SB

81

HOUSE COMMITTEE REPORT

(7)
Date Referred to Committee: March 14, 2001 **FURTHER REFERRALS:**

Date of Committee Action: 4.20.01

The JUDICIARY Committee considered: **SB 81**

SENATE BILL NO. 81 **NONADEMPTION OF TRANSFERS IN TRUSTS**

"An Act relating to the nonademption of property transfers; and providing for an effective date."

Recommends it be replaced with _____CS_____(_____) [ ] Same Title [ ] New Title
For Senate Bills with new title: [ ] Technical Title [ ] New Title: HCR_____

[ ] attach amendments
[ ] add new referral to _____ Committee
[ ] Letter of Intent _____Committee

List of Abbrev. For Depts.:
ADM
CED
COR
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LAA
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***NEW* FISCAL NOTES**
*For Chief Clerk's Office Use Only

FN# *	List by Dept(s):	Fiscal	Indet.	Zero

***PREVIOUS* FISCAL NOTES**

List by Dept(s):	FN #	Fiscal	Indet.	Zero
LAW	1			✓

Signing with recommendations	Printed Last Name	DP	DNP	NR	AM
	Berkowitz			✓	
	Meyer	✓			
	Coghill	✓			
	JAMES	✓			
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Chair:					

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Senate District Q

Senate

Senate Bill 81 **"An Act relating to the nonademption of property transfers; and providing for an effective date."**

Sponsor: **Senator Gene Therriault**

Sponsor Statement

Senate Bill 81 corrects a section of law that was enacted by the Twenty-first Legislature regarding the rules of construction applicable to wills and other governing instruments.

Section 1 of House Bill 275, signed into law in July of 2000, changed a rule of construction that outlines what happens when a request in a will cannot be carried out. Section 2 of House Bill 275 was meant to take the same rule of construction being applied to wills and apply it to revocable trusts, which are commonly used as will substitutes. The language as adopted, however, was not correctly modified to apply to trusts and still refers to terms used in the drafting of wills. This bill clarifies the wording of AS 13.12.712 to apply it to revocable trusts.

Email: Senator_Gene_Therriault@legis.state.ak.us

CSSS House Bill 275 (JUD)

Sponsor: Representative Gene Therriault

Sponsor Statement

House Bill 275 further refines the Uniform Probate Code to continue enhancing the estate planning climate in the State of Alaska. By a nearly unanimous vote in both the House and Senate, in 1996 the Twentieth State Legislature passed a major overhau. of the laws that had governed decedent's estates, guardianships, transfers and trusts since 1972. The changes, based on the 1990 version of the national Uniform Probate Code, as subsequently amended in 1991 and 1993, were made to adapt our laws to the increasing complexity of family structure and investment alternatives that have developed in recent decades. House Bill 275 proposes further revisions to clarify ambiguities, simplify the probate procedure, and minimize tax consequences.

Much of the language is derived from statutes of other states and reflects a consensus of ideas agreed upon by Alaskan estate planning lawyers who have met informally over the last two years to discuss possible improvements.

Section 1

This section changes a very limited rule of construction contained in the 1993 Uniform Probate Code enacted by the Legislature in 1996.

"Nonademption of specific devises" pertains to the rules that apply when a person creating a trust or will (the decedent) designates that a specific person (specific devisee) is to receive a specific gift (specific devise), and the request is unable to be carried out, because, for example, the decedent lost or sold the gift. The question is whether, when a decedent designates a specific gift, the decedent means to give specifically *that gift* or whether the decedent would want the person to receive the *value* of the gift in the absence of the gift. **Section 1** of HB 275 deals with the specific instance of nonademption when a decedent has sold the specific devise prior to the decedent's death and is still owed money for the property. Under current law, if the property were sold and the decedent received full payment before death, the payment would be distributed equally between all parties because the identity of the property, and thus its designation as a specific devise, is presumed to have been lost. If, however, the property were sold and the decedent did not receive full payment before death, the payment received after death and any promissory note would go to the specific devisee. Under HB 275 the payment received after the decedent's death and any promissory note

would not go to the specific devisee. Instead, the payment and any promissory note would be treated in the same manner as all other property that the decedent owned, and would be distributed equally among the beneficiaries. The rationale for the change is that the question of who ultimately receives the proceeds should not depend on whether the decedent received full or partial payment before death.

For example, Susan Smith provides in her will that her son David Smith is to receive the family farm and the remaining property in her estate is to be divided equally between David and his brothers and sisters. In this case, the family farm is the specific devise. Under current law, if Mrs. Smith sold the farm prior to her death and received cash for the transaction, at her death the money would be included in the estate and shared equally between all the children. If, however, Mrs. Smith sold the farm and received a seller-financed note because the buyer was unable to obtain sufficient third-party financing, when Mrs. Smith dies, David would receive the balance of the promissory note owed to Mrs. Smith, to the exclusion of his brothers and sisters. These sections change that result and would treat the promissory note in the same manner as all other property Mrs. Smith might own. The promissory note would be shared equally by all the children. As this is only a rule of construction that controls in the absence of other language, if Mrs. Smith really wants the balance of the promissory note to go to David to the exclusion of the other children, she could state this in her will or trust.

Section 2, 13.12.712 makes the rules of construction under 13.12.606 applicable to trusts.

Section 2, 13.12.720

This section relates to the new family-owned business deduction of Internal Revenue Code section 2057. Section 2057 provides an additional estate tax deduction for the owners of family businesses. This provision follows a similar statute found in Michigan law. It is meant to provide a correct tax result by having this deduction taken into account under a provision that defines the credit shelter trust so the deduction will not be wasted on a marital bequest. It is an important provision, especially in Alaska where so many businesses are family owned.

Section 3

Th s section would change the amount of interest that is paid on a pecuniary devise, and would usually allow more time for the trust or will to be settled before interest begins accruing.

A pecuniary devise is a gift of a monetary amount, whether given outright or placed in trust for the beneficiary. Our present statute states interest must be paid on a pecuniary devise and begin one year after the appointment of a personal representative. Interest is set at the legal rate, which is presently 10.5%. This is unrealistically high and does not take into account that interest rates fluctuate. It can also shortchange other heirs. For instance, Mrs. Smith leaves $100,000 in trust for the benefit of her grandchild and leaves the rest of her estate in equal shares to her children. If a federal estate tax return is required, and taxes must be paid, the $100,000 cannot be distributed to the grandchild until the personal representative has received a closing letter from the IRS. Typically it might be 2-3 years after a decedent's death before the closing letter is received. Under present law the interest payment made to the grandchild will come out of the children's share of the estate, for no other reason than that federal bureaucracy makes it impossible for the estate to be distributed

within a year. This section changes the interest rate from 10.5 % to a variable rate taken verbatim from AS 45.45.010(b) and commonly referred to as the discount borrowing rate.

In addition, an adverse generation-skipping transfer tax can result if appropriate interest as defined by state law isn't paid in a timely manner. The principle consequence is that a trust that might otherwise be shielded from generation-skipping transfer tax may now be subjected to it. HB 275 changes the time at which interest begins to accrue from one year after a personal representative is appointed to two years after the decedent dies. This amendment allows the administrator more time to fund pecuniary bequests when the estate may still be in the process of being audited by federal tax authorities, which in turn gives the personal representative more time to settle the estate.

Our present statute comes from Uniform Probate Code Provision promulgated in 1963. Many states, such as Washington, do not require the payment of interest on pecuniary devises.

Section 4

This section also pertains to interest on a pecuniary devise. It adds a new section stating that no interest must be paid on a pecuniary marital bequest, but that a pro-rata portion of the income earned by the estate must be credited to the pecuniary marital bequest from the date of death. The provision requiring the payment of income comes from a similar provision found in Virginia law. This provision assures Alaskans that a trust established for the benefit of a spouse will meet the "all the income" requirement established by Internal Revenue Code sections 2056(b) and 2523(f), which is required of trusts qualifying for the marital deduction.

Although this section eliminates the requirement that any interest be paid on a pecuniary marital bequest, this section nonetheless meets the appropriate interest requirement set forth in the generation-skipping transfer tax regulations. Lastly, it should be noted that, under recently promulgated federal regulations governing the allocation of estate and trust income to separate shares, the payment of interest would not only increase the amount that must be paid to a pecuniary marital bequest, (a result one generally wants to avoid because more property will ultimately be subjected to estate tax), but unnecessarily creates taxable income for the family with no corresponding deduction to the estate.

Section 5

This section gives the personal representative more discretion over how to distribute the residuary estate assets to heirs, as long as it is "in the best interests of the distributees." For example, it would allow the personal representative to make non pro-rata distributions of assets. This means if an estate consists of two assets of equal value and there are two heirs, the personal representative could distribute one asset entirely to one heir and the other asset entirely to the other heir instead of having to make a distribution of ½ of each asset to each heir. This section allows the personal representative to use this method of funding even though the authority for doing so might be absent in the will or trust. As a result better tax planning is possible. This section follows North Carolina legislation.

Section 6

This adds a new section to Chapter 36, Trust Administration. AS 13.36.153 is meant to provide a beneficial interpretation to a document that would otherwise produce a negative tax consequence in the limited circumstances addressed by this section. To achieve this, it limits distributions by a person who is not an independent trustee, (for example, a person who is both a trustee and beneficiary), by requiring an "ascertainable standard" relating to maintenance and support.

As an example, presume the settlor of a trust wants to benefit his spouse. He wants to name his spouse as trustee and also wants to give his spouse as many rights to the trust assets as possible without having the trust assets included in his spouse's gross estate for federal estate purposes. Internal Revenue Service regulations state that, in her position as trustee, the spouse can possess the right to distribute principal, provided that right is limited by an ascertainable standard." The regulations state an ascertainable standard will be found if the spouse is given the power to use principal for her "support in reasonable comfort." However, the regulations also provide that a right to use principal for "her comfort, welfare, or happiness" is not limited by the requisite standard. While most people would think there is no meaningful difference between "support in reasonable comfort" and "comfort, welfare, or happiness," the use of the latter phrase would create the unwanted consequence of having the trust principal included in the spouse's estate for federal estate tax purposes. Section 6 prevents inadvertently triggering this horrendous tax result by providing that, unless specifically stated in the trust document, the spouse would only have the right to distribute principal to herself in a manner limited to an ascertainable standard.

This section also provides that principal and income can not be used to discharge an individual legal obligation of certain trustees who are not independent trustees.

Furthermore, these provisions would apply to a trustee who is related or subordinate to the person who has the right to remove and replace a trustee. Were it not for these provisions an unintended and harmful tax result would occur. This section is taken principally from Colorado law.

Section 7

In order to make favorable marital deduction and generation-skipping tax elections, it is necessary to be able to split a single trust into two trusts. The beneficial interests in each trust remain the same, the only difference is that the two trusts will be administered separately. This section provides that, under certain conditions, a trustee may divide a trust into two or more separate trusts as long as the resulting trusts are substantially identical in terms to the existing trust. This provision will allow a trustee to make favorable tax elections whether it relates to the marital deduction or to an allocation of generation-skipping transfer tax exemption. Trust instruments drafted subsequent to the changes in tax law that necessitate the ability of a trustee to divide trusts most likely include a provision stating the trustee can divide a trust. However, this provision might not exist in a trust created before or shortly after the change in the tax law. This section assists individuals affected by trusts lacking this provision. Typically the trustee making these elections will be the surviving spouse, who will also be named as the lifetime income beneficiary of the trust. Because the surviving spouse is also a beneficiary, she may benefit personally from the election. Subsection (a) states nonetheless a trustee can split the trust to make tax elections even though the trustee, in the trustee's dual status of beneficiary, might personally benefit from the election.

This section follows Washington legislation.

Section 8

This section states that certain asset distribution provisions applicable to the administration of a probated estate also apply to the administration of a revocable trust following the death of the settlor of the trust. The provisions that apply are: AS 13.16.540, Distribution; order in which assets appropriated; abatement. AS 13.16.545, Right of retainer. AS 13.16.550, Interest on general pecuniary devise. AS 13.16.560, Distribution in kind; valuation; method; and AS 13.38.030(a), a provision pertaining to when an income beneficiary becomes entitled to the income from a trust.

Section 9

This section relates back to Sections 6 and 7. Section 9 describes those individuals who for some unforeseen reason might want to elect out of these sections. While it can be fairly stated no one aware of the tax implications of electing out would do so, this section nonetheless defines who the "parties in interest" would be if a decision to opt out is made.

Section 10

This section provides that in those trusts where the spouse is entitled to all the income earned by a trust paid no less frequently than annually, and a marital deduction is claimed for the trust, the spouse has the power to require the trustee to make the trust assets produce income. This simple provision is a required statement in all trusts intending to qualify for the marital deduction. This section provides the required language for those trusts lacking this provision.

Section 11

This section ends the confusion over the ability to transfer real property to or from a trust in the name of the trust, whether or not the trustee is actually named on the deed. In addition, this section provides protection for good faith purchasers who purchase property held in the name of a trust.

FISCAL NOTE

STATE OF ALASKA
2001 LEGISLATIVE SESSION

Fiscal Note Number: 1
Bill Version: SB 81
(S) Publish Date: 2/26/01

Revision Date/Time (Note if correction): _____
Dept. Affected: Law
Title "An Act relating to the nonademption of property transfers; and providing for an effective date."
BRU Civil Division
Component Commercial Section
Sponsor Senator Therriault
Requester Senate Judiciary Committee
Component No. 2211

Expenditures/Revenues (Thousands of Dollars)

Note: Amounts do not include inflation unless otherwise noted below.

OPERATING EXPENDITURES	FY 2002	FY 2003	FY 2004	FY 2005	FY 2006	FY 2007
Personal Services						
Travel						
Contractual						
Supplies						
Equipment						
Land & Structures						
Grants & Claims						
Miscellaneous						
TOTAL OPERATING	0.0	0.0	0.0	0.0	0.0	0.0
CAPITAL EXPENDITURES						
CHANGE IN REVENUES ( )						

FUND SOURCE (Thousands of Dollars)						
1002 Federal Receipts						
1003 GF Match						
1004 GF						
1005 GF/Program Receipts						
1037 GF/Mental Health						
Other (Specify Type)						
TOTAL	0.0	0.0	0.0	0.0	0.0	0.0

Estimate of any current year (FY2001) cost: 0.0

Check this box (X) if funding for this bill is included in the Governor's FY 2002 budget proposal: ☐

POSITIONS

Full-time						
Part-time						
Temporary						

ANALYSIS: *(Attach a separate page if necessary)*

SB 81 makes a technical correction to a drafting error which occurred in HB 275, passed in 2000. Generally, the purpose behind HB 275 and this bill is to make the law applicable to wills also applicable to trusts. It generally provides that a beneficiary of a trust who was supposed to get a particular piece of property will still get the equivalent to the property even though the property itself may no longer exist.

Passage of this legislation will have no fiscal impact on the Department of Law.

Prepared by: Joan M. Kasson
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Division Attorney General's Office
Date/Time 2/21/01 3:31 PM
Approved by: Kathryn Daughhetee for Bruce M. Botelho, Attorney General
Date 2/21/01
Agency Department of Law

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February 14, 2001

Honorable Gene Therriault
Alaska State Senate
State Capitol
Juneau, Alaska 99801-1182

Re: SB 81

Dear Senator Therriault:

You have asked for a letter from the Department of Law regarding SB 81. SB 81 amends AS 13.12.712 to correct a problem discovered during the last legislative session when this particular statute was created. In particular, existing sections (b), (d) and (e) of AS 13.13.712 make no sense within the context of a trust. SB 81 appears to amend AS 13.13.712 to properly reflect the purpose for the entire statute, namely the nonademption of specific transfers in trusts.

Should you have any questions regarding this matter, please do not hesitate to contact me.

Sincerely,

BRUCE M. BOTELHO
ATTORNEY GENERAL

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Re SB 81

Date: 4/20/01

Time: 3:45

Pages (excluding this cover page) 1

Message: Requested explanation. I thought the explanation contained in the last 2 paragraphs had been incorporated in the Sponsor Statement, but apparently not. Hope this helps.

EXPLANATION FOR SB 81

House Bill No. 275, Section 1, as passed by the Twenty-First legislature in the Second Session amended AS 13.12.606(a). This section changed a very limited rule of construction contained in the 1993 Uniform Probate Code as enacted by the Legislature in 1996. Section 1 is a rule of construction applicable only to wills. A companion provision was found in Section 2 of this bill. Section 2 was meant to apply the same rule of construction as found in AS 13.12.606(a) to revocable trusts, which are commonly used as will substitutes. Section 2 created a new AS 13.12.712. The wording of that section, as now enacted into law, contains language which could only apply to individuals making wills and which could not apply to settlors of revocable trusts. This bill clarifies the wording of AS 13.12.712 to address revocable trusts.

This section provides for certain nonademption rules.

"Ademption" refers to a general rule of construction that applies when the person creating a trust (settlor) designates that a specific person is to receive a specific item of property, and the request is unable to be carried out, because, for example, the settlor has sold the property prior to death. The general rule is that the specific bequest is adeemed (extinguished) if the specific property does not exist at death of the settlor.

However there are a few instances when the specific bequest is not adeemed. AS 13.12.712 (a) describes those circumstances. These are when (1) the property has been condemned and a condemnation award for the taking of the property remains unpaid at death; (2) there has been an insured casualty claim and the insurance proceeds remain unpaid at death; (3) there is a specific bequest of a promissory note but the note is foreclosed upon prior to death. In each of these circumstances the beneficiary of the specific bequest would receive what remained of the specifically bequeathed property and any of the additional unpaid proceeds described above. Subsection (b) is meant to address a situation where a settlor makes a specific bequest but subsequently becomes incompetent and the trustee then proceeds to sell the specifically bequeathed property. In this instance the intended recipient of the specifically bequeathed property is entitled to other property of equal value.