HB

101

Alaska State Legislature

House of Representatives

House Judiciary Committee

State Capitol, Room 120
Juneau, Alaska 99801-1182
(907) 465-4990

Date: February 11, 1997

To: David Shaftel
Fax: 278-6015

From: Lisa Kirsch
House Judiciary Committee Aide
Fax: 465-4316 Phone: 465-4990

Subject: **HB 101**

I have attached a bill for your consideration. Any input you may have as to the effects or potential pitfalls of this legislation would be appreciated.

If you have no interest, would you be so kind as to direct me to an estate planning organization or other entities that might be able to help us evaluate this bill.

NOTE: BILL IS TWO-SIDED.
YOU WILL RECEIVE ODD NO. PAGES
& THEN I WILL RELOAD THE
EVEN NO. PAGES.

The University of Michigan
Law School
Hutchins Hall
625 South State Street
Ann Arbor, MI 48109-1215

LAWRENCE W. WAGGONER
Lewis M. Simes Professor of Law

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May 21, 1996

BY TELEFAX

Diane L. Wendlandt
Assistant Attorney General
Alaska Department of Law
1031 West 4th Ave., Suite 200
Anchorage, AK 99501-1994

Re: Alaska Family Trust Act , HB 459(JUD)

Dear Diane:

The governor should veto the above referenced bill. It is ambiguous in part, and, more importantly, is against public policy.

1. *Asset Protection Trusts Jeopardize Marital and Other Rights Relating to Family Obligations, As Well as Legitimate Creditor Rights, Sections 4 and 7.* Section 4 adds 13.36.310 and section 7 revises 34.40.110. Both sections jeopardize marital and other rights relating to family obligations, and are against public policy. 13.36.310 (line 12) explicitly protects these trusts from claims by way of a marital or similar right. 34.40.110 (line 11) refers to a creditor "or another person" (i.e., this includes the spouse of the settlor or the spouse or minor child of a beneficiary), and disallows such person from satisfying a claim out of the beneficiary's interest in the trust. There are three exceptions: a transfer in fraud of creditors, a revocable trust, and a trust where the trustee *must* distribute income or principal to the settlor. The exceptions do not go nearly far enough. The limited nature of these exceptions opens up a gap in spousal protection laws (such as the elective share of the surviving spouse) that any lawyer could maneuver through with ease. Notice that the third exception relates to a trust in which the trustee *must* distribute income or principal to the settlor. How easy it would be just to set up a trust with a friendly trustee, and instead of requiring the trustee to distribute income to the settlor, give the trustee "discretion" whether to distribute income to the settlor. (The plan would of course be that the friendly trustee would always decide to distribute income to the settlor.) Such trusts are called discretionary trusts, and American law in general holds that a settlor cannot avoid his/her own creditors or claims of his/her own spouse by establishing such a trust for himself/herself. The American rule is a sound one in policy, and HB 489(JUD) would reverse that rule.

Insofar as marital rights are concerned, HB 489(JUD) is actually inconsistent with the spousal protection provisions in a bill enacting the Uniform Probate Code that passed the Alaska legislature this very session.

2. *Perpetuities, Sections 5 and 6.* The proposed amendment to the Uniform Statutory Rule Against Perpetuities is not sanctioned by the Uniform Law Commission. The amendment is ambiguous. Subsection (3) says that a nonvested future interest cannot be invalid under the Rule Against Perpetuities (in other words, the nonvested future interest is exempt from the Rule Against Perpetuities) if it is in a trust in which the trustee has discretion to distribute income or principal to a person who is living when the trust was created. Does this mean that such a trust continues to be exempt forever, even after the person dies, or does it lose its exemption once the person dies? The language is unclear, and would surely lead to unnecessary litigation.

I have reason to believe that the intention is that the trust will continue to be exempt forever. If this is so, the bill sets up a situation in which a wealthy person, whether an Alaskan or a resident of another state, can set up a so-called "dynasty trust" in Alaska, a trust that lasts perpetually.

Why do the promoters of this bill want Alaska to allow perpetual dynasty trusts? The apparent purpose is purely commercial (to manipulate state law in order to give Alaska banks a competitive advantage over banks in nearly all other states). The public policy against dynasty trusts (trusts that last longer than a life in being plus 21 years or 90 years) is lost in the wake of these commercial interests. Ironically, the genesis is the federal generation-skipping tax (GST tax), which imposes high costs for creating trusts that persist through more than one generation. The GST tax would therefore seem to discourage long-term trusts. But the GST tax also contains a $1 million per donor GST exemption that relies only on state perpetuity law to control the length of exempt trusts. The apparent purpose of this bill is to abolish the Rule Against Perpetuates for Alaskan trusts in order give Alaskan banks a competitive advantage in attracting out of state $1 million ($2 million for married donors) GST-exempt trusts. There are a few other states that have, in effect, abolished the Rule Against Perpetuities for trusts—Wisconsin, Idaho, South Dakota, and Delaware. But I am in touch with people at the IRS and the U.S. Treasury Department, and on the basis of what they tell me, it is only a matter of time before Congress or the Treasury Department by regulation puts a stop to this, for it is an unintended loophole in the GST tax. Once the loophole is closed, the tax incentive for creating perpetual or dynasty trusts will disappear, but trusts created before the loophole is closed will continue to exist. Does Alaska want to be known as the home of the dynasty trust?

Sincerely yours,

Lawrence W. Waggoner

Lawrence W. Waggoner

Larry Wagoner, Loyola Law School, LA; commissioner on the Uniform Probate Code -- 213-736-8168

Richard Wellman, University of Georgia Law School; former commissioner on the Uniform Probate Code -- 706-542-5174

Jeffrey Schoenblum, Vanderbilt Law School -- 615-322-2668

The first two are people the sponsors of the bill like to quote. Letter from Wagoner re HB 459 attached. All three have copies of HB 101.

TONY KNOWLES
GOVERNOR

P.O. Box 110001
Juneau, Alaska 99811-0001
(907) 465-3500
Fax (907) 465-3532

STATE OF ALASKA
OFFICE OF THE GOVERNOR
JUNEAU

May 23, 1996

The Honorable Gail Phillips
Speaker of the House
Alaska State Legislature
State Capitol
Juneau, AK 99801-1182

Dear Speaker Phillips:

Under the authority of art. II, sec. 15 of the Alaska Constitution, I have vetoed the following bill:

CSHB 459(JUD) am

"An Act relating to the jurisdiction governing a trust, to challenges to trusts or property transfers in trust, to the validity of trust interests, and to transfers of certain trust interests."

While this Administration applauds innovation and imaginative efforts to attract business opportunities, I am concerned that the potential benefits of this bill are outweighed by its inadvertent consequences to the people of Alaska. Therefore, I find it necessary to veto this bill.

This legislation would make a dramatic change in our trust laws and policy. In fact, these changes to Alaska law would make this the only state to espouse such public policy. The bill raises many questions and concerns which require a level of consideration and analysis that, frankly, was not received with just one hearing before each body of the Legislature.

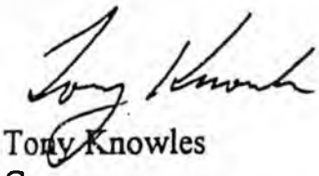
Specifically, one of the chief concerns I have about this bill is that it would shift the burden of proving intent to defraud onto creditors, spouses, and children of the settlor. Currently, if one transfers assets into a trust of which the settlor is a beneficiary, the trust is void as to present or future creditors. Under the terms of this bill, the burden of proof is shifted so that a creditor or a spouse in a divorce setting would have to litigate to prove the settlor's fraudulent intent before the trust assets could be invaded to meet those interests.

Another important concern is the bill's provision that a trust cannot be set aside on the grounds it defeats an interest conferred by a marital or similar relationship. Thus, a settlor could disinherit his or her spouse. Upon the settlor's death, the spouse would be unable to obtain the normal elective share (usually one-third) of the estate. The same would be true for surviving children who would be unable to reach these assets in payment of child support arrears. This provision contradicts the legislature's action on another bill passed this year updating Alaska's probate code.

I realize this trust law is meant to mirror laws common in some offshore jurisdictions, such as Bermuda and the Cayman Islands. However, parts of this bill, particularly the provision to prevent the spousal elective share of a trust, go even further than the offshore trust laws.

There may be aspects of this proposal that could benefit Alaska's economy by attracting financial investments without harming the public good. I would welcome further work in this area with the understanding that any future changes in our trust laws undergo thorough scrutiny and public hearings.

Sincerely,



Tony Knowles
Governor

Alaska State Legislature

Official Business
Fax: (907) 465-3472

State Capitol
Juneau, AK. 99801-1182
(907) 465-3720
(907) 465-2689

Speaker of the House of Representatives

LISA as I get it, our estate law needs amending to
· AVOID OLD COMMON LAW PITFALL
· ENCOURAGE EST PLANNING IN ALASKA
Pls review & lets get this old man up to speed. Thanks
Joe

DATE: December 5, 1996

TO: Representative Joe Green

FROM: Speaker Gail Phillips

RE: Alaska's Family Trust Act -- HB 459 from 19th Legislature

Enclosed is a letter from Robert Manley and a proposed draft substitute for HB 459 on the Alaska Family Trust Act from last session. This bill was vetoed by the Governor; and Mr. Manley's suggestions regarding the need for further revisions to the bill are well taken.

After reviewing the enclosure, I would appreciate the opportunity to talk with you regarding Mr. Manley's suggestions as soon as possible.

GP:jmj

Enclosure

HUGHES THORSNESS POWELL
HUDDLESTON & BAUMAN LLC
ATTORNEYS AT LAW

Judi - Pls review & respond
Send copy of this whole packet to Rep. Green and let him know I want to discuss this w/him as soon as he's had a chance to go through it.

November 21, 1996

Direct Dial:
(907)263-8251

Gail Phillips
P. O. Box 3304
Homer, AK 99603

Re: Alaska Family Trust Act
Committee Substitute for House Bill 459 (JUD am)
Our File No. 2270-72

Dear Representative Phillips:

As you know, the above referenced bill passed both houses in the legislature but was vetoed by Governor Knowles. The Governor's veto message contained numerous factual and legal errors. However, he was correct that under some circumstances, a trust under the act could have limited collection of child support. In addition, the Governor was correct when he stated that the trust could have been used to defeat the forced elective share of one-third of the augmented estate in the event a spouse dies and fails to adequately provide for his or her surviving spouse.

In response, bill proponents have redrafted a new version of the bill addressing the Governor's stated concerns and improving the bill in several regards including the adding of provisions facilitating Alaska Native Claim Settlement Act trusts. Enclosed for your reference is a copy of a September 26, 1996 letter from Jonathan Blattmachr to Fran Ulmer detailing these matters.

At a recent meeting of the Alaska Bar Association Section on probate and estate planning, it was suggested that the new legislative majority might re-introduce all bills vetoed in the last legislature and pass them through without hearing under a veto proof majority. That may be appropriate in most cases, however given the proposed revisions to the Alaska Family Trust Act, it might be better to review the proposed modifications in the normal legislative process rather than simply reenacting the bill.

I think the more measured approach will get us a better over all result. If the old version of the bill is passed, we will lose much of the interest in momentum in getting the other modifications and improvements through.

HUGHES THORSNESS POWELL
HUDDLESTON & BAUMAN LLC
ATTORNEYS AT LAW

Accordingly, I suggest that you give serious consideration to waiting for the new version of the bill rather than simply pushing the old one through.

I am copying this letter to Representative Porter because as Chairman of the House Judiciary Committee, he was instrumental in reviewing and securing passage of the bill during the last legislature.

If you have any questions, please let me know.

Very truly yours,

HUGHES THORSNESS POWELL
HUDDLESTON & BAUMAN LLC

By Robert L. Manley

RLM:kao:46580

Enc.
cc: Representative Brian Porter w/enc.

Alaska State Legislature

Official Business
Fax: (907) 465-3472

Speaker of the House of Representatives

State Capitol
Juneau, AK. 99801-1182
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December 5, 1996

Mr. Robert L. Manley
Hughes Thorsness Powell
Huddleston & Bauman LLC
550 West 7th Avenue, Suite 1100
Anchorage, AK 99501-3563

Dear Mr. Manley:

Thank you for your letter regarding the Alaska Family Trust Act (HB 459). Your points regarding the Governor's veto of this bill, and the advisability of the legislature's holding hearings on this issue before overriding his veto, are well taken.

With that in mind, I have forwarded a copy of your letter and it's enclosures to Representative Green who will be the Chair of the House Judiciary Committee throughout the upcoming Legislature. In addition, I have asked that Rep. Green contact me atter he has had a chance to review your letter and enclosures. During my talk with him, it is my intention to emphasize the need for the changes which the new draft proposes.

Again, I appreciate hearing from you and look forward to your continued participation in revising the Alaska Trust Act.

Sincerely,

Gail Phillips
SPEAKER OF THE HOUSE

GP:jmj

cc: Representative Joe Green

ALASKA STATE LEGISLATURE

SPEAKER OF THE HOUSE GAIL PHILLIPS

TO: Kimby **FAX:** 258-0226

FROM: Gail Jordan **PHONE:** _____

DATE: 12/6/96

RE: Family Trust letter

COMMENTS: enclosure

NUMBER OF PAGES (Including Cover) 25

Speaker: State Capitol, Juneau, Alaska 99801-1182 • Phone: (907) 465-2669 Fax: (907) 465-3472
Legislative P.O. Box 3304, Homer, Alaska 99603 • Phone: (907) 235-2921 Fax: (907)235-4008

(2)

MILBANK, TWEED, HADLEY & McCLOY
1 CHASE MANHATTAN PLAZA, NEW YORK, 10005-1413

COPY

from person who drafted the bill

September 26, 1996

BY EXPRESS MAIL

The Honorable Fran Ulmer
Lieutenant Governor
State of Alaska
P.O. Box 110015
Juneau, Alaska 99811-0015

Re: Alaska Trust Act of 1997

Dear Fran:

Thank you so much for taking your valuable time to meet with Linda Hulbert and me on September 6 in Anchorage. I greatly enjoyed the meeting and I hope it was informative.

As promised, I am enclosing a copy of a tentative draft of a new proposed bill which is based, in large part, on the bill entitled the "Alaska Family Trust Act of 1996," which, as you are aware, was passed by the Legislature but vetoed by the Governor. Please let me know if you would like me to prepare a "blacklined" version to show the changes from the 1996 bil. We anticipate that the proposed new bill will be called the "Alaska Trust Act of 1997." As discussed in more detail below, it would repeal Alaska's rule against perpetuities, permit individuals to create

certain trusts for their benefit and enact legislation which, with the other provisions of the bill, would facilitate the creation of so-called "settlement trusts" by Regional Corporations. The primary purpose of the bill is to increase trust and related financial businesses in Alaska by providing Americans an opportunity to enhance legitimate lifetime estate and related planning by using Alaska trusts rather than trusts created in certain foreign jurisdictions.

Repeal of the Ancient Rule Against Perpetuities

The proposed new bill would repeal the rule against perpetuities (which limits how long trusts can stay in existence) in Alaska. Four states, South Dakota, Delaware, Wisconsin and Idaho, have already repealed theirs. South Dakota and Delaware have received considerable trust business as a result. In fact, Citibank, N.A., one of the nation's largest banks, has now acquired a trust company in South Dakota and the business it has attracted is considerable according to its officers I have discussed it with. South Dakota and Delaware have received most of the business because no state income tax is imposed on the trusts situated there. Although Delaware has an income tax, it imposes the tax only if the trust has Delaware beneficiaries.

There are a few academics who have a vested interest in seeing that the rule against perpetuities is maintained. Some are reporters on the Uniform Statutory Rule Against Perpetuities. Perhaps, some honestly feel that the time trusts can last should be limited. They have argued with me that 90 or 100 years ought

to be enough. (If 100 years is okay, why not 101? If 101, why not 102? As you know, it is, in any case, a hopelessly complex and misunderstood law.) That is their opinion. Maybe, they feel the same way about corporations. However, I am unaware of anyone who deals regularly with trusts in the real world, such as practicing lawyers and trust officers, who sees any reason to keep the rule against perpetuities in force. In fact, I am aware of movements of several bar groups to have the rule repealed in their state.

In any case, because Alaska currently has no income tax, it should experience an increase in trust business, just as South Dakota and Delaware have. (Also, like Delaware and New York, Alaska could prevent any state income tax being imposed on trusts created in its state by non-residents if it does eventually adopt an income tax.) I think it is appropriate to mention that avoiding state income tax is not the reason why Americans throughout the country are creating trusts in South Dakota and Delaware. Rather, the reason is to accomplish more effective estate planning because trusts there can be perpetual, providing the potential for greater ultimate estate tax savings. Once a decision is made to create a perpetual trust for that reason, individuals typically choose the most favorable income tax jurisdiction. If income tax savings were the only consideration, New Yorkers would create trusts in New Jersey and vice versa. Although each of those states imposes an income tax, they impose them only on trusts created by their own residents.

Creation of Trusts for One's Own Benefit

The second change which the proposed bill would make would, in my judgment, bring even more trust and related financial business to Alaska than the repeal of the rule against perpetuities would alone. That change would be to permit an individual to create a trust of which he or she is eligible (but not entitled) to receive distributions without automatically and permanently subjecting the trust assets to attachment by the individual's creditors unless the transfer to the trust is in defraud of creditors.

In addition to making a few stylistic and clarification changes, the proposed new bill has been redrafted to address the concerns which we understand the Governor expressed as the reasons for vetoing the bill.

1. Possible Use to Disinherit a Spouse. The Governor apparently was concerned that one spouse could "disinherit" his or her surviving spouse from the minimum or elective share to which the surviving spouse would be entitled from the "augmented estate" by creating a trust for his or her own benefit. To address this concern, Section 1 of the proposed new bill would amend AS 13.12.205(2)(A) by adding the parenthetical material so that the deceased spouse's augmented estate automatically would include a trust described in AS 34.40.110 (i.e., one from which the deceased spouse was eligible, even if not entitled to receive distributions). As with other predeath transfers, such a trust created before the marriage or one with respect to which

the surviving spouse had in writing expressly waived his or her right of election would not be included in the augmented estate.

2. Possible Use to Avoid Child Support Payments. Apparently, the Governor also was concerned that a parent might make transfers of property to a trust described in AS 34.40.110 (i.e., one from which the parent is eligible to receive distributions) to avoid having that property seized to satisfy child support payments. The proposed bill addresses that concern in three provisons ways. First, under Section 9 of the bill, at AS 34.40.110(b)(1), the transfer to the trust would be void if it was intended in whole or in part to hinder, delay or defraud creditors or other persons under AS 34.40.010. (As mentioned at our meeting, Alaska appears to have a six-year statute of limitations on fraudulent transfers; I do not believe any state has a longer one.) Presumably, a transfer to avoid making child support payments is a fraudulent transfer. Second, Section 9 at AS 34.40.110(b)(4) would, in effect, make the trust void if the settlor were in default on child support payments by 30 or more days. Third, Section 9 at AS 34.40.110(d) would make a distribution declared to the settlor, or any other beneficiary, attachable by the Child Support Enforcement Division. We hope and believe these three provisions adequately address the Governor's concern with respect to child support. We believe these changes will not adversely affect using Alaska trusts for estate planning purposes, discussed below.

I think it also is appropriate to mention that, perhaps, the best thing that could happen from a child support enforcement viewpoint would be for a parent to create an Alaskan trust. The trust assets then would be directly under the jurisdiction of an Alaska court. As a result, I think it is extremely unlikely that a parent would even consider creating an Alaskan trust if the parent were trying to avoid making child support payments. If anything, the parent would hide assets, transfer them directly to someone else (such as a "new" spouse) or create an asset protection trust outside of the United States, so no U.S. court would have jurisdiction over its assets.

In any case, we hope these changes will allow the Knowles administration enthusiastically to support the proposed new bill. Please contact me at your most early convenience if these changes do not accomplish that.

No Change in Burden of Proof

We understood that there was some question raised as whether the Alaska Family Trust Act of 1996 would have changed the burden of proof on a transfer which allegedly was made in defraud of creditors. It would not do so. As mentioned above, under Section 9 of the bill, transfers to the trust are void if made in defraud of creditors under AS 34.40.010 just as other fraudulent transfers are.

The Bill Would Not Permit or Enhance Fraudulent Transfers

Under American law, transfers made to defraud known or anticipated creditors are void. But under every state, transfers

can be made to immunize assets from claims of future unknown creditors. For example, one spouse can transfer assets to or in trust for the other spouse (or anyone else) and immunize them from claims of future unknown creditors. As I mentioned at our meeting, I have placed a portion of my assets in trust for my wife and children precisely for that reason. Nonetheless, under an ancient English law, known as the Statute of Elizabeth, which probably persists throughout the country, except perhaps Missouri, Indiana and Maryland, assets transferred to an irrevocable trust, even if not made in defraud of creditors, remain permanently subject to the claims of the transferor's creditors, even future unknown and unanticipated ones, if the transferor is merely eligible to receive assets back from the trust. Among other things, this frustrates legitimate estate planning for Americans in using American trusts, as will be explained in more detail later.

As indicated, the law of Alaska and all other states permits individuals, although not in defraud of known or anticipated creditors, to take legitimate action to immunize their personal assets from claims of unknown future creditors. These actions include making gifts to or creating trusts for others, placing money in qualified retirement plans and IRAs, and operating business through corporations, limited partnerships and limited liability companies. Many states permit as individual to immunize assets from future creditors in ways which Alaska does not permit. Several jurisdictions, for example, exempt without

limit cash in a life insurance policy or in an annuity contract from claims of creditors. That is the case in New York. Other states, such as Florida, provide complete immunity for homes, regardless of their value. Alaska does not immunize life insurance policies, annuity contracts or homes from creditor claims. But, as mentioned above, Alaska, and all other states, permit an individual to immunize assets from claims of his or her creditors by transferring them into trust for other people, such as other family members. The Alaska Trust Act of 1997 would make one relatively minor change by maintaining the immunization for trust assets from claims of future unknown creditors where the transferor is eligible but not entitled to receive property from the trust, but only if the transfer to the trust is not in defraud of creditors. Although this is a minor change in creditor rights, it will result in a major change in opportunities in estate and financial planning.

In our meeting, you raised the question about whether the bill would send the wrong "message" about Alaska as being a place where one could defraud creditors. If anything, I think it would send the opposite message. Something like 17 countries (and the list appears to be growing) permit U.S. persons to create trusts to defraud creditors. Under their laws, it does not matter whether the trust is for the benefit of the settlor or someone else. Basically, once the property gets into a trust under the jurisdiction of that country it is immunized from the claims of the transferor's creditors. As a practical matter,

these countries do not have real fraudulent transfer rules. I know that because clients of ours have been defrauded by transfers to such trusts. That could not happen under Alaska Trust Act of 1997.

Under Alaska law, there is a very long-term fraudulent transfer statute of limitations, six years. AS 09.10.050. Clearly, no one is going to try to transfer assets in defraud of creditors by creating an Alaskan trust.

Alaska Trusts Would Enhance Estate Planning for All Americans

Nonetheless, as we discussed, Americans will be able to use Alaskan trusts to enhance estate planning opportunities. As you know, the most effective estate planning almost always involves transferring assets well before death. Individuals, however, very often hesitate in doing that because, to be effective, there usually must be no way the property can ever be returned to the individual. Under the law of virtually all states, creditors can attach assets transferred to a trust even if not transferred in defraud of creditors if the transferor is merely eligible to receive the property in the discretion of an independent trustee. The ability of creditors to attach the property means the transfer is incomplete for estate and gift tax purposes. That is one of the ways foreign trusts can be legitimately used. A recent article written by Joseph Kartiganer, Esq., one of the nation's leading estate planning lawyers, discussing the use of foreign trusts for estate planning purposes, is enclosed. Under the proposed bill, this type of

estate planning could be done in Alaska. We believe Americans would prefer to create trusts in Alaska rather than in foreign countries for estate planning purposes.

As mentioned at our meeting, under the bill, individuals could create trusts in Alaska to immunize assets from claims of future, unknown creditors. This can be done today anywhere in the United States. As mentioned, I have done it by transferring assets to a trust here in New York for my wife and children. But such a transfer cannot be done, except perhaps in Missouri, Indiana and Maryland, if the person who created the trust is eligible to receive property back from the trust. Under the bill, Alaska law would be changed so one could create a trust (provided it is not done in defraud of creditors) including himself or herself. According to one U.S. government report, nearly one-half trillion dollars has been transferred by Americans to foreign asset protection trusts. Some of these transfers are in defraud of creditors, and, hence, would not have been created in Alaska, even under the bill, or anywhere else in America. But many of the transfers to foreign trusts by Americans are not in defraud of creditors. These latter transfers are being made for estate planning reasons or to protect assets from future unknown creditors only, something permitted under the law of all states. Under the bill, these non-fraudulent transfers could be made to Alaska trusts rather than to foreign trusts and we believe most would choose Alaskan

trusts. This would, in our judgment, substantively benefit the trust and financial industries in the state.

ANCSA Settlement Trusts

The proposed new bill contains a new section (Section 10) which expressly deals with "settlement trusts" created by Regional Corporations under Section 39(a) of the federal law, the Alaska Native Claims Settlement Act (ANCSA). Although we have been advised by legal counsel to certain of the Regional Corporations that the Alaska Family Trust Act of 1996 would have facilitated the creation of settlement trusts under Section 39(a) of ANCSA, it was recommended that additional changes be made to Alaska trust law with respect to settlement trusts, and we have done so.

* * *

Thank you again for meeting with me. It is an honor to be dealing with you about this important matter. I look forward to hearing from you.

Sincerely yours,

Jonathan G. Blattmachr

JGB:agw
Enclosure
cc: Ms. Linda Hulbert
Fax No.: 907-479-6536

bcc: Richard Thwaites, Jr., Esq.
Fax No.: 907-274-1126

Richard Hompesch, Esq.
Fax No.: 907-456-5693

Mr. Douglas Blattmachr
Fax. No. 406-791-7385

112638

THE FOLLOWING PAGES MAY
NOT FILM LEGIBLY BECAUSE OF
THE POOR QUALITY OF THE ORIGINAL

Completed Gifts to Offshore Trusts and the Three-Year Rule

Joseph Kartiganer, Pamela L. Rollins, and Abraham D. Piontnica

Transfers to an irrevocable offshore trust where the settlor remains a potential beneficiary of the trust require careful planning.

In recent years, the offshore asset protection trust has gained popularity as an estate planning tool. Unlike trusts established in most domestic jurisdictions, the offshore trust permits settlors to protect themselves from future creditors without having to give up completely the benefit of the transferred assets.

Commentators generally have assumed that transfers to the offshore trust will be structured so that they will be wholly incomplete for Federal gift tax purposes and be includible in the settlor's gross estate for Federal estate tax purposes.[1] Frequently overlooked are significant potential gift and estate tax benefits that are available to a settlor who instead makes a completed gift to an irrevocable offshore trust of which he is a discretionary beneficiary, structured so that the trust assets will be excluded from his gross estate. The decision whether to use such a structure should take into account the fact that many foreign jurisdictions have a waiting period during which creditors whose claims arise after the creation of such a trust may reach the assets of the trust (hereinafter "subsequent creditors"); this waiting period will delay completion of the gift and may trigger the three-year rules of Sections 2035(d)(2) or 2038(a) of the Internal Revenue Code of 1986 (IRC), thereby extending the period during which the trust assets will be includible in the settlor's estate.

Creditor Protection

A primary reason for creating an offshore trust is its usefulness in protecting assets from creditors' claims.[2] In most cases, the settlor may retain an interest in the offshore trust as a discretionary beneficiary without giving up this asset protection.[3] By contrast, domestic courts have refused to extend such protection to a settlor-beneficiary of a domestic self-settled trust.[4]

Benefits of Completed Gift Structure

For a settlor willing to give up a certain measure of control over assets and to pay any applicable gift tax, an irrevocable offshore trust can provide the estate planning benefits associated with domestic completed gifts in addition to asset protection.

A completed gift is designed to exclude the trust assets and any gift tax paid thereon from the settlor's gross estate. In addition, estate and gift taxes are avoided with respect to any post-transfer income and appreciation of the transferred assets. Furthermore, because the offshore trust is a grantor trust for income tax purposes,[5] the trust will grow on a tax-free basis, with the grantor paying the income taxes (without gift tax consequences).[6]

Joseph Kartiganer, Esq., is a Partner in the New York law firm of Simpson Thacher & Bartlett and specializes in the area of personal planning. Pamela L. Rollins, Esq., is Counsel to the same firm. Abraham D. Piontnica, Esq., is an associate at the firm. All three specialize in the area of personal planning.

EXHIBIT 1
Statutory Authority

IRC Section 2501 imposes a tax on the transfer of property by gift by an individual. IRC Section 2511 provides that the tax shall apply whether the transfer is in trust or otherwise, whether the gift is direct or indirect, and whether the gift is real or personal, tangible or intangible.

Treasury Regulation Section 25.2511-2 contains the following provisions:

(b) As to any property, or part thereof or interest therein, of which the donor has so parted with dominion and control as to leave in him no power to change its disposition, whether for his own benefit or for the benefit of another, the gift is complete. But if upon a transfer of property (whether in trust or otherwise) the donor reserves any power over its disposition, the gift may be wholly incomplete, or may be partially complete and partially incomplete, depending upon all the facts in the particular case...

(c) A gift is incomplete in every instance in which a donor reserves the power to revest the beneficial title to the property in himself.

For settlors who are convinced of the benefits of lifetime giving but are fearful that they may be left with insufficient funds for themselves, the offshore trust provides an opportunity for transfers at gift tax rates (with the benefit of any remaining $600,000 credit shelter) while retaining beneficiary status.

Gift and Estate Tax Consequences

Gift Tax. Whether a transfer is a completed gift turns on whether the settlor has sufficiently abandoned dominion and control over the property. For discussion of the statutory guidelines on this element, see Exhibit 1. The settlor of an irrevocable offshore trust will not be deemed to have completely parted with dominion and control of property where the settlor could receive the economic benefit and enjoyment of the trust assets by borrowing money or by transferring his interest in the trust fund and relegating his creditors to the trust fund for payment.[9] This applies to the maximum amount the trustee may pay to the settlor or apply for his benefit, even if the settlor is only a discretionary beneficiary and regardless of whether such power is, in whole or in part, actually exercised.

However, a gift, even though initially incomplete, becomes complete when the settlor's actions may no longer affect creditors' rights to reach the trust assets.[10] Accordingly, the gift becomes complete when the period specified under the law of the foreign jurisdiction ends. Indeed, in a private letter ruling, the Internal Revenue Service (IRS), holding that a completed gift was made to an irrevocable offshore trust, relied on the claims of the settlors' representative that under applicable foreign law neither the settlor-beneficiary nor its creditors may compel the trustee to distribute the trust's assets to or for their benefit.[10]

Estate Tax. IRC Sections 2036 and 2038 operate to include in a decedent's gross estate transfers that leave the transferor a significant interest in or control over the property transferred during his lifetime, on the theory that the transferor really kept the benefit of the property. These sections differ slightly in their definitions of what is includable in the decedent's gross estate. Section 2036(a) provides that the decedent's gross estate shall include

> the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer...under which [the decedent] has retained for his life or for a period not ascertainable without reference to his death, or a period which did not in fact end before his death (1) the possession or enjoyment of, or right to income from the property, or (2) the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom.

Section 2038(a)(1) provides that the decedent's gross estate shall include

> the value of all property [t]o the extent of any interest therein of which the decedent has at any time made a transfer,...where the enjoyment thereof was subject at the date of death to any change through the exercise of a power (in whatever capacity exercisable) by the decedent (without regard to when or from what source the decedent acquired such power) to alter, amend, revoke or terminate, or any such power is relinquished during the 3-year period ending on the date of the decedent's death.

Such retained powers exist where the settlor is deemed to retain the economic benefit and enjoyment of the trust assets by being able to incur debt and relegate his creditors to the trust for payment, again as measured by the extent of the trustee's discretion to pay assets to the settlor.[11] However, the settlor will be deemed to have relinquished such powers when his actions may no longer affect creditors' rights,[12] at the same time as the gift is complete (that is, upon the expiration of the period during which the settlor's incurrence of debt would allow creditors to reach the trust assets under the foreign law).

Sections 2035 and 2038 and the Three-Year Rule

Notwithstanding the fact that, once the period during which creditors may reach the trust assets terminates, the gift will be complete and the settlor will no longer be deemed to hold a Section 2036 or 2038 power with respect to the trust, the question remains whether termination of the settlor's powers by operation of law triggers the rules of Section 2035(d)(2) or Section 2038(a)(1) and extends for a *further* three years, the period in which the trust's assets will be includible in the settlor's gross estate.

Section 2035(d)(2) would include in the decedent's gross estate trust assets as to which a retained interest or power terminated as a result of a "volitional act or otherwise" within three years of death.[13] Section 2035(a) provides that the gross estate shall include the value of all property interests transferred by the decedent within three years of death. Under Section 2035(d)(1), the provisions of Section 2035(a) are generally not applicable to the estates of individuals dying after December 31, 1981. However, Section 2035(d)(2) provide that Section 2035(d)(1)

> shall not apply to a transfer of an interest in property that is included in the value of the gross estate under Sections 2036, 2037, 2038 or 2042 or would have been included under any of such sections if such interest had been retained by the decedent.

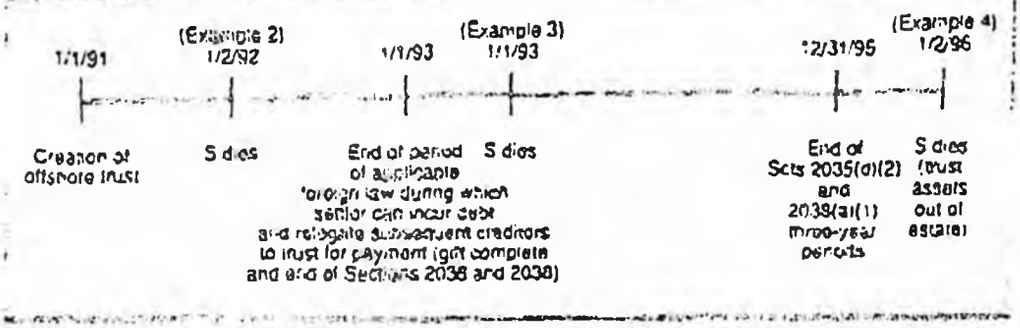
Under Section 2038, the settlor will be deemed to have relinquished a power to alter, amend, or revoke the trust on the date the period under foreign law has run (that is, by allowing the power to borrow money or otherwise incur debt and to relegate his creditors to the trust for payment to expire without action on his part).

In *Wien v. United States*,[14] the settlor had the power to amend or revoke the terms of a trust requiring mandatory distributions to the beneficiaries *prior* to the vesting date. The court held that the failure of the settlor to exercise the powers to amend or revoke the trust was a relinquishment of such powers by the settlor, causing all unpaid mandatory distributions vesting within three years of the settlor's death to be includible in the settlor's gross estate pursuant to Section 2038.

In a private letter ruling,[15] the IRS held that assets of a trust were includible in the settlor's gross estate pursuant to Sections 2035 and 2038 where the settlor died within three years of the termination of the trust according to its own terms. The settlor, by allowing his Section 2038 powers, which he could have exercised, to expire without action on his part, was found to have "relinquished" the powers on the date the trust terminated. The IRS further held that because the trust assets would have been includable under IRC Section 2038, it would also be includible under Section 2035.

"The gross estate shall include the value of all property interests transferred by the decedent within three years of death."

Time Line Graph (for Examples 2-4)



How is the transfer in the final example treated? The transfer by *S* will have been deemed a completed gift on January 1, 1993 and no part of the trust income or corpus or gift tax paid will be included in *S*'s gross estate.

Conclusion

A settlor can use an irrevocable offshore trust as an effective estate planning tool while remaining a potential beneficiary of the trust. However, the gift will not be deemed to be complete and the assets will be includible in the settlor's gross estate pursuant to Sections 2036 and 2038 until the expiration of the period under foreign law during which the settlor's actions may affect creditors' rights to reach the trust assets. In addition, it is likely that Sections 2035 and 2038 will further extend the period in which the assets will be includible in the settlor's gross estate for three years after the deemed termination of the settlor's Sections 2036 and 2038 powers. ■

[1]Osborne, Asset Protection, Domestic and International Law and Tactics, Section 24:23; Rosen, 810 T.M., Asset Protection Planning at A-22.

[2]The asset protection afforded a settlor of an offshore trust by many foreign jurisdictions is, with respect to creditors of the settlor whose claims exist prior to the creation of the offshore trust, generally limited to the fraudulent conveyance laws of such jurisdictions. Accordingly, unless otherwise provided, references in this article to creditors shall refer to subsequent creditors of the settlor. See Engel, "Using Foreign Situs Trusts for Asset Protection," 20 Est. Plan. 212, 215 (1993).

[3]76 Am. Jur. 2d, Trusts § 139; Marty-Nelson, "Offshore Asset Protection Trusts: Having Your Cake And Eating It Too," 47 Rutgers L. Rev. 11, 62 (1994).

[4]See Vanderbilt Credit Corp. v. Chase Manhattan Banks, 473 N.Y.S.2d 242, 245-246 (App. Div. 1984); Marty-Nelson, supra note 4 at 31.

[5]Upon the death of the grantor, the trust ceases to be a grantor trust and there is a chance that an excise tax pursuant to IRC § 1491 may be due. See Rev. Rul. 87-61, 1987-2 CB 219.

[6]See C.T. Montesano, Defensive Grantor Trusts: Gift Tax Consequences of Payment of Income Tax Liability by Grantor, 20 Tax Mgmt. Est., Gifts & Tr. J. 183 (Sept. 14, 1995); but see Priv. Ltr. Rul. 9410033 (Nov. 4, 1993).

[7]Comm'r v. Vander Weele, 254 F.2d 895 (6th Cir. 1958); Priv. Ltr. Rul. 9332006 (Aug. 13, 1993); Estate of Paxton v. Comm'r, 86 TC 785, 815 (1986); Outwin v. Comm'r, 76 TC 153 (1981).

[8]Outwin v. Comm'r, 76 TC at 163.

[9]Rev. Rul. 77-378, 1977-2 CB 347; Rev. Rul. 76-103, 1976-1 CB 304.

[10]Priv. Ltr. Rul. 9332006 (Aug. 13, 1993).

[11]Estate of Uhl v. Comm'r, 25 TC 22 (1955), rev'd, 241 F.2d 867 (7th Cir. 1957); Estate of Paxton, 86 TC at 814.

[12]Rev. Rul. 76-103, 1976-1 CB 304.

[13]IRC § 2035(d)(2). See Priv. Ltr. Rul. 9032002 (Aug. 10, 1990) discussing circumstances under which termination of retained interests or powers in trust would require inclusion of trust assets in a settlor's gross estate under Section 2035(d)(2), and citing two gift tax cases as examples of what is meant by "a voluntary act or otherwise." See Webster v. Comm'r, 65 TC 968, 979 (1976); Goodman v. Comm'r, 4 TC 191 (1944).

[14]White v. United States, 881 F. Supp. 688 (D. Mass. 1995).

[15]Priv. Ltr. Rul. 9127008 (July 5, 1991).

[16]The protector is unique to foreign trusts. The protector may be granted broad powers, including, without limitation, the power to remove and replace trustees and to vary beneficiaries. If the settlor appoints himself as protector, the gift may not deemed complete and the trust assets may be includible in the settlor's gross estate. See Priv. Ltr. Rul. 9532008.

[17]Priv. Ltr. Rul. 9332006.

HOUSE BILL NO.

IN THE LEGISLATURE OF THE STATE OF ALASKA

TWENTIETH LEGISLATURE - FIRST SESSION

BY THE HOUSE JUDICIARY COMMITTEE

Amended:
Offered:

Sponsor(s): REPRESENTATIVE

A BILL

FOR AN ACT ENTITLED

"An Act relating to the jurisdiction governing a trust, to challenges to trusts or property transfers in trust, to the validity of trust interests, to transfers of certain trust interests, and the augmented estate."

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF ALASKA:

* Section 1. AS 13.12.205(2)(A) is amended to read:

(A) an irrevocable transfer in which the decedent retained the right to the possession or enjoyment of, or to the income from, the property, if and to the extent the decedent's right terminated at or continued beyond the decedent's death (including an irrevocable transfer to a trust described in AS 34.40.110); the amount included is the value of the fraction of the property to which the decedent's right related, to the extent the fraction of the property passed outside probate to or for the benefit of a person other than the decedent's estate or surviving spouse.

* Section 2. AS 13.36.035(a) is amended to read:

(a) The court has exclusive jurisdiction of proceedings initiated by interested parties concerning the internal affairs of trust, including trusts covered by (c) of this section. Except as provided in (c) - (d) of this

section, proceedings that may be maintained under this section are those concerning the administration and distribution of trusts, the declaration of rights and the determination of other matters involving trustees and beneficiaries of trusts. These include proceedings to

(1) appoint or remove a trustee;

(2) review trustees' fees and to review and settle interim or final accounts;

(3) ascertain beneficiaries, determine any question arising in the administration or distribution of any trust including questions of construction of trust instruments, instruct trustees, and determine the existence or nonexistence of any immunity, power, privilege, duty or right; and

(4) release registration of a trust.

* Section 3. AS 13.36.035 is amended by adding new subsections to read:

(c) A provision that the laws of this state govern the validity, construction, and administration of the trust and that the trust is subject to the jurisdiction of this state is valid, effective, and conclusive for the trust if

(1) some or all of the trust assets are deposited in this state and are being administered by a qualified person;

(2) a trustee is a qualified person; and

(3) part or all of the administration of the trust occurs in this state.

(d) The validity, construction, and administration of a trust with a state jurisdiction provision are determined by the laws of this state, including the

(1) capacity of the settlor;

(2) powers, obligations, liabilities, and rights of the trustees and the appointment and removal of the trustee; and

(3) existence and extent of powers, conferred or retained, including a trustee's discretionary powers, the powers retained by a beneficiary of the trust, and the validity of the exercise of a power.

(e) For purposes of subsection (c)

(1) some or all of the trust assets shall be treated as being deposited in this state and being administered by a qualified person if any part of the assets of the trust are held in a checking account, time deposit, certificate of deposit, brokerage account or similar account or deposit within this state.

(2) a qualified person shall be treated as being a trustee if the qualified person is designated as a trustee under or pursuant to the terms of the governing instrument or by any court having jurisdiction over the trust and the powers exercisable by the qualified person as trustee include or are limited to maintaining on an exclusive or non-exclusive basis books and records of and on behalf of the trust and to preparing or arranging on an exclusive or non-exclusive basis for the preparation of any income tax returns which must be filed by the trust.

(3) part or all of the administration of the trust shall be treated as occurring in this state if books and records of the trust are physically maintained in this state.

*Section 4. AS 13.36.045(a) is amended to read:

(a) The court will not, over the objection of a party, entertain proceedings under AS 13.36.035 involving a trust registered or having its principal place of administration in another state, unless

(1) all appropriate parties could not be bound by litigation in the courts of the state where the trust is registered or has its principal place of administration;

[OR]

(2) the interests of justice otherwise would seriously be impaired; or

(3) the trust contains a state jurisdiction provision; and

(A) some or all of the trust assets are deposited in this state and are being administered by a qualified person; or

(B) a trustee is a qualified person.

* Section 5. AS 13.36 is amended by adding new sections to read:

Section 13.36.310. CHALLENGES TO TRUST. Except as provided in AS 34.40.110; a trust that is covered by AS 13.36.035(c) or that is otherwise governed by the laws of this state, or a property transfer in trust that is covered by AS 13.36.035(c) or that is otherwise governed by the laws of this state, is not void, voidable, liable to be set aside, defective in any fashion, or questionable as to the settlor's capacity on the grounds that the trust or transfer avoids or defeats a right, claim, or interest conferred by law on a person by reason of a personal or business relationship with the settlor or by way of a marital or similar right.

Section 13.36.390. DEFINITIONS. In AS 13.36,

(1) "qualified person" means:

(A) an individual who, except for brief intervals, military service, attendance at an educational or training institution, or for absences for good cause shown, resides in this state, whose true and permanent home is in this state, who does not have a present intention of moving from this state, and who has the intention of returning to this state when away;

(B) a trust company that is organized under AS 06.25 and that has its principal place of business in this state; or

(C) a bank that is organized under AS 06.05, or a national banking association that is organized under 12 U.S.C. 21 - 216d, if the bank or national banking association possesses and exercises trust powers and has its principal place of business in this state;

(2) "settlor" means a person who transfers property in trust; "settlor" includes a person who furnishes the property transferred to a trust even if the trust is created by another person;

(3) "state jurisdiction provision" means a provision that the laws of this state govern the validity, construction, and administration of a trust and that the trust is subject to the jurisdiction of this state.

* Section 6. AS 34.27.050(a) is amended to read:

(a) A nonvested property interest is invalid unless

(1) when the interest is created, it is certain to vest or terminate no later than 21 years after the death of an individual then alive; [OR]

(2) the interest either vests or terminates within 90 years after its creation; or

(3) the interest is in a trust and all or part of the income or principal of the trust may be distributed, in the discretion of the trustee, to a person who is living when the trust is created.

* Section 7. AS 34.27.060 is amended to read:

Sec. 34.27.060. REFORMATION. Upon the petition of an interested person, a court shall reform a disposition in the manner that most closely approximates the transferor's manifested plan of distribution and is within the 90 years allowed by AS 34.27.050(a)(2), (b)(2), or (c)(2) if

(1) a nonvested property interest or a power of appointment becomes invalid under AS 34.27.050;

(2) a class gift is not but might become invalid under AS 34.27.050 and the time has arrived when the share of any class member is to take effect in possession or enjoyment; or

(3) a nonvested property interest that is not validated by AS 34.27.050(a) can vest but not within 90 years after its creation.

* Section 8. AS 34.40.010 is amended to read:

Sec. 34.40.010. INVALIDITY GENERALLY. Except as provided in AS 34.40.110, a conveyance or assignment, in writing or otherwise, of an estate or interest in land, or in goods, or things in action, or of rents or profits issuing from them or a charge upon land, goods, or things in action, or upon the rents or profits from them, made with the intent to hinder, delay, or defraud creditors or other persons of their lawful suits, damages, forfeitures, debts, or demands, or a bond or other evidence of debt given, action commenced, decree or judgment suffered, with the like intent, as against the persons so hindered, delayed, or defrauded is void.

* Section 9. AS 34.40.110 is repealed and reenacted to read:

Sec. 34.40.110. RESTRICTING TRANSFERS OF TRUST INTERESTS. (a) A person who in writing transfers property in trust may provide that the interest of a beneficiary of the trust may not be either voluntarily or involuntarily transferred before payment or delivery of the interest to the beneficiary or beneficiaries by the trustee. In this subsection,

(1) "property" includes real property, personal property, and interests in real or personal property;

(2) "transfer" means any form of transfer, including deed, conveyance, or assignment.

(b) If a trust contains a transfer restriction allowed under (a) of this section, the transfer restriction prevents a creditor existing when the trust is created, a person who subsequently becomes a creditor, or another person from satisfying a claim out of the beneficiary's interest in the trust, unless the

(1) transfer was intended in whole or in part to hinder, delay, or defraud creditors or other persons under AS 34.40.010;

(2) trust provides that the settlor may revoke or terminate all or part of the trust without the consent of a person who has a substantial beneficial interest in the trust and the interest would be adversely affected by the exercise of the power held by the settlor to revoke or terminate all or part of the trust; in this paragraph, "revoke or terminate" does not include a power to veto a distribution from the trust, a testamentary special power of appointment or similar powers, or the right to receive a distribution of income and/or corpus in the discretion of a person, including a trustee, other than the settlor;

(3) trust requires that all or part of the trust's income or principal, or both, must be distributed to the settlor; or

(4) at the time of the transfer, the settlor is in default by 30 or more days of making any payment due under any judgment or order of support of a child of the settlor.

(c) The satisfaction of a claim under (b)(1)-(3) of this section is limited to that part of the trust to which (b)(1)-(3) of this section applies.

(d) Notwithstanding any provision in the trust instrument, once a distribution has been declared by and is payable from a settlement trust, the Child Support Enforcement Division may enforce the support obligations of a beneficiary, including any settlor of the trust who is a beneficiary, of the trust against the portion of the distribution which the beneficiary would otherwise be entitled.

(e) In this section, "settlor" means a person who transfers real property, personal property, or an interest in real or personal property, in trust.

* Section 10. New AS 13.36.310 is added to read:

Sec. 13.36.310. Settlement Trust Organized Under Pub L. No. 92-203.

(a) In General. Except to the extent that this section provides to the contrary, the provisions of AS 13.36 and 13.38 apply to any settlement trust organized under the Alaska Native Claims Settlement Act ("ANCSA"), Pub. L. NO. 92-203. This section applies to any such settlement trust, regardless of whether such settlement trust is established before or after the date of enactment of this section. As used in this section, a "settlement trust" is any trust meeting the definition of a settlement trust imposed by ANCSA.

(b) Dissenter's Rights. Dissenters rights do not apply to (i) any shareholder vote relative to a settlement trust (including without limitation, any shareholder vote whether to establish or transfer assets to a settlement trust), (ii) any actual transfer of corporate assets to a settlement trust, (iii) any action or activity of the settlement trust.

(c) Alaska Securities Laws. None of the following is a sale of a security under AS 45.55.070 and AS 45.55.130(10): (i) the establishment of a settlement trust in accordance with the procedures set forth in ANCSA; (ii) the transfer of assets by a Native corporation to a settlement trust in accordance with ANCSA; (iii) the transfer of a beneficial interest in a settlement trust, provided that the transfer would have been permitted under 43 U.S.C. § 1606(h) if the beneficial interest being transferred had instead been a share of stock in a Native corporation and the provisions of 43 U.S.C. § 160(h) had applied to such Native

corporation. The provisions of AS 45.55.139 shall apply to any settlement trust having at least 30 Alaska resident beneficiaries, provided that such settlement trust has total assets exceeding $100,000 and at least 500 total beneficiaries.

(d) Beneficiary Protection. The trust agreement for a settlement trust may contain one or more provisions restricting or preventing transfer or alienation of the beneficial interests in such settlement trust, as well as a provision restricting or preventing anticipatory assignments of the distribution from such settlement trust. Any such provisions shall be enforceable against all persons, except as set forth herein. Notwithstanding any such provision in the trust agreement for a settlement trust, once a distribution has been declared by and is payable from a settlement trust, the Child Support Enforcement Division may enforce the support obligations of a beneficiary of the settlement trust against the portion of such distribution to which that beneficiary would otherwise be entitled in the same manner as support obligations may be enforced against a distribution which has been declared and is payable by the ANCSA corporation itself.

(e) Trust Registration. Notwithstanding any contrary provision of AS 13.36, the following rules shall apply to a settlement trust.

(1) Initial Registration. Upon the shareholder vote establishing a trust, such settlement trust shall be registered with the Commissioner of the Department of Commerce and Economic Development or the Commissioner's designee. Such initial registration shall be on such forms as the Commissioner shall provide, and shall set forth the name of the ANCSA corporation establishing the trust, the date on which the shareholder vote occurred which approves the trust as a settlement trust within the meaning of ANCSA, the date of the initial trust agreement establishing the trust, the names of the initial trustees, the actual street address at which the principal administration of the trust is to occur, and a person or entity designated to accept process upon such trust. The Native corporation which established the settlement trust or an officer of such corporation may be designated to accept process. The trust agreement of settlement trust shall not be filed.

(1) Further Biennial Registration Required. Each settlement trust shall also file with the Commissioner or the Commissioner's designee a

biennial registration statement setting forth the same information described in (e)(1) above as of the date of such registration statement.

(3) Application to Existing Registrations. Any settlement trust which as of the date of enactment of this section has filed a registration statement in accordance with AS 13.36.005 et. seq. shall file a registration statement with the Commissioner or the Commissioner's designee in the form described in (e)(1) within 180 days of the enactment of this section. Upon such timely filing, such settlement trust shall be deemed to have been continuously registered under the laws of Alaska State commencing upon the date of its registration with the Superior Court.

(4) Commissioner As Agent for Process. In addition to any person or entity designated in the registration statement to accept service of process, the Commissioner of Commerce and Economic Development or the Commissioner's designee is also hereby automatically designated to accept process for any settlement trust. Upon such acceptance of process, the Commissioner or the Commissioner's designee shall promptly notify the settlement trust of the process which has been accepted.

(5) Fees. No fee shall be imposed for any of the registration statements described in (e)(1) through (3) of this section.

* Section 11. This Act does not apply to a trust unless the trust is created on or after the effective date of this Act or is a settlement trust created pursuant to section 39(a) of ANCSA.

* Section 12. This Act shall take effect immediately.

HB 101 — (Path HB 459)

Crystal Smith

Vince Vera had problems @ spousal support
Rule agst. perpetuities

[House Labor & Commerce has only referral

Out of committee

Lobbying — Joe Hayes - Trust Co
— Fbks estate planning
— Ins. Linda Hurlbert supports

designed to allow you to set up irrevocable trusts

Child support / surviving spousal shares

Gov. vetoed

→ Read across tomorrow

Pat Portid — wants to make it work if poss.

276-6015

MEMORANDUM

Date: February 21, 1997

To: Joe Green

From: Lisa Kirsch

Re: **HB 101--Trust Act**

This is the legislation we talked about earlier that changes the rules governing trusts that people use for estate planning. Those opposing the legislation think it will create a loophole for debtors who want to avoid paying child support or spousal support. See the attached letter from the drafter of the Uniform Probate Code and memo from the Dept. of Law.

The bill also abolishes "the rule against perpetuities." In very simple terms, this rule prevents a person from setting up a trust that continues forever. Ordinarily, the length of time a trust lasts is determined by a person's lifetime plus 21 years or 90 years. A quick example of a trust in compliance with the rule would be a trust that ends by paying out 21 years after the death my daughter (which could be > 90 years) or if I don't want to link it to anyone's lifetime, a trust that terminates in 90 years.

Abolishment of the rule creates a loophole to escape from taxes that would come due when the trust pays out; however, even though this may seem inviting, it may also create headaches for courts for years to come as more and more descendants of the original trustor battle for smaller and smaller shares. Forty-six states have the rule against perpetuities.

Supporters, many of whom want to sell these new types of trusts, say that this bill will bring lots of business to Alaska since few states have laws that allow this type trust. This is uncontested by the opposition. Supporters argue that revenue from the sale of these trusts is now going to foreign banks and trust companies because these trusts are prohibited here.

This bill comes up on the floor today.

Legal Issues Raised by HB 101

- CHILD SUPPORT: bill deals with *established* child support arrearage for child of the settlor. Does not provide for support obligation arising after creation of the trust; need to ensure that trust could be invaded to provide for support obligation which arises after creation of the trust. Does not provide for support obligation that may be established for other than the biological child of the settlor; e.g., needs to be equally clear that support obligation ordered for a stepchild or other obligee is covered. We would suggest that this section be amended to provide that non-payment of *any* support obligation established, spousal or child, be grounds to either void or invade the trust.

- BURDEN OF PROOF Re: INTENT OF SETTLOR: The burden of proof to establish that trust was created for purpose of hindering or defrauding creditors appears to be shifted to person seeking to void trust. If burden of proof is not a concern for the bill's proponents (as the letter from Blattmachr seems to aver), they should be willing to insert language that provides essentially that, if the trust actually functions to avoid certain obligations - such as spousal and child support, and certain others - that is prima facie evidence of intent, rebuttable by settlor.

- SPOUSAL INHERITANCE: The bill's proponents assert this flaw from last year's bill has been fixed. There is no one in the Department sufficiently skilled in this area to confirm that the bill does what it purports to do.

POLICY ISSUES

- The bill's primary intent is to allow the formation of trusts which are intended to be able to permit the trustor to "hide" assets from certain creditors, including the IRS. We will express no opinion on this, merely point it out for consideration by the legislature.

- Doing away with the Rule Against Perpetuities has policy implications. On the positive side, it permits a trustor to ensure the preservation/handling of the trust far beyond his/her demise. On the negative, this "dead hand" could prevent alienation of property far into the future, what the Rule was meant to protect against. The prevailing status among the majority of states is to keep the Rule, but with perhaps some modifications.

Lisa Kirsch - F-U

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February 13, 1997

Ms. Marilyn May
Assistant Attorney General
State of Alaska
Department of Law
1031 West 4th Ave., Suite 200
Anchorage, AK 99501-1994

Re: Alaska House Bill No. 101

Dear Marilyn:

Thanks for giving me the opportunity to review and comment on House Bill No. 101, which is a revised version of the Alaska Family Trust Act, HB 459(JUD) upon which I commented last summer. My opinion of this version of the bill has not changed. The legislature should not pass it, and if they do, the governor should veto it. The bill is still ambiguous in part, and, more importantly, is against public policy. *Make no mistake about one thing: This bill is aimed at one type of trust that the out-of-state lawyer who is behind this bill wants to create for his wealthy clients: A discretionary trust (with a friendly trustee) that will protect the client's assets from creditors of all types (including his or her child support obligations) and that will last in perpetuity.*

Sections 1 and 8, Spousal Elective Share Rights. The principal change from the prior version appears in the provision concerning the spousal elective share. The promoters of the bill apparently have decided that they overreached last year, and are willing to cut back on protecting discretionary trusts from the spouse's elective share. Hence, section 1 of the new bill adds the underlined clause to 13.12.205(2)(A). However, there may still be an intended or unintended loophole. I would only feel that spousal elective share rights are truly protected if:

(1) the same clause were added to 13.12.205(2)(B); and
(2) 34.40.110 (added by Section 8) were amended to add at the beginning of subsection (2) the following language: "Except as provided in 13.12.205,".

The reason for adding the "except" clause is that, without it, 34.40.110(b) refers to a creditor "or

another person," a term which includes the spouse of the settlor.

Other Spousal Rights, Including Rights on Divorce. What I said above pertains only to spousal *elective share* rights. As I read 34.40.110, a settlor could avoid his or her obligations under the *divorce laws* by setting up a discretionary trust with the proverbial friendly trustee.

Child Support Obligations. The bill as revised still allows a settlor to set up a trust and have it immune from child support obligations. 34.40.110(d) provides no protection, because it only applies to distributions out of the trust and in the hands of the beneficiary (the settlor or another beneficiary). This is nothing new in American law. Our law has always provided that all creditors can reach property distributed from a trust and in the hands of the distributee, regardless of any contrary provision in the trust document. This well-accepted principle has never been restricted to child support obligations. In fact, by negative implication, this provision suggests that this well-accepted principle now *only* applies to child support, so that a settlor could provide in the trust document that creditor protection would continue to apply to the property *after* distribution.

Section 6, Perpetuities. The proposed amendment to the Uniform Statutory Rule Against Perpetuities is not sanctioned by the Uniform Law Commission. The amendment is ambiguous, and very bad policy. Subsection (3) says that a nonvested future interest cannot be invalid under the Rule Against Perpetuities (in other words, the nonvested future interest is exempt from the Rule Against Perpetuities) if it is in a trust in which the trustee has discretion to distribute income or principal to a person who is living when the trust was created. Does this mean that such a trust continues to be exempt forever, even after the person dies, or does it lose its exemption once the person dies? The language is unclear, and would surely lead to unnecessary litigation.

I have reason to believe that the intention is that the trust will continue to be exempt forever. If this is so, the bill sets up a situation in which a wealthy person, whether an Alaskan or a resident of another state, can set up a so-called "dynasty trust" in Alaska, a trust that lasts perpetually.

Why do the promoters of this bill want Alaska to allow perpetual dynasty trusts? The apparent purpose is purely commercial (to manipulate state law in order to give Alaska banks a competitive advantage over banks in nearly all other states). The public policy against dynasty trusts (trusts that last longer than a life in being plus 21 years or 90 years) is lost in the wake of these commercial interests. Ironically, the genesis is the federal generation-skipping tax (GST tax), which imposes high costs for creating trusts that persist through more than one generation. The GST tax would therefore seem to discourage long-term trusts. But the GST tax also contains a $1 million per donor GST exemption that relies only on state perpetuity law to control the length of exempt trusts. The apparent purpose of this bill is to abolish the Rule Against Perpetuates for Alaskan trusts in order give Alaskan banks a competitive advantage in attracting out of state $1 million ($2 million for married donors) GST-exempt trusts. There are a few other states that have, in effect, abolished the Rule Against Perpetuities for trusts—Wisconsin, Idaho, South Dakota, and Delaware. But I am in touch with people at the IRS and the U.S. Treasury

Department, and on the basis of what they tell me, it is only a matter of time before Congress or the Treasury Department by regulation puts a stop to this, for it is an unintended loophole in the GST tax. Once the loophole is closed, the tax incentive for creating perpetual or dynasty trusts will disappear, but trusts created before the loophole is closed will continue to exist.

On the surface, dynasty trusts might appear attractive to settlors, but will in the end prove to be curses on the settlors' descendants, as they proliferate generation by generation in geometric fashion, some staying in Alaska but some moving far, far away. Such trusts do not preserve family property, but rather divide and subdivide it into shares so that four, five or six generations down the road, each descendant's share represents a smaller and smaller share of the asset. What good is a 1/30th share, or a 1/70th share, or a 1/200th share, or a 1/1000th share?

I have been involved in law reform work at the multi-state level for over ten years, and have been in law teaching at major law schools for over thirty years. I was the Chief Reporter for (author of) the 1990 revisions of the Uniform Probate Code that was recently passed in Alaska. I am also the Reporter for (author of) the Restatement (Third) of Property (Wills and Other Donative Transfers). This is perhaps the most pernicious bill I have ever seen in that time, allowing as it does a wealthy settlor to set up a particular type of trust to skirt his or her obligations to his or her children, spouse, creditors, and in the end to set up a trust that will last so long that its beneficiaries will number well into the hundreds, so that the share of each is nothing more than a nuisance.

Yours sincerely,

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