HB
212

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Date: February 18, 2003 Time:
Sent By: Karon Our File No.:

FROM:	TO:
Name: Susan L. Evans	Name: Representative McGuire
Company: HOMPESCH & EVANS A PROFESSIONAL CORPORATION	Company:
Phone: (907) 452-1700	Re: Trust Bill
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Total Number of Pages: 2 (including this page)

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February 18, 2003

VIA E-MAIL AND FAX

Representative Lesil McGuire
Juneau, Alaska

Re: The Trust Bill

Dear Representative McGuire:

I am writing with regard to the Trust Bill. As you know, the bill amends both AS 13.36 and AS 34.40. I am in favor of both amendments. My reasons are as follows:

Amendment to AS 13.36. I favor codifying the positions and listed powers of trust protectors and trust advisors because of the flexibility they add to trusts. If there is no built-in flexibility the beneficiaries and trustees inevitably end up in court grappling with issues unforeseen at the time the trust was created. I also favor the default rule that neither the trust protector nor trust advisor have fiduciary duty. Clients often name close family friends and advisors as trust protectors and trust advisors, recognizing that they would not be able to serve if they were held to the highest (fiduciary) standard of care.

Amendment to AS 34.40. I favor the amendments to AS 34.40 because they bring much-needed clarification to the section.

I am grateful for your attention to this matter.

Sincerely yours,

HOMPESCH & EVANS
A Professional Corporation

Susan L. Evans

SLE/

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Vanessa

February 20, 2003

VIA E-MAIL AND FAX

Representative Lesil McGuire
Juneau, Alaska

Re: The Trust Bill

Dear Representative McGuire:

I am writing with regard to the Trust Bill. As you know, the bill amends both AS 13.36 and AS 34.40. I am in favor of both amendments. My reasons are as follows:

Amendment to AS 13.36. I favor codifying the positions and listed powers of trust protectors and trust advisors because of the flexibility they add to trusts. If there is no built-in flexibility the beneficiaries and trustees inevitably end up in court grappling with issues unforeseen at the time the trust was created. I also favor the default rule that neither the trust protector nor trust advisor have fiduciary duty. Clients often name close family friends and advisors as trust protectors and trust advisors, recognizing that they would not be able to serve if they were held to the highest (fiduciary) standard of care.

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Sincerely yours,

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Susan L. Evans

SLE/

V- I see not the trustee, but the advisor held to lower standard - L

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Member
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Representative Lesil McGuire
House District 28

Sponsor Statement
HB 212

"An Act relating to trusts, including trust protectors, trustee advisors, transfers of property in trust, and transfers of trust interests, and to creditor' claims against, property subject to a power of appointment."

Alaska was once in the lead in development of trust law. However, since that time other states have not only enacted similar legislation but have improved on it. Delaware has amended in statute six times since the date of enactment. The last time we amended our trust statutes and in particular our spendthrift statute was in 1998 and as a result, our laws are viewed as being deficient in many respects. This not only places our trust companies in an uncompetitive position but also places Alaska residents at a disadvantage when compared to the citizens of our competitor states. This bill rectifies many of these shortcomings.

This bill provides statutory authority to provisions commonly found in trust instruments. For instance, Section 1 of the bill specifically provides for the position of a trust advisor and trust protector and clarifies the manner in which these positions relate to the administrations of a trust. Delaware, South Dakota, and Idaho has similar legislation. Many trust instruments allow a trustee to make trust assets available for the use of a beneficiary. Section 2 allows trusts assets consisting of real property and tangible personal property to be used by a beneficiary without the use being considered a distribution which could in turn be subjected to the claims of a beneficiary's creditors. For example, a trustee could exercise its discretion and permit a beneficiary to reside in a family home. Were it not for this provision, the settlor's intention that a family homestead be made available for future generations might be defeated.

Other sections contained in the bill codify a number of matters which have always been accepted by Alaska trust practitioners as being the common law of this state, but for which there has been no statutory counterpart. Section 4 provides that trust assets can not be attached by a beneficiary's creditor until such time that trust assets are actually distributed to a beneficiary, no can there be a continuing order against the trustee with respect to future distributions that a trustee would choose to make. Section 6 adds a new subsection (i) to AS 34.30.110, which clarifies that the statute affording spendthrift protection for beneficial interests applies not only to trusts in which a settlor may have a

retained interest, but also to the very common third party settled trust where a beneficiary might be serving as sole trustee.

Sections 3, 5, and 6 make amendments or add subsections to AS 34.40.110, which will assist a future court in the interpretation of our spendthrift statute, something an Alaska court has yet to do. Section 3 clarifies that a trust can be set aside only if a creditor is able to successfully assert by a preponderance of the evidence that the settlor's transfer of property in trust was made with the primary intent to defraud that creditor. In so doing, the finder of fact must weight all the circumstances surrounding the transfer before making that determination. Section 5 clarifies that a fraudulent conveyance action may only be brought against a settlor of a trust and then only as to a specific transfer of assets that are determined to be fraudulent as to that creditor. Section 5 also clarifies the definition of preexisting creditors who can avail themselves during the time period found in AS 34.40.110(d)(1) by bringing a fraudulent conveyance action against the settlor of a self-settled trust. Subsection (h) as found in Section 6 provides a transfer restriction will be valid with respect to a beneficial interest retained by a settlor even though the settlor serves as a co-trustee, provided the settlor doesn't have control over the manner in which distributions may be make to the settlor. Subsection (k) invalidates any unwritten agreement or understanding between a settlor who is a beneficiary and a trustee that gives the settlor rights greater than those that are permitted to be expressed in the trust instrument.

Lastly, there are several provisions contained in this bill that have their counterpart in the laws of other states. Section 3 provides the circumstances in which a transfer restriction will continue to be valid even though a settlor retains a unitrust or annuity interest in the trust. These provisions presently exist in Delaware. Section 7 of the bill clarifies when property subject to a power of appointment can be subjected to the claims of a donee's creditors and codifies the common law as enunciated in the Restatement 2nd of Property and has its genesis in a comparable Rhode Island statute. All the provisions found in this bill are necessary additions not only if Alaska expects our trust industry to remain competitive with other states, but also if Alaska residents are to have the benefits comparable to those of citizens in other states.

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Representative Lesil McGuire
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Sectional Analysis
HB 212

"An Act relating to trusts, including trust protectors, trustee advisors, transfers of property in trust, and transfers of trust interests, and to creditor' claims against, property subject to a power of appointment."

Section 1:
AS 13.36.370 adds a new provision commonly found in trust instruments concerning the role of the disinterested trust protector. South Dakota, Delaware, and Idaho also have a statutory framework delineating a trust protector's authority. It is fully within the settlor's discretion as to whether or not there will be a trust protector. If a settlor does not want a trust protector there will be no trust protector. Furthermore, a trust protector will only have those powers that the settlor grants the trust protector. An irrevocable trust containing a trust protector provision provides flexibility to take into account changed circumstances.

For instance, suppose a settlor creates a trust for the benefit of a child and names a friend to act as trustee. Subsequently it is discovered that the trustee is not using the trust assets for the benefit of the beneficiary in the manner in which the settlor had originally intended. Unless the trustee voluntarily resigns, it could require an expensive court proceeding to remove and replace the trustee. However, if there is a trust protector who has the authority to remove and replace an existing trustee, the trustee could be replaced without the necessity of a court proceeding. Another example of where a trust protector might be valuable is when there is an unforeseen change in tax laws. For instance, if the estate tax is permanently repealed, certain provisions of existing trusts might be unnecessary or undesirable. If the settlor so provided, a trust protector could amen the trust and eliminate an otherwise undesirable provision in the trust.

Notwithstanding the foregoing, a trust protector is not permitted to change the beneficial interest of the State in a Miller trust.

In addition, AS 13.36.375 adds a new provision commonly found in trust instruments concerning the role of a trustee advisor. This provision is commonly found where a settlor appoints an institution as the trustee to handle the investing and administrative functions but wants to appoint a family friend, who is aware of the beneficiary's needs, to advise the trustee when trust distributions may or may not be appropriate. This section states the advisor will not be held accountable as a trustee for rendering or failing to render advice to the trustee.

Section 2:

A "use" provision is commonly found in trust instruments and allows a trustee to make trust assets available for the use of a beneficiary. This section amends AS 34.40.110(a) by stating that property may be made available for the use of a beneficiary without the use being considered a distribution that could possibly expose the trust assets to the claims of a beneficiary's creditors. Furthermore, the original owner can be assured that important family assets such as heirlooms and a vacation home may be maintained by the family and that their use can be made available for future generations.

Section 3:

AS 34.30.110(b)(1) is amended to provide that a transfer restriction can be disregarded only if a creditor proves by a preponderance of the evidence that the settlor's primary intent in making the transfer was to defraud the settlor's creditors. This section eliminates ambiguous language such as "hinder and delay." It also eliminates meaningless language such as "other persons," which is meaningless in the sense that the only class of persons who could possibly be defrauded by a settlor transferring property into trust is creditors of that settlor.

This section was also amended to clarify that it must be first determined that the primary intent of the settlor in creating a trust was to defraud a creditor before the transfer in trust can be set aside as a fraudulent conveyance. Adding the word "primary" to this section provides judicial guidance heretofore missing. Because a settlor will rarely admit to actually intending to defraud a creditor, courts typically consider factual circumstances constituting "badges of fraud" to infer fraud. For instance, a transfer to an insider (as would be the case of any gift to a family member) is considered a badge of fraud under Section 4(b) of the Uniform Fraudulent Transfer Act. Unfortunately, this might be enough for a court to infer fraud. This lack of statutory guidance could lead to a very arbitrary and capricious finding that the mere existence of a singular "badge of fraud" renders the entire transfer fraudulent. The use of the word "primary" make it necessary for the finder of fact to weight all the circumstances surround the transfer. Only if a creditor is able to prove by a preponderance of the evidence that the primary intent of the settlor was to defraud that creditor can the transfer in trust be set aside.

AS 34.40.110(b)(3) is amended to provide a transfer restriction will continue to be valid with respect to an annuity or unitrust interest retained by a settlor provided the remainder interest is given to a public charity. In addition, a settlor may also retain an annuity or unitrust interest irrespective of whether the remainder interest is designated to charity provided the annuity or unitrust interest does not exceed the amount set forth as "income" under the Alaska Principal and Income Act or under the Internal Revenue Code. A similar statute is found in Delaware.

Section 4:

AS 34.40.110(c) is amended to provide that a creditor of a beneficiary may not attach trust assets while the assets remain in trust if the beneficial interest is subject to a valid transfer restriction. In addition, this provision is meant to assure the settlor that trust assets can not be subjected to the claims of a beneficiary's creditor until such time that trust assets have actually been distributed to the beneficiary. Furthermore, this section provides that no attachment or other order may be made against a trustee by a creditor with respect to a beneficial interest which

might compel the trustee to make a future distribution to a creditor in lieu of making a distribution directly to the beneficiary.

Section 5:

This section clarifies that only a creditor of a settlor can bring a fraudulent conveyance action with regard to a transfer of assets to a trust and only in regard to a specific transfer of assets by a settlor to the trust. A third party beneficiary's creditor can not set aside a transfer when the property was originally that of a settlor and not that of the third party beneficiary. On the other hand, where the settlor is retained as a beneficiary under the terms of the trust, a creditor can bring a fraudulent conveyance action because in this case the settlor is also a beneficiary.

AS 34.40.110(d) sets forth a prescribed period of time in which a fraudulent conveyance action must be brought depending on whether the creditor is a preexisting creditor or a subsequent creditor.

A preexisting creditor (i.e., a creditor who was in existence prior to the settlor transferring property in trust) must bring the fraudulent conveyance action within the later of four years after the transfer of a settlor's assets is made or one year after the transfer is or reasonably could have been discovered by the creditor. A subsequent creditor must bring the fraudulent conveyance within four years after the transfer of a settlor's assets is made.

A preexisting creditor has what is essentially an unlimited statute of limitations period to bring a fraudulent conveyance action because it can be brought within one year after the transfer is or reasonably could have been discovered. A creditor might not reasonable discover the transfer in trust until such time that the creditor has first reduced the action to judgment and conducted a judgment debtor examination. The problem with the statute as it now stands is that the term "preexisting creditor" is not defined. Consider a doctor who performs an operation and thinks all went well with the operation, engages in estate planning and transfers property in trust. At a later point in time the patient has complications and asserts that the doctor was negligent. Should this patient be considered a "preexisting creditor" even thought the patient never asserted a claim against the doctor prior to the doctor transferring assets to the trust? What about the engineer or architect who builds a bridge which falls down 20 years later. Is the plaintiff to be considered a "preexisting creditor"? If so, then no one who has been in business for any length of time could ever safely create a trust or otherwise engage in estate planning without risking the possibility that a transfer in trust might later be set aside, even though the "preexisting creditor" might be unknown to the settlor. Nonetheless, there comes a point in time when every doctor and every engineer should be able to arrange their estate planning affairs like anyone else and have the assurance that at some point in time it will not be undone. This bill attempts to provide that assurance but does so in a manner that balances the legitimate rights of the settlor's creditors.

Thus, it is important that the statute define a "preexisting creditor." A "preexisting creditor" is defined as one who either

(1) demonstrates, by a preponderance of the evidence, that they asserted a specific claim against the settlor before the settlor transferred assets to the trust; or

(2) within four years after the settlor transferred assets to the trust, files an action in court against the settlor which asserts a specific cause of action based on an act or omission of the settlor that occurred before the transfer of assets to the trust.

Section 6:
This section adds a number of sections to existing law that clarify that an otherwise valid transfer restriction will not be invalidated even though:

(h) a settlor who is also a beneficiary is serving as a co-trustee or advisor to the trustee provided the settlor does not have a trustee power over discretionary distributions;

(i) a beneficiary of a third party settled trust is serving as sole trustee of the trust, a co-trustee or as an advisor to the trustee; or

(j) a settlor is given the authority to appoint a trust protector or a trust advisor.

Subsection (k) invalidates any unwritten agreement or understanding between a settlor, who is being retained as a beneficiary, and the trustee, which attempts to give the settlor rights greater than those that are permitted to be expressed in the trust instrument.

Section 7:
This section codifies the common law as now found and enunciated in the Restatement 2nd of Property, by adding a new section AS 34.40.115. This section states that assets subject to a power of appointment, whether a non-general power of appointment or a presently exercisable or testamentary general power of appointment, cannot be subjected to the claims of the donee's (holder's) creditors. The legal theory behind this statute is that until the donee exercises the power, the donee has not accepted control over the appointive assets that give the donee the equivalent of ownership. This statute provides that only until a testamentary or a presently exercisable general power of appointment is actually exercised, can the appointive assets be subjected to the payment of claims which a creditor might have against the donee of the power of appointment. This statute is taken from a similar statute in Rhode Island.

Section 8:
This section contains the effective dates.

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PROFESSIONAL STAFF
BARBARA CORY-HOMPESCH
ENROLLED AGENT (IRS)

March 30, 2003

VIA E-MAIL AND FAX

Representative Lesil McGuire
Juneau, Alaska

Re: The Trust Bill

Dear Representative McGuire:

I am writing with regard to the Trust Bill. As you know, the bill amends both AS 13.36 and AS 34.40. I am in favor of both amendments. My reasons are as follows:

Amendment to AS 13.36. I favor codifying the positions and listed powers of trust protectors and trust advisors because of the flexibility they add to trusts. If there is no built-in flexibility the beneficiaries and trustees inevitably end up in court grappling with issues unforeseen at the time the trust was created. I also favor the default rule that neither the trust protector nor trust advisor have fiduciary duty. Clients often name close family friends and advisors as trust protectors and trust advisors, recognizing that they would not be able to serve if they were held to the highest (fiduciary) standard of care.

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I am grateful for your attention to this matter.

Sincerely yours,

HOMPESCH & EVANS
A Professional Corporation

Susan L. Evans

SLE/

Patrick Rumley
3312 Purdue Street
Anchorage, Alaska 99508

February 28, 2003

Honorable Representative Lesil McGuire
State Capitol, Room 118
Juneau, AK 99801-1182

RE: New Trust Bill

Dear Representative McGuire:

I am writing to express my support and to encourage your serious consideration and support of a new trust bill soon to be proposed by Mr. Stephen Greer, a leading estate planning practitioner in Alaska. He has been instrumental in the passage of landmark legislation in this area for Alaska. He is also one of a small group of knowledgeable and competent specialists in the trust area who care enough to give freely of their time in furtherance of good public policy for our state. I have worked professionally with Mr. Greer and know that he approaches his practice and his contributions in the area of trust law with the highest integrity and professionalism.

I have worked in the estate planning area as a practicing lawyer and now am a financial consultant at a major brokerage firm in Anchorage. I have read the proposed legislation and supporting annotation from both a legal and financial perspective. My opinion is that the draft legislation is worthy of passage for several reasons: 1) it clarifies several important points left unaddressed by existing trust statute and not definitively resolved by common law 2) it provides for an unbiased "trust protector" to facilitate the intent of the trust in a cost effective way 3) it keeps Alaska competitive with its sister states in the area of trust administration to help attract more trust dollars.

You are in a position within the legislature to ensure that this bill receives serious attention and ultimate passage. I urge you to support the bill and pass it through your committee to the House for full consideration.

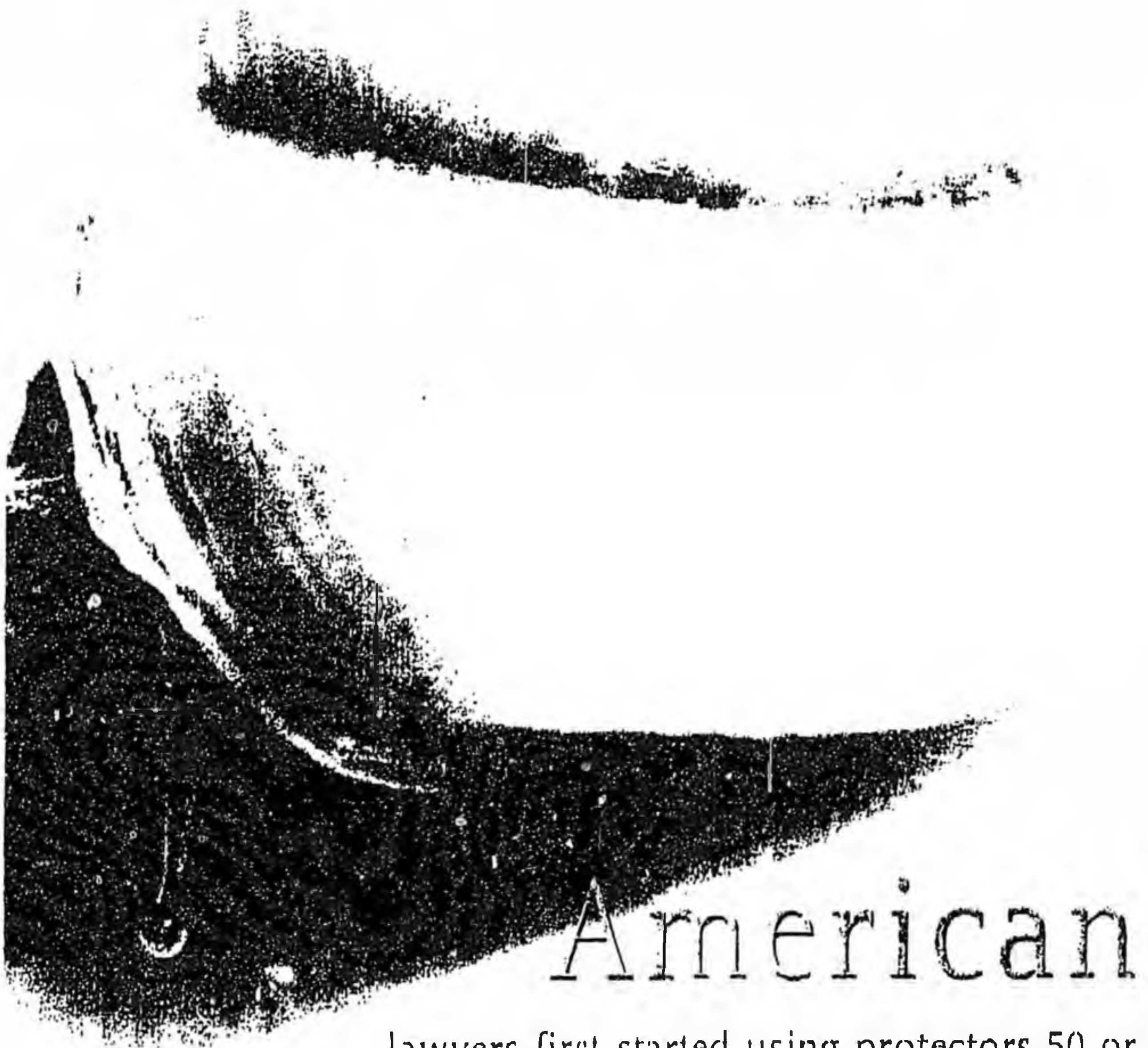
Sincerely,

Patrick Rumley

One of the challenges for lawyers drafting long-term irrevocable trusts is to come up with a framework that will achieve the client's goals for many years—in some cases for generations. Problem is, neither a family's needs nor the laws on estate tax are constants. The possibility that angelic toddlers will grow up to be family black sheep is always an issue. But the most immediate concern is the uncertainty surrounding federal estate-tax repeal: if the estate tax is permanently repealed, the wealth-transfer strategies most appropriate for clients could completely change. In fact, repeal could make certain provisions of existing trusts unnecessary or undesirable. The best that advisers can do for their clients right now is provide flexibility. To do that, they're adding a feature to domestic trusts that until recently was more familiar in the context of foreign ones. Planners are recommending that in addition to naming a trustee, clients also designate a trust protector, someone who can adapt various trust terms to accommodate changing circumstances.

This device recently came in handy with a trust Skip Fox, a lawyer at Schiff Hardin & Waite in Chicago, had prepared eight years ago for an elderly couple. Their estate plans indicated that when the second of them died, all of their assets would be divided into two trusts—one for each of their children. The trusts, funded with about $5 million apiece, were designed to terminate when the beneficiaries reached age 30, at which point they would receive the funds outright. The clients named a bank as trustee and a family friend as the trust protector. In that role, the friend had the power to add or delete beneficiaries within the family and to change the terms or the ages for distributing the money.

Several years after the second parent died, the corporate trustee found out that one of the beneficiaries, then 28, had a drug problem and was involved with a religious cult. If she received the trust principal two years later, as initially planned, it was likely to be spent on drugs or wind up in the hands of the religious group. The trustee notified the trust protector, who decided that the beneficiary shouldn't receive the outright distribution. Exercising his power, the protector directed that the funds be kept in trust for the rest of the beneficiary's life and that she receive discretionary distributions



American

lawyers first started using protectors 50 or more years ago in offshore trusts aimed at asset protection. Ten years ago they showed up on domestic shores

of income and principal. The parents had no inkling of their daughter's problem when they prepared their estate plans, Fox says. Providing for a trust protector just seemed like a good way to address possible changes in the family situation.

Flexibility may be even more important in the growing number of states that have abolished the rule against perpetuities, opening the door for dynasty trusts that can continue forever, says Denis Kleinfeld, a lawyer with his own firm in Miami (see "Saving More Than Memories," April 2002). Plus with estate-tax repeal in flux, Kleinfeld notes, advisers need to keep open as many options as possible. Lately he and other lawyers have been urging clients to consider using trust protectors, sometimes called special trustees or trust advisers, in irrevocable and, in some cases, revocable trusts.

Although trust protectors have been prevalent in other countries for decades, they're something of a recent phenomenon in the United States, says Gideon Rothschild, a lawyer with Moses & Singer in New York. American lawyers first

Protectors were initially given limited powers. But lately the menu of options has expanded to look like the list of entrées available at a Red Lobster

started using protectors 50 or more years ago in offshore trusts aimed at asset protection, Rothschild says. Suspicious of foreign trustees, clients designated a friend, family member, or trusted adviser as a watchdog. About 10 years ago, U.S. lawyers began to use protectors in domestic trusts as well.

Protectors are most helpful in two kinds of trusts, says Mark Edwards, a lawyer at Poyner & Spruill in Charlotte, N.C. One is a trust that won't be funded until the person who sets it up, known as the grantor or the settlor, dies. With the grantor gone, someone must be entrusted to make tough personal decisions. And professional trustees don't want to make judgment calls about when to accelerate payments of principal, for instance. They prefer to deal with matters such as managing money, keeping records, and preparing taxes. So Edwards likes to leave such technical issues to the trustee and put personal decisions in the hands of a trust protector.

As trustee of a $6 million trust one of her clients created, Clare Springs, a lawyer at Titchell, Maltzman, Mark & Ohleyer in San Francisco, welcomed the participation of the client's son-in-law, who was given limited powers and responsibilities as protector. The trust beneficiaries included the protector's wife, daughter, and his wife's siblings. The protector made crucial decisions about how to divide the assets based on need, Springs says. For example, one sibling, who had a drug problem, needed cash right away to attend a detox program. The trust protector decided how to arrange for that without reducing the other beneficiaries' shares.

Trust protectors can also perform a key function with irrevocable trusts funded during life in order to get property out of the grantor's estate, Edwards says. Much as the grantor might like to be able to add beneficiaries, for instance, doing so would cause the trust property to be included in his estate for federal-tax purposes. But let's say the grantor has named his brother as protector. The brother could take that action instead, Edwards says. In this example, appointing a protector is a "transfer of judgment from the grantor to someone else to permit them to do what the grantor would have done if taxes hadn't interfered," Edwards says.

In drafting these provisions, lawyers don't have much legal authority to guide them. Very few U.S. court cases address the subject, and only three states—Delaware, Idaho, and South Dakota—have a statutory framework for trust protectors. The Delaware law, which refers to them as trust advisers, distinguishes between consent advisers, who approve or veto the trustee's initiatives, and direction advisers, who tell the trustee affirmatively what to do, says Don Sparks, a lawyer at Richards, Layton & Finger in Wilmington. Consent advisers are often sufficient to meet a client's needs, but direction advisers play a significant role with trusts that contain closely held business interests, Sparks says. That's because most families don't want a corporate fiduciary voting those shares. Therefore, Sparks drafts a trust document so whoever has the power to appoint subsequent protectors can switch from one type of adviser to the other.

The flexibility a protector provides can be useful for other reasons. Given all the recent bank mergers and changes at trust companies, for example, clients may want the freedom to switch trustees after their familiar trust officers have been replaced. Sparks says he almost always includes a provision enabling the protector to remove and replace a corporate trustee, no matter how long the trust is intended to last. Without such a provision, the parties may need to go to court.

A trust can make the protector's powers broad or limited, says Alexander Bove, a lawyer with his own practice in Boston. Initially grantors just gave protectors the power to remove or replace trustees or to veto distributions—for instance, in a trust authorizing fiduciaries to make discretionary payouts to beneficiaries. But lately the menu of options has expanded to the size of the list of available entrées at a Red Lobster, Bove says. Some trusts authorize the protector to add or delete beneficiaries within a family, to change distributions, to alter the manner in which beneficiaries receive property—either outright or in trust—to veto or direct investment decisions, and even to terminate the arrangement entirely.

Increasingly, lawyers recommend that protectors be able to change the trust to implement various tax strategies. Kleinfeld, for example, advises they be given the power when appropriate to change the situs, or location, for the trust to a jurisdiction that's more favorable for asset protection

or permits dynasty trusts. Likewise, given the continuing uncertainty about estate-tax repeal, it may also be a good idea to give protectors the ability to modify the trust to achieve the most favorable tax result, Kleinfeld says. That way, for example, if the estate tax is repealed, the protector could terminate the trust, and if the estate tax survives he could keep the trust going indefinitely.

Rothschild says he also uses protectors in revocable, or living, trusts, which are likely to become more popular during the next few years. As the applicable exclusion amount—what people can give away at death without triggering estate tax—rises incrementally from $1 million to $3.5 million by 2009, clients with bypass and marital trusts may need to rethink the formulas used to divide their estates between the two, he says. For the most part, the client can make the necessary adjustments himself as the tax law changes. But a client who's no longer competent can't modify his or her will. In such a case, a trust protector could make the necessary amendments to achieve the best tax solution. Another possibility is to set up a system of checks and balances, authorizing the trustee to make necessary amendments, but only with the protector's consent.

A word of caution: The more expansive a protector's list of powers gets, the greater the potential for problems. For example, if, through the protector, the grantor controls the disposition of trust assets, there's a risk that they'll be included in his or her estate, says Richard Dees, a partner at the Chicago law firm of McDermott, Will & Emery.

Another complication you'll need to address is the amount of discretion, and potential liability, the client wants the protector to have. There's some debate over whether, like a trustee, a trust protector is a fiduciary who's obliged to disregard any personal interest and put the welfare of the trust and its beneficiaries first. A fiduciary, who's held to the highest standard of care, can be found liable for negligence as well as intentional misdeeds. Without a fiduciary duty, the protector can be held liable only for intentional wrongs. Dees generally includes language saying the protector is not a fiduciary. He does this partly to enable the protector to remove beneficiaries—for instance if a person was extremely irresponsible in his handling of money. The protector wouldn't be free to do that if he had fiduciary duties to all beneficiaries the way a trustee does, Dees says.

But Bove thinks no matter what the trust says, "there is simply no question that the protector is a fiduciary." By operation of law, there's generally an implied duty to act as a fiduciary, he says. About the only exception is the rare case in which the protector is a beneficiary who could benefit personally from decisions he makes as trust protector.

A related question involves the potential liability of a trustee who acts on the protector's direction. By statute, Delaware, Idaho, and South Dakota all limit that liability. Elsewhere, some lawyers include language in the trust absolving the trustee of liability for taking orders from the

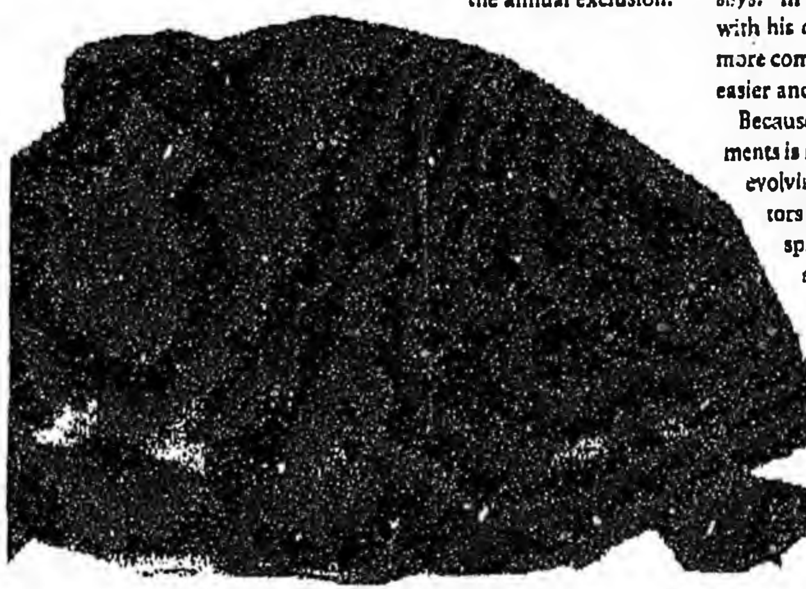
"Adding a third party, with his own lawyer, might make any conflict more likely, more complicated, and more expensive to resolve instead of easier and cheaper to resolve"

protector. But Bove believes that regardless of what state laws and trust documents say, "the trustee is under an absolute duty not to carry out any act that the trustee believes is against the interest of the trust or the beneficiaries." Any other result would be against public policy, he adds.

Given the potential liability of protectors, finding someone who's willing to take on these responsibilities can be a problem, lawyers say. Many corporate fiduciaries don't want the responsibility, especially when the powers are broad. With the power to terminate the trust and distribute the assets, for instance, there are no standards about right and wrong, says Steve Akers, managing director at Bessemer Trust in Dallas, who says there's "no way" he would accept that role. "If you [exercise the power] you could be sued. If you don't you could be sued," he says.

Of course, an equally important issue is determining whom the client can trust to serve as protector. Most people choose friends, personal advisers who know the family, close business associates, or family members who aren't beneficiaries. Depending on the specifics of their role and the time they spend fulfilling their obligations, they may serve for free or for minimal compensation.

It's important that the protector have some understanding of how a trust works and the pitfalls to avoid, lawyers say. For certain kinds of trusts, the protector needs to be careful that exercising his or her power doesn't ruin the tax advantages that go with that trust, Fox says. For example, with a marital trust, taking away income from the surviving spouse would deprive the client of the marital deduction. With a Crummey trust, denying the holder of a Crummey power the right to make withdrawals during the specified period each year could result in certain gifts to the trust being taxable, rather than eligible for the annual exclusion.



Another issue to raise with clients is whether they want to provide for successor protectors. Lawyers vary widely in their approach to this issue. At one end of the spectrum is Dees, who might give the protector the power to appoint his or her successor but limits the protector to acting while the grantor or the grantor's spouse is still alive. Dees, who drafts trusts to say that the protector doesn't have a fiduciary duty, worries that there will be no one to oversee the protector's significant powers after the grantor dies.

At the other end of the spectrum is Edwards, who writes the protector powers to survive the life of the grantor but doesn't generally provide for a method of succession. The powers given the protector reflect the grantor's confidence in that particular individual, he explains, and the client might not have that confidence in anybody else. Edwards did make an exception for one client who set up a trust for his mentally disabled child. The trust protector in that case was a psychologist involved in the child's care, and the client thought that person should be able to appoint a similarly qualified individual.

If a client decides to provide for successors, he'll also need to establish a mechanism for choosing them. Sparks, who deals regularly with dynasty trusts, lays out various options for clients. One possibility is to allow an income beneficiary to designate a successor. Often clients prefer to have a committee—say of three—who can take action by majority rule, he says.

Advisers should keep in mind that trust protectors are not a panacea, says Stephan Leimberg, president of Leimberg Information Services, a tax-law commentary service in Bryn Mawr, Pa. "If the beneficiaries should disagree with the trust protector, the beneficiaries may simply end up in litigation with the trust protector instead of the trustee," he says. "In fact, it's possible that the addition of a third party, with his own lawyer, might make any conflict more likely, more complicated, and more expensive to resolve instead of easier and cheaper to resolve."

Because the use of trust protectors in domestic arrangements is relatively new, lawyers' experience with them is still evolving. Many of the professionals who include protectors in their trust documents have only rarely seen them spring into action. And inevitably most efforts to draft a perfect clause for a particular client are based on the theoretical rather than the practical. Still, says Edwards, for clients who want or need flexibility, the trust protector is "one of the most useful tools in the estate planner's arsenal."

Deborah L. Jacobs, J.D., a business writer specializing in legal issues, often covers estate planning.

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AL JOURNAL.

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THURSDAY, FEBRUARY 20, 2003 D1

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in her family's plot. Michigan spouses make burial decisions. d with Mr. Techner: "Is there nts can be together?" The fu- lied "Your stepmother gets to now. But upon her death, you immediate next of kin. If you im and move him next to your your right."
o his stepmother and told her ther in her family's plot, "but one moment buried beside d carry out that threat, she sband be buried with his first attend the graveside service. ff these postmortem battles, ng California, Texas, Wash- mpshire—have begun accept-
o Page D4, Column 5

The Tax Shelter Next Door

To Avoid Higher Taxes at Home, Some Stash Cash in Out-of-State Trusts; the Case for Delaware

By Ruth Simon
And Rachel Emma Silverman

LOOKING FOR A place to set up a tax shelter? You don't have to go to some tropical island.

In an effort to shave state tax bills, attorneys and trust companies are encouraging clients to set up trusts, not out of the country, but merely out of state. The aim is to let your investments grow free of state taxes by setting up a trust account in a place with favorable tax laws. Someone in New York, for example, where state taxes are high, could set up a trust account in South Dakota, which has no state income tax.

The incentive to duck state taxes is likely to grow. Locked in their worst budget crisis in decades, close to half the states are considering raising taxes of various kinds, and California and Connecticut have proposals for income-tax increases on the table. At the same time, federal tax rates are being rolled back. Bottom line: A greater share of your total tax bill is likely to go to the state where you live.

Banks and trust departments are touting these trusts in newsletters, seminars and in meetings with clients, attorneys and financial advisers.

"Clients wishing to establish irrevocable trusts often assume those trusts should be located in their state of residence," J.P. Morgan Chase & Co. advises its upscale private bank clients in a newsletter. As state laws change, advisers "will need to be especially attentive in their search to find the best jurisdiction for establishing and administering trusts."

Delaware attracts a lot of money, partly because it has changed its laws to make them extremely friendly to out-of-state trusts. As long as the beneficiaries of a trust live out of state, it imposes no state income tax. "The national banks that do business in Delaware are pushing it very hard," says Joshua S. Rubenstein, a trust and estate lawyer in New York. Other states with favorable laws include Washington and Alaska. (See chart on page D2 for a list of state policies.)

How to Set One Up

If you're planning an out-of-state trust:

- **Find a lawyer** familiar with tax laws in the state where you live as well as the one where the trust actually will be located.
- **Hire a reputable trustee** in the target state.
- Remember: Beneficiaries may have to pay **state tax** on income the trust distributes.

Your state taxes may be rising soon; see page D2

How does an out-of-state trust work? Suppose you live in New York, which has a top tax rate of almost 7%, and have $1 million in stocks you want to sock away for a few years. If you keep the money in New York trust, you have to pay state tax on any capital gains or dividend income.

But the picture changes if you set up a trust in Delaware and stick the $1 million there. In that case, there is no state tax imposed on income and capital gains retained by the trust.

"With very wealthy clients, I feel I'm not doing my job if I don't mention there are states that may be attractive to them," says Dennis Belcher, a

Please Turn to Page D2, Column 1

Fighting A...

In many other states, the odds of | About half of the estimated 1.9 | E-mail me at tom.herman@wsj.com.

The Tax Shelter Next Door: an Out-of-State Trust

Continued From Page D1

trust and estates lawyer in Richmond, Va.

The trust will still be subject to federal income taxes. And beneficiaries of the trust must pay state income taxes on any income paid out by the trust.

Setting up an out-of-state trust isn't cheap. For starters, you'll need to hire an attorney who understands the quirks of your home state's laws and the laws of the state you'd like to move your trust to. In California, for instance, an out-of-state trust may still be subject to some state tax if one or more of the beneficiaries live in the state.

It's also wise to have the trust documents reviewed by a lawyer in the state where the trust will be located. That can cost anywhere from a few hundred dollars to a few thousand dollars, depending on how complex the trust is.

Finally, you'll have to pay for the services of an out-of-state trustee, with the fees you pay determined by the amount of money under management. At Delaware's Wilmington Trust Co., for instance, fees start at 1% on the first $2 million in the trust with a $10,000 minimum fee.

Dealing with an out-of-state trustee can also be more complicated than what many people are used to. "People like being able to walk into the bank," notes Michael Fredlender, a partner with the accounting firm Grant Thornton LLP.

Where to Go

Here are five states that are particularly attractive for individuals to set up out-of-state trusts. Trustees in these states generally charge an annual fee ranging from 0.5% to 1.25% of the assets in the trust.

STATE	TRUST ATTRACTIONS
Alaska	No state income tax.* Trusts may be subject to a 1,000-year limit. Asset protection laws against future claimants in cases like a divorce or a lawsuit.
Delaware	Delaware imposes no state income tax on trusts set up by non-residents if beneficiaries also reside out of state. A 110-year limit for real estate but no limits on other assets. Asset protection laws against future claimants.
Florida	No state income tax. Trust limit of 360 years.
South Dakota	No state income tax. Trusts can last forever.
Washington	No state income tax. Trust limit of 150 years.

*Some states, such as Alaska, have corporate income tax.

Such hassles make moving a trust not worth the bother for someone who has $500,000 or even $1 million in a trust, Mr. Fredlender says. But for multimillion dollar trusts, it could be worth the time and expense, he adds.

The tax beneficiaries face depends on where they live. If it's New York, they will be subject to that state's regular income tax. But if they've moved in the meantime to a state with no income taxes, such as Florida, they're avoid paying state taxes on the income.

Setting up an out-of-state trust correctly takes some work. To qualify for favorable treatment, the trust must be irrevocable, meaning you can't undo it later. At least one trustee must reside in the state where the trust is located. Many people choose to use a trust company set up in that location. South Dakota's tax laws are so attractive that Citigroup, which has a large credit-card processing operation there, has also set up a major trust outfit in the state.

Avoiding capital-gains taxes isn't the only attraction of going out of state. In many states a trust can last for a fixed period that's normally less than 100 years. But Delaware and more than a dozen other states allow trusts to go on for centuries or, in some cases, indefinitely.

"The trust can go on forever without any state taxes and with no federal death taxes," explains Max Gutierrez Jr., a trust and estates lawyer in San Francisco. An out-of-state trust may also provide better protection against creditors' claims in cases like a divorce or a lawsuit, trust lawyers say.

In some cases, it can make sense to situate your trust in a state that's not known as a tax haven. That's because each state has different rules that define whether the trust's income is taxable. For New York state to tax a trust, for example, the trust must be created by someone who lives in the state. "If you live in New Jersey, you can create a trust in New York with no New York or New Jersey income tax," says Gail Cohen, senior vice president and general trust counsel for Fiduciary Trust Co. International.

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THE WALL STREET JOURNAL.

of their own! ... sic in western New York. Laura Diaz is the defending champ. The sports world should care, but will it?

runs ... vately owned fish houses. Mrs. McQuoid was directing operations from Mac's lakeside office, a 10-by-20 fish house that she said is indica-

April 20. ... fristcenter.org. —Stuart Ferguso

FISCAL NOTE

STATE OF ALASKA
2003 LEGISLATIVE SESSION

Fiscal Note Number:
Bill Version: HB 212
() Publish Date:

Revision Date/Time (Note if correction):
Title "An Act relating to trusts, including trust protectors, trustee advisors, transfers of property in trust, . . ."
Sponsor Representative McGuire
Requester House Labor and Commerce Committee

Dept. Affected: Law
BRU Civil Division
Component Commercial
Component No. 2211

Expenditures/Revenues (Thousands of Dollars)

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

OPERATING EXPENDITURES	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009
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–Do not abbreviate)						
TOTAL	0.0	0.0	0.0	0.0	0.0	0.0

Estimate of any current year (FY2003) cost: 0.0
Check this box (X) if funding for this bill is included in the Governor's FY 2004 budget proposal: [ ]

POSITIONS

Full-time						
Part-time						
Temporary						

ANALYSIS: *(Attach a separate page if necessary)*
HB 212 provides for the appointment of a trust protector and a trust advisor. The bill also prevents creditors of beneficiaries from attaching assets transferred into a trust unless certain conditions are met by all parties, and establishes a statute of limitations regarding when creditors must bring an action for a fraudulent transfer claim.

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

Prepared by: Joan M. Kasson
Division Attorney General's Office
Phone (907) 465-5370
Date/Time 3/28/03 2:45 PM
Approved by: Joan M. Kasson for Gregg D. Renkes, Attorney General
Agency Department of Law
Date 3/28/2003

(Revised 9/2002 OMB)

ALASKA STATE LEGISLATURE

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Rep. Ralph Samuels
Rep. Les Gara
Rep. Max Gruenberg

State Capitol, Room 120
Juneau, AK 99801-1182
(907) 465-4990
Fax (907) 465-6592

House Judiciary Committee

Memorandum

To: Leg. Legal

From: Vanessa Tondini, Committee Aide
House Judiciary Committee

Date: March 31, 2003

Re: CS Request

Please create a work draft House Judiciary Committee Substitute for work order # 23-LS0471\H, HB 212: Powers of Appointments/Trusts/Creditors, incorporating the attached changes. The bill will have its first hearing in House Judiciary on Wednesday, April 2nd, and we discovered this one last change to incorporate in the bill.

If you have any questions, please call me at 4990. Thank you!

The information attached to this memo is **CONFIDENTIAL** an/or privileged. It is intended to be reviewed initially by only the individual named above. If the reader of this Memorandum is not the intended recipient or a representative of the intended recipient, you are hereby notified that any review, dissemination, or copying of the information contained herein is prohibited. If you have received this in error, please immediately notify the sender by telephone and return this to the sender at the above address.

Sec. 7. AS 34.40 is amended by adding a new section to read:

Sec. 34.40.115. Subjecting appointed property to the claims of a donee's creditor. The property that a donee of a power of appointment is authorized to appoint is not subject to the claims of the creditors of the donee except to the extent that a donee of an inter vivos or testamentary power of appointment

(1) is permitted by the donor of the power to appoint the property to the **donee, the creditors of the donee, the** donee's estate or to the creditors of the donee's estate; and

(2) effectively exercises the power of appointment in favor of the **donee, the creditors of the donee, the** donee's estate or to the creditors of the donee's estate.

23-LS0471\I
Bannister
4/1/03

CS FOR HOUSE BILL NO. 212(JUD)

IN THE LEGISLATURE OF THE STATE OF ALASKA

TWENTY-THIRD LEGISLATURE - FIRST SESSION

BY THE HOUSE JUDICIARY COMMITTEE

Offered:
Referred:

Sponsor(s): REPRESENTATIVE MCGUIRE

A BILL

FOR AN ACT ENTITLED

1 **"An Act relating to trusts, including trust protectors, trustee advisors, transfers of**
2 **property in trust, and transfers of trust interests, and to creditors' claims against**
3 **property subject to a power of appointment."**

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

5 * **Section 1.** AS 13.36 is amended by adding new sections to read:
6 **Sec. 13.36.370. Trust protector.** (a) A trust instrument may provide for the
7 appointment of a disinterested third party to act as a trust protector.
8 (b) A trust protector appointed under (a) of this section has the powers,
9 delegations, and functions conferred on the protector by the trust instrument, which
10 may include the power to
11 (1) remove and appoint a trustee;
12 (2) modify or amend the trust instrument to achieve favorable tax
13 status or to respond to changes in 26 U.S.C. (Internal Revenue Code) or state law, or
14 the rulings and regulations under those laws;

1 (3) increase or decrease the interests of any beneficiary to the trust; and
2 (4) modify the terms of a power of appointment granted by the trust.
3 (c) A modification authorized under (b) of this section may not
4 (1) grant a beneficial interest to an individual or a class of individuals
5 unless the individual or class of individuals is specifically provided for under the trust
6 instrument;
7 (2) modify the beneficial interest of a governmental unit in a trust
8 created under AS 47.07.020(f).
9 (d) Subject to the terms of the trust instrument, a trust protector is not liable or
10 accountable as a trustee or fiduciary because of an act or omission of the trust
11 protector taken when performing the function of a trust protector under the trust
12 instrument.
13 **Sec. 13.36.375. Trustee advisor.** (a) A trust instrument may provide for the
14 appointment of a person to act as an advisor to the trustee with regard to all or some of
15 the matters relating to the property of the trust.
16 (b) Unless the terms of the trust instrument provide otherwise, if an advisor is
17 appointed under (a) of this section, the property and management of the trust and the
18 exercise of all powers and discretionary acts exercisable by the trustee remain vested
19 in the trustee as fully and effectively as if an advisor were not appointed, the trustee is
20 not required to follow the advice of the advisor, and the advisor is not liable as or
21 considered to be a trustee of the trust or a fiduciary when acting as an advisor to the
22 trust.
23 * **Sec. 2.** AS 34.40.110(a) is amended to read:
24 (a) A person who in writing transfers property in trust may provide that the
25 interest of a beneficiary of the trust**, including a beneficiary who is the settlor of the**
26 **trust,** may not be either voluntarily or involuntarily transferred before payment or
27 delivery of the interest to the beneficiary by the trustee. **Payment or delivery of the**
28 **interest to the beneficiary does not include a beneficiary's use or occupancy of**
29 **real property or tangible personal property owned by the trust if the use or**
30 **occupancy is in accordance with the trustee's discretionary authority under the**
31 **trust instrument.** In this subsection,

1 (1) "property" includes real property, personal property, and interests
2 in real or personal property;
3 (2) "transfer" means any form of transfer, including deed, conveyance,
4 or assignment.
5 * **Sec. 3.** AS 34.40.110(b) is amended to read:
6 (b) If a trust contains a transfer restriction allowed under (a) of this section,
7 the transfer restriction prevents a creditor existing when the trust is created **or** [,] a
8 person who subsequently becomes a creditor[, OR ANOTHER PERSON] from
9 satisfying a claim out of the beneficiary's interest in the trust, unless the **creditor is a**
10 **creditor of the settlor and**
11 (1) **the settlor's** transfer **of property in trust** was **made with the**
12 **primary intent** [INTENDED IN WHOLE OR IN PART] to [HINDER, DELAY, OR]
13 defraud **that creditor** [CREDITORS OR OTHER PERSONS UNDER
14 AS 34.40.010];
15 (2) **the** trust provides that the settlor may revoke or terminate all or
16 part of the trust without the consent of a person who has a substantial beneficial
17 interest in the trust and the interest would be adversely affected by the exercise of the
18 power held by the settlor to revoke or terminate all or part of the trust; in this
19 paragraph, "revoke or terminate" does not include a power to veto a distribution from
20 the trust, a testamentary **nongeneral** [SPECIAL] power of appointment or similar
21 power, or the right to receive a distribution of income, **principal** [CORPUS], or both
22 in the discretion of a person, including a trustee, other than the settlor**, or a right to**
23 **receive a distribution of income or principal under (3)(A) or (B) of this**
24 **subsection**;
25 (3) **the** trust requires that all or a part of the trust's income or principal,
26 or both, must be distributed to the settlor**; however, this paragraph does not apply**
27 **to a settlor's right to receive**
28 **(A) income or principal from a charitable remainder**
29 **annuity trust or charitable remainder unitrust; in this subparagraph,**
30 **"charitable remainder annuity trust" and "charitable remainder**
31 **unitrust" have the meanings given in 26 U.S.C. 664 (Internal Revenue**

1 Code) as that section reads on the effective date of this bill section and as
2 it may be amended;
3 (B) a percentage of the value of the trust each year as
4 determined from time to time under the trust instrument, but not
5 exceeding the amount that may be defined as income under AS 13.38 or
6 under 26 U.S.C. 643(b) (Internal Revenue Code) as that subsection reads
7 on the effective date of this bill section and as it may be amended; or
8 (4) at the time of the transfer, the settlor is in default by 30 or more
9 days of making a payment due under a child support judgment or order.
10 * **Sec. 4.** AS 34.40.110(c) is amended to read:
11 (c) The satisfaction of a claim under (b)(1) - (4) of this section is limited to
12 that part of the trust for [TO] which a transfer restriction is not allowed under
13 (b)(1) - (4) of this section, and an attachment or other order may not be made
14 against the trustee with respect to a beneficiary's interest in the trust or against
15 property that is subject to a transfer restriction, except to the extent that a
16 transfer restriction is determined not to be allowed under (b)(1) - (4) of this
17 section [APPLIES].
18 * **Sec. 5.** AS 34.40.110(d) is amended to read:
19 (d) A cause of action or claim for relief with respect to a fraudulent transfer of
20 a settlor's assets under (b)(1) of this section [, OR UNDER OTHER LAW,] is
21 extinguished unless the action under (b)(1) of this section is brought by a creditor of
22 the settlor [AS TO A PERSON] who
23 (1) is a creditor of the settlor before the settlor's assets are
24 transferred to the trust, and the action under (b)(1) of this section is brought
25 [WHEN THE TRUST IS CREATED,] within the later of
26 (A) four years after the transfer is made; or
27 (B) one year after the transfer is or reasonably could have been
28 discovered by the creditor if the creditor
29 (i) can demonstrate, by a preponderance of the
30 evidence, that the creditor asserted a specific claim against the
31 settlor before the transfer; or

1 **(ii) files another action, other than an action under**
2 **(b)(1) of this section, against the settlor that asserts a cla[illegible] based**
3 **on an act or omission of the settlor that occurred before the**
4 **transfer, and the action described in this sub-subparagraph is filed**
5 **within four years after the transfer** [PERSON]; or
6 (2) becomes a creditor subsequent to the transfer into trust, **and the**
7 **action under (b)(1) of this section is brought** within four years after the transfer is
8 made.
9 * **Sec. 6.** AS 34.40.110 is amended by adding new subsections to read:
10 (g) A transfer restriction allowed under (a) of this section and enforceable
11 under (b) of this section applies to a settlor who is also a beneficiary of the trust even
12 if the settlor serves as a co-trustee or as an advisor to the trustee under AS 13.36.375 if
13 the settlor does not have a trustee power over discretionary distributions.
14 (h) A transfer restriction allowed under (a) of this section and enforceable
15 under (b) of this section applies to a beneficiary who is not the settlor of the trust,
16 whether or not the beneficiary serves as a sole trustee, a co-trustee, or an advisor to the
17 trustee under AS 13.36.375.
18 (i) A transfer restriction is allowed under (a) of this section and is enforceable
19 under (b) of this section even if a settlor has the authority under the terms of the trust
20 instrument to appoint a trust protector under AS 13.36.370 or an advisor to the trustee
21 under AS 13.36.375.
22 (j) A settlor whose beneficial interest in a trust is subject to a transfer
23 restriction that is allowed under (a) of this section may not benefit from, direct a
24 distribution of, or use trust property except as may be stated in the trust instrument.
25 An agreement or understanding, express or implied, between the settlor and the trustee
26 that attempts to grant or permit the retention of greater rights or authority than is stated
27 in the trust instrument is void.
28 * **Sec. 7.** AS 34.40 is amended by adding a new section to read:
29 **Sec. 34.40.115. Subjecting appointed property to claims of donee's**
30 **creditor.** The property that a donee of a power of appointment is authorized to
31 appoint is not subject to the claims of the creditors of the donee except to the extent

1 that a donee of an inter vivos or testamentary power of appointment
2 (1) is permitted by the donor of the power to appoint the property to
3 the donee, the creditors of the donee, the donee's estate, or the creditors of the donee's
4 estate; and
5 (2) effectively exercises the power of appointment in favor of the
6 donee, the creditors of the donee, the donee's estate, or the creditors of the donee's
7 estate.
8 * **Sec. 8.** The uncodified law of the State of Alaska is amended by adding a new section to
9 read:
10 APPLICABILITY. This Act applies to a trust regardless of whether the trust was
11 created before, on, or after the effective date of the applicable section of this Act.

Conceptual Amendment # 1
to CSHB 212

A settlor of a trust is required to sign an affidavit of solvency prior to the creation of a trust.

Conceptual
AMENDMENT 2
to HB 212

By Rep. Gruenberg

Section 6. AS 34.40.110

1 page 6, line 15, add a new section to read:

2 (8) the assets being transferred into the trust were not derived from unlawful activities.

House Bill 212 – Summary of Issues

CSED is concerned about this bill because it will make it easier for some parents to avoid supporting their children.

These are the primary problems that we see with this bill.

(1) Section 2 (page 2, lines 25-26) of the bill allows the person creating the trust to also be the beneficiary of the trust and still receive protection from creditors. We have always considered that fact – that the settlor and beneficiary are the same person – as an indication of fraud. By adding this provision, the bill, if passed, would make it more difficult to prove a fraudulent transfer.

(2) Section 2 (page 2, lines 27-31) of the bill states that a beneficiary (who can be the person creating the trust) can retain possession of the trust property and still receive protection from creditors. Normally, the fact that the person transferring the property retains possession of that property is an indication of fraud. The bill, if passed, would make it more difficult to prove a fraudulent transfer.

(3) Section 3 (page 3, lines 9-10) of the bill limits the exceptions to trust protection to cases in which "the creditor is a creditor of the settlor." However, it is often the beneficiary who is hiding behind or living off the trust. *See* example (b) in paragraph (6), below.

(4) Section 3 (page 3, lines 11-12) of the bill increases the proof required to prove intent to defraud creditors. Currently, we only have to prove that the person intended *in part* to defraud creditors. There may have been legitimate reasons for the transfer, but if defrauding creditors was part of the intent, the trust will not be protected from creditors. If the bill passes, we will have to prove that defrauding creditors was the *primary* intent. This is much more difficult to prove, especially since we are talking about a *subjective* intent, which is hard to prove to begin with.

(5) Section 3 (page 3, lines 25-31, and page 4, lines 1-7) of the bill allows persons to shelter their money from creditors in certain types of trusts even though the trust requires that all or a part of the trust's income or principal be distributed to the person creating the trust. Thus, in some cases where we would argue there are clear indicia of fraud, the statutory protection against creditors would still apply.

(6) Section 3 (page 4, lines 8-9) of the bill states the limited child support exception currently in AS 34.40.110(b)(4). This exception is not adequate to protect children because it only applies when the settlor was in default at the time of the transfer. This leaves some very large gaps. For example:

(a) A man receives a paternity complaint on January 1, 2000. Knowing that he is the child's father and that the mother will demand child support from

him, he immediately creates a trust, something which he later claims that he had intended to do all along, not to avoid child support, but to take advantage of the tax benefits. A support order is established several months later. The father then refuses to pay support and arrears accrue. The father takes distributions from the trust in order to pay his living expenses and refuses to work, thus avoiding wage withholding. The child support exception would not apply because the settlor was not in default when he transferred the property into trust.

(b) A man has a son who is not good with money. The man sets up a trust for his son, the income and principal of which are used to pay the son's living expenses. Thus, the son doesn't have to work to support himself. At some point, the son has a child but fails to pay child support. There is no need for him to work because he is able to live off the discretionary distributions from the trust. The child support exception wouldn't apply because it's the beneficiary who is in default.

Because the child support exception is very limited, CSED will be forced to rely on the "intent to defraud creditors" exception. CSED is concerned about this bill because it makes that exception much more difficult, if not impossible, to prove.

(7) Section 5 (page 4, line 31, and page 5, lines 1-2) of the bill says that in order to avoid the transfer restriction based on an intent to defraud creditors, the creditor must show that "the creditor asserted a specific claim against the settlor before the transfer." This may make sense in the context of arms-length commercial transactions, but it does not work in the context of child support. In the commercial context, most claims are put in writing and thus are easy to prove. In the domestic arena, specific claims are rarely put in writing until long after the fact. Moreover, a specific claim is necessary for parents to know that they have a legal duty to support their children. There doesn't need to be any "specific claim" by the custodial parent or by CSED before the non-custodial parent knows enough to start hiding assets.

(8) Section 6 (page 5, lines 6-15) of the bill extends the protections against creditors to situations where creditors are most likely to argue fraud. The provisions allow the person creating the trust to also be a beneficiary and co-trustee of the trust. They allow a beneficiary who is not the settlor to be the sole trustee. They also allow the person creating the trust to have the authority to appoint a trust protector who has super-powers over the trust. All of these provisions blur the lines between the concept of a trust and sole possession and control over property, making it that much more difficult to prove that there was an intent to defraud creditors.

Yes, CSED has many other enforcement tools, such as a criminal action for nonsupport and aiding and abetting. However, CSED's goal is not to put people in jail. Our goal is to assure that children receive the support to which they are entitled and that the state is

reimbursed for the money it spends to support these children when the parents don't. This bill will limit CSED's ability to accomplish that purpose in cases where income is being sheltered in trusts under these statutes.

One solution would be to broaden the child support exception of 34.40.110(b)(4) so that CSED does not have to rely on proof of an intent to defraud creditors in order to avoid the transfer restriction. This solution would simply state that the protections against creditors don't apply if the creditor is seeking to satisfy a child support debt.

AFFIDAVIT OF SOLVENCY

The undersigned, ______________________________, makes oath and swears as follows:

1. That I am a Grantor of the ______________________________ dated ____________________, and I may make transfers of property thereto in addition to my initial contribution.

2. That I have full right, title and authority to transfer the assets to the trust.

3. No particular event or transaction has occurred which I expect will develop into a controversy or problem with any creditor in the future.

4. There are no pending or threatened claims or lawsuits against me, and I am not a named Defendant in any lawsuits [except that named in the attached Schedule A] or involved in any administrative proceedings [except that named in the attached Schedule A] as of this date.

5. Following my transfers to the Trust, I will remain solvent and able to pay my reasonably anticipated debts as they become due, with due consideration to be given to the extent to which I have otherwise provided for the payment of any such debts.

6. This transfer represents less than one-half (1/2) of my net worth.

7. I am not engaged in or about to become engaged in a business or transaction for which my remaining assets will be unreasonable in relation to the business or transaction.

8. I do not intend to incur or reasonably believe that I will incur debts beyond my ability to pay as they become due, and I do not have the actual intent to hinder, delay or defraud any creditor.

9. I do not contemplate filing for relief under the provisions of the US Bankruptcy Code, nor am I involved in any situation that I reasonably anticipate would cause me to file for relief under any Chapter of the US Bankruptcy Code in the future.

10. I have read and understand the description of the Money Laundering Control Act, attached as Schedule B and confirm and represent that none of the assets which I may transfer was derived from any of the activities specified in such Act, and that none of the items of "financial misconduct" are applicable to me.

11. That I am not, nor do I reasonably expect to be, under investigation by any Federal or State Agency, or in violation of any statutes administered by, or empowering the Internal Revenue Service, the Federal Trade Commission, the Securities and Exchange Commission, the United States Postal Service, the Drug Enforcement Agency or the Federal Bureau of Investigation.

12. I am not in default by more than (30) days on child support payments. *

Sworn to and affirmed under penalties of perjury

____

Subscribed and sworn to before me by the said ____________________
this _____ day of _______________, ______.

____

Notary Public
For the state of ____________________
My Commission expires: ________________

The Money Laundering Control Act

The Money Laundering Control Act ("the Act") makes it criminal for anyone to conduct or attempt to conduct certain financial activities which involve the proceeds of unlawful activities. As the transfer of assets into a limited partnership, trust, or other entity may constitute a financial activity within the scope of the Act, it is necessary, that you swear under oath that none of the assets intended to be transferred into such entities was derived from any of the criminal activities specified in the Act.

The specified unlawful activities under the Act consist primarily of drug trafficking offenses, financial misconduct, and environmental crimes. Drug trafficking offenses include the manufacture, importation, sale, or distribution of controlled substances; the commission of acts constituting a continuing criminal enterprise; the illegal procurement of precursor; and transportation of drug paraphernalia.

Covered financial misconduct includes the concealment of assets from a receiver, custodian, marshal, or other officer of the court, from creditors in a bankruptcy proceeding, or from the Federal Deposit Insurance Corporation, the Resolution Trust Corporation, or a similar agency or person; the making of a fraudulent conveyance in contemplation of a bankruptcy proceeding or with the intent to defeat the bankruptcy law; the giving of false oaths or claims in relation to a bankruptcy proceeding, bribery; the giving of commissions or gifts for the procurement loans; theft, embezzlement, or misapplication of bank funds or funds of other lending, credit, or insurance institutions; the making of fraudulent bank or credit institution entities or loan or credit applications; and mail, wire, or bank fraud or bank or postal robbery or theft.

Environmental crimes include violations of the Federal Water Pollution Control Act, the Ocean Dumping Act, the Safe Drinking Water Act, the Resources Conservation and Recovery Act, and similar federal statutes. Other specified crimes include counterfeiting, espionage, kidnapping or hostage-taking, copyright infringement, entry of goods by means of false statements, smuggling goods into the United States, removing goods from the custody of Customs, illegally exporting arms, and trading with United States enemies.

Schedule A

1. ____

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2. ____

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3. ____

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4. ____

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5. ____

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6. ____

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7. ____

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8. ____

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9. ____

____

ALASKA STATE LEGISLATURE

Rep. Lesil McGuire, Chair
Rep. Tom Anderson, Vice-Chair
Rep. John Coghill
Rep. Jim Holm
Rep. Ralph Samuels
Rep. Les Gara
Rep. Max Gruenberg

State Capitol, Room 120
Juneau, AK 99801-1182
(907) 465-4990
Fax (907) 465-6592

House Judiciary Committee

Memorandum

To: Terri Bannister, Leg. Legal

From: Vanessa Tondini, Committee Aide
House Judiciary Committee

Date: April 3, 2003

Re: CS Request

Please create a work draft House Judiciary Committee Substitute for work order # 23-LS0471\I, HB 212, incorporating the attached two amendments. The bill will be brought back before the committee tomorrow, Friday, April 11 at 1:00pm, so if you could get the draft to me as soon as possible that would be wonderful!

If you have any questions, please call me at 4990. Thank you so much!

The information attached to this memo is **CONFIDENTIAL** an/or privileged. It is intended to be reviewed initially by only the individual named above. If the reader of this Memorandum is not the intended recipient or a representative of the intended recipient, you are hereby notified that any review, dissemination, or copying of the information contained herein is prohibited. If you have received this in error, please immediately notify the sender by telephone and .return this to the sender at the above address.

Conceptual Amendment #1 to CSHB 212(JUD)

Add a new subsection to AS 34.40.110 (Page 5, Line 28):

(k) A settlor who creates a trust which names the settlor as a beneficiary and whose beneficial interest is subject to a transfer restriction that is allowed under (a) of this section shall sign an affidavit, sworn to and affirmed under penalties of perjury, before the settlor makes a transfer of assets to the trust. The affidavit shall state that:

1. #2 of the attached affidavit; (rephrase to make consistent with the language of the bill).
2. the transfer of assets to the trust will not render the settlor insolvent;
3. the settlor has no intention to defraud a creditor by the transfer of assets to the trust;
4. #4 of the attached affidavit; (rephrase to make consistent with the language of the bill)
5. at the time of the transfer of assets to the trust the settlor is not currently in default of a child support obligation by more than 30 days; and
6. #9 of the attached affidavit (rephrase to make consistent with the language of the bill).

Theresa: this change needs to be prospective and not retroactive like so many other aspects of the bill.

Amendment # 2
Page 3, Line 12:
Delete "primary"

23-LS0471\Q
Bannister
4/4/03

CS FOR HOUSE BILL NO. 212(JUD)

IN THE LEGISLATURE OF THE STATE OF ALASKA

TWENTY-THIRD LEGISLATURE - FIRST SESSION

BY THE HOUSE JUDICIARY COMMITTEE

Offered:
Referred:

Sponsor(s): REPRESENTATIVE MCGUIRE

A BILL

FOR AN ACT ENTITLED

1 **"An Act relating to trusts, including trust protectors, trustee advisors, transfers of**
2 **property in trust, and transfers of trust interests, and to creditors' claims against**
3 **property subject to a power of appointment."**

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

5 * **Section 1.** AS 13.36 is amended by adding new sections to read:
6 **Sec. 13.36.370. Trust protector.** (a) A trust instrument may provide for the
7 appointment of a disinterested third party to act as a trust protector.
8 (b) A trust protector appointed under (a) of this section has the powers,
9 delegations, and functions conferred on the protector by the trust instrument, which
10 may include the power to
11 (1) remove and appoint a trustee;
12 (2) modify or amend the trust instrument to achieve favorable tax
13 status or to respond to changes in 26 U.S.C. (Internal Revenue Code) or state law, or
14 the rulings and regulations under those laws;

1 (3) increase or decrease the interests of any beneficiary to the trust; and
2 (4) modify the terms of a power of appointment granted by the trust.
3 (c) A modification authorized under (b) of this section may not
4 (1) grant a beneficial interest to an individual or a class of individuals
5 unless the individual or class of individuals is specifically provided for under the trust
6 instrument;
7 (2) modify the beneficial interest of a governmental unit in a trust
8 created under AS 47.07.020(f).
9 (d) Subject to the terms of the trust instrument, a trust protector is not liable or
10 accountable as a trustee or fiduciary because of an act or omission of the trust
11 protector taken when performing the function of a trust protector under the trust
12 instrument.
13 **Sec. 13.36.375. Trustee advisor.** (a) A trust instrument may provide for the
14 appointment of a person to act as an advisor to the trustee with regard to all or some of
15 the matters relating to the property of the trust.
16 (b) Unless the terms of the trust instrument provide otherwise, if an advisor is
17 appointed under (a) of this section, the property and management of the trust and the
18 exercise of all powers and discretionary acts exercisable by the trustee remain vested
19 in the trustee as fully and effectively as if an advisor were not appointed, the trustee is
20 not required to follow the advice of the advisor, and the advisor is not liable as or
21 considered to be a trustee of the trust or a fiduciary when acting as an advisor to the
22 trust.
23 * **Sec. 2.** AS 34.40.110(a) is amended to read:
24 (a) A person who in writing transfers property in trust may provide that the
25 interest of a beneficiary of the trust**, including a beneficiary who is the settlor of the**
26 **trust,** may not be either voluntarily or involuntarily transferred before payment or
27 delivery of the interest to the beneficiary by the trustee. **Payment or delivery of the**
28 **interest to the beneficiary does not include a beneficiary's use or occupancy of**
29 **real property or tangible personal property owned by the trust if the use or**
30 **occupancy is in accordance with the trustee's discretionary authority under the**
31 **trust instrument.** In this subsection,

1 (1) "property" includes real property, personal property, and interests
2 in real or personal property;
3 (2) "transfer" means any form of transfer, including deed, conveyance,
4 or assignment.
5 * **Sec. 3.** AS 34.40.110(b) is amended to read:
6 (b) If a trust contains a transfer restriction allowed under (a) of this section,
7 the transfer restriction prevents a creditor existing when the trust is created **or** [,] a
8 person who subsequently becomes a creditor [, OR ANOTHER PERSON] from
9 satisfying a claim out of the beneficiary's interest in the trust, unless the **creditor is a**
10 **creditor of the settlor and**
11 (1) **the settlor's** transfer **of property in trust** was **made with the**
12 **intent** [INTENDED IN WHOLE OR IN PART] to [HINDER, DELAY, OR] defraud
13 **that creditor** [CREDITORS OR OTHER PERSONS UNDER AS 34.40.010];
14 (2) **the** trust provides that the settlor may revoke or terminate all or
15 part of the trust without the consent of a person who has a substantial beneficial
16 interest in the trust and the interest would be adversely affected by the exercise of the
17 power held by the settlor to revoke or terminate all or part of the trust; in this
18 paragraph, "revoke or terminate" does not include a power to veto a distribution from
19 the trust, a testamentary **nongeneral** [SPECIAL] power of appointment or similar
20 power, or the right to receive a distribution of income, **principal** [CORPUS], or both
21 in the discretion of a person, including a trustee, other than the settlor**, or a right to**
22 **receive a distribution of income or principal under (3)(A) or (B) of this**
23 **subsection**;
24 (3) **the** trust requires that all or a part of the trust's income or principal,
25 or both, must be distributed to the settlor**; however, this paragraph does not apply**
26 **to a settlor's right to receive**
27 **(A) income or principal from a charitable remainder**
28 **annuity trust or charitable remainder unitrust; in this subparagraph,**
29 **"charitable remainder annuity trust" and "charitable remainder**
30 **unitrust" have the meanings given in 26 U.S.C. 664 (Internal Revenue**
31 **Code) as that section reads on the effective date of this bill section and as**

New Text Underlined [DELETED TEXT BRACKETED]

1 it may be amended:

2 (B) a percentage of the value of the trust each year as

3 determined from time to time under the trust instrument, but not

4 exceeding the amount that may be defined as income under AS 13.38 or

5 under 26 U.S.C. 643(b) (Internal Revenue Code) as that subsection reads

6 on the effective date of this bill section and as it may be amended; or

7 (4) at the time of the transfer, the settlor is in default by 30 or more

8 days of making a payment due under a child support judgment or order.

9 * **Sec. 4.** AS 34.40.110(c) is amended to read:

10 (c) The satisfaction of a claim under (b)(1) - (4) of this section is limited to

11 that part of the trust **for** [TO] which **a transfer restriction is not allowed under**

12 (b)(1) - (4) of this section**, and an attachment or other order may not be made**

13 **against the trustee with respect to a beneficiary's interest in the trust or against**

14 **property that is subject to a transfer restriction, except to the extent that a**

15 **transfer restriction is determined not to be allowed under (b)(1) - (4) of this**

16 **section** [APPLIES].

17 * **Sec. 5.** AS 34.40.110(d) is amended to read:

18 (d) A cause of action or claim for relief with respect to a fraudulent transfer **of**

19 **a settlor's assets** under (b)(1) of this section [, OR UNDER OTHER LAW,] is

20 extinguished unless the action **under (b)(1) of this section** is brought **by a creditor of**

21 **the settlor** [AS TO A PERSON] who

22 (1) is a creditor **of the settlor before the settlor's assets are**

23 **transferred to the trust, and the action under (b)(1) of this section is brought**

24 [WHEN THE TRUST IS CREATED,] within the later of

25 (A) four years after the transfer is made; or

26 (B) one year after the transfer is or reasonably could have been

27 discovered by the **creditor if the creditor**

28 **(i) can demonstrate, by a preponderance of the**

29 **evidence, that the creditor asserted a specific claim against the**

30 **settlor before the transfer; or**

31 **(ii) files another action, other than an action under**

1 **(b)(1) of this section, against the settlor that asserts a claim based**
2 **on an act or omission of the settlor that occurred before the**
3 **transfer, and the action described in this sub-subparagraph is filed**
4 **within four years after the transfer** [PERSON]; or
5 (2) becomes a creditor subsequent to the transfer into trust, **and the**
6 **action under (b)(1) of this section is brought** within four years after the transfer is
7 made.
8 * **Sec. 6.** AS 34.40.110 is amended by adding new subsections to read:
9 (g) A transfer restriction allowed under (a) of this section and enforceable
10 under (b) of this section applies to a settlor who is also a beneficiary of the trust even
11 if the settlor serves as a co-trustee or as an advisor to the trustee under AS 13.36.375 if
12 the settlor does not have a trustee power over discretionary distributions.
13 (h) A transfer restriction allowed under (a) of this section and enforceable
14 under (b) of this section applies to a beneficiary who is not the settlor of the trust,
15 whether or not the beneficiary serves as a sole trustee, a co-trustee, or an advisor to the
16 trustee under AS 13.36.375.
17 (i) A transfer restriction is allowed under (a) of this section and is enforceable
18 under (b) of this section even if a settlor has the authority under the terms of the trust
19 instrument to appoint a trust protector under AS 13.36.370 or an advisor to the trustee
20 under AS 13.36.375.
21 (j) A settlor whose beneficial interest in a trust is subject to a transfer
22 restriction that is allowed under (a) of this section may not benefit from, direct a
23 distribution of, or use trust property except as may be stated in the trust instrument.
24 An agreement or understanding, express or implied, between the settlor and the trustee
25 that attempts to grant or permit the retention of greater rights or authority than is stated
26 in the trust instrument is void.
27 (k) A settlor who creates a trust that names the settlor as a beneficiary and
28 whose beneficial interest is subject to a transfer restriction allowed under (a) of this
29 section shall sign an affidavit before the settlor transfers assets to the trust. The
30 affidavit must state that
31 (1) the settlor has full right, title, and authority to transfer the assets to

1 the trust;
2 (2) the transfer of the assets to the trust will not render the settlor
3 insolvent;
4 (3) the settlor does not intend to defraud a creditor by transferring the
5 assets to the trust;
6 (4) the settlor does not have any pending or threatened court actions
7 against the settlor, except for those court actions identified by the settlor on an
8 attachment to the affidavit;
9 (5) the settlor is not involved in any administrative proceedings, except
10 for those administrative proceedings identified on an attachment to the affidavit;
11 (6) at the time of the transfer of the assets to the trust, the settlor is not
12 currently in default of a child support obligation by more than 30 days; and
13 (7) the settlor does not contemplate filing for relief under the
14 provisions of 11 U.S.C. (Bankruptcy Code).
15 * **Sec. 7.** AS 34.40 is amended by adding a new section to read:
16 **Sec. 34.40.115. Subjecting appointed property to claims of donee's**
17 **creditor.** The property that a donee of a power of appointment is authorized to
18 appoint is not subject to the claims of the creditors of the donee except to the extent
19 that a donee of an inter vivos or testamentary power of appointment
20 (1) is permitted by the donor of the power to appoint the property to
21 the donee, the creditors of the donee, the donee's estate, or the creditors of the donee's
22 estate; and
23 (2) effectively exercises the power of appointment in favor of the
24 donee, the creditors of the donee, the donee's estate, or the creditors of the donee's
25 estate.
26 * **Sec. 8.** The uncodified law of the State of Alaska is amended by adding a new section to
27 read:
28 APPLICABILITY. (a) Except as provided by (b) of this section, this Act applies to a
29 trust regardless of whether the trust was created before, on, or after the effective date of the
30 applicable section of this Act.
31 (b) AS 34.40.110(k), enacted by sec. 6 of this Act, applies to a trust only if the trust is

1 created on or after the effective date of this Act.

Delaware

§ 3573. Persons not subject to qualified dispositions.

Notwithstanding the provisions of § 3572 of this title, this subchapter shall not apply in any respect:

(1) To any person to whom the transferor is indebted on account of an agreement or order of court for the payment of support or alimony in favor of such transferor's spouse, former spouse or children, or for a division or distribution of property in favor of such transferor's spouse or former spouse, to the extent of such debt; or

(2) To any person who suffers death, personal injury or property damage on or before the date of a qualified disposition by a transferor, which death, personal injury or property damage is at any time determined to have been caused in whole or in part by the act or omission of either such transferor or by another person for whom such transferor is or was vicariously liable. Paragraph (1) shall not apply to any claim for forced heirship or legitime.

(71 Del. Laws, c. 159, § 1; 71 Del. Laws, c. 254, § 36; 71 Del. Laws, c. 343, § 8; 72 Del. Laws, c. 341, § 9.)

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Rhode Island

TITLE 18
Fiduciaries

CHAPTER 18-9.2
Qualified Dispositions in Trust

SECTION 18-9.2-5

§ 18-9.2-5 **Persons not subject to qualified dispositions.** – Notwithstanding the provisions of § 18-9.2-4, this chapter does not apply to defeat a claim brought by:

(1) Any person to whom the transferor is indebted on or before the date of a qualified disposition on account of an agreement or order of court for the payment of support or alimony in favor of the transferor's spouse, former spouse or children, or for a division of distribution of property in favor of this transferor's spouse or former spouse, to the extent of the debt; or

(2) To any person who suffers death, personal injury or property damage on or before the date of a qualified disposition by a transferor, which death, personal injury or property damage is at any time determined to have been caused in whole or in part by the act or omission of either the transferor or by another person for whom the transferor is or was vicariously liable.

Nevada- No exceptions.

NRS 166.120 Restraints on alienation.

1. A spendthrift trust as defined in this chapter restrains and prohibits generally the assignment, alienation, acceleration and anticipation of any interest of the beneficiary under the trust by the voluntary or involuntary act of the beneficiary, or by operation of law or any process or at all. An exception is declared, however, when the trust does not provide for the application for or the payment to any beneficiary of sums out of capital or corpus or out of rents, profits, income, earnings, or produce of property, lands or personalty. In such cases, the corpus or capital of the trust estate, or the interest of the beneficiary therein, may be anticipated, assigned or aliened by the beneficiary voluntarily, but not involuntarily or by operation of law or by any process or involuntarily at all. The trust estate, or corpus or capital thereof, shall never be assigned, aliened, diminished or impaired by any alienation, transfer or seizure so as to cut off or diminish the payments, or the rents, profits, earnings or income of the trust estate that would otherwise be currently available for the benefit of the beneficiary.

2. Payments by the trustee to the beneficiary **shall be made only to and into the proper hands of the beneficiary** and not by way of acceleration or anticipation, **nor to any assignee of the beneficiary, nor to or upon any order, written or oral, given by the beneficiary, whether such assignment or order be the voluntary contractual act of the beneficiary or be made pursuant to or by virtue of any legal process in judgment, execution, attachment, garnishment, bankruptcy or otherwise, or whether it be in connection with any contract, tort or duty.**

3. The beneficiary shall have no power or capacity to make any disposition whatever of any of the income by his order, voluntary or involuntary, and whether made upon the order or direction of any court or courts, whether of bankruptcy or otherwise; **nor shall the interest of the beneficiary be subject to any process of attachment issued against the beneficiary, or to be taken in execution under any form of legal process directed against the beneficiary or against the trustee, or the trust estate, or any part of the income thereof, but the whole of the trust estate and the income of the trust estate shall go to and be applied by the trustee solely for the benefit of the beneficiary, free, clear, and discharged of and from any and all obligations of the beneficiary whatsoever and of all responsibility therefore.**

4. The trustee of a spendthrift trust is required to disregard and defeat every assignment or other act, voluntary or involuntary, that is attempted contrary to the provisions of this chapter.

Past & Future Of

Alaska Trust

Legislation

Presented By:

02/20/2003 11:40 FAX 9072581649 ALASKA TRUST COMPANY 003

Legislation Passed Into Law 1997

HB 101 – Effective April 2, 1997

- Perpetual Trusts
- Self-Settled Spendthrift Trusts

HB 266 – Effective July 1, 1997

- Limited Partnership & LLC Improvements Statute

Legislation 1998

SB 354 – Effective April 12, 1998

- General Modernization of Trust and Estate Laws

HB 199 – Effective May 23, 1998

- Alaska Community Property Trust

HB 321 – Effective May 23, 1998

- Alaska Uniform Prudent Investor Act

HB 490 – Effective June 26, 1998

- Life Insurance Premium Tax

HB 222 – Effective March 8, 2000

- Improvements & Technical Changes to Limited Partnerships LLC Statute

SB 166 – Effective March 8, 2000

- Technical Changes to Alaska Community Property Trust

SB 162 – Effective April 22, 2000

- Modification to Perpetual Trust Statute

HB 275 – Effective August 9, 2000

- "Safety Net" Estate Planning Legislation

SB 163 – Effective August 30, 2000

- Modification and Improvement to General Trust Statutes

Why Alaska

- Personal
- Familiar with Alaska Statutes and Estate Planning Professionals
- Estate Planning Professionals wanted Institutions that would Specialize in Trust and Investment Management Services
- No State Income Tax On Trusts & Estates

Has It Been Successful?

Yes Yes Yes

Positive Developments

Alaska Has Become Known Throughout the Country for Being Creative and Innovative Regarding its Trust Laws. Alaska is Considered the Leading Jurisdiction for Trust Administration.

Alaska's 1st Independent Trust Company

- Has 7 full time employees; 5 are born & raised Alaskans
- Pays State Corporate Income Tax
- Annually puts hundreds of thousands of dollars into the Alaska Economy
- We have on deposit with local banks (Northrim & 1st Interstate) Tens of Millions of dollars
- Over 700 clients have come to Alaska from other states

Professionals in Alaska Have Benefited

- Attorneys have increased business both from outside clients and Alaska clients
- CPA'S have increased business
- Insurance agents
- Stock brokers
- Others

Alaskans have benefited directly from the legislation

Many Alaskans are taking advantage of the unique Trust & Estate Legislation

State Of Alaska

- Increase in Life Insurance Premium Taxes
  - Additional estimated 2001 Premium Tax of $700,000.00 directly related to Trust Legislation
- Increase Corporate Income Tax
- Increase revenue from LLC & LP filings
- Insurance Companies are considering opening up subsidiaries in Alaska

All This Has Happened in Less Than 5 Years With No Financial Outlay From the State

Why the Need to Have Additional Legislation

- Much of this Legislation is structured to meet IRS rules & guidelines. When IRS makes a change it may require a change in Alaska Statute to stay effective.
- Other states are trying to improve their Trust Laws. If they come up with a better approach we need to adjust in Alaska to stay effective.
- Fine tune legislation to make sure it is the best.

The Future Looks Very Bright for Alaska to Continue to Attract Business to the State. The Only Potential Problem Would Be the Implementation of an Income Tax on Trusts and Estates Set up by Non-Resident's.

The Implementation of Such a Tax Would Cause Alaska to Lose Within One Year 99% of the Business It Has Attracted. The Business Would Go to a State That Does Not Tax Non-Resident Trusts.

Thank You

For your prior involvement and hope for your continued support

Enact Beth's virtual representation bill

Amend AS 09.30.120(b)(3), to state that recognition of self settled trusts represent the strong public policy of this state. Truthfully an entire review of the Uniform Foreign Money-Judgments Recognition Act and the Uniform Enforcement of Foreign Judgments Act, as well as the Alaskan Supreme Court decisions under these acts should be undertaken to see if they can be tweaked. I think outright repeal would be impossible although only a minority of states have enacted these Acts, Alaska being one, and they are irrelevant to the extent that the U.S. Supreme Court has spoken. Personally I think they conflict with one another, as I don't see the possibility for a hearing, without the posting of a bond, under the Uniform Enforcement of Foreign Judgments Act.

Statute of limitations to bring action to enforce other state's judgments. Delaware enacted this statute.

Think about statutorily defining those items which constitute a badge of fraud and in the process eliminate the depletion of assets and one other badge that our Supreme Court has added to the language contained in the Uniform Fraudulent Transfer Act.

Provide a statute where an Alaskan court can substitute trustees change if trust attacked and a foreign court exercises jurisdiction over the Alaska trustee. I think this is suspect but Delaware has a similar statute.

Enact Rich's living probate bill.

Alaska Adopts a New Trust Law

The primary author of the legislation explains how it substantially improves creditor protection

By Stephen E. Greer, sole practitioner, Anchorage, Alaska

On July 10, Alaska Governor Frank Murkowski signed into law a new state trust bill that passed the 23rd Alaska legislature by unanimous vote.[1] The provisions of this bill improve creditor protection for third-party beneficiary trusts and self-settled trusts, further enhancing Alaska's desirability as a place to create and maintain trusts. The most dramatic change for third-party beneficiary trusts is the ability of a third-party beneficiary to serve as sole trustee and still be protected from creditor claims. Now, for the first time, a domestic self-settled trust law limits the class of creditors that can be considered "pre-existing creditors" with the right to an unlimited statute of limitations during which to bring a fraudulent conveyance action against a settlor. But there is a lot more to Alaska's new laws.

DYNASTY TRUSTS

Changes in the law for dynasty trusts are, in order of importance:

No need to worry now that a judge might order a distribution, which a creditor could then attach.

• **COURTS CANNOT COMPEL DISTRIBUTIONS OR ATTACH BENEFICIAL INTEREST.** One of the principle reasons for creating a dynasty trust is to provide creditor protection for third-party beneficiaries. Creditor protection is dependent on the protection given by a spendthrift clause and the law of the state where the trust administration occurs.[2] Alaska's spendthrift clause provides extremely powerful protection because it bars all creditors from attaching trust assets before payment or delivery of the assets to the beneficiary. This protection includes claims brought against a beneficiary by spouses for

support, ex-spouses for alimony, providers of necessities, tort creditors and claims for child support.[3] This protection continues as long as the assets remain in trust and ends when the trust assets are paid or delivered to the beneficiary.[4]

Previously, practitioners were concerned that an Alaska judge might circumvent this protection by ordering the trustee to make a distribution to the beneficiary, which then could be attached by a creditor. That worry was put to rest by a provision in the new state law stating that an attachment or other order may not be made against the trustee with respect to a beneficiary's interest held in trust.[5]

• BENEFICIARY CONTROL WITH NO LOSS IN PROTECTION. In many circumstances, a settlor would like to give a beneficiary as much control as possible, provided there is no loss in creditor protection. Toward this end, many settlors want the beneficiary to serve as the sole trustee. The trend in the law, however, is to treat a beneficiary serving as the sole trustee as having a limited form of ownership.[6] The *Restatement of the Law Third, Trusts* provides that when a beneficiary is appointed as the sole trustee, a claimant can reach the maximum amount that the beneficiary could distribute to himself.[7] The bill, in marked contrast to the Restatement, provides a spendthrift provision will be valid, even though the beneficiary is appointed the sole trustee.[8]

Now one can name a non-resident beneficiary as a co-trustee without compromising creditor protection.

If a beneficiary is appointed the sole trustee, the beneficiary's authority to make a trust distribution to himself must be limited to an ascertainable standard that relates to the beneficiary's health, education, maintenance or support, to avoid having the assets included in the beneficiary's taxable estate.[9] This restriction might place an unwanted ceiling on the level of distributions that can be made to the beneficiary. To get around it, the trust instrument could provide that the beneficiary, serving as a co-trustee, would have the authority to make distributions to himself that are limited to an ascertainable standard, while an Alaskan trustee, independent of the beneficiary within the meaning of Internal Revenue Code Section 672(c), would have the authority to make distributions to the beneficiary unrelated to this standard.

If the beneficiaries are not residents of Alaska, there should be a direct expression of intent that the administration of the trust occur in Alaska, and that there always be one trustee who is a "qualified person" as defined in Alaska Statutes 13.36.390(2).[10] Before the new Alaska law, creditor protection for non-residents could be achieved only by appointing an independent trustee with discretionary authority to make trust distributions. It is now possible to name a non-resident beneficiary as a co-trustee with distribution authority without compromising creditor protection.

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• MERE POSSESSION OF A GENERAL POWER OF APPOINTMENT DOES NOT EXPOSE THE ASSETS TO CREDITOR CLAIMS. In every large estate, it is possible that distributions will be made to subtrusts — which may or may not be exempt from generation-skipping transfer taxes. Because the estate tax is progressive, federal taxes payable at death often will be less if the assets in a non-exempt trust are exposed to estate tax at the beneficiary's death (rather than having the assets exposed to generation-skipping transfer tax). To accomplish this, a beneficiary in a non-exempt trust can be given a testamentary general power of appointment that will result in the trust assets being included in the beneficiary's estate tax base.

One of the most important provisions of Alaska's new law states that a beneficiary can have a general power of appointment and the assets subject to this power can not be attached by the beneficiary's creditors.[11] This protection exists regardless of whether the power of appointment is testamentary or presently exercisable.

The position of the *Restatement of the Law, Property Second* as it relates to both an unexercised testamentary general power of appointment and an unexercised but presently exercisable general power of appointment, is that the appointive assets cannot be subjected to the claims of a beneficiary's creditors, unless provided by statute.[12] The theory is that until the donee exercises the power, he has not accepted enough control over the appointive assets to confer the equivalent of ownership.[13] If a beneficiary exercises a testamentary or a presently exercisable general power of appointment, the appointive assets can be reached by creditors.[14] Nonetheless, mere possession of a power of appointment, potentially exercisable in favor of a donee's creditors, is considered a general power of appointment under Treasury Regulations Section 20.2041-1(c).

This provision is also important in any trust that has given a beneficiary a Crummey withdrawal right. The *Restatement of the Law Third, Trusts* considers a beneficiary with a Crummey right to be the owner of the property over which the rights could be exercised, thus exposing the trust to creditors' claims.[15] In Alaska, a beneficiary can have a Crummey withdrawal right and the trust assets can be protected from creditors' claims.

> Alaska has corrected a major defect common in self-settled laws. It now provides a definition for a "pre-existing creditor."

• USE PROVISIONS RESPECTED. A use provision allows a trustee to make trust assets available to the beneficiary. The new Alaska law states that property may be made available for the use of a beneficiary without being considered a distribution, thus insulating the trust assets from the claims of a beneficiary's creditors.[16]

• TRUST PROTECTORS AND TRUST ADVISORS ARE NOT CONSIDERED FIDUCIARIES. No doubt better creditor protection can be achieved where an independent trustee is given the discretionary authority to make distributions. A frequent objection to this arrangement is the corresponding lack of control that a beneficiary will have over the trust assets. To minimize this concern, settlors often give a trust protector the power to remove and replace the trustee. In the absence of state law to the contrary, however, a court could consider the trust protector a fiduciary, thus decreasing the possibility of finding someone willing to take on the trust protector role. The new Alaska law states that a trust protector will not be held accountable as a fiduciary.[17]

Additionally, a settlor might appoint a trust advisor who is personally knowledgeable about the beneficiary's circumstances to assist a corporate trustee. The appointment of an advisor greatly improves the chances of fulfilling the settlor's purpose. The new Alaska law states that an advisor will not be held accountable as a fiduciary.

SELF-SETTLED TRUSTS

Many of the protections applicable to third-party beneficiary trusts also apply to self-settled trusts. But the new law contains some very important changes that apply exclusively to self-settled trusts. In order of importance, they are:

• CORRECTION OF MAJOR DEFECT IN SELF-SETTLED LEGISLATION. The new Alaska law remedies a substantial defect contained in all other domestic self-settled trust legislation: the lack of a definition for a "pre-existing creditor." In all domestic self-settled jurisdictions, a "pre-existing creditor" has the benefit of what is essentially an unlimited statute of limitations to set aside a transfer of assets as a fraudulent conveyance.[18] A pre-existing creditor has an undefined period of time to make a fraud claim because the creditor might not reasonably discover the transfer of assets to a trust until many years afterwards.

Consider this example: A doctor,

unaware of any patient complaints, transfers property to a self-settled trust. Subsequent to the transfer, a patient who was seen prior to the transfer alleges he was negligently misdiagnosed. Should this patient be considered a "pre-existing creditor" even though the patient's claim was unknown to the doctor at the time the doctor transferred assets to the trust? If so, the patient would be allowed an unlimited period of time in which to assert a claim that the settlor's transfer in trust was fraudulent and to have the transfer in trust set aside. As a result, no doctor, no contractor or, for that matter, no individual who has ever been engaged in business for any length of time, could ever completely discount the possibility of a "pre-existing creditor" successfully attacking the trust.

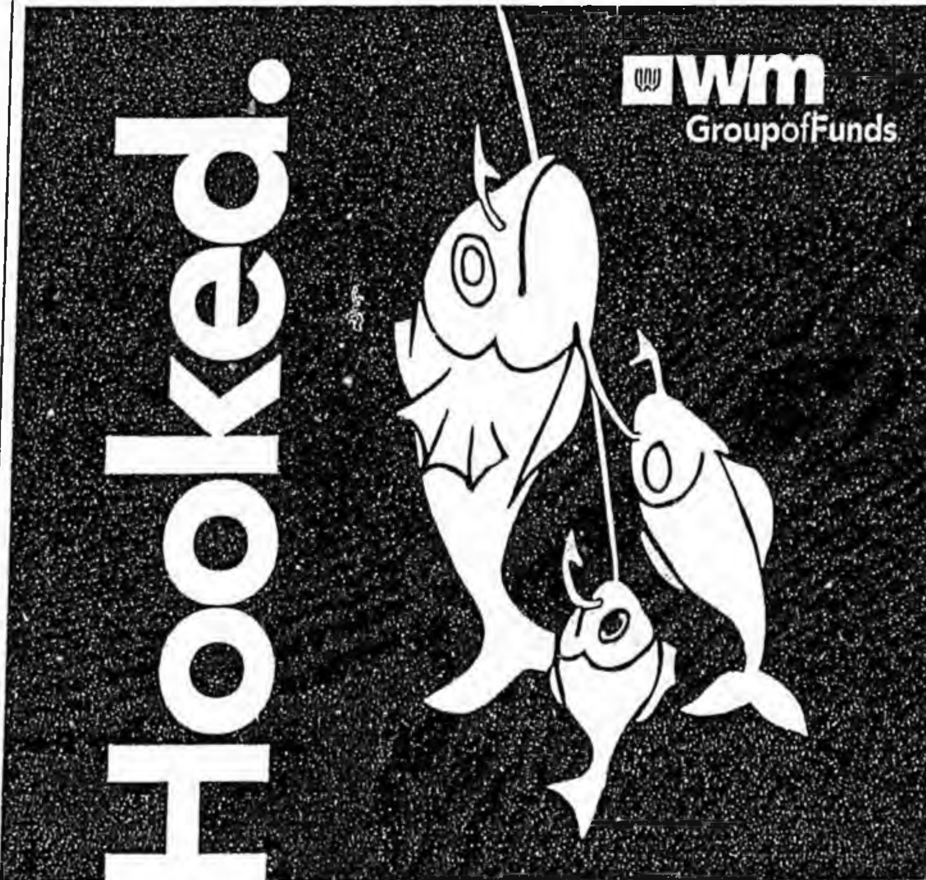
The new Alaska law defines a "pre-existing creditor" as one who either:

- demonstrates, by a preponderance of the evidence, that he asserted a specific claim against the settlor before the settlor transferred assets to the trust; or
- within four years after the settlor transferred assets to the trust, files an action in court against the settlor asserting a specific cause of action based on an act or omission (for instance, a negligent surgery) that occurred before the transfer.

• TIGHTENING THE DEFINITION OF A FRAUDULENT CONVEYANCE. Before the new Alaska law was enacted, a transfer to a self-settled trust could be set aside if the creditor proved a transfer in trust was "intended in whole or in part, to hinder, delay, or defraud."[9] Unfortunately, that open language gave creditors a huge arsenal with which to attack a trust.

By its very nature, a self-settled trust is meant "to hinder or delay" a creditor. The term "hinder or delay" is contained in Section 4 of the Uniform Fraudulent Transfer Act that has been adopted by Delaware, Nevada, Rhode Island and Utah.[10] The problem created by the phrase "hinder or delay" surfaced in the recent Wyoming case of *Breitenstine v. Breitenstine.*[11] In that case, the state Supreme Court said: "Our case law indicates that an 'intent to hinder or delay creditors' is enough to consider the conveyance fraudulent even if there was no actual fraud."

Alaska has solved this problem by deleting the two phrases "in whole or in part" and "hinder or delay" from its statute. A settlor's transfer of property in trust can now be set aside only if a creditor can prove the transfer was made with an



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"intent to defraud that creditor."

• **NEW AFFIDAVIT REQUIREMENT.** It is common practice for an attorney to require an affidavit from a settlor of a self-settled trust stating the conveyance is not fraudulent as to any creditor. Alaska now requires the settlor to sign a sworn affidavit containing specific provisions before the settlor transfers assets to the trust.[13] As a result, the chance of a fraudulent conveyance has been reduced; the affidavit also provides additional protection to the attorney who drafts the trust.

• **PROTECTION OF CRTS, INCLUDING UNITRUSTS WITH NON-CHARITABLE REMAINDER BENEFICIARIES.** Various other provisions in the new Alaska law duplicate provisions of Delaware's Qualified Dispositions in Trust Act. The most important of these allow a settlor to protect an annuity or unitrust interest that has been retained in a charitable remainder trust.[14] In addition, a settlor may create a self-settled trust and protect the retention of a unitrust interest, provided the unitrust amount does not exceed the maximum that may be stated as income under Alaska's newly amended Principal and Income Act or under IRC Section 643(b).[15]

• **PRESERVATION OF A DISTINCTION IN ALASKA LAW.** What remains unchanged is a very important distinction contained in Alaska law that is not found in the self-settled trust legislation of Delaware and Utah. In Alaska, no creditor of the settlor (not a child support agency, a spouse, nor an ex-spouse) is able to reach any of the trust assets.[16] Completed gift treatment is dependent upon a determination that no creditor is able to satisfy its claim out of the trust assets. Herein lies the ability of a settlor in an Alaskan self-settled trust to make a completed gift that is not theoretically possible in Delaware or Utah. In each of those other states, specified creditors who come into existence after the trust is established can have their claims satisfied out of the trust.[17] Because a transfer of assets in a self-settled trust in those states must be viewed as an incomplete gift, the trust assets are still part of, and thus must be included in, the settlor's gross estate.[18]

Admittedly, Alaska requires that a settlor cannot be delinquent in a child support obligation when the trust is settled. The status of these obligations, however, can be determined easily when the trust is settled. As the new Alaska law made its way through the legislative process, the Child Support Enforcement Division wanted a child-support exception for claims that arose after the trust was settled. Ultimately the legislature agreed that the ability of a settlor to make a completed gift was an important attribute to maintain, and that spendthrift protection should be effective against all creditors who arise subsequent to the establishment of the trust.

STAY TUNED

Preserving wealth during life and moving it forward in a manner that can benefit future generations should be the goal of every estate planner. As reflected by the new trust law, Alaska is in the vanguard of a growing list of states that has embraced these dual objectives. The question remains: What will Alaska do next?

Endnotes

1. The bill may be found at *http://www.legis.state.ak.us/pdf/23/Bills/HB0212B.PDF*
2. *Restatement Second,* Conflict of Laws Section 273.
3. The spendthrift statute applies equally to third-party beneficiary trusts and self-settled trusts, see AS 34.40.110 (a), (h).
4. Ibid.
5. AS 34.40.110(c)
6. *Restatement Third,* Trusts Section 60, cmt g.
7. Ibid.
8. AS 34.40.110(h)
9. Treas. Reg. 20-2041-1(c)
10. AS 13.36.035(c)
11. AS 34.40.115. Rhode Island has a similar statute, see R.I. Gen. Laws Section 34-22-13
12. *Restatement, Property Second,* Donative Transfers Section 13.2 (1986)
13. Ibid.
14. Ibid. Sections 13.4, 13.5, see AS 34.40.115
15. *Restatement Third,* Trusts Section 58, cmt. f(1), ex. 11. The concept of ownership in the *Restatement Third,* Trusts, is in contrast to the *Restatement* Second Property: Donative Transfers Section 13.2 (1986).
16. AS 34.40.110(a)
17. AS 13.36.370
18. See Del. Code Ann. title 12 Section 3572 (b)(1); NRS Section 166.170; Rhode Island Gen Laws Section 18-9.2-4 (b); Utah Code Ann. Section 25-6-14 (4)(a)
18. AS 34.40.110(d)
19. AS 34.40.110(b)
20. Del. Code Ann. title 6 Section 1304(a)(1); NRS 112.180(1)(a); Rhode Island Gen. Laws Section 6-16-4 (a)(1); Utah Code Ann. Section 25-6-14(2)(c)(i).
21. 2003 WY 16, 62 P.3d 587, paragraph 18 (Wyo. Jan. 30, 2003)
22. AS 34.40.110(k), which has prospective application only.
23. AS 34.40.110(b)
24. AS 34.40.110(b)
25. See PLR 9837007, Treas. Reg. 25.2511-2; Rev. Rul. 76-103, 1976-1 C.B. 293; *Paolozzi v. Commissioner,* 23 T.C. 182 (1954); *Commissioner v. Vander Weele,* 254 F.2d 895 (6th Cir. 1958); *Estate of German v United States,* 7 Cl. Ct. 641 (1985)
26. Del. Code Ann. title 12 § 3573 (2) allows trust assets to be attached to satisfy a claim for child support or alimony. Utah Code Ann. Section 25-6-14(2)(c)(vii) allows trust assets to be attached in satisfaction of a claim or tax of the state or its political subdivisions.
27. An argument has been advanced by Richard W. Nenno and W. Donald Sparks, II, in Schurig and Osborne, *Asset Protection: Domestic and International Law and Tactics* (West Group, 1995), Section 14A:126 which claims the statutorily authorized exceptions in Delaware law are "acts of independent significance" which do not produce an adverse transfer tax result.

HOUSE COMMITTEE REPORT

(7)
Date Referred to Committee: March 26, 2003 **FURTHER REFERRALS: Finance**

Date of Committee Action: April 4, 2003

The JUDICIARY Committee considered: **HB 212**

HOUSE BILL NO. 212 **POWERS OF APPOINTMENTS/TRUSTS/CREDITORS**

"An Act relating to trusts, including trust protectors, trustee advisors, transfers of property in trust, and transfers of trust interests, and to creditors' claims against property subject to a power of appointment."

Recommends it be replaced with [ ] HCS *or* **[X] CS** *for* HB 212 (JUD)
For Senate Bills with new title: [ ] Technical Title [ ] New Title: HCR_______ **[ ] Same Title [ ] New Title**

[ ] attach amendments
[ ] add new referral to ___________Committee
[ ] Letter of Intent__________Committee

List of Abbrev for Depts.:
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DPS
REV
DOT
UA

***NEW* FISCAL NOTES**
*Assigned by Chief Clerk's Office

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

***PREVIOUS* FISCAL NOTES**

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

Signing with recommendations	Printed Last Name	DP	DNP	NR	AM
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[signature]	Holm			✓	
[signature]	Gara	✓			
[signature]	Ogg	✓			
[signature]	Gruenberg	✓			
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Sponsor Statement
HB 212

"An Act relating to trusts, including trust protectors, trustee advisors, transfers of property in trust, and transfers of trust interests, and to creditor' claims against, property subject to a power of appointment."

Alaska was once in the lead in development of trust law. However, since that time other states have not only enacted similar legislation but have improved on it. Delaware has amended in statute six times since the date of enactment. The last time we amended our trust statutes and in particular our spendthrift statute was in 1998 and as a result, our laws are viewed as being deficient in many respects. This not only places our trust companies in an uncompetitive position but also places Alaska residents at a disadvantage when compared to the citizens of our competitor states. This bill rectifies many of these shortcomings.

This bill provides statutory authority to provisions commonly found in trust instruments. For instance, Section 1 of the bill specifically provides for the position of a trust advisor and trust protector and clarifies the manner in which these positions relate to the administrations of a trust. Delaware, South Dakota, and Idaho has similar legislation. Many trust instruments allow a trustee to make trust assets available for the use of a beneficiary. Section 2 allows trusts assets consisting of real property and tangible personal property to be used by a beneficiary without the use being considered a distribution which could in turn be subjected to the claims of a beneficiary's creditors. For example, a trustee could exercise its discretion and permit a beneficiary to reside in a family home. Were it not for this provision, the settlor's intention that a family homestead be made available for future generations might be defeated.

Other sections contained in the bill codify a number of matters which have always been accepted by Alaska trust practitioners as being the common law of this state, but for which there has been no statutory counterpart. Section 4 provides that trust assets can not be attached by a beneficiary's creditor until such time that trust assets are actually distributed to a beneficiary, no can there be a continuing order against the trustee with respect to future distributions that a trustee would choose to make. Section 6 adds a new subsection (i) to AS 34.30.110, which clarifies that the statute affording spendthrift protection for beneficial interests applies not only to trusts in which a settlor may have a

retained interest, but also to the very common third party settled trust where a beneficiary might be serving as sole trustee.

Sections 3, 5, and 6 make amendments or add subsections to AS 34.40.110, which will assist a future court in the interpretation of our spendthrift statute, something an Alaska court has yet to do. Section 3 clarifies that a trust can be set aside only if a creditor is able to successfully assert by a preponderance of the evidence that the settlor's transfer of property in trust was made with the primary intent to defraud that creditor. In so doing, the finder of fact must weight all the circumstances surrounding the transfer before making that determination. Section 5 clarifies that a fraudulent conveyance action may only be brought against a settlor of a trust and then only as to a specific transfer of assets that are determined to be fraudulent as to that creditor. Section 5 also clarifies the definition of preexisting creditors who can avail themselves during the time period found in AS 34.40.110(d)(1) by bringing a fraudulent conveyance action against the settlor of a self-settled trust. Subsection (h) as found in Section 6 provides a transfer restriction will be valid with respect to a beneficial interest retained by a settlor even though the settlor serves as a co-trustee, provided the settlor doesn't have control over the manner in which distributions may be make to the settlor. Subsection (k) invalidates any unwritten agreement or understanding between a settlor who is a beneficiary and a trustee that gives the settlor rights greater than those that are permitted to be expressed in the trust instrument.

Lastly, there are several provisions contained in this bill that have their counterpart in the laws of other states. Section 3 provides the circumstances in which a transfer restriction will continue to be valid even though a settlor retains a unitrust or annuity interest in the trust. These provisions presently exist in Delaware. Section 7 of the bill clarifies when property subject to a power of appointment can be subjected to the claims of a donee's creditors and codifies the common law as enunciated in the Restatement 2nd of Property and has its genesis in a comparable Rhode Island statute. All the provisions found in this bill are necessary additions not only if Alaska expects our trust industry to remain competitive with other states, but also if Alaska residents are to have the benefits comparable to those of citizens in other states.

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House District 28

Sectional Analysis
HB 212

"An Act relating to trusts, including trust protectors, trustee advisors, transfers of property in trust, and transfers of trust interests, and to creditor' claims against, property subject to a power of appointment."

Section 1:
AS 13.36.370 adds a new provision commonly found in trust instruments concerning the role of the disinterested trust protector. South Dakota, Delaware, and Idaho also have a statutory framework delineating a trust protector's authority. It is fully within the settlor's discretion as to whether or not there will be a trust protector. If a settlor does not want a trust protector there will be no trust protector. Furthermore, a trust protector will only have those powers that the settlor grants the trust protector. An irrevocable trust containing a trust protector provision provides flexibility to take into account changed circumstances.

For instance, suppose a settlor creates a trust for the benefit of a child and names a friend to act as trustee. Subsequently it is discovered that the trustee is not using the trust assets for the benefit of the beneficiary in the manner in which the settlor had originally intended. Unless the trustee voluntarily resigns, it could require an expensive court proceeding to remove and replace the trustee. However, if there is a trust protector who has the authority to remove and replace an existing trustee, the trustee could be replaced without the necessity of a court proceeding. Another example of where a trust protector might be valuable is when there is an unforeseen change in tax laws. For instance, if the estate tax is permanently repealed, certain provisions of existing trusts might be unnecessary or undesirable. If the settlor so provided, a trust protector could amen the trust and eliminate an otherwise undesirable provision in the trust.

Notwithstanding the foregoing, a trust protector is not permitted to change the beneficial interest of the State in a Miller trust.

In addition, AS 13.36.375 adds a new provision commonly found in trust instruments concerning the role of a trustee advisor. This provision is commonly found where a settlor appoints an institution as the trustee to handle the investing and administrative functions but wants to appoint a family friend, who is aware of the beneficiary's needs, to advise the trustee when trust distributions may or may not be appropriate. This section states the advisor will not be held accountable as a trustee for rendering or failing to render advice to the trustee.

Section 2:

A "use" provision is commonly found in trust instruments and allows a trustee to make trust assets available for the use of a beneficiary. This section amends AS 34.40.110(a) by stating that property may be made available for the use of a beneficiary without the use being considered a distribution that could possibly expose the trust assets to the claims of a beneficiary's creditors. Furthermore, the original owner can be assured that important family assets such as heirlooms and a vacation home may be maintained by the family and that their use can be made available for future generations.

Section 3:

AS 34.30.110(b)(1) is amended to provide that a transfer restriction can be disregarded only if a creditor proves by a preponderance of the evidence that the settlor's primary intent in making the transfer was to defraud the settlor's creditors. This section eliminates ambiguous language such as "hinder and delay." It also eliminates meaningless language such as "other persons," which is meaningless in the sense that the only class of persons who could possibly be defrauded by a settlor transferring property into trust is creditors of that settlor.

This section was also amended to clarify that it must be first determined that the primary intent of the settlor in creating a trust was to defraud a creditor before the transfer in trust can be set aside as a fraudulent conveyance. Adding the word "primary" to this section provides judicial guidance heretofore missing. Because a settlor will rarely admit to actually intending to defraud a creditor, courts typically consider factual circumstances constituting "badges of fraud" to infer fraud. For instance, a transfer to an insider (as would be the case of any gift to a family member) is considered a badge of fraud under Section 4(b) of the Uniform Fraudulent Transfer Act. Unfortunately, this might be enough for a court to infer fraud. This lack of statutory guidance could lead to a very arbitrary and capricious finding that the mere existence of a singular "badge of fraud" renders the entire transfer fraudulent. The use of the word "primary" make it necessary for the finder of fact to weight all the circumstances surround the transfer. Only if a creditor is able to prove by a preponderance of the evidence that the primary intent of the settlor was to defraud that creditor can the transfer in trust be set aside.

AS 34.40.110(b)(3) is amended to provide a transfer restriction will continue to be valid with respect to an annuity or unitrust interest retained by a settlor provided the remainder interest is given to a public charity. In addition, a settlor may also retain an annuity or unitrust interest irrespective of whether the remainder interest is designated to charity provided the annuity or unitrust interest does not exceed the amount set forth as "income" under the Alaska Principal and Income Act or under the Internal Revenue Code. A similar statute is found in Delaware.

Section 4:

AS 34.40.110(c) is amended to provide that a creditor of a beneficiary may not attach trust assets while the assets remain in trust if the beneficial interest is subject to a valid transfer restriction. In addition, this provision is meant to assure the settlor that trust assets can not be subjected to the claims of a beneficiary's creditor until such time that trust assets have actually been distributed to the beneficiary. Furthermore, this section provides that no attachment or other order may be made against a trustee by a creditor with respect to a beneficial interest which

might compel the trustee to make a future distribution to a creditor in lieu of making a distribution directly to the beneficiary.

Section 5:

This section clarifies that only a creditor of a settlor can bring a fraudulent conveyance action with regard to a transfer of assets to a trust and only in regard to a specific transfer of assets by a settlor to the trust. A third party beneficiary's creditor can not set aside a transfer when the property was originally that of a settlor and not that of the third party beneficiary. On the other hand, where the settlor is retained as a beneficiary under the terms of the trust, a creditor can bring a fraudulent conveyance action because in this case the settlor is also a beneficiary.

AS 34.40.110(d) sets forth a prescribed period of time in which a fraudulent conveyance action must be brought depending on whether the creditor is a preexisting creditor or a subsequent creditor.

A preexisting creditor (i.e., a creditor who was in existence prior to the settlor transferring property in trust) must bring the fraudulent conveyance action within the later of four years after the transfer of a settlor's assets is made or one year after the transfer is or reasonably could have been discovered by the creditor. A subsequent creditor must bring the fraudulent conveyance within four years after the transfer of a settlor's assets is made.

A preexisting creditor has what is essentially an unlimited statute of limitations period to bring a fraudulent conveyance action because it can be brought within one year after the transfer is or reasonably could have been discovered. A creditor might not reasonable discover the transfer in trust until such time that the creditor has first reduced the action to judgment and conducted a judgment debtor examination. The problem with the statute as it now stands is that the term "preexisting creditor" is not defined. Consider a doctor who performs an operation and thinks all went well with the operation, engages in estate planning and transfers property in trust. At a later point in time the patient has complications and asserts that the doctor was negligent. Should this patient be considered a "preexisting creditor" even thought the patient never asserted a claim against the doctor prior to the doctor transferring assets to the trust? What about the engineer or architect who builds a bridge which falls down 20 years later. Is the plaintiff to be considered a "preexisting creditor"? If so, then no one who has been in business for any length of time could ever safely create a trust or otherwise engage in estate planning without risking the possibility that a transfer in trust might later be set aside, even though the "preexisting creditor" might be unknown to the settlor. Nonetheless, there comes a point in time when every doctor and every engineer should be able to arrange their estate planning affairs like anyone else and have the assurance that at some point in time it will not be undone. This bill attempts to provide that assurance but does so in a manner that balances the legitimate rights of the settlor's creditors.

Thus, it is important that the statute define a "preexisting creditor." A "preexisting creditor" is defined as one who either

(1) demonstrates, by a preponderance of the evidence, that they asserted a specific claim against the settlor before the settlor transferred assets to the trust; or

(2) within four years after the settlor transferred assets to the trust, files an action in court against the settlor which asserts a specific cause of action based on an act or omission of the settlor that occurred before the transfer of assets to the trust.

Section 6:

This section adds a number of sections to existing law that clarify that an otherwise valid transfer restriction will not be invalidated even though:

(h) a settlor who is also a beneficiary is serving as a co-trustee or advisor to the trustee provided the settlor does not have a trustee power over discretionary distributions;

(i) a beneficiary of a third party settled trust is serving as sole trustee of the trust, a co-trustee or as an advisor to the trustee; or

(j) a settlor is given the authority to appoint a trust protector or a trust advisor.

Subsection (k) invalidates any unwritten agreement or understanding between a settlor, who is being retained as a beneficiary, and the trustee, which attempts to give the settlor rights greater than those that are permitted to be expressed in the trust instrument.

Section 7:

This section codifies the common law as now found and enunciated in the Restatement 2nd of Property, by adding a new section AS 34.40.115. This section states that assets subject to a power of appointment, whether a non-general power of appointment or a presently exercisable or testamentary general power of appointment, cannot be subjected to the claims of the donee's (holder's) creditors. The legal theory behind this statute is that until the donee exercises the power, the donee has not accepted control over the appointive assets that give the donee the equivalent of ownership. This statute provides that only until a testamentary or a presently exercisable general power of appointment is actually exercised, can the appointive assets be subjected to the payment of claims which a creditor might have against the donee of the power of appointment. This statute is taken from a similar statute in Rhode Island.

Section 8:

This section contains the effective dates.

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March 30, 2003

VIA E-MAIL AND FAX

Representative Lesil McGuire
Juneau, Alaska

Re: The Trust Bill

Dear Representative McGuire:

I am writing with regard to the Trust Bill. As you know, the bill amends both AS 13.36 and AS 34.40. I am in favor of both amendments. My reasons are as follows:

Amendment to AS 13.36. I favor codifying the positions and listed powers of trust protectors and trust advisors because of the flexibility they add to trusts. If there is no built-in flexibility the beneficiaries and trustees inevitably end up in court grappling with issues unforeseen at the time the trust was created. I also favor the default rule that neither the trust protector nor trust advisor have fiduciary duty. Clients often name close family friends and advisors as trust protectors and trust advisors, recognizing that they would not be able to serve if they were held to the highest (fiduciary) standard of care.

Amendment to AS 34.40. I favor the amendments to AS 34.40 because they bring much-needed clarification to the section.

I am grateful for your attention to this matter.

Sincerely yours,

HOMPESCH & EVANS
A Professional Corporation

Susan L. Evans

SLE/

FISCAL NOTE

STATE OF ALASKA
2003 LEGISLATIVE SESSION

Fiscal Note Number:
Bill Version: HB 212
() Publish Date:

Revision Date/Time (Note if correction):
Title "An Act relating to trusts, including trust protectors, trustee advisors, transfers of property in trust, . . ."
Sponsor Representative McGuire
Requester House Labor and Commerce Committee

Dept. Affected: Law
BRU Civil Division
Component Commercial
Component No. 2211

Expenditures/Revenues (Thousands of Dollars)

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

OPERATING EXPENDITURES	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009
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)

Fund Source	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009
1002 Federal Receipts						
1003 GF Match						
1004 GF						
1005 GF/Program Receipts						
1037 GF/Mental Health						
Other (Specify Type–Do not abbreviate)						
TOTAL	0.0	0.0	0.0	0.0	0.0	0.0

Estimate of any current year (FY2003) cost: 0.0

Check this box (X) if funding for this bill is included in the Governor's FY 2004 budget proposal: [ ]

POSITIONS

Positions	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009
Full-time						
Part-time						
Temporary						

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

HB 212 provides for the appointment of a trust protector and a trust advisor. The bill also prevents creditors of beneficiaries from attaching assets transferred into a trust unless certain conditions are met by all parties, and establishes a statute of limitations regarding when creditors must bring an action for a fraudulent transfer claim.

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

Prepared by: Joan M. Kasson
Division: Attorney General's Office
Phone: (907) 465-5370
Date/Time: 3/28/03 2:45 PM

Approved by: Joan M. Kasson for Gregg D. Renkes, Attorney General
Agency: Department of Law
Date: 3/28/2003

(Revised 9/2002 OMB)