in the vicinity of \$3 [million] to \$4 million of gain in the two estates - between the two of them - that disappeared, and they got a stepped up income tax basis - [the] dad did - for the whole amount of the property, thus eliminating the gain entirely. ... That enabled him to liquidate ... some of the property and [pass] it on to [his children and] grandchildren ... for education [and] other purposes, and still left him with the other assets pretty much intact and [with] the flexibility to ... deal with his estate plan as he felt appropriate.

MR. THWAITES also recounted another example:

[This was] a much smaller situation where [a] husband and wife had some property - and we're only talking about \$35,000 to \$40,000 worth of eliminated tax, but that's still a significant number - and it was a ...

smaller estate in the \$600,000 range, but yet, by the time we got the large gains that they had in that little estate, [the] mom was able to liquidate only the assets that she needed to, ... to make the transition into being sort of a single parent at the age of 70. ... It was a smooth transition, and I think it helped her a lot knowing that she wasn't going to have a large, \$40,000 tax bill at the end of the year, thus requiring liquidation of other assets that she didn't really need to liquidate at that time.

SENATOR COWDERY posited that liquidation of those assets would probably have created another tax liability.

Number 16.37

MR. THWAITES clarified that in that example, "that would have been the additional liability; that was taking that into consideration, but it just was a smooth transition that helped quite a bit." He said that what he has experienced over the past couple of years is that in Alaska, there is a cadre of estate-planning professionals who work in the area of financial planning, such as accountants and attorneys, and they have formed an organization consisting of about 200 individuals statewide. They are all starting to have more involvement, he noted, with this more fluid estate-planning statute, and everybody recognizes now that Alaska is probably the preeminent jurisdiction. He explained that even though the marketing budget has not been very extensive, "we're still making an impact ... because we're ... still a couple of steps ahead of everybody else." [Alaska] has maintained that position because of the legislature's continued cooperation. "You've helped us put these things into place, [and] other people throughout the country are recognizing that," he said.

MR. THWAITES noted that he is a fellow of the American College of Trust and Estates Counsel (ACTEC), which is a group made up exclusively of estate planning attorneys. He said that when he attends ACTEC's meetings, other fellows have come to him and inquired, "How are the Alaska trusts going," and every year he gets several referrals from these fellows asking for assistance in developing Alaska trusts for their clients who live in Texas, Hawaii, North Carolina, and all over the country. He views this as evidence that "we're getting the word out," it's just taking a little longer. The first couple of years, there were perhaps 10 or 12 attorneys throughout the country that were really "talking to us seriously," he remarked, whereas just this last

year, there were probably 50 to 60 attorneys that consistently provided information on behalf of out-of-state clients. He also mentioned that there is now a website that is readily available to anyone wishing for information or access to forms, "and we just try to get as much exposure out there as we can for Alaska; we encourage them to come up, we encourage them to bring their dollars up here and leave them in our local banks, because we've found the local banks like that too.

MR. THWAITES said:

The tradition of the trust industry is that as your trust grows and you develop that basis and it keeps growing, you will then have the insurance trusts when somebody passes away. The typical thing is [that] that money stays in that trust for administration, and [so] instead of getting a flat annual fee for just doing the maintenance of the insurance trust, it converts into a much larger fee for doing the administration and taking care of the beneficiaries and so forth.

Number 19.58

MR. BLATTMACHR added that of the insurance trusts that his company has set up just this year, about \$1.4 billion is in death benefits, which, in theory, will ultimately come into Alaska. So it's been quite successful from his company's point of view, he said, particularly since his company is just a small organization and these transactions have only transpired recently. He opined that the outlook of the industry in Alaska is very good and should continue to attract business and continue to grow.

MR. THWAITES posited that when Mr. Blattmachr spoke of "the \$700,000 additional premium tax," he was referring to the tax just in 2001.

MR. BLATTMACHR said, "Yes."

MR. THWAITES noted that "this" didn't come into existence until 1999, and then it took a while to get [the information] out. So for a while no one thought much about it, but then all of a sudden people started to recognize that some of their clients could be saving several tens of thousands of dollars per year by doing business in Alaska. That's why now, in 2001, there is growth in that area, he explained.

MR. THWAITES said that as a lifelong Alaskan, he wants to see the state flourish, but he is worried that when he goes down to the next ACTEC meeting in March he is going to be asked about the possibility of an income tax being imposed in Alaska. What raises concerns, he explained, is the fact that Alaska's legislature is now having discussions regarding adoption of an income tax. He indicated that although 50 states are currently having discussions regarding revenue shortfalls, should the statement, "Yes, we're discussing revenue options in Alaska," be coupled with a statement to the effect that, "This fledgling industry in the finance and trust area is not something that we want to impact or kill because of that," then it wouldn't have quite the same chilling effect.

MR. THWAITES said that "when we first did this trust work, we were" a little shocked that the offshore jurisdictions - the Cayman Islands, the Cook Islands, for example - mounted an advertising campaign against the Alaska trusts. Basically what these advertisements were saying is that Alaska trusts don't work because the IRS will find out about the revenue. He noted that there was never any intention to shelter anything from the IRS; "we always said we would report whatever was appropriate, but there are enough estate planning benefits, in all this stuff that we've drawn up, to encourage people to come here." He pointed out the federal government now has huge penalties for people who went offshore and didn't report income.

Number 22.50

MR. BLATTMACHR added that his company has had a number of individuals bring their offshore trusts back to the United States - to Alaska - because they now realize that they can do the same thing they were doing offshore but be under U.S. jurisdiction.

CHAIR TAYLOR remarked that at one point the IRS had been talking about federal legislation that would allow those offshore monies to "come home for free," but then once the money is back in the U.S., it would have to stay. He asked whether any of that federal legislation has been adopted.

MR. THWAITES said not that he is aware of. He acknowledged, however, that "there is quite an effort by [the U.S. Department of the Treasury] to do that." Notwithstanding this, [the IRS] does impose a \$7,500 penalty on people who fail to state on their tax return that they have an offshore trust. He observed

that the IRS and the [U.S. Department of the Treasury] have not resolved, in their own minds, what they want to do; on the one hand, they want to bring the money back, but on the other hand, they are not willing to say, "Yes, all this stuff works." Mr. Thwaites pointed out that there is a treatise that is put out nationally that is called the "Restatement of Trusts" in which, every so often, the college professors and the professionals in the industry redraw a summary of what the law of the land ought to be with regard to trusts. In the most recent version, he noted, it is acknowledged that there is a place in the law of the land for the Alaska and Delaware trusts, although it is not recommended that all states follow suit, because not everybody is going to want an asset-protection trust and it would not be competitive for the states that do offer it.

MR. THWAITES said:

We're not trying to focus exclusively on asset-protection trusts. We're talking about community property trusts, asset-protection trusts; we're talking about irrevocable insurance trusts, and all of those kinds of vehicles. It is a comprehensive plan; it is probably the best estate-planning jurisdiction in the entire United States, maybe even in the world, other than perhaps having your own island and not having any jurisdiction [under] anybody else. So I think we're on the right track. ... We don't have a lot of marketing money to do this yet, [though] that would certainly enhance [efforts]; we're having to pay for that out of the revenues gained from the trusts that we have right now. I'm very, very positive about the future, I really am. The federal estate tax is probably going to impact it somewhat if it stays the way it's currently rendered, but we're trying to deal with those issues as well.

Number 26.02

REPRESENTATIVE LISA MURKOWSKI, referring to the marketing issues, said that she would be glad to discuss how to assist in getting the word out to other trust attorneys across the country. After noting that earlier testimony indicated that banks are benefiting from this industry, she asked whether there is any way to "piggyback with the marketing efforts that the banking institutions have," or whether the trust industry is at odds with the banking industry.

MR. BLATTMACHR indicated that he would not characterize the two industries as being at odds with one another, since the trust industry does not provide any banking services. Perhaps rather it is just that the banking industry has not seen enough benefits; some institutions, he noted, haven't gone into it as aggressively as others. National Bank of Alaska (NBA) has started to take advantage of the possible benefits, but Wells Fargo has not. Key Bank did some in the beginning but has not done any recently, and so perhaps the other institutions have taken a wait-and-see-how-it-works kind of attitude. He remarked that his company feels that the more people there are that know about the various options provided by this Alaskan industry, the better. He noted that banks in other states, particularly in Delaware, are attracting more business because they are saying that their states can do what Alaska does, only better, and that it would be difficult to simply go to those institutions and confront them with counter arguments. At estate planning conventions, however, he said that he is able to explain to people that Alaska can do all of the things that other states can do plus some things that can't be done elsewhere.

MR. THWAITES noted that many financial institutions do not focus on the things that the trust industry specializes in, although some, such as "First of Alaska," now have trust departments that offer services to their clients. But [these financial institutions] are relatively conservative in their approach and are not marketing that service as a way of bringing in profits. For the most part, financial institutions like Wells Fargo, for example, look to their general banking services as the way to make money, "not this new niche/trust stuff," he added. Key Bank started out providing trust services but then moved everything to Cleveland, he said, "and that doesn't match the Alaska law," and so that institution might now be doing trusts out of Rhode Island or Delaware.

Number 29.35

MR. THWAITES said:

We have an education program - the 529 plans - and [recently] the state put those out for bid for people putting money aside for their children's education, and T. Rowe Price is the operator of that. And I just saw an article in Kiplinger's [Personal Finance] magazine, a full-page ad, that advertises [a] University of Alaska Fairbanks school-savings plan,

because you can put money into that and still go to a different college or university....

The advantage of Alaska's [program] is that you can put up to \$250,000 into this plan, with a very favorable estate-planning result. In other states, you can only put \$100,000 in - per child - so they're promoting Alaska as having a larger ceiling for doing this. But I noticed in their article, and I'm not quite sure what it means, but it says, "We can do the 529 plans," and then it has two words, "and, oh, by the way, 'Alaska Trust,'" and I don't know what that means in the ad, because I'm not sure that they're doing Alaska trusts. So I thought maybe I should call them up and find out exactly what that refers to.

MR. BLATTMACHR posited that, to some extent, the reason some of the other institutions aren't marketing trust services as much as companies like his do is because "it's just kind of a department in their bank." Trust companies, on the other hand, can focus all of their marketing dollars on attracting trust business and investment management business.

Number 31.03

MR. THWAITES explained that historically, the investment management business is one that builds cumulatively over time, which New York and similar other jurisdictions have done, and his hope is that given the time, and given the strength and fortitude of proceeding with this on a fairly determined basis, Alaska can become one of those jurisdictions. "Certainly on the west coast we're having a lot of interest," he added. A lot of the [financial] planning going on right now won't show results until people are deceased; so as a planner, he doesn't tell his clients, "You better get this done this Wednesday because on Friday you're not going to be here any longer." "That would certainly make our estate planning easy if we knew exactly when they were going to die, but for many of these things, ... five years is just way too soon," he said, adding that it is more likely that the impact will be [felt] "twenty years out as far the volume goes." So it's more of a long-term plan than a short-term plan; "we're sort of in there for that long-term goal, and we think that the state of Alaska could realize a lot of additional revenues as a result of the spin-off from these planning goals."

REPRESENTATIVE MURKOWSKI commented: "You know you've finally arrived when they start advertising against you, so you must be doing a great job."

CHAIR TAYLOR thanked Mr. Blattmachr and Mr. Thwaites for their presentation. He said:

Some of us have long waited to see what the results might be; John was there with me when we started this whole process, and the questions we constantly heard on each of these bills going through is, "What does this thing do?" And we would try our best in [the Senate Judiciary Standing Committee] and other places to explain some of these rather sophisticated concepts and tax ramifications and so on. I don't think we educated very many people, but there was a wonderful trusting attitude throughout the legislative process, both on the House side and the Senate. [And] we all hoped that by making some of these modifications, ... it would result in some additional benefits flowing to the state of Alaska, to our banking institutions and others, and to Alaskans in general as they would have more flexibility in the way they [could] ... establish their estates.

Number 33.75

And so it's very fulfilling today ... to have this wonderful report come in. I still dream of the day when our [U.S. Department of the Treasury] is able to get together with the IRS and ... cut a deal [regarding] ... what is estimated to be well over a trillion dollars of U.S. income that is sitting offshore in banks right now, because when that happens, there will be a flood to return to home. They want to be under our laws, not some dictatorship [on] some Cayman Island, ... and they would like to come home and be able to set up a very stable trust that their family - for future generations - can count upon. And when that happens, Alaska should be in the catbird seat to take advantage of at least a good percentage of that.

CHAIR TAYLOR continued:

And if I remember correctly, it's actually something that Governor Steve Cowper at one time had talked

seriously about, and that was that Alaska - and Anchorage, because of its location, in particular - could become somewhat of a financial trade center. You can't become that financial trade center if you don't have a bank where somebody can put their money and ... rely on it being there, rely on that trust being properly handled, and rely on it being stable. And probably stability is most important thing, but it's been with the help of a wonderful group [of people] within this legislature, over a lengthy period of time, that [we] have created this opportunity now. And I'm just so pleased to hear your report, and I thank you for taking your time and money to come down here and provide us with this.

Number 35.56

I know we have another piece of legislation going through this year on the regulation. We haven't got down to how we're going to regulate trust companies yet; none of those laws have been changed for a long time. I had the privilege of meeting with a young lawyer here in town that used to work [for] me ... on the [Senate Judiciary Standing Committee]; he now has a fine practice and a couple [of] partners, and they're doing significant amounts of work in estate planning.

Normally, [with regard to] estate planning among the bar here in Southeast, no one could maintain that ... level of expertise because there wasn't a lot of it going on. It was being done in Seattle and it was being done in Portland and San Francisco, and so a client that needed estate help was often referred to one of the larger firms down there. That's not occurring now; that work is staying here in Alaska, and I'm just so pleased to see that happening and it's literally because this legislature took the time to go through some rather complex things and to trust that it would work out.

REPRESENTATIVE ROKEBERG, Chair, House Judiciary Standing Committee, referring to states that exempt nonresidents but tax residents for their trust income, asked whether this was due to concerns that residents only establish trusts as a subterfuge to avoid paying state taxes.

MR. BLATTMACHR opined that it has more to do with political reasons; "I think the perception is that if you ... use the word 'trust,' it has to be a lot of money and it's for the wealthy." New York, he reiterated, is seriously considering not taxing its resident trusts because of the realization that "residents are leaving the state." Up until 15 years ago, he noted, people were pretty much staying within their states, but as other states started to do certain things, people realized that some states, like South Dakota, allowed people to have perpetual trusts and to take advantage of having a trust that doesn't terminate within a fixed number of years. South Dakota was seeing hundreds and hundreds of trusts being transferred there, each year, by people from all over the country who did not want to set up a trust that terminates within 80 years.

MR. BLATTMACHR said that at the same time, people were realizing that they did not want to subject such perpetual trusts to a state income tax if it wasn't absolutely necessary. Therefore, although states felt that they wouldn't be able to attract business if they taxed nonresident trusts, they had not thought that residents would move their trusts to other jurisdictions to avoid that same tax. This has not proven to be the case, however, and now practitioners are feeling obligated to inform their clients that there are other alternatives than just "doing something within their borders."

Number 38.48

MR. THWAITES added that one of the common estate-planning vehicles is the "idea of a living trust," and the IRS has created a special category for that called a grantor trust, where everything is taxed to the individual on his/her own "1040 return." That's the one area, he opined, that most of those states are worried about: that that grantor trust would be such that people could just put the name "trust" on their checking account and then anything that went into that checking account would avoid the tax. But the IRS has taken the position that it is a grantor trust, as opposed to a simple or complex trust, and as such, it really is money that belongs to that individual - that that individual has earned - and therefore is subject to his/her income tax. That's a pretty common probate-avoidance device, he noted, that is not significantly used in Alaska because its probate system is pretty streamlined, whereas New York and, especially, California "would be extremely concerned about that because that is the main planning device" for those states.

REPRESENTATIVE ROKEBERG sought confirmation that it is atypical for a trust to be "set up to avoid current income." He asked whether there is a way, under current Alaska statutes, to "avoid current income taxation."

MR. BLATTMACHR said, "Not federal income tax." It would be very difficult, he added, for somebody to set up a trust that avoids income tax, particularly Alaskan residents. For one thing, trusts are taxed at the highest rate: after about \$8,000 they go to the 39.9-percent [tax] bracket. So one would really have to have a large trust for it to be worthwhile to try to avoid a state income tax, because the income would instead be subject to the 39.9-percent tax bracket. He said that most trusts that are set up "as a beneficiary," are considered by the IRS to be grantor trusts and are thus disregarded for tax purposes, "and all that income is put on their tax returns, so there would be no way for them to avoid it ... from an individual perspective."

REPRESENTATIVE ROKEBERG, referring to the possibility of offering a state income-tax exemption on trusts to both nonresidents and residents, asked, "What would the harm be if we did, in fact, exempt residents from that."

Number 42.16

MR. BLATTMACHR said that the only time it would have an impact would be when someone sets up a trust for somebody else and the trust does not mandate payment of income, and that's called a complex trust. A simple trust is where the document says, "All income earned has to be paid out to the beneficiary"; in that case, if an Alaskan is the beneficiary, that trust is going to distribute that income to that beneficiary, and that beneficiary is going to report that income on his/her federal income tax return. The only time there would be nonpayment of a state income tax, he explained, would be if the trust kept all the income.

MR. BLATTMACHR said that what happens then is that the trust is considered a taxable entity and would therefore pay federal tax, and if the state did tax it, it would be on the income of the trust. "But again, when the trust makes a distribution, the trust gets a deduction and the beneficiary picks it up," he reiterated. Most of the time, some or all of the income, and sometimes part of the principal, is distributed even though it is not required. The only time that it could be said that the state might lose a little bit of revenue, he posited, is when the trust didn't pay out any of the income.

MR. THWAITES added that most of the individuals that one would deal with in the area of estate planning are the kind of people who want to hang on to their money until they're done with it, so it's rare for complex trusts to be set up. He noted that lately he is often setting up special-needs trusts for disabled parents or disabled children, but these are not usually large trusts. In those instances, there are discretionary distributions and so they do become complex trusts. He pointed out that with complex trusts, the income is subject to an immediate increase with regard to the federal income tax bracket, and so for most people, it doesn't make any sense to go that route until a trust is producing upwards of \$200,000 in income.

Number 45.07

REPRESENTATIVE ROKEBERG sought confirmation that there would be no real harm done to Alaska's income stream by exempting residents from income taxes on their trusts.

MR. BLATTMACHR said no, the [number of] exemptions would be very minimal.

REPRESENTATIVE ROKEBERG, referring to the special-needs trusts that Mr. Thwaites mentioned, asked whether there was anything specific that the legislature could do to help with regard to the mental health trust.

MR. THWAITES mentioned that the Omnibus Reconciliation Act of 1993 - referred to as OBRA '93 - established four federal special-needs trusts and two other types of trusts - testamentary special-needs trusts and third-party special-needs trusts. The federal government basically exempted these specialized trusts from consideration as a resource for determining eligibility for Medicaid, as did some of the Social Security Supplemental Security Income (SSI) rules. He added that the federal government has recognized that the more Medicaid eligibility criteria is restricted, the more often co-payments, dental and vision services, and a lot of other services are not covered. Therefore, a parent who has a disabled child, for example, might be better served by setting up a testamentary or third-party special-needs trust for that child if that property and money will be available to supplement the child's care and needs after the parents are deceased. The other choice for parents, he noted, would be to give the money to the other kids and leave the disabled child in the Welfare

system, otherwise the money "just goes away quickly and isn't available if it is counted as a resource."

TAPE 02-12, SIDE B [House JUD tape]  
Number 46.42

MR. THWAITES mentioned that it was in 1993 that the federal government provided more definitions for "those types of trusts," and encouraged their use as estate-planning devices for the elderly and the disabled, and as supplements to Medicare benefits. He noted that "most of that stuff" is found under Title 42 of the U.S. Code, which is very strict. He said:

Once you see one of those and recognize that it's under that criteria, basically everybody just says, "Okay, we know what that is, it's sacrosanct under the federal rules, we're not going to mess with it." And that's what it is: it's a personal injury settlement for a disabled person that enables them to have a home, to have a car, and to have payments for things that are not going to be covered by Medicaid, without disqualifying them.

REPRESENTATIVE ROKEBERG asked whether Mr. Thwaites could administer those types of trusts and still make a profit without it being too burdensome.

MR. THWAITES said, "We could do that." He mentioned that he is currently having discussions with the Mental Health Trust Authority regarding administering some of the "pooled income trust monies." In this way, he noted, the corpus of those pooled income trusts could be paid back to the Mental Health Trust Authority when the beneficiary dies.

CHAIR TAYLOR, after noting that there were no more questions, again thanked Mr. Blattmachr and Mr. Thwaites for their presentation.

#### **ADJOURNMENT**

Number 43.49

There being no further business before the committees, the joint meeting between the Senate Judiciary Standing Committee and the House Judiciary Standing Committee was adjourned at 2:59 p.m.