SB
163

ALASKA STATE SENATE

Session:
State Capitol
Juneau, Alaska 99801-1182
(907) 465-2327
(907) 465-5241 Fax

Interim:
119 N. Cushman, Suite 201
Fairbanks, Alaska 99701
(907) 456-8161
Senator_Ralph_Seekins@legis.state.ak.us

Senator Ralph Seekins
District D

SB 163 Sponsor Statement

In 1997 legislation was passed making Alaska one of the best trust jurisdictions nationwide. This legislation made two significant changes to existing law:

1. Provided that an individual could set up a trust and have the trust last as long as the family wanted. This is known as a Perpetual Trust; and,

2. Provided that an individual could set up a trust where he or she could be a beneficiary and have the trust's assets protected from future creditors. This is known as a Self Settled Spendthrift Trust.

Over the last six years the states of Delaware, Rhode Island and Nevada have not only adopted similar legislation but also incorporated improvements to certain provisions. States such as Idaho and South Dakota have also added features to their general trust laws that now make them comparatively advantageous. Senate Bill 163 places Alaska Trust legislation back on an equal footing with these states.

Additionally, Senate Bill 163 codifies a number of matters that have been accepted by Alaska trust practitioners as being the common law of this state but for which there has been no statutory counterpart. The Bill essentially updates and clarifies provisions of prior legislation.

Overall, these changes are designed to keep Alaska as the premier trust jurisdiction thereby not only retaining financial resources in-state, but also continuing to attract non-resident trust assets to Alaska.

23-LS0774\I
Bannister
4/10/03

CS FOR SENATE BILL NO. 163(JUD)

IN THE LEGISLATURE OF THE STATE OF ALASKA

TWENTY-THIRD LEGISLATURE - FIRST SESSION

BY THE SENATE JUDICIARY COMMITTEE

Offered:
Referred:

Sponsor(s): SENATOR SEEKINS

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

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

* Sec. 3. AS 34.40.110(b) is amended to read:

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

(1) the settlor's transfer of property in trust was made with the intent [INTENDED IN WHOLE OR IN PART] to [HINDER, DELAY, OR] defraud that creditor [CREDITORS OR OTHER PERSONS UNDER AS 34.40.010];

(2) the trust provides that the settlor may revoke or terminate all or part of the trust without the consent of a person who has a substantial beneficial interest in the trust and the interest would be adversely affected by the exercise of the power held by the settlor to revoke or terminate all or part of the trust; in this paragraph, "revoke or terminate" does not include a power to veto a distribution from the trust, a testamentary nongeneral [SPECIAL] power of appointment or similar power, or the right to receive a distribution of income, principal [CORPUS], or both in the discretion of a person, including a trustee, other than the settlor, or a right to receive a distribution of income or principal under (3)(A) or (B) of this subsection;

(3) the trust requires that all or a part of the trust's income or principal, or both, must be distributed to the settlor; however, this paragraph does not apply to a settlor's right to receive

(A) income or principal from a charitable remainder annuity trust or charitable remainder unitrust; in this subparagraph, "charitable remainder annuity trust" and "charitable remainder unitrust" have the meanings given in 26 U.S.C. 664 (Internal Revenue Code) as that section reads on the effective date of this bill section and as

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 a sworn 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;

13 (7) the settlor does not contemplate filing for relief under the
14 provisions of 11 U.S.C. (Bankruptcy Code); and

15 (8) the assets being transferred to the trust were not derived from
16 unlawful activities.

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

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

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

25 (2) effectively exercises the power of appointment in favor of the
26 donee, the creditors of the donee, the donee's estate, or the creditors of the donee's
27 estate.

28 * **Sec. 8.** The uncodified law of the State of Alaska is amended by adding a new section to
29 read:

30 APPLICABILITY. (a) Except as provided by (b) of this section, this Act applies to a
31 trust regardless of whether the trust was created before, on, or after the effective date of the

1 applicable section of this Act.

2 (b) AS 34.40.110(k), enacted by sec. 6 of this Act, applies to a trust only if the trust is

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

FISCAL NOTE

STATE OF ALASKA
2003 LEGISLATIVE SESSION

Fiscal Note Number:
Bill Version: SB 163
() 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 Senator Seekins
Requester Senate Judiciary 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)*

SB 163 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
Phone (907) 465-5370
Division Attorney General's Office
Date/Time 4/14/03 10:37 AM
Approved by: Kathryn Daughhetee for Gregg D. Renkes, Attorney General
Date 4/14/2003
Agency Department of Law

(Revised 9 2002 OMB)

Subject: SB 163
Date: Wed, 09 Apr 2003 17:56:08 -0800
From: "Stephen E. Greer" <greer@ak.net>
To: Brian Hove <Brian_Hove@legis.state.ak.us>

Brian- this should be easy. Looking at the Senate Bill, delete "primary" on p. 3 line 12.

Section 6 adds a new subsection (k), as indicated in the House bill. I have faxed this to you.

Section 8 of should be changed as indicated in the House bill. I have faxed this to you.

--
Stephen E. Greer, Esq.

P.O. Box 24-2903
Anchorage, AK 99524-2903
ph. (907) 561-5520/ fax (907) 563-5020

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Sectional Analysis

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 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 which the settlor grants the trust protector. A 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 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 unforseen change in the tax law. 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 amend 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 **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 property may be made available for the use of a beneficiary without the use being considered a distribution which 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 so its use can be made available for future generations.

Section 3. AS 34.40.110(b)(1) is amended to eliminates ambiguous language such as **A**hinder and delay.@ It also eliminates meaningless language such as **A**other persons.@ Meaningless in the sense that the only class of persons who could possibly be defrauded by a settlor transferring property

into trust are creditors of that settlor.

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 that amount set forth as Aincome@ under the Alaska Principal and Income Act or under the Internal Revenue Code. A similar statute is found in Delaware.

Section 4 amends AS 34.40.110(c) to provide 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 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 fraudulent conveyance action can be brought by a creditor 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 must be brought within the later of

(A) four years after the transfer of a settlor=s assets is made; or

(B) one year after the transfer is or reasonably could have been discovered by the creditor.

A subsequent creditor must bring the fraudulent conveyance action 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 reasonably 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 the term Apreexisting 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 the doctor was negligent. Should this patient be considered a Apreexisting creditor@ even though 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 pre-existing 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 Apre-existing 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 can 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 adds a number of sections which clarify that an otherwise valid transfer restriction will not be invalidated even though:

(g) 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. Furthermore subsection;

(h) 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;

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

(j) 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 which are permitted to be expressed in the trust instrument.

(k) a settlor of a self settled trust must sign an affidavit stating those items mentioned in the bill before transferring assets to the trust.

Section 7 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 it be 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 gives 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.

Sections 8 contains effective dates.

Sponsor Statement

Alaska once led the nation in the development of trust law. However since that time other states have not only enacted similar legislation but have improved on it. Delaware has amended its statute six times since enacting its trust legislation. The last time we amended our trust statutes and in particular our spendthrift statute was in 1998 and as a result, our laws are now 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 example, 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 administration 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 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, nor can there be a continuing order against the trustee with respect to future distributions that a trustee would choose to make.

Sections 3, 5 and 6 make amendments or adds 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 intent to defraud that creditor. Section 5 clarifies a fraudulent conveyance action may only be brought against a settlor of a trust and then only as to a specific transfer of assets which are determined to be fraudulent as to that creditor. This section also clarifies the definition of a preexisting creditor who can avail themself of the time period found in AS 34.40.110(d)(1) for bringing a fraudulent conveyance action against the settlor of a self-settled trust. 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 made to the settlor. Section 6 adds a new subsection (h) to AS 34.40.110 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 in the very common third party settled trust where a beneficiary might be serving as sole

trustee, co-trustee or an advisor to the trustee. Section 6 invalidates any unwritten agreement or understanding between a settlor who is a beneficiary and a trustee which gives the settlor rights greater than those which are permitted to be expressed in the trust instrument. Lastly, Section 6 adds an affidavit requirement wherein the settlor of a self settled trust must sign a sworn affidavit stating those items indicated in the bill prior to making a transfer of assets into the trust.

Finally, there are several provisions contained in this bill which 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 benefits comparable to those of citizens in other states.

LEGAL SERVICES

DIVISION OF LEGAL AND RESEARCH SERVICES
LEGISLATIVE AFFAIRS AGENCY
STATE OF ALASKA

(907) 465-3867 or 465-2450
FAX: (907) 465-2029
Mail Stop 3101

State Capitol
Juneau, Alaska 99801-1182
Deliveries to: 129 6th St., Rm. 329

MEMORANDUM April 8, 2003

SUBJECT: Sectional summary of SB 163 (Work Order No. 23-LS0774\H)

TO: Senator Ralph Seekins
Attn: Brian

FROM: Theresa L. Bannister
Legislative Counsel

You have requested a sectional summary of the above-described bill. As a preliminary matter, note that a sectional summary of a bill should not be considered an authoritative interpretation of the bill and the bill itself is the best statement of its contents.

Section 1. Establishes two new sections relating to trusts.

AS 13.36.370. Provides for the appointment of a trust protector. Requires that the trust protector be a disinterested third party. Gives the trust protector the powers, delegations, and functions conferred on the protector by the trust instrument, and identifies some of these powers. Sets a limit on a modification the trust protector is allowed to make. Subject to the trust's terms, provides that a trust protector is not liable or accountable as a trustee or fiduciary when acting as a trust protector.

AS 13.36.375. Provides for the appointment of an advisor to the trustee with regard to matters relating to a trust's property. Provides that even if an advisor is appointed, the property and management of the trust and the exercise of powers and discretionary acts remain vested in the trustee. States that the trustee is not required to follow the advisor's advice. States that an advisor is not liable as, or considered to be, a trustee or fiduciary when acting as an advisor.

Section 2. Makes various substantive and stylistic changes to the subsection that allows for the establishment of a restriction on the transfer of a beneficiary's trust interests. States that a "beneficiary" can include a beneficiary who is the settlor of the trust. Excludes certain activities from being considered as "payment or delivery" of a trust interest for purposes of applying the subsection.

Section 3. Makes various substantive and stylistic changes to the subsection that applies the transfer restriction against the claims of creditors. States when a creditor can satisfy a claim despite the transfer restriction.

Section 4. Makes various substantive and stylistic changes to the subsection that addresses the satisfaction of claims of creditors under (b) of the section. Provides that an attachment or other order may not be made against a trustee with respect to a beneficiary's interest or against property subject to a transfer restriction, except to the extent that a transfer restriction is not allowed under (b)(1) - (4) of the section.

Section 5. Makes various substantive and stylistic changes to the subsection that identifies which creditors may bring a cause of action or claim for relief for a fraudulent transfer under (b)(1) of the section, and within what time frame the action or claim must be brought.

Section 6. Adds new subsections to AS 34.40.110.

Subsection (g) applies the transfer restriction to settlors who are also beneficiaries even if the settlor serves as a co-trustee or an advisor to the trustee, as long as the settlor does not have trustee power over discretionary distributions.

Subsection (h) applies the transfer restriction to a beneficiary who is not the settlor, even if serving as a sole trustee, a co-trustee, or an advisor to the trustee.

Subsection (i) allows a transfer restriction even if a settlor has the authority to appoint a trust protector or an advisor to the trustee.

Subsection (j) prohibits a settlor with a beneficial interest subject to a transfer restriction from benefiting from, directing a distribution of, or using trust property except as stated in the trust. Voids an agreement or understanding between the settlor and the trustee that attempts to grant or permit the retention of greater rights or authority than stated in the trust instrument.

Section 7. States that 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 certain conditions are met.

Section 8. Applies this Act to trusts created before, on, or after the effective date of the particular section of the Act that is involved.

If I may be of further assistance, please advise.

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THURSDAY, FEBRUARY 20, 2003 D1

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 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

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

emarry,
hickens

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. ...If these postmortem battles, ...ng California, Texas, Wash... ...mpshire—have begun accept-

...o Page D4, Column 5

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

... editor on the Journal

... 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 Ferguson

Past & Future Of

Alaska Trust

Legislation

Presented By:

ALASKA TRUST COMPANY

Wealth Management Specialists

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

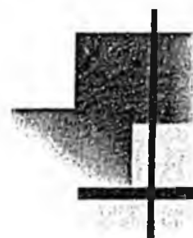
SB 163 – Effective August 30, 2000

- 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

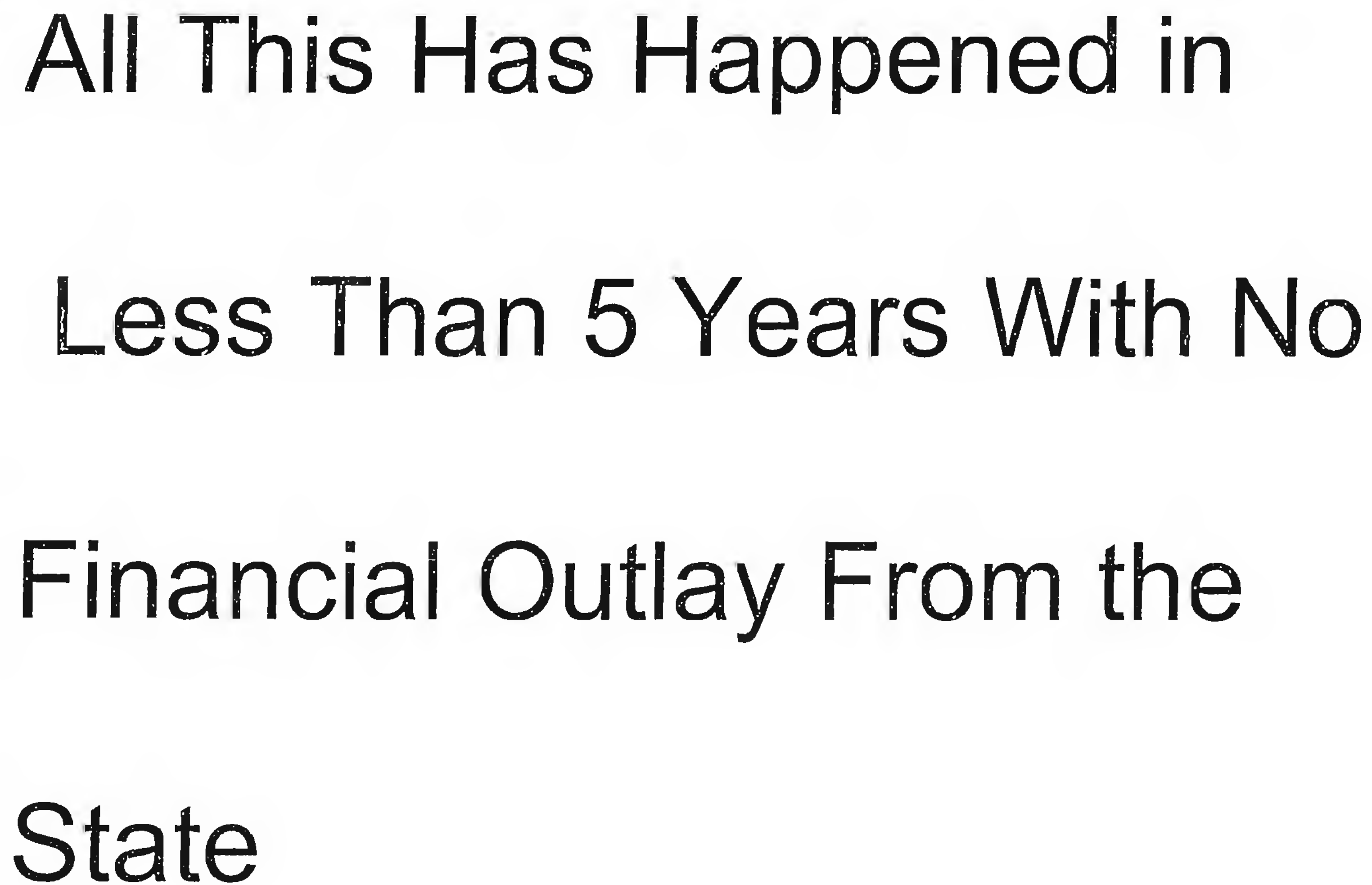
Professionals in Alaska Have Benefited

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

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.

For your prior involvement and hope for your continued support

A New Direction In Estate Planning: North To Alaska

Alaska recently has enacted legislation similar to laws in certain foreign asset protection jurisdictions. As a consequence, an American in any state can create a trust for his or her own benefit which is protected from creditors provided, among other things, it is not a transfer intended to defraud known creditors. Perhaps of greater importance, Alaska trusts open a new dimension in estate planning. One of this article's co-authors, Jonathan Blattmachr, was the principle draftsman of this new Alaska legislation.

Two goals that often are sought to be achieved in estate planning are estate tax reduction and protection of assets from claims of creditors. Reducing taxes significantly may be a "sum zero" game if the assets are attached by creditors. Similarly, protecting assets from creditors' claims may not accomplish all goals sought unless taxes also are reduced. Fortunately, these two goals are not only compatible, they usually are complementary. That is, the steps to protect assets from claims of creditors may allow tax reduction to occur, as well. On the other hand, a transfer that fails to protect property from claims of the transferor's creditors is likely to fail to reduce taxes because, almost always, if a creditor of the transferor can attach the asset the transfer is regarded as incomplete for gift and estate tax purposes.[1] The Alaska Trust Act (Chapter No. 6, SLA 1997, effective April 2, 1997) offers a new tool in the United States to accomplish the dual goals of asset protection and tax reduction. The Act also effectively repeals the rule against perpetuities for a trust created under Alaska law. This article discusses the dual goals of asset protection and estate tax reduction and how the Alaska Trust Act can be used in the context of estate planning. It also compares some aspects of Alaska trusts with certain offshore trusts.

Steps To Reduce Estate Taxation

It seems well accepted that an effective, if not the most effective, estate tax reduction planning step is to make lifetime transfers. Lifetime transfers can avoid gift tax (and, by removing an asset from an estate, can avoid estate tax, as well) in ways that cannot be used at death to avoid estate taxation. However, lifetime transfers are effective for these purposes only if they are "complete" under the federal estate and gift tax rules.[2] The law appears well established that a transfer is complete for such tax purposes only if it is not (or when it no longer is) subject to the claims of the transferor's creditors.[3]

Fraudulent Transfers, Etc.

IN GENERAL, "fraudulent conveyances" with respect to creditors whose claims arise either before or after the transfer are transfers (a) that the debtor made with actual intent to hinder, delay or defraud his or her creditors or (b) (i) for which the debtor received less than "a reasonably equivalent value" and (ii) after which the debtor had insufficient assets to meet future business needs or to pay debts. A transfer made by a debtor is fraudulent as to a creditor whose claim arose before the transfer if the debtor made the transfer without receiving "reasonably equivalent value" and the debtor was insolvent at the time of or as a result of the transfer.[4] Proof of actual intent to defraud is not required. Most states have adopted these rules in the form of the Uniform Fraudulent Transfer Act. However, some states (including New York) still have in effect the Uniform Fraudulent Conveyance Act. (See N.Y. Debtor and Creditor Law Secs. 273-281.) Alaska has adopted neither the Uniform Fraudulent Transfers Act nor the Uniform Fraudulent Conveyance Act. [See *Summers v. Hasen*, 852 P.2d 1165, 1169 n.5 (Alaska 1993).] Its fraudulent transfer rules are contained in Alaska Statutes (AS) 34.40.010 et seq.

Similar rules are contained under the Bankruptcy Code, and in the case of bankruptcy, fraudulent conveyances may be defined with reference to the Bankruptcy Code or under applicable state law. The Bankruptcy Code permits such transfers to be set aside

By **Douglas J. Blattmachr**
Alaska Trust Company
Anchorage, Alaska
and **Jonathan G. Blattmachr**
Milbank, Tweed, Hadley & McCloy
New York, NY

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only if made within one year before filing of the petition, but many states permit reference to a much longer period, especially, in the case of transfers to family members. [See, e.g., *FDIC v. Pappadio*, 606 F. Supp. 631, 632 (S.D.N.Y. 1985) (under New York law a claim to set aside a fraudulent conveyance is governed by a six year statute of limitations).] Avoided fraudulent conveyances are "brought back" into the debtor's estate, usually for distribution to the debtor's creditors. In addition, some fraudulent conveyances may deprive a debtor of (1) homestead or other property exemptions[5] and (2) a bankruptcy discharge.[6]

As a general rule, a transfer is found to have been made with an actual intent to hinder, delay or defraud creditors only if it was intended to remove assets from claims of specifically known or anticipated creditors. "If the debtor has particular creditors in mind and is trying to remove his assets from their reach, this would be grounds to deny the [bankruptcy] discharge [on the ground of a fraudulent conveyance]. If the debtor is merely looking to his future well-being, [the conveyance would not be fraudulent and as such] the discharge will be granted."[7]

An example will help illustrate this principle. A property owner makes a gift to a family member (whether outright or in trust) which does not result in the property owner being insolvent or unable to pay her debts as they mature. She has no known or specifically identifiable creditors. Nonetheless, she realizes that a claim against her could arise on account of unforeseen circumstances, such as being involved in a car accident, occurring in the future. This gift should not be regarded as a fraudulent conveyance, despite the fact that she is making it with the general intention to protect the property from claims that could arise against her in the future.

Although the fraudulent conveyance rules apply to creditors in bankruptcy, obviously they also have a broader application. For example, in a number of states a tort claimant is permitted to attack as fraudulent a transfer made after the time of the tort but prior to any judgment.[8]

Interests in Trusts

Two sets of contrasting rules must be considered to determine whether interests in trusts are subject to claims of creditors. First, as a general rule, a beneficial interest in trust that is subject to a restriction on transfer (called a "spendthrift provision") is not subject to the claims of a beneficiary's creditors.[9] Thus, if the debtor is a beneficiary of a trust established for his or her benefit by another person (such as by a parent) which interest by its terms and/or applicable state law is not assignable, the trust assets should be protected.[10] However, property transferred in trust for the beneficiary may be attached by the creditors of the grantor if the transfer to the trust was a fraudulent conveyance.[11]

In virtually all states, property may be placed in trust for another and thereby be protected from the claims of most creditors of the beneficiaries (and of the grantor). The degree of "creditor proofing" usually varies depending on whether the trust gives the beneficiary the right to receive all of the income, is for the "support" of the beneficiary and/or restricts alienation of the beneficiary's interests.[12] It appears the maximum protection of trust property from the claims of the beneficiary's creditors may be achieved by placing property in a trust that gives the trustee complete discretion as to whether and when to distribute income and/or principal to the beneficiary or beneficiaries of the trust, and which also imposes spendthrift restrictions. The trustee, having control over distributions, probably should not be one of the beneficiaries, both to secure the creditor protection and to avoid inclusion of the property in the estate of a beneficiary for tax purposes (which may be viewed as an additional form of credit protection). The beneficiary, however, may participate as a trustee in investment decisions and may have a non-general power of appointment over all or part of the trust corpus.[13]

Such a trust offers major advantages to the beneficiaries. First, the trust assets should be entirely protected from the claims of most creditors of the beneficiaries, including creditors in bankruptcy and spousal property, and in some cases, even support claims, in the event of divorce or upon death of the beneficiary.[14] In order to maximize the creditor protection, the trustee may be given broad authority not only to distribute or accumulate income and principal, but also to purchase assets for the use of trust beneficiaries. For example, the trustee may be authorized to purchase a home for the use of the beneficiary, thereby preserving that asset in the trust protected from the claims of the beneficiary's creditors. (It seems that this use by a beneficiary should not cause any income to be imputed to the beneficiary.) The purchase of assets "inside" the trust as opposed to distributions also preserves the wealth transfer tax savings that may be achieved through the use of such a trust. Thus, the property owner can confer a substantial benefit on the chosen objects of his or her bounty by transferring during lifetime or bequeathing at death assets to such a "discretionary" trust.[15]

As noted above, however, a transfer for less than fair value[16], including a gratuitous transfer in trust for the benefit of another, may be set aside if it constitutes a fraudulent conveyance. For example, a person could not defeat an outstanding liability by transferring while insolvent all of his or her assets into a trust for the benefit of his or her spouse. Thus, in the case of lifetime planning, it is best to have created trusts and make the transfers in advance of any financial difficulties in order to successfully avoid the challenge that such transfers were fraudulent conveyances.[17]

The second general rule relates to whether and to the extent of which the grantor of the trust has a beneficial interest in it. As to a trust created for one's own benefit, the "black letter" law is that a transfer in trust for the benefit of the transferor is void as against his or her creditors, whether their claims arise before or after the transfer.[18] In other words, the general rule that has

prevailed throughout the United States, at least until the enactment of the Alaska Trust Act[19], has been that the assets in the trust may be claimed by the creditors of the grantor to the extent the grantor is entitled or eligible to receive assets from the trust, even if the transfer to it was not in default of creditors and even though the statute of limitations for a person to make a claim that the transfer to the trust was fraudulent has expired.[20] For example, an individual creates a trust in 1970 from which the individual is eligible, but not entitled, in the exercise of discretion of a third party as trustee, to receive distributions. A judgment is rendered against the grantor in 1997 on account of a car accident that occurred in 1996. To the extent the trustee has the capacity to make distributions of trust property to the grantor, the judgment against the grantor could be enforced according to the Restatement (2d) Trusts against the trust assets even though the grantor had no intention of defrauding that creditor, or any other creditor, when the trust was created in 1970. On the other hand, a judgment creditor of the grantor generally may not attach the assets in a trust of which the grantor is neither eligible nor entitled to receive distributions unless the transfer was in defraud of creditors.

The Tax Rule

THE TREATMENT OF self-settled domestic trusts has been explored in a series of federal tax cases that follow from the creditors' rights analysis. Specifically, if the grantor's creditors can reach the entire corpus of such a trust, the transfer to the trust is regarded as wholly incomplete and no gift tax is due upon creation of the trust. As a corollary, however, the entire trust is included in the creator's estate under Code Sec. 2036(a)(1).

Thus, in *Paolozzi v. Commissioner*[21], the settlor transferred property to a trust under which the trustees had discretion to pay over the income to her during her lifetime. The Tax Court determined that under Massachusetts law, the settlor's creditors could reach the maximum amount that, under the trust terms, could be paid to the settlor — that is, the entire income interest. Accordingly, the gift was incomplete to the extent of that interest. In *Outwin v. Commissioner*[22], also considering Massachusetts law, the Tax Court reached the same result where the trustee could distribute income and principal to the settlor in the trustee's discretion but only with the consent of the settlor's spouse. The spouse had an income interest following the settlor's death, could receive principal in the discretion of the trustee at that time, and had a limited testamentary power of appointment. However, the Tax Court concluded that the spouse's veto power was not sufficient to distinguish the situation from Paolozzi, regardless of the fact that the spouse might be an adverse party for gift-tax purposes.[23]

More recently, in *Paxton v. Commissioner*[24], the Tax Court held that a trust was included in the settlor's estate where the trustee had discretion to apply income and principal among a class of persons including the settlor; the trustee was the settlor's son, who also had a beneficial interest in the trust. The Tax Court looked to Washington state law, but relied primarily on the Restatement rule, discussed earlier, to support its holding.[25]

Offshore Trusts

IN THE PAST FEW YEARS, there has been considerable use of trusts created in those foreign jurisdictions that provide greater protection against claims of creditors than is available under American law. A so-called "asset protection trust" allows a grantor to protect assets from his or her creditors without requiring the settlor to relinquish all interest in the assets in the trust. In general, asset protection trusts are trusts established in foreign jurisdictions that have limited the recourse of creditors to trust assets.

The selection of the foreign jurisdiction in which the asset protection trust will be established requires great care because of the existence of the English "Statute of Elizabeth" (precursor to U.S. fraudulent conveyance law, discussed above), which makes it possible to set aside a transfer that is intended to defeat future, but currently unknown, creditors. Some offshore sites have enacted "Statute of Elizabeth override" statutes to circumvent any questions concerning the applicability of the Statute of Elizabeth. Some of the offshore sites that have passed such legislation are the Bahamas, Bermuda, the Cayman Islands, the Cook Islands (which appears to offer particularly strong protection against creditors) and Gibraltar[26]. Other concerns are political stability and the availability of adequate banking and other financial services in the chosen jurisdiction.

Asset protection trusts usually are designed so that the settlor, upon creation of the trust, will experience no tax consequences. In almost all cases, an asset protection trust will be a so-called "grantor trust" for federal income tax purposes, with the result that the creator will continue to be taxed on all the trust income in the same manner as if he or she continued to own the trust property outright.[27] In addition, the settlor typically retains certain powers or interests sufficient to render the transfer to the trust an incomplete gift, thereby avoiding gift tax and keeping the trust property within the settlor's gross estate for estate tax purposes. For example, in Private Letter Ruling 9536002 (May 12, 1995) (not precedent), the IRS ruled that a transfer to an offshore trust was incomplete because the grantors retained a limited power of appointment over the trust property.

The New Alaska Trust Law

Elimination of the Rule Against Perpetuities. Under the Alaska Trust Law, an interest in a trust will not fail to be valid because it is non-vested if all or part of the income or principal of the trust may be distributed, in the discretion of the trustee, to a person who is living when a trust is created.[28] As a practical matter, this means a trust can be of perpetual duration provided the Trustee has discretion to distribute trust income and principal to the beneficiaries, at least one of whom is living when the trust is created. (This might be contrasted with South Dakota law, which provides that a trust may be perpetual if the trustee is authorized

to sell the trust assets and with Delaware law which has abolished the rule against perpetuities in its entirety, except with respect to real estate.) Thus, a perpetual trust now can be created under the law of Alaska which imposes no income tax. And if the trust is not a grantor trust (causing the income to be attributed directly to the grantor), state (and local) income tax can be avoided to the extent trust income is not currently distributed to beneficiaries who are tax residents of states (or localities) that impose income tax.

Spendthrift Provisions. Alaska law also was amended expressly to provide that a person who transfers property in trust may direct that the interest of a beneficiary of the trust may not be either voluntarily or involuntarily transferred before payment or delivery of the property to the beneficiary by the trustee. It further provides that if the trust contains such a transfer restriction, the restriction prevents a creditor existing when the trust is created, a subsequent creditor or any other person from seeking to satisfy a claim out of the beneficiary's interest in the trust, subject to four exceptions.

First, if the settlor retains the power to revoke or terminate the trust, his or her creditors may attach the trust property to the extent of the power of revocation or termination. However, a power to revoke or terminate does not include a power to veto distributions from the trust to another beneficiary, the retention of a special testamentary power of appointment, or the right to receive a distribution of income, corpus or both in the discretion of another person, including a trustee, other than the settlor of the trust. The veto power and power of appointment may be retained by the grantor to prevent the transfer to the trust from being complete for federal gift-tax purposes.[29] By the same token, retention of such powers will cause the assets to be includable in the gross estate of the grantor at death.[30]

Second, creditors of the settlor may also attach property in the trust to the extent that the trust income and principal must be distributed to the grantor.

Third, the transfer is void with respect to creditors if at the time of the transfer to the trust the settlor was in default by 30 or more days in making a payment due under a child support judgment or order.[31]

Fourth, the transfer is subject to attachment by the settlor's creditors if the transfer was intended, in whole or in part, to hinder, delay or defraud creditors under the Alaska fraudulent transfer law. (AS 34.40.010.) However, an action to claim the transfer was fraudulent may not be commenced unless (1) if the claimant was a creditor when the trust was created, the action is brought within the later of four years after the transfer to the trust was made or one year after the trust is or could have been reasonably discovered, or (2) if the claimant becomes a creditor after the transfer, the action is commenced within four years after the transfer to the trust.[32]

The foregoing means that if the settlor is not in default by 30 or more days of making a child support payment, the transfer was not intended to defraud creditors and the grantor retains no power to revoke or terminate the trust or the mandatory right to receive income or principal but only retains the right to receive a distribution in the discretion of a trustee, creditors of the grantor cannot reach the assets contained in the Alaska trust. If the grantor retains the power to veto a distribution to other beneficiaries and a special testamentary power of appointment or similar right, the transfer to the trust will not be complete for gift and estate tax purposes even though it is not subject to the claims of the grantor's creditors. On the other hand, if the grantor retains no such power to veto or power of appointment or similar right, the transfer to the trust will be complete for estate and gift tax purposes. Thus, the Act offers flexibility to integrate creditor protection with the grantor's tax and other estate planning objectives.

The Rule for Making the Trust Alaskan

ALTHOUGH FOUR OTHER jurisdictions (Delaware, South Dakota, Idaho and Wisconsin) allow trusts to last perpetually in their jurisdictions, no statutory guidance is provided by their laws as to what connection or nexus is sufficient to cause their state's law to apply to the trust. The Alaska statute, however, provides an explicit rule as to what makes a trust an Alaskan trust for both the purpose of avoiding the rule against perpetuities and the purpose of creating a trust that will not be subject to claims of the settlor's creditors. First, some of the trust assets must be deposited in the state and be administered by a "qualified person." Deposited in Alaska means held in a checking account, time deposit, certificate of deposit, brokerage account, trust company fiduciary account or other similar account located in Alaska. A "qualified person" is an Alaskan domiciliary or an Alaskan trust company or bank. Second, the Alaskan trustee's duties must at least include an obligation to maintain records for the trust (on an exclusive or nonexclusive basis with other trustees) and the obligation to prepare or arrange for the preparation of income tax returns that must be filed by the trust (again on an exclusive basis or on a nonexclusive basis with other trustees). Third, part of the administration must occur in the state.

Some Contrasts to Foreign Asset Protection Trusts

ALTHOUGH AN AMERICAN now is able to create an Alaskan trust of which he or she is a discretionary beneficiary which will be protected from the claims of his or her creditors, an Alaska trust will not provide the same level of practical protection from claims of creditors which may be afforded to a trust created in one of the offshore jurisdictions, such as the Cook Islands or the Bahamas. The laws of such offshore jurisdictions typically have extremely short statutes of limitations before the period to commence an action claiming the transfer to the trust was fraudulent runs which, as a practical matter, cannot be met by a creditor especially if the trust is created and funded sufficiently in advance of the entry of a final judgment against the debtor in an American court.[33] Second, the

jurisdiction may prohibit the enforcement of American judgments. That means the action must be retried in the offshore jurisdiction. As a practical matter, that may well be impossible. Because Alaska is one of the American states, its courts will be required to give full faith and credit to any judgment of a sister state although, as indicated, a judgment against the debtor will not be enforceable against the Alaska trust unless there is a finding that the transfer to the trust was a fraudulent transfer or some other reason for voiding the trust, such as the grantor having been in default by 30 or more days in child support payments at the time the trust was created. Third, at least some of these offshore jurisdictions explicitly exclude some claimants from contending a transfer was fraudulent. For instance, in some cases, a claim founded on a domestic right (such as an equitable distribution claim to property in the event of a divorce) cannot be brought against a trust situated in that jurisdiction.

In some ways, however, a foreign asset protection trust may be less desirable than an Alaska trust. Obviously, there is greater political risk in these offshore jurisdictions than there is in the United States. In addition, new "anti-foreign trust" provisions added to the Internal Revenue Code (see, e.g., Code Sec. 6048) will not apply to an Alaska trust. Also, it may be that a court would be more prone to view the creation of a foreign asset protection trust as an attempt to remove or secrete assets than it would the creation of an Alaska trust. In a recent bankruptcy court case, the court expressed considerable hostility to the creation of an offshore trust and ultimately applied New York law to determine whether the debtor had retained a property interest in the trust (which was established under Jersey law) for purposes of determining whether he should be denied a discharge in bankruptcy.[34] It appears, however, that this case may have turned on the rather extraordinary facts, which the court apparently perceived as involving a course of deception and concealment of assets by the debtor.

Options Under the Alaska Trust Act

A SIGNIFICANT OBSTACLE to the making of lifetime transfers is that the property owner is then cut off from the property. For example, some persons are willing to make a gift, and anticipate that they will be comfortable without the gifted asset and/or the income therefrom under the most likely scenarios, but are concerned about a "disaster" situation in which they might need access to the funds. They may not be at all concerned about protecting assets from creditors. In such a case, an offshore trust may be appropriate to consider. Precisely because the normal U.S. rule permitting creditors to reach the trust does not apply, the fact that the grantor is a permissible beneficiary of trust income and/or principal in the discretion of an independent trustee should not render the gift incomplete and includable in the estate under Code Sec. 2036 or 2038. Thus, the trust can be structured so that the transfer is a completed gift upon creation.[35] Gift tax would be paid (or unified credit applied). In that way, the "normal" estate planning benefits of removing gifted assets and the appreciation thereon from the estate are achieved. However, the Trustee can give the settlor access to the trust assets.

These same opportunities are now available to Americans using Alaska trusts. For example, an individual could create a so-called "Crummey trust"[36] in Alaska for the benefit of himself or herself as well as members of his or her family and protect transfers to the trust from gift tax using annual exclusions with respect to the other family members. For instance, a woman who is married and has two children could transfer up to $50,000 under the protection of the annual exclusion under Code Sec. 2503(c) granting her husband and each child the right, respectively, to withdraw $10,000 and $20,000 from the trust. The transfers to such a trust created under Alaska law would be complete and should be excludable from the grantor's estate at death even though the grantor is eligible, although not entitled, to receive distributions from the trust in the discretion of a trustee other than himself or herself. Of course, the beneficiaries may exercise the powers of withdrawal so that there is no property left in the trust from which the grantor could benefit. In addition, to the extent that the powers of withdrawal have not lapsed tax-free pursuant to Code Sec. 2514(e) and 2041(b)(2), the property subject to the powers of withdrawal will be includable under Code Sec. 2041(a) in the gross estates of the powerholders.

An individual also could create an Alaska trust and transfer the amount of his or her remaining gift tax exemption equivalent (which can be as great as $600,000) and remain a beneficiary eligible to receive distributions in the discretion of a trustee other than himself or herself and avoid having the property includable in his or her estate. This provides an opportunity to remove the income and appreciation earned on the property during the balance of his or her lifetime from his or her gross estate even though the grantor has retained the possibility of receiving assets back in the discretion of the trustee if appropriate circumstances arise. Similarly, an individual could make a transfer, which is complete for estate and gift tax purposes, to an Alaska trust, of which he or she is eligible to receive distributions, equal to his or her remaining GST exemption under Code Sec. 2631(a) which can be as great $1 million. This would allow the amount protected from generation-skipping transfer tax to increase by post-transfer income and appreciation during the balance of the transferor's lifetime even though the grantor is an eligible beneficiary of the trust.

The entitlement to payments from a grantor retained annuity trust (GRAT) described in Code Sec. 2702(b)(1) or grantor retained unitrust (GRUT) described in Code Sec. 2702(b)(2) must terminate prior to the death of the grantor or the trust assets will be includable, in whole or in part, in the grantor's estate.[37] However, if the GRAT or GRUT is created under Alaska law, the property may continue in trust after the grantor's annuity or uni-

trust term ends, and the grantor thereafter could be eligible to receive distributions from the trust without causing the trust to be includable in his or her estate, provided the grantor survives the annuity or unitrust term.

Conclusions

THE DUAL GOALS OF asset protection and reduction in taxation are often compatible and complementary. The new Alaska Trust Act provides an opportunity for Americans in all states to create trusts in Alaska which may help achieve both goals. Although not providing all of the practical protection that may be available through similar trusts created in offshore jurisdictions, many Americans will prefer for their assets to remain in the United States. For them, Alaska trusts may be considered. Although not discussed in detail in this article, making the trust perpetual may offer additional financial, tax and estate planning benefits. ◆

End Notes

1. See, e.g., *Paolozzi v. Commissioner*, 22 T.C. 182 (1954).
2. Compare Reg. Sec. 25.2511-2(c) with Code Sec. 2038(a).
3. "If and when the grantor's dominion and control of the trust assets ceases, such as by the trustee's decision to move the situs of the trust to a state where the grantor's creditors cannot reach the trust assets, then the gift is complete for Federal gift tax purposes...." Rev. Rul. 76-103, 1976-1 CB 293. See generally, Kartiganer, Rollins & Piontnica, "Completed Gifts to Offshore Trusts and the Three-Year Rule," Journal of Asset Protection (March/April 1996).
4. See generally, P. Alces, The Law of Fraudulent Conveyance, Sec. 504 (1989) (1991 Cum. Supp. No. 2).
5. See, e.g., Tex. Prop. Code Sec. 42.004(a); (under Texas law, a debtor who acquires otherwise exempt personal property with intent to hinder, delay or defraud creditors loses the personal property exemption--however, that is not the case with the Texas homestead exemption, although a bankruptcy discharge may be denied); *Anderson Mill & Lumber Co. v. Clements*, 134 So. 588, 592 (Fla. 1931); (under Florida law, debtor who acquires otherwise exempt homestead property with intent to hinder, delay or defraud creditors loses homestead exemption).
6. See, e.g., Bankruptcy Code Sec. 727(a)(2); *In re Reed*, 700 F.2d 986, 988 (5th Cir. 1983) ("a debtor who converts nonexempt assets to an exempt homestead immediately before bankruptcy, with intent to defraud his creditors, must be denied a discharge in bankruptcy because of the provisions of Section 727 of the Bankruptcy Code"); *In re Myerson & Kuhn*, 121 B.R. 145, 158-159 & n.15 (Bkrcty. S.D.N.Y. 1990).
7. *Oberst v. Oberst*, 91 B.R. 97, 101 (Bkrcty. C.D. California 1988). *See, also, Klein v. Klein* et al., 122 NYS 2d 546 (1952) (similar).
8. See *Myers v. Redmill*, 266 Ala. 270, 96 So. 2d 450 (1957) (conveyance to wife two days after automobile accident), and cases cited in annot., 73 A.L.R.2d 749. See, also, annot., 38 A.L.R.3d 597.
9. Such an interest would normally be excluded from a beneficiary's bankruptcy estate as well. See Bankruptcy Code Sec. 541(c)(1) and (2). *In re Remington*, 14 BR 496 (Bankr. DNJ 1981) (in bankruptcy proceeding of New Jersey resident, both income and principal of trust created for his benefit by relative who resided in Pennsylvania protected under Bankruptcy Code because under Pennsylvania law spendthrift provision was effective to provide that protection).
10. In some states, trusts are "spendthrift" only to the extent so provided in the governing instrument. In other states, they are "automatically" spendthrift unless the governing instrument provides otherwise. In still others, they may not be "spendthrift" at all (*i.e.* they are subject to creditor claims regardless of spendthrift provisions in the instruments). See, e.g., *Industrial Nat'l Bank v. Budlong*, 106 RI 780, 264 A2d 18 (1970).
11. *See e.g.*, N.Y. Debtor and Creditor Law, Secs. 278 and 279.
12. *See, e.g.*, Scott, 11A The Law of Trusts, Secs. 152, 155-157.1 (4th ed. 1987); Restatement (2d) Trusts, Secs. 155 and 157; Cal. Prob. Code Ann. Secs. 15400-15307.
13. See Code Sec. 2041.
14. *See Converstan v. Kellogg*, 136 Mich. App. 504, 357 N.W. 2d 705 (Mich. App. 1984); Scott, *supra*, Sec. 157.1.
15. *See* Oshins & Blattmachr, "The Megatrust_: An Ideal Family Wealth Preservation Tool", Trusts & Estates 20 (November 1991).
16. It is not always clear whether a transfer is for fair value for this purpose. The analysis will depend on applicable law and the facts of the case.
17. See *Oberst v. Oberst*, 91 B.R. 97 (Bkrtcy. C.D. Cal. 1988).
18. *See, e.g.*, Restatement (2d) Trusts, Sec. 156.2.
19. Although apparently not widely known, a rule somewhat similar to that in Alaska is contained in Missouri Revised Statute Sec. 456.080.
20. However, it seems that not every retained interest will trigger the application of this rule. For example, a power to direct investments probably is not attachable by the grantor's creditors. A related issue is whether creditors can reach the assets of a trust over which the settlor retained a power of revocation (or a general power of appointment), and whether creditors can reach the assets of such a trust to satisfy the debts of the settlor/decedent. It appears that the trend is to allow assets in such a trust to be used to satisfy the debts of the settlor/decedent and toward extending the recourse of creditors (including creditors of a decedent) against such trusts, in some cases by statute. *See*, e.g., Cal. Prob. Code. Ann Secs. 18200 and 18201; *State Street Bank & Trust Co. v. Reiser*, 389 N.E.2d 768 (Mass. App. 1979).
21. 22 T.C. 182 (1954). *See, also*, Rev. Rul. 77-378, 1972-2 CB 347; Rev. Rul. 76-103, 1976-1 CB 394.
22. 76 T.C. 153 (1981), acq. 1981-2 C.B. 1.
23. See *Comm'r v. Vander Wheele*, 254 F2d 895 (6th Cir. 1958), *acq*. 1962-1 CB 5 (same result under Michigan law); PLR 8350004 (same result under California law). Neither a private letter ruling (PLR) nor a national office technical advice memorandum may be cited or used as precedent. Code Sec. 6110(j).
24. 86 T.C. 785 (1986).
25. *See*, however, *Estate of German v. United States*, 85-1 TC ¶ 13,610 (Ct. Cl. 1985) and *Herzog v. Comm'r*, 116 F.2d 591 (2d Cir. 1941), finding that creditors could not reach assets of a trust of which the settlor was one of several discretionary beneficiaries (or found that the Internal Revenue Service had failed to meet its burden to show that settlor's creditors could reach the asset held in the trust). However, the conclusion reached by the Federal courts in these cases may not be the same as those reached by state courts. Compare *Vanderbilt Credit Corp. v. Chase Manhattan Bank, N.A.*, 100 AD2d 544, 473 NYS 2d 242 (2d Dep't 1984) with *Herzog v. Comm'r*, supra.
26. In general, it appears that asset protection trusts will be effective only against future, but currently unknown, creditors. The settlor, generally, cannot be insolvent at the time the trust is created or become insolvent as a result of the creation of the trust.
27. *See* Code Sec. 677(a) (a trust is a grantor trust if, among other situations, the trustee, without the consent of an "adverse party", can distribute the trust assets to the grantor.) There will be no Code Sec. 1491 excise tax consequences since no tax will apply to the transfer of appreciated assets to a foreign trust so long as that trust is a "grantor trust" and the settlor is a U.S. person. Rev. Rul. 87-61, 1987-1 CB 219.
28. AS 34.27.050(a)
29. Reg. Sec. 25.2511-1(c).
30. Code Sec. 2036(a)(2), 2038(a).
31. An Alaska trust could not be used to avoid child support or alimony payments because neither a judgment for child support nor one for alimony is dischargeable in bankruptcy. Bankruptcy Code Sec. 523(a)(5).
32. It is possible that a court would determine that the statute of limitations of the grantor's domicile state (or another state) should be applied rather than the one provided under the new Alaska law. This could mean a shorter, longer or "different" statute of limitations. However, the determination that the trust is "spendthrift" under Alaska law should apply even if the grantor is domiciled elsewhere. *See 4 Collier on Bankruptcy*, 544.02 at 544-13 to 544-14 and fn. 17 (15th ed. 1989) ("The

tendency of the courts is to treat the law of the site of property at the commencement of the case as governing to the extent that Sec. 544(a) refers to non-bankruptcy law"); *4A Collier on Bankruptcy*, ¶ 70.26 at 364-365 (14th ed.) ("Whether the bankrupt's interest as a *cestui que trust* was, at the time of bankruptcy, assignable or transferable, or subject to attachment, seizure or judicial sale, is a matter generally to be determined by the law of the state where the trust has its situs" [footnote omitted]); *Ferrari v. Barclays Business Credit, Inc.*, 108 B.R. 384, 387 (D. Mass. 1989) ("The authorities ... have shown a preference for applying the law of the site of the conveyed property); *In re Remington, supra* (applying Pennsylvania law to determine interest of New Jersey debtor in trust established under Pennsylvania law). But cf. In re Portnoy, infra (alleged concealment of assets of offshore trust as grounds for denial of discharge in bankruptcy).

33. But, see 515 S. *Orange Grove Owners Ass'n v. Orange Grove Partners*, Plaint No. 208/94 (High Ct. Raratonga, Civil Div., Nov. 6, 1995)
34. *In re Larry Portnoy*, 201 B.R. 685, 695 (S.D.N.Y. 1996).
35. *See, e.g.*, PLR 9332006 (not precedent) (transfer to offshore trust of which grantor and members of grantor's family are eligible beneficiaries a completed gift and will not be in grantor's estate because under the law governing the trust creditors of the grantor cannot attach the trust assets).
36. *See*, generally, Blattmachr & Slade, "Building an Effective Life Insurance Trust"

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Trusts & Estates 29 (May 1990) explaining how to structure such a trust to hold insurance policies on the grantor's life. Crummey trusts can hold other assets as well. It seems that the life insurance proceeds should not be includable in the grantor's estate under Code Sec. 2042 if the grantor is merely an eligible beneficiary of the trust which is not subject to the claims of his or her creditors, because the incidents of ownership (which is the "touchstone" for application of Code Sec. 2042) held by a trust are not automatically attributed to the beneficiary whose life is insured. *See, e.g.*, PLR 9434028 (not precedent).
37. The Internal Revenue Service has contended that a GRAT is includable in its entirety under Code Sec. 2039(a) if the grantor dies during the term for which he or she is entitled to annuity payments. *See* PLR 9345035 (not precedent).

Estate Planning on America's Last Frontier: Alaska Trusts, Limited Partnerships, and LLCs

*by Jonathan G. Blattmachr, New York, New York**
George E. Goerig, Jr., Anchorage, Alaska; and
Richard S. Thwaites, Jr., Anchorage, Alaska

Two 1997 statutory changes to Alaska law provide new estate planning opportunities for clients throughout the country, as well as for some outside the United States. The Alaska Trust Act, Chapter No. 6, SLA 1997, which became effective in April, 1997, allows individuals to create "self-settled" trusts under Alaska law that are immunized under that state's laws from claims of the individual's creditors. Another act amended Alaska law relating to limited partnerships and limited liability companies formed in that state. Chapter No. 78, SLA 1997. This second change was designed to simplify the formation and operation of these entities as permitted under the new Treasury Department "check the box" regulations. These two statutory changes provide enhanced opportunities in the United States for asset protection. Perhaps of greater interest to Fellows, the two acts provide new opportunities in estate planning. Although using either act alone may be effective, estate planning may be more enhanced in many cases by using a combination of Alaska trusts and Alaska limited partnerships or limited liability companies.

Alaska Trusts

The principal changes made by the Alaska Trust Act are (1) effectively to repeal the rule against perpetuities for Alaska trusts, and (2) to permit an individual to create an Alaska trust of which he or she is an eligible beneficiary yet (unlike the law that prevails in virtually all other American states) which will not be subject to the claims of his or her creditors. This latter change not only provides asset protection, but also allows lifetime transfers to be complete for federal gift and estate tax purposes in ways not previously available under American law.[1]

As a general matter, to the extent that a creditor can reach assets transferred by an individual to a trust, those transfers will not constitute completed gifts and will be includable in the gross estate of the transferor. However, it seems certain that if the trust is formed in "a state where the grantor's creditors cannot reach the trust assets, then the gift is complete for federal gift tax purposes...." Rev. Rul. 76-103, 1976-1 C.B. 293. See also Rev. Rul. 77-378, 1977-2 C.B. 347; *Estate of German v. U.S.*, 7 Ct. Cl. 641 (1985); *Estate of Uhl v. Commissioner*, 241 F.2d 867 (7th Cir. 1957); *Estate of Wells v. Commissioner*, T.C. Memo 1951-574. Both Rev. Rul. 76-103 and Rev. Rul. 77-378 specifically deal with completed gifts, and not with estate exclusion. These rulings make clear that if, under the law where the trust is created, creditors cannot reach the property transferred, the transfer is *entirely* complete for gift tax purposes.[2] If the grantor has retained an interest, as noted above, creditors can reach that interest and presumably the transfer would not be entirely complete. Although it is theoretically possible for a transfer to be entirely subject to gift tax (even though partially an incomplete gift) and still be included in the gross estate of the transferor, such circumstances are rare. However, the rulings state that the transfer is entirely complete for gift tax purposes, not just that it is entirely subject to gift tax. It is thus reasonable to conclude that the Internal Revenue Service has determined that no interest was retained by the transferor because if the grantor had retained an interest, the transfer would be partly incomplete.[3]

In contrast to the law of most American states, many jurisdictions outside the United States provide that the interest of a grantor in a trust he or she created is not subject to the claims of his or her creditors unless the transfer to the trust was a fraudulent transfer under that jurisdiction's rules. As a consequence, under U.S. law transfers to such a foreign trust can be complete for U.S. estate and gift tax purposes, even though the grantor is a beneficiary of the trust. Indeed, the *German*, *Uhl*, and *Wells* cases cited above so hold. In addition, the IRS has explicitly so ruled in private letter rulings. For instance, in PLR 9332006,[4] the Service held that a transfer to an offshore trust of which the grantor and members of the grantor's family were eligible as beneficiaries in the discretion of a trustee (who was a person other than the grantor) was a completed gift and would not be in the grantor's gross estate for federal estate tax purposes because, under the law governing the trust, creditors of the grantor could not attach the trust assets. See also PLR 8037116. With the Alaska Trust Act, such a tax-advantaged trust can now be created under the law of Alaska.

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Self-Settled Estate Planning Trusts

The Alaska Act opens a new dimension in estate planning for Americans. They can now make lifetime transfers, which are complete for federal gift and estate tax purposes, to an Alaska trust of which the grantor is eligible, but not entitled, to receive distributions in the discretion of a trustee (other than himself or herself).[5] Such self-settled Alaska trusts could be used for virtually all lifetime estate planning transfers.

For instance, an individual may make transfers under the protection of the Internal Revenue Code §2503(b) gift tax annual exclusion by transferring property to an annual exclusion or so-called "Crummey" trust, which provides that certain individuals (such as a transferor's spouse, descendants, and perhaps others, but not the grantor) can withdraw property transferred to the trust up to the amount of annual exclusions not used elsewhere. With an Alaska trust, the grantor may remain eligible to receive distributions of trust property in the discretion of a trustee other than the grantor without causing the trust assets to be includable in his or her estate. From an estate planning perspective, the grantor will want distributions to him or her to be minimized, because such distributions diminish the estate tax planning benefits of having made completed transfers to the trust that otherwise would be excludable from his or her estate.

If an agreement that the grantor would receive the income from or the use of the assets held by the trust may be inferred from the circumstances, the assets almost certainly will be includable in the grantor's estate, under Code §2036(a)(1), even when coupled with the finding that the grantor had no legal entitlement to such income or use. See, e.g., *Estate of Skinner v. U.S.*, 197 F. Supp. 726 (E.D. Pa. 1961), *aff'd*, 316 F. 2d 517 (3rd Cir. 1963). On the other hand, only occasional use of trust assets or occasional receipt of trust income should avoid any such inference. See, *e.g.*, *Estate of Wells v. Commissioner, supra.* Actual retention of the property or the income (that is, the failure actually to transfer the property or the income to another) may also result in estate tax inclusion. See, *e.g.*, *Lee v. United States*, 86-1 U.S.T.C. ¶ 13,649 (CCH)(W.D. Ky. 1986).

Annual Exclusion Trusts

Not infrequently, a Crummey trust will acquire one or more life insurance contracts on the life of the grantor or on the lives of the grantor and the grantor's spouse. Ownership of the policies by the trust is an attempt to keep the proceeds paid at death from inclusion in the estate(s) of the insured(s). If the insured holds no "incident of ownership" in the policy at or within three years of death, and if the proceeds are not paid to the estate of the insured, the proceeds should not be included in the insured's gross estate. Code §2035, 2042.

If the terms of an annual exclusion (or another type) Alaska trust that acquires a cash value life insurance contract provide merely that the trustee may, in the exercise of its discretion, distribute trust assets to the grantor, the incidents of ownership in the contract should not be attributed to the insured grantor so as to cause the proceeds to be includable in his or her estate. See, *e.g.*, PLR 9434028 (incidents of ownership held by a trust are not automatically attributed to the beneficiary whose life is insured if the beneficiary is not a trustee).

This provides an opportunity for the grantor, through the exercise of discretion of a trustee other than himself or herself, to be eligible to receive cash value in the policy without causing the proceeds paid at death to be includable in his or her estate.

Unified Credit, GST Exemption, and Other Trusts

One of the most effective lifetime planning techniques is to transfer as early as possible in life the amount protected from gift tax by reason of the unified credit allowable under Code Sec. 2010 or by reason of the amount of GST exemption under Code Sec. 2631. Use of the unified credit (which under the Taxpayer Relief Act of 1997 will increase commencing in 1998 and continuing through 2006) early in life can result in a very large amount being excludable from the transferor's estate. The early use of the $1 million GST exemption (which under the Taxpayer Relief Act of 1997 is indexed for inflation) can be even more effective from an estate planning perspective. In the long run, because the GST exemption can be used to avoid wealth transfer tax on property as it passes from one generation to the next without limit, the use of the GST exemption to avoid tax may be even more important than use of the unified credit. (As noted earlier, an Alaska trust can be structured so it can last perpetually. Also, Alaska has no income tax.)

The remainder following the grantor's retained interest term in a grantor retained annuity trust (GRAT), grantor retained unitrust (GRUT), or grantor retained income trust (GRIT), including a qualified personal residence trust, can pass outright to others or remain in trust. In most jurisdictions in the United States, the property will continue to be includable in the grantor's estate if the grantor is eligible to receive continuing distributions in the discretion of a trustee after the grantor's entitlement to payments ceases, because the grantor's creditors will be able to attach the trust assets. See Rev. Rul. 77-378, *supra.* However, if the GRAT, GRUT, or GRIT is an Alaska trust, the property should not be includable in the grantor's estate after the annuity, unitrust, income, or use term

ends, even if the grantor remains eligible to receive distribution from the continuing trust for the balance of his or her lifetime in the discretion of the trustee other than the grantor.

If the Alaska trust holds real property outside of that state, it is possible that a court would apply the spendthrift trust rule of the state where the property is situated rather than the spendthrift trust rule of Alaska. If the real estate is located in a state where spendthrift trust provisions are not effective in protecting the grantor's interest in the trust from claims of his or her creditors, it may be appropriate to permit the trustee to distribute trust property to the grantor only if the real property outside of the state of Alaska is no longer held in the trust (*e.g.*, the non-Alaska real estate has been sold by the trustee or distributed to other beneficiaries).

In most states, the grantor could not become a beneficiary to whom the trustee could distribute assets from any continuing trust after the charitable term of a charitable lead trust without causing the property to be includable in the grantor's estate due to the right of the grantor's creditors to attach the trust assets. See Rev. Rul. 77-378. If the charitable lead trust is created under Alaska law, however, the grantor may remain eligible to receive distributions from the continuing trust after the charitable term ends without causing the property to be includable in his or her estate. *Estate of German v. U.S., supra, Estate of Wells v. Commissioner, supra, Estate of Uhl v. Commissioner, supra.*

Use of Alaska Trusts by Non-U.S. Persons

Alaska trusts may also be effective vehicles for use by non-U.S. persons. For example, many individuals who are neither U.S. citizens nor U.S. domiciliaries ("foreigners") have American relatives or friends whom they wish to benefit. Except for U.S. real estate and tangible personal property, a foreigner may make lifetime gifts to or in trust for Americans without the imposition of U.S. gift tax. Similarly, a foreigner may make transfers at death to or in trust for Americans without the imposition of U.S. estate tax, except to the extent the transfer consists of U.S. real estate or tangibles, stock in U.S. corporations, and certain indebtedness of U.S. obligors. In addition to avoiding U.S. gift and estate tax, these transfers may be made free of generation-skipping transfer tax. Treas. Reg. §26.2663-2(b). A foreigner can thus transfer to or place in trust for Americans unlimited amounts of non-U.S. assets which will never be subject to U.S. wealth transfer tax. Such an opportunity suggests consideration of the creation of a very long-term or perpetual trust by a foreigner for American relatives or friends whom the foreigner wishes to benefit.

Six American states allow trusts to last perpetually: Alaska, Delaware, Idaho, South Dakota, and Wisconsin. Alaska may be the most preferable of all for several reasons. First, if the foreigner wishes, he or she could remain a beneficiary of an Alaska trust to whom the trustee could make distributions without causing the trust to be includible in his or her estate for federal estate tax purposes. This could be very important due to the major distinction in the taxation of foreigners for gift tax purposes on the one hand, and estate tax purposes on the other. Lifetime gifts by foreigners of U.S. securities are not subject to U.S. gift tax but those same securities, as a general rule, are subject to U.S. estate tax if includible in the foreigner's estate at death. Hence, a foreigner could transfer U.S. stock to an Alaska Trust free of U.S. tax, remain an eligible beneficiary for life and yet avoid U.S. estate tax on the trust assets at death. Also, only Alaska has a statutory rule of what makes a trust be treated as sited there: (i) there must be an Alaska trustee whose duties consist at least of maintaining a set of trust records and of preparing or arranging for the preparation of any trust tax returns, (ii) part of the trust assets must be maintained in Alaska, such as by maintenance of a bank or brokerage account there, and (iii) some part of the administration must occur in Alaska, such as holding some trustee meetings there or effecting some "trades" there.

In fact, even if a foreigner does not wish to benefit Americans but simply wants to create a trust for his or her own benefit that is protected from claims of his or her creditors, an Alaska trust may be preferable to one created in an "offshore" jurisdiction even if that jurisdiction provides for the trust assets to be protected from claims of the grantor's creditors. For several reasons, many foreigners acquire or maintain assets in the United States. Holding those assets through an Alaska trust may well provide an additional level of protection for them.

Alaska Limited Partnerships and Limited Liability Companies

Limited partnerships and limited liability companies have become a mainstay in business and personal planning. The adoption by the Treasury Department of the so-called "check the box" regulations effective January 1, 1997, vastly simplified the formation and administration of such entities. See Treas. Reg. §301.7701-1, 2, 3. Prior to the adoption of those regulations, four complex factors (known as "corporate characteristics factors") had to be analyzed to determine whether an entity other than a corporation would be taxed as a corporation or as a partnership. It is generally preferable for an entity to be taxed as a partnership rather than a corporation because profits are taxed once, losses are passed through to the owners of the entity, and adjustments to basis are usually more favorable. See, e.g.,

IRC § 754. Moreover, entities treated as partnerships for income tax purposes can be much more flexible in formation, operation and ownership than so-called S corporations. Subject to certain exceptions (such as for domestic (U.S.) corporations), an entity may elect on its first tax return filed after 1997 to be treated as a partnership (or, alternatively, as a corporation) for federal income tax purposes.

Entities treated as partnerships, in certain circumstances, can be used to enhance the protection of assets from claims of creditors. First, "buy-out" provisions contained in a partnership agreement (or other document) sometimes provide other owners or the entity itself the right to buy partnership interests (or comparable interests in a LLC) from a partner who becomes bankrupt. Although these "triggered by bankruptcy" provisions sometimes are not enforceable, they may be enforceable in certain other cases. In any event, their mere existence may chill a creditor from attempting to attach a partnership interest. Second, as a general matter, any creditor who does succeed to the economic interest of the bankrupt partner but does not become a partner (because, for example, state law or the partnership agreement so provides) nonetheless may be taxed apparently on a pro rata portion of the income, even if no distributions are made. See Rev. Rul. 77-137, 1977-1 C.B. 178. This may make the attached interest in the partnership a liability in the hands of the creditor (because it may generate an income tax liability without a concomitant distribution of cash or other assets,) which may cause the creditor to agree to disgorge the asset at a lower price or possibly to abandon it. Under the law of virtually all jurisdictions, however, a court having jurisdiction over the partnership may order its liquidation for any "equitable" reason. See, *e.g.*, 8A N.Y. Cons. Law §121-802. In addition, under those state laws that otherwise permit a partner to demand to be bought out upon six month's notice (which is the default rule contained in the Revised Uniform Limited Partnership Act), a creditor might convince a court that a creditor should be able to exercise that power to be liquidated out.

Under the new Alaska law, a court will be able to order the dissolution of a partnership or limited liability company only if it determines that it is impossible for the enterprise to continue to operate. Therefore, the court will be unable to order a liquidation merely for an "equitable" reason. In addition, unlike the default rules under most state laws, an Alaska limited partnership or limited liability company does not go out of existence upon the death of a general partner of a limited partnership or of a member of an LLC.

Limited partnerships and LLCs are widely used for estate planning. They can accomplish many goals, including providing a family unit with an opportunity to shift income more efficiently, share in lower brokerage and investment advisory fees, and centralize and harmonize the management of assets and investment decisions. Use of these entities changes the nature of what is owned. In other words, family members no longer own an interest in the assets owned by the partnership or LLC, but rather own interests in the partnership or LLC. Because the nature of the family's interest changes, so does it value. Often, the value is reduced. Lower value may mean lower gift, estate, or generation-skipping transfer tax when an interest is transferred. It can also mean a smaller "step-up" in income tax basis at death. See IRC §1014.

The Internal Revenue Service has shown a strong and growing inclination to disregard the existence of the partnership (or LLC) when disregarding its existence would result in a larger value for estate, gift, or generation-skipping transfer tax purposes, and thus, higher taxes. The Service's attack, to date, has revolved around four primary arguments. See, generally, Aucutt, "More on Deathbed FLPs," 9 *Probate Practice Report* 1 (August 1997), for a discussion of some of these arguments.

First, the IRS has contended that the taxpayer may be making a gift upon formation of the entity to other equity owners (*e.g.*, partners) if the taxpayer receives back an interest worth less than what he or she contributed. The argument may not be sound. For example, upon termination any such "gift" to the other partners may be offset by a "gift" back from the others. If so, any transfer upon formation must be for full consideration and cannot be a gift. At least in some cases, the courts have not completely dismissed the argument that a gift can be made upon formation, thus this argument should not be disregarded in forming a limited partnership or LLC. Cf. *Estate of Trenchard v. Commissioner*, T.C. Memo 1995-232. See, also, Horn, "Limited Partnerships: Some Thoughts and Theories about Key Issues." 23 *ACTEC Notes* 37 (Summer 1997).

Second, the IRS has contended that the existence of the partnership should not be respected in those cases where the partnership was formed only for tax reduction reasons, at least if its existence has no other substantial economic impact. It appears more likely that there will have been a smaller non-tax impact if a transfer of partnership units occurs immediately after the formation of the entity. See, *e.g.*, National Office Technical Advice Memorandum (NOTAM) 9719006 (formation of partnership by individual who was terminally ill and died two days after partnership was formed). See, also, NOTAM 9723009 (formation 54 days before death), and NOTAM 9725002 (formation two months before death).

Third, the Internal Revenue Service also has recently contended that the existence of the partner-

ship should be ignored because it constitutes a restriction on the use of the assets of the partnership. See, *e.g.*, NOTAM 9719006. IRC §2703 provides that, in certain circumstances, an option, agreement, or other right to acquire or use property at a price less than fair market value or any restriction on the right to sell or use the property is ignored for estate, gift, and generation-skipping transfer tax valuation purposes unless it is established by the taxpayer that the option, etc., is comparable to similar ones found in arms' length transactions.

Fourth, the IRS has attempted to attack partnership discounts under IRC §2704(b), on the basis that the partnership agreement (or LLC operating agreement) imposes one or more applicable restrictions. See, e.g., NOTAM 9724703 (provision of partnership agreement that eliminates the right under Massachusetts law of a limited partner to withdraw on six months' notice is disregarded). A restriction is disregarded for valuation purposes under Code Sec. 2704(b) only if the restriction will expire or if the family acting together without non-family members can remove it. It is understood that the Internal Revenue Service may contend that any applicable restriction in a partnership that contains a fixed term (such as terminating in the year 2039) means that the applicable restriction will expire by the terms of the partnership when the term of the partnership ends, and, therefore, any such restriction should be disregarded for valuation purposes. The Internal Revenue Service may also contend that the family can remove any applicable restriction (which under Treas. Reg. §25.2704-2(b) is to be determined under default state law, and not as limited by the terms of the partnership agreement) even in a circumstance where a non-family member (such as a niece or nephew) is also a partner. Under the partnership laws of many states, certain actions may not require unanimous consent of all the partners (unless the partnership agreement expressly so provides).

Alaska law was amended not only to permit simpler formation of limited partnerships and LLCs pursuant to the check-the-box regulations and to use them more effectively for asset protection and other non-tax reasons, but also to assist a taxpayer in resisting such IRS attacks on valuation of interests in partnerships and LLCs. First, Alaska law is now clear that a single member (one owner) LLC may be formed. Forming a limited partnership with only one real owner of equity (*e.g.*, the same person owns all limited partnership interests and all of the stock of a corporation which owns a relatively small general partnership interest) or a single member LLC should avoid any argument by the Internal Revenue Service that a gift is made upon formation from one owner to another. (If a husband and wife, both of whom are United States residents, are the only partners or members, there also is no taxable gift because any gift from one to the other should qualify for the gift tax marital deduction under IRC §2523, barring some provision that would make it a so-called "terminable interest.") The Internal Revenue Service has essentially conceded that a subsequent gift of an interest even in a wholly owned enterprise is to be valued by looking at the interest transferred in isolation. Rev. Rul. 93-12, 1993-1 C.B. 202. Hence, the "depletion of the value of the estate" argument, which is essentially what the gift upon formation contention is, should not arise if the entity is formed by a single owner who thereafter makes gifts to others of interests in the entity.

One of the most effective ways to avoid the IRS contention that the partnership was formed only for tax reduction reasons and without any other substantial economic or other impact is to operate the partnership or LLC for substantial period of time prior to making gifts or sales of the units (and forming it as long before death as practicable if the interests in it will be held until then). As mentioned above, limited partnerships and limited liability companies often provide significant non-tax benefits, such as providing for asset protection and lower brokerage or investment advisory fees through the aggregation of wealth. By making gifts of relatively small interests in the enterprise, the others who receive these transfers can participate in such non-tax benefits attributable to the structure of the enterprise.

The IRS argument that the existence of the partnership should be ignored under IRC §2703 appears flawed. It is based on the Code section, regulations promulgated thereunder, and its legislative history, which indicate that the section applies only with respect to the property which is the subject of the gift or transfer at death. In the case of gifts or transfers at death of partnership interests, it is those interests (not the underlying partnerships assets) that must be restricted for the section to apply. As mentioned, the section does not apply where the taxpayer establishes that unrelated third parties have entered into similar arrangements. Presumably hundreds of such entities will be created under Alaska law, a majority of which probably will be created by unrelated third parties. In many cases, these agreements will contain no provisions other than those provided under default state law. This may help establish that any family partnership agreement or limited liability company, at least to the extent that the governing agreement does not provide additional restrictions, is the same as that entered into by unrelated third parties.

The new Alaska law should go far in combatting the IRS arguments under §2704(b). First, as a matter of default state law, Alaska limited partnerships and

limited liability companies last indefinitely (just as corporations do). In addition, as a matter of default Alaska law, the terms of a partnership agreement (or governing documents of a limited liability company) can only be changed with the unanimous of all partners (or members of an LLC). Hence, if there is any partner who is not a family member (such as a niece or nephew), the family will not be able to remove the restriction and, accordingly, it should not constitute an applicable restriction the existence of which may be disregarded under IRC §2704(b).

Alaska has also eliminated any right of a limited partner or LLC member to demand to be bought out on six months' notice. In fact, under default state law, a partner or member is entitled to distributions only as provided in the governing documents. Moreover, unlike the default rules under the law of virtually all the other states, neither a limited partnership nor a limited liability company is dissolved under Alaska law upon the death of any general partner or member. Rather, a limited liability company continues for as long as there is one member. A limited partnership continues in existence as long as there is another general partner, or if there is none, it dissolves only if a majority-in-interest of the remaining partners fail to elect a new general partner within 90 days.

New Delaware Asset Protection Trust Legislation

Effective July 1, 1997, Delaware enacted a new law similar to and intended to produce the same estate planning and asset protection benefits that the Alaska Trust Act provides. The official synopsis of the new Delaware law states that the purpose of the Act is to facilitate the establishment of trusts in Delaware and is intended to be like the Alaska Trust Act. In fact, much of the language in the Delaware law is identical to the Alaska law.[6]

Unfortunately, it appears that the Delaware law will provide less asset protection than the Alaska law will. Perhaps of much greater significance, it may not be possible for a gift to a self-settled trust formed under Delaware law, as enacted, to be complete for federal tax purposes. See Dela. Stat. Ann. §3573. Subsection §3573(a) appears to provide that the trust is permanently available to discharge the grantor's obligation to pay alimony, child support, and property settlement awards even if the obligation arises after the transfer to the trust occurs. As indicated above, a transfer is incomplete for Federal estate and gift tax purposes to the extent the grantor can relegate the grantor's creditors to the trust. Here, because the potential use of trust assets is limited and probably ascertainable, it seems the transfer might be only partly incomplete (i.e., to the extent potential use of trust assets for child support, etc. is ascertainable). See Treas. Reg. §20.2036-1(a)(ii).

Probably most troublesome is §3573(b), under which the grantor can certify in writing to any creditor (including apparently someone who becomes a creditor after the trust has been created) that the trust assets are available to satisfy the creditor's claim. That certification seems to make the trust assets available to that creditor. This virtually assures that the gift to the trust is incomplete, because the grantor can relegate his or her future creditors to the trust assets. This power of relegation is sufficient to render the gift incomplete. Rev. Rul. 77-378, *supra.*

Third, under §3573(c) the trust assets are permanently available to claimants who have suffered personal injury, death, or property damage that occurs prior to the transfer to the trust. It appears quite certain that these claimants continue for all time to have access to the property in the Delaware trust to satisfy their claims, even if the transfer to the trust was not a fraudulent conveyance. It seems that transfers to the Delaware trust are incomplete to the extent of any such pre-transfer claims, under Dela. Stat. Ann. §3573(c).

Nonetheless, supporters of the new Delaware trust act are likely to seek to have these potential problems with the legislation cured early in that state's 1998 legislative session. With certain changes, Delaware law will provide the same estate planning benefits currently available under Alaska law.

Notes

[1] The extent of asset protection is discussed in more detail in Hompesch, Rothschild and Blattmachr, "Does the New Alaska Trusts Act Provide an Alternative to the Foreign Trust?" *The Journal of Asset Protection*, 9 (July-August, 1997).

[2] For example, Rev. Rul. 77-378 states, in part:

> There would be no doubt of his nonliability for gift tax upon the value of the income if he had reserved to himself the absolute right to the income for his life. But he made no such reservation. *He transferred the entire property. Whether he would enjoy any of its income depended entirely on the trustee, who, in his uncontrolled discretion, could deprive him of it completely.* It was only by virtue of the trustee's direction, which on this record must be regarded as entirely voluntary, that the donor received any of the income: and this direction might be terminated whenever the trustee deemed it proper that the wife should receive the income. *Such a hope of passive expectancy is not a right. It is not enough to lessen the value of the property transferred.... 'Whether the grantor enjoy any of the trust's assets is dependent entirely on the uncontrolled discretion of the trustee. Such a hope or passive expectancy does not lessen the value of the property transferred....'* Rev. Rul. 62-13 is hereby clarified to remove any implication

that an entirely voluntary power held by a trustee to distribute all of the trust's assets to the grantor is sufficient to render a gift incomplete either **in whole or in part** (emphasis added).

Section 2036(a)(1) requires that the decedent retain either 'possession or enjoyment' or 'the right to the income.' If he has no legal right to income, the 'income' phrase would not support inclusion under Section 2036. Perhaps it may be said he has retained 'enjoyment.' However, if some meaning is to be accorded the word 'retained,' some showing of an arrangement, more than the fact that income was paid to the decedent, should be required.... Since such transfers are treated as complete when made for gift tax purposes there is even less reason for the imposition of estate tax liability under Section 2036."

Stephens et al., *Federal Estate and Gift Taxation*, .08[4][c] (footnote numbers and footnotes, other than a portion the text from n. 42, omitted).

[4] Neither a private letter ruling nor a national office technical advice memorandum may be cited or used as precedent. IRC § 6110(j)(3). However, they often are indicative of the Internal Revenue Service's position.

[5] There are four exceptions (or limitations) to the new Alaska spendthrift rule: (i) to the extent the transfer is a fraudulent conveyance, (ii) to the extent that the grantor is in default by 30 or more days in child support, (iii) to the extent that the grantor retains the right to distributions, or (iv) to the extent that the grantor retains a power to revoke. A power to revoke does not include a power to veto distributions to others or to exercise a testamentary special power of appointment. These two powers (i.e., to veto or exercise a testamentary special power) can be used to prevent the transfer to the trust from being a completed gift, but the retention of either power will cause inclusion in the grantor's estate for federal estate tax purposes.

[6] See, generally, Hompesch, "Alaska v. Delaware: Comparison of Recent Trust Legislation," to be published in *Probate & Property* (Jan./Feb. 1998). Mr. Hompesch was the principal drafter of the Alaska LLC/Limited Partnership Amendment Act.

ACTEC NOTES

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3415 S. Sepulveda Boulevard, Suite 330 • Los Angeles, California 90034 • (310) 398-1888 • FAX: (310) 572-7280

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Jerold I. Horn

President's Message

My first President's Message, appearing in the Summer, 1997, issue of *ACTEC Notes*, signalled my long-held belief that the most important issue that confronts trusts and estates lawyers, and the most significant issue that I can address and can induce the College to address, is an economic and professional malaise that befalls the legal specialty in which we practice. I devote this President's Message to revisiting the theme.

As I view the essentials and state them directly, the issue is nothing less than whether our work is sufficiently valuable to generate the fees that will enable us to continue to perform our work in the manner in which we are prepared and inclined and in which our professional standards require. The economic and professional standards that I see at the margins of the market are not cause for encouragement.

The recent and vast increase in the number of lawyers arguably is having the greatest impact upon those types of

(continued on page 183)

PLEASE NOTE

1998 Summer Meeting, Portland, Oregon, July 9-12

Enclosed with this issue are a letter from E. James Gamble, a hotel brochure and reservation form, and a return postcard for a free Northwest Oregon travel guide.

Alaska Consensual Community Property Law And Property Trust

THE STATE OF ALASKA has adopted a new community property law by which a married couple may elect to treat all of their assets or specific assets as community property. This article discusses the estate planning uses and implications of converting one's separate property to community property, and how non-Alaskans may use an Alaska Community Property Trust to obtain the tax and nontax benefits of community property status for select assets.

By **Jonathan G. Blattmachr**
Milbank, Tweed, Hadley & McCloy
New York, NY
and **Howard M. Zaritsky**
Attorney
Rapidan, VA

In most community property states, many forms of property acquired by a married couple are automatically held as community property, unless the couple enter into a binding agreement to treat their assets as separate property. The Alaska Community Property Act (the Act) gives Alaska residents the option of conducting their marital finances within a community system, making it the first wholly consensual community property statute in nearly 60 years.[1] Of even greater importance to estate planners in other states, however, the Act allows both residents and non-residents to establish Alaska Community Property Trusts, by which specific assets can be held as community property under Alaska law.

Alaska Community Property

The Act, which became law on May 22, 1998, allows a husband and wife who are both domiciled in Alaska to enter into an agreement that converts any or all of their property into community property.[2] The Act draws many of its key provisions from the Uniform Marital Property Act, which has previously been adopted only in Wisconsin.[3] The key elements of the Alaska community property rules for residents are that:

1. The couple may select which assets are to be community property and which are to be held in some other form of separate or joint ownership;[4]

2. Community property may be owned with rights of survivorship;[5]

3. Each spouse owns and may control a one-half interest in the community property,[6] but the spouses may choose to grant management authority to one of them;[7]

4. Each spouse is required to act in good faith toward the other with respect to their community property.[8]

5. A spouse may "reclaim" community property given to a third party by one of them unless the non-transferring spouse consents, except for gifts that do not exceed $1,000 in any calendar year or larger gifts which are reasonable, in light of the economic position of both spouses;[9]

6. An Alaska court may equitably divide community property along with marital property in the event of divorce, except to the extent, if any, the spouses have provided otherwise in a community property agreement or trust;[10]

7. Community property is not subject to a claim by a surviving spouse to any minimum or elective share when the first spouse dies;[11]

8. An Alaska Community Property Agreement may be set aside if it is found that it was unconscionable when made, was not voluntarily executed, or that he or she was not given and did not have fair and reasonable disclosure of the property and financial obligations of the other spouse and did not voluntarily waive such disclosure.[12]

The Alaska Community Property Trust

Both resident and nonresident married couples may classify property as community property by transferring it to a community property

trust and by providing in the trust agreement that the property is community property.[13] The Act requires for a valid Alaska Community Property Trust that:

1. One or both spouses transfer property to a trust;

2. The trust expressly declares that some or all the property transferred is community property under Chapter 75 of Title 34 of the Laws of the State of Alaska;

3. At least one trustee of the trust is a "qualified person" whose powers include or are limited to a. maintaining records of the trust and b. preparing or arranging for the preparation of any income tax returns that must be filed by the trust. A "qualified person" is an individual Alaska domiciliary, Alaska trust company or Alaska bank as described in AS 34.75.100(a) (Michie 1998). The powers to maintain trust records and prepare or arrange for the preparation of trust income tax returns may be given either to the Alaska trustee alone or to the Alaska trustee and one or more other trustees;

4. The Trust must contain the following language (in capital letters) at the beginning of the trust agreement:

THE CONSEQUENCES OF THIS TRUST MAY BE VERY EXTENSIVE, INCLUDING, BUT NOT LIMITED TO, YOUR RIGHTS WITH RESPECT TO CREDITORS AND OTHER THIRD PARTIES, AND YOUR RIGHTS WITH YOUR SPOUSE BOTH DURING THE COURSE OF YOUR MARRIAGE AND AT THE TIME OF A DIVORCE. ACCORDINGLY, THIS AGREEMENT SHOULD ONLY BE SIGNED AFTER CAREFUL CONSIDERATION. IF YOU HAVE ANY QUESTIONS ABOUT THIS AGREEMENT, YOU SHOULD SEEK COMPETENT ADVICE.[14]

5. Both spouses must sign the trust, even if only one transfers property to the trust;

6. The trustees must maintain records that identify which property held by the trust is community property and which property held by the trust is not community property.

An Alaska Community Property Trust that meets these requirements will allow the conversion of the trust assets from separate or joint property into community property. Furthermore, it allows the spouses to enter into enforceable agreements regarding:

1. Their rights and obligations in the property transferred to the trust;

2. The management and control of the property transferred to the trust;

3. The disposition of the property transferred to the trust in the event of the dissolution of the marriage or of the trust, death of either or both spouses or the occurrence or nonoccurrence of another event;

4. The choice of law governing the interpretation of the trust; and

5. Any other matter that affects the property transferred to the trust and does not violate public policy or a statute imposing a criminal penalty.

An Alaska Community Property Trust may not be amended or revoked unless the agreement itself provides for revocation on a particular date or on the occurrence of a particular event or unless the agreement is amended or revoked by a later community property trust. To amend or revoke the trust, the later community property trust is not required to declare any property held by the trustee as community property. This means that the spouses may amend the trust to transmute property back from community property to separate property. Both an Alaska Community Property Trust and a later (amending) Community Property Trust are enforceable without consideration,

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although no such agreement is enforceable if unconscionable when made or the spouse against whom enforcement is sought was not given a fair and reasonable disclosure of the property and financial obligations of the other spouse, did not voluntarily sign a written consent expressly waiving the right to disclosure of the property and financial obligations of the other spouse beyond any disclosure made and did not have notice of the property or financial obligations of the other spouse.

Efficacy Of Alaska Community Property Trusts

An Alaska Community Property Trust for nonresidents of the State of Alaska should be valid for tax purposes if the trust can create enforceable property rights with respect to property contributed by persons who are not resident or domiciled within the State of Alaska. The law on point supports the use of a trust in one state to create beneficial and property rights for nonresident beneficiaries, but even in jurisdictions in which the law may be less supportive, good planning can help assure the desired result.

The rules by which the state that should assume jurisdiction over various aspects of trust administration, construction and the rights of beneficiaries, depend upon whether the trust corpus is real or personal property. Generally, the intent of the settlor determines the jurisdiction for a trust holding personal property, while the sites of the real property are determinative with respect to a trust on real property.

Issues of the administration of a trust holding personal property (whether tangible or intangible) are determined under the jurisdiction in which the trust is otherwise administered, which itself is determined on the basis of the intent of the settlor, as disclosed in the governing instrument. Absent an express declaration in the instrument as to the place of administration, the settlor's intent is usually assumed to be that the trustee shall administer the trust at the trustee's principal place of business or domicile. A settlor who names two or more trustees who are domiciled in different states may manifest an intention that the trust should be administered at the domicile or place of business of one of them. Therefore, if the settlor names one or more trustees situated in Alaska, as is required of an Alaska Community Property Trust, it may be assumed that the trust should be administered in Alaska and that it should be supervised by the courts of that state.

The requirements for an Alaska Community Property Trust include the designation of at least one Alaska trustee and refer repeatedly to the construction of the rights of the parties in the property under Alaska law. Under the general rule, therefore, Alaska courts should have jurisdiction over matters involving the administration of an Alaska Community Property Trust even though they might lack jurisdiction over some or all of the beneficiaries.[15]

Questions relating to the construction of an inter vivos trust holding personal property and the rights of the various beneficiaries will be based on the law of the state designated in the instrument, or in the absence of such a designation, the law of the place of administration, if the issue relates to trust administration, or otherwise the jurisdiction that the settlor would probably have desired to apply.[16] A state need have no connection with the trust in order to use its law in construing the trust instrument, if the settlor has selected that particular state's law.[17]

A similar rule applies in determining the overall validity of a trust of personal property. The validity of the trust is determined under the law of the state designated by the settlor, as long as that state has a substantial relation to the trust and that the application of its law does not violate a strong public policy of the state with which the trust has its most significant relationship.[18] A state

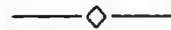
has a substantial relation to a trust if the settlor designates that the trust is to be administered there, if any trustee has its principal place of business or domicile in that state when the trust is created, if the trust is administered in that state or if it is the domicile of the beneficiaries.

As to trusts of interests in land, however, the law of the situs of the land becomes more important. The administration and validity of a trust in land is determined according to the law of the state in which the land is situated, even if the trustees are situated elsewhere.[19] A court of a state other than that in which the property is situated may still exercise jurisdiction over the administration of the trust, if this does not unduly interfere with the control by the courts of the situs.[20]

Issues of construction of the trust instrument, however, have not always been construed according to the situs. Some courts apply the law of the situs,[21] but a few others have applied the law designated by the settlor in construing a trust on real estate.[22] The law of the situs almost certainly controls issues of construction only in the absence of a designation in the instrument of the governing law.

Therefore, it appears very likely that an Alaska Community Property Trust holding personal property will be respected in matters of administration, construction and trust validity, as long as it meets the basic rules set forth by Alaska law. On the other hand, it is quite possible that a court would view an Alaska Community Property Trust as not creating community property interests in real estate, the title to which is held by the trust but the location of which is in another state that has no community property rules, or that has significantly different rules from those adopted in Alaska. A practitioner who wishes to create an Alaska Community Property Trust to hold out-of-state real estate should, therefore, arrange for the transfer of the real estate to an Alaska corporation or partnership or limited liability

> The administration and validity of a trust in land is determined according to the law of the state in which the land is situated, even if the trustees are situated elsewhere.



company if that is otherwise compatible with the client's wishes, since stock, partnership interests and LLC interests are themselves personal property, even if the underlying assets are real property. The stock or partnership or LLC interests may then be transferred to an Alaska Community Property Trust, the terms of which would be governed more clearly by Alaska law.

Gift Tax Consequences Of Creating An Alaska Community Property Trust

Although an Alaska Community Property Trust could be irrevocable, the grantor or grantors should ensure that neither spouse will be deemed to make a completed gift for Federal gift tax purposes to any third party upon the transfer of property to the trust or thereafter unless that is what he, she or they wish. Because both spouses must sign the trust, even if only one of them transfers assets to it, one spouse cannot create the trust, make the assets community property and unilaterally control what the disposition of those assets will be. If the other spouse does not agree to the proposed disposition, he or she presumably will not sign the trust.

The gift tax marital deduction would appear to be a simple protection against adverse gift tax consequences on the creation of an Alaska Community Property Trust, but the law does not clearly establish that granting one's spouse the immediate, unilateral and continuing right until death to withdraw one-half of any property transferred to and which becomes a community property asset should qualify such one-half interest for the gift marital deduction. In other words, the fact that the donee-spouse's interest in the community property under the Alaska Community Property Trust will terminate at his or her death (if the right to withdraw that interest from the trust is not exercised) may mean it is a terminable interest.[23]

With reasonable planning and drafting, a transfer to an Alaska Community Property Trust should be capable of qualifying for the marital deduction.[24] One way is to create an interest which constitutes an "estate trust," that terminates in favor of the donee-spouse's own probate estate, making it thereby disposable by that spouse's Will.[25] Alternatively, the transfer may be made to qualify by falling under the life estate general power of appointment exception.[26] The donee-spouse must be entitled to all of the income for life payable at least annually and be granted a lifetime and/or testamentary general power of appointment exercisable by the donee-spouse alone and in all events in favor of that spouse and/or his or her estate. These are known as general powers of appointment marital deduction trusts.

Although the statute relating to such general power of appointment marital deduction trusts states that the income must be payable to the spouse at least annually, the regulations promulgated under the gift tax regulations relating to such trusts clarify that the income does not, in fact, have to be paid to the donee-spouse but merely be subject to withdraw by that spouse.[27]

The interest created for the donee-spouse in the Alaska Community Property Trust could be made to qualify alternatively for QTIP treatment under Code Sec. 2523(f) by structuring the donee-spouse's interest that way and by election on a timely filed United

States Gift Tax Return. However, it nonetheless seems appropriate to grant the donee-spouse the immediate, unilateral and continuing right to withdraw his or her half of the assets transferred to the Alaska Community Property. The nature of community property is that each spouse owns and may control his or her one-half of the assets. Of course, the trust could provide that either or both spouses could relinquish his or her unilateral right to withdraw although, presumably, care should be taken to ensure that any such relinquishment is not a taxable gift, unless that result is intended.[28]

Income Tax Treatment Of Alaska Community Property Trusts

If one spouse transfers property to the Alaska Community Trust, the trust presumably will be treated as a grantor trust in its entirety with respect to that spouse so that all the trust property, whether all or only part of it becomes community property under Alaska law, is treated as owned for income tax purposes by the grantor-spouse as long as the income and corpus may be distributed, without the consent of an adverse party, to or for the benefit of either or both spouses.[29] Even if the other spouse has the unilateral right to withdraw his or her half of the community property from the trust, powers held by the grantor's spouse are attributed under Code Sec. 672(e) to the grantor. As a result, the grantor-spouse will be treated as though he or she held that power to withdraw, presumably negating any possible application of Code Sec. 678, under which a beneficiary, who is not the trust's grantor but has a unilateral right to withdraw trust property, is treated as the owner of that property for income tax purposes. Moreover, the Internal Revenue Service has consistently held that the provisions of the grantor trust rules (Code Secs. 671-679) which cause the actual grantor to be treated as the owner of the trust assets supercede Code Sec. 678.[30]

When the grantor spouse dies,

When the grantor spouse dies, the trust property will no longer be treated as owned by that spouse for income tax purposes.

the trust property will no longer be treated as owned by that spouse for income tax purposes. To the extent that the surviving spouse has a unilateral power to withdraw such property from the trust that spouse will be treated as the owner under Code Sec. 678. Often, a joint revocable community property trust (that is, one created by both spouses with their community property, as well as, perhaps, separate property) provides, when the first spouse dies, that the survivor's half of the assets which had been community property as well as the survivor's separate property, if any, remains subject to that spouse's power of withdrawal. If that pattern is followed in an Alaska Community Property Trust, the surviving spouse will be considered the owner of such property for income tax purposes under the grantor trust rules. However, to the extent the surviving spouse's power unilaterally to withdraw one-half of the community property contributed by the other spouse expires at or before the death of the grantor spouse, the surviving spouse will not be treated as the owner of such property under the grantor trust rules.[31]

To the extent a spouse makes a contribution to the Alaska Community Property Trust that spouse presumably will continue to be treated as the owner of the property, as discussed above, for income tax purposes under the grantor trust rules even if the non-contributing spouse has a unilater-

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al right to withdraw none, some (e.g., half) or all of property so contributed if the income from the property contributed or the property itself may be distributed, without the consent of an adverse party, to either or both spouse.[32] As a result, during the spouses' joint lifetimes, each spouse will be treated as owning for income tax purposes the assets he or she contributed. That probably will be the case even if the spouses are treated as exchanging interests in assets contributed. For example, the wife contributes Asset X worth $2 million to the trust which became community property (and, therefore, treated as owned under Alaska law as one-half by the husband) and the husband contributes Asset Y worth $1 million which became community property (and, therefore, treated as owned under Alaska law as one-half by the wife). Even if the wife is treated as exchanging a 25 percent interest of Asset X for a 50 percent interest in Asset Y and the husband is treated as exchanging a 50 percent interest in Asset Y for a 25 percent interest in Asset X, the wife probably will be treated as owning all of Asset X and the husband probably will be treated as owning all of Asset Y for Federal income tax purposes. The reason is that for income tax purposes (of which the grantor trust rules are a part), that exchange normally would be treated as a gift rather than as an exchange.[33] Hence, the spouse who contributed the property presumably will be treated as the sole grantor of that asset for income tax purposes.

To the extent of the property contributed by him or her, the surviving spouse will continue to be treated as the property owner for income tax purposes under the grantor trust rules to the extent the property or its income may be distributed to that spouse, without the consent of any adverse party,[34] after (as well as before) the other spouse dies. In addition, the surviving spouse may become to be treated as the owner under Code Sec. 678 of property contributed by the first spouse to die upon that spouse's death to the extent the survivor has a unilateral right to withdraw the property after the death of the first spouse to die.

Basis Adjustment At Death

One major tax advantage of creating an Alaska Community Property Trust is that it enables residents of non-community property states to take advantage of Sec. 1014(b)(6), which states that, upon the death of either spouse, the basis of the entire community property asset (and not just one-half of the asset) becomes equal to the value of the asset at the death of that spouse (or, if applicable, on the alternate valuation date determined under Code Sec. 2032). Sec. 1014(b)(6) does not distinguish between property that is held as community property under automatic (opt out) state laws or under elective (opt in) state laws. Furthermore, significant authority strongly suggests that community property under an opt in law, such as that adopted in Alaska, would be eligible for the basis adjustment at death under Sec. 1014(b)(6).[35]

However, it is appropriate to note that Code Sec. 1014(b)(6) only requires that the property is community property under the laws of any State (or possession or foreign country). If a non-Alaska married person or persons transfers property to an Alaska Community Property Trust, the property will be community property under the law of Alaska. Therefore, it seems literally to fall under the section.

Although it seems the asset which is community property under Alaska law is "community property ... under the community property laws of [a] State," it is possible the courts will hold otherwise.[36] Accordingly, married couples should elect into the Alaska community property system only if that form of ownership reflects their wishes regardless of whether the basis of the surviving spouse's interest in the property

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will be determined on the death of the first spouse to die under Code Sec. 1014(b)(6). Moreover, because the Alaska Community Property law's treatment under that section is untested, it may be preferable for the couple, if it is seeking a step-up in basis for all of their wealth when the first spouse dies, to place all of the assets in the name of the spouse who will die first. Unfortunately, that is not always predictable well before that death occurs. Under Code Sec. 1014(e), no change in basis occurs under Code Sec. 1014(a) for property which was given to the decedent within a year of his or her death and is reacquired, directly or indirectly, by the donor.[37]

Conclusions

Under the Alaska Community Property Act, both married Alaskans and non-Alaskans may elect for some or all of their assets to be community property under Alaska law. To the extent the value of what one spouse converts to community property exceeds the value of what the other so converts, a gift will be made. That gift should usually qualify for the gift tax marital deduction unless the donee spouse is not a U.S. citizen and the gift, along with other gifts to the spouse, exceeds $100,000 in a calendar year.[38]

Although converting assets to community property that may provide the surviving spouse a significant income tax benefit when the first spouse dies, the change in the nature of assets may have other far-reaching effects.[39] Each spouse, in fact, will have a 50 percent ownership interest in the community property. That means, for example, that the community assets will be subject to a 50 percent division in the event of divorce (except to the extent the court having jurisdiction over the divorce may and does order a different division under applicable equitable distribution or similar laws) and each spouse will be permitted to dispose of his or her one-half of the assets when he or she dies except to the extent agreed otherwise. As with other community property systems, spouses hold other rights with respect to their community property which do not exist with respect to other property they own. As a consequence, it is likely that only couples in long-term stable marriages, and perhaps only those who have descendants only of their common union, will elect to have their assets treated as community property under Alaska law.

Even if neither the Internal Revenue Service nor the courts rule that Alaska community property is community property under Code Sec. 1014(b)(6), it seems likely it will be treated as a "50-50" tenancy in common between the spouses or, if elected under the Alaska Act to be "survivorship" community property as the Act permits,[40] as a joint tenancy with rights of survivorship between the spouses. If so, that probably means one-half of the asset will be included in the estate of the first spouse to die.[41]

Thus, the Alaska Community Property Act and the Alaska Community Property Trust offer a rare opportunity for clients whose marriages are extremely sound, to convert those assets that they wish into community property, with possibly significant income tax advantages upon the first spouse's death. Furthermore, these new laws present this opportunity with remarkably few downside risks. ◆

End Notes

1. In other community property states, marital property agreements frequently convert some or all of the parties' non-community property assets into community property, filling the gaps left by state law. However, those agreements differ materially from the Alaska Community Property Agreements because the former add some assets to an extant stack of community property, while the latter starts from a situation in which no assets are community property prior to the agreement. On the non-Alaska form of agreement, see, e.g, Rasmussen, "Divorce Provisions in Opt-In Marital Property Agreements," 67 *Wisc. Lawyer* 15 (Apr. 1994).
2. Alaska Stat. 34.75.060(a) (Michie 1998).
3. The Uniform Marital Property Act was approved by the National Conference of Commissioners on Uniform State Laws in 1983. It is adopted in Wisconsin at Wisc. Stat. Ann. Sec. 766.001-766.97.

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4. Alaska Stat. 34.75.030 (Michie 1998).
5. *See, e.g.* Alaska Stat. 34.75.1101(e) (Michie 1998).
6. *See, e.g.*, Alaska Stat. 34.75.30(c) (Michie 1998).
7. *See, e.g.*, Alaska Stat. 34.75.040 and 34.75.909(d) (Michie 1998).
8. Alaska Stat. 34.75.010 (Michie 1998)
9. Alaska Stat. 34.75.050 (Michie 1998).
10. Alaska Stat. 25.24.160(d) (Michie 1998).
11. Alaska Stat. 13.12.208(d) (Michie 1998).
12. Alaska Stat. 34.75.090(g) and (h) (Michie 1998).
13. Alaska Stat. 34.75.060(b) (Michie 1998).
14. A similar requirement exists for an Alaska Community Property Agreement. *See*, Alaska Stat. 34.75.090(b) (Michie 1998).
15. See *Mullane v. Central Hanover Bank & Trust Co.*, 339 U.S. 306 (1950).
16. Restatement (2d) Conflicts of Law, Sec. 268.
17. *Hughes v. Commissioner of Internal Revenue*, 104 F.2d 144 (9th Cir. 1939); *Noble v. Rogan*, 49 F.Supp. 370 (S.D.Cal.1943); *Application of Eyre*, 133 N.Y.S.2d 511 (1954); *Matter of Grant-Suttie*, 205 Misc. 940, 129 N.Y.S.2d 572 (1954); *Matter of Carter*, 13 Misc.2d 1040, 178 N.Y.S.2d 569 (1958).
18. Restatement (2d) Conflicts of Law, Sec. 270.
19. Restatement (2d) Conflicts of Law, Sec. 276.
20. *Fuller v. McKim*, 187 Mich. 667, 154 N.W. 55 (1915); *Knox v. Jones*, 47 N.Y. 389 (1872); *Matter of Osborn*, 151 Misc. 52,270 N.Y.S. 616 (1934); *In re Sandford's Will*, 81 N.Y.S.2d 377 (1948); *In re Fagan's Estate*, 84 N.Y.S.2d 558 (1949); *In re Piazza's Estate*, 130 N.Y.S.2d 244 (1954); *In re Master's Will*, 136 N.Y.S.2d 907 (1954); *In re Warburg's Estate*, 237 N.Y.S.2d 557 (1963).
21. *Bowen v. Frank*, 179 Ark. 1004, 18 S.W.2d 1037 (1929); *Veach v. Veach*, 205 Ga. 185, 53 S.E.2d 98 (1949); *Peet v. Peet*, 229 Ill. 341, 82 N.E. 376 (1907); *Scofield v. Hadden*, 206 Iowa 597, 220 N.W. 1 (1928); *Thompson v. Penn*, 149 Ky. 158, 148 S.W. 33 (1912); *In re Estate of Hencke*, 220 Minn. 414, 19 N.W.2d 718 (1945); *Minot v. Minot*, 17 App.Div. 521, 45 N.Y.S. 554 (1st Dep't 1897); *Matter of Good*, 304 N.Y. 110, 106 N.E.2d 36 (1952), *aff'g* 278 App.Div. 806, 927, 104 N.Y.S.2d 804 (1st Dep't 1951), *aff'g* 278 App.Div. 806, 927, 104 N.Y.S.2d 804 (1st Dep't 1951), *aff'g* 96 N.Y.S.2d 798 (1950).
22. *Greenwood v. Page*, 138 F.2d 921 (D.C.Cir.1943); *Guerard v. Guerard*, 73 Ga. 506 (1884); *Brown v. Ramsey*, 74 Ga. 210 (1884) (*inter vivos trust*); *Keith v. Eaton*, 58 Kan. 732, 51 P. 271 (1897); *Houghton v. Hughes*, 108 Me. 233, 79 A. 909 (1911); *Martin v. Eslick*, 229 Miss. 234, 90 So.2d 635 (1956); *Zombro v. Moffett*, 329 Mo. 137, 44 S.W.2d 149 (1931); *Applegate v. Brown*, 344 S.W.2d 13 (Mo. 1961); *Cary v. Carman*, 116 Misc. 463, 190 N.Y.S. 193 (1921).
23. As a general rule, a terminable interest does not qualify for the marital deduction. Code Sec. 2523(b)(1). Certain terminable interests may so qualify. *See, e.g.*, Code Sec. 2523(e), 2523(f).
24. As a general rule, no marital deduction is allowed if the transferor's spouse is not a citizen of the United States. Code Sec. 2523(i).
25. *See, e.g.*, Reg. Sec. 20.2056(c)-2(b)(1)(i). Cf. Rev. Rul. 72-33, 1972-2 C.B. 530.
26. Code Sec. 2523(e).
27. Reg. Sec. 25.2523(e)-1(f)(8). See, also, Reg. Sec. 25.2523(f)-1(f), *Example 2* and *Example 3*.
28. *See, generally*, Reg. Sec. 25.2511-2.
29. Code Secs. 672(e), 673, 676 and 677. The trust may be a grantor trust for income tax purposes for other reasons as well. *See*, Code Sec. 674 (control of beneficial interests in the trust) and 675 (administrative powers).
30. *See, generally*, Blattmachr & Sembler, "Crummey Powers and Income Taxation", *The Chase Review* (July 1995).
31. *See* PLR 9321050, essentially reversing PLR 9026036.
32. As mentioned above, the trust may be a grantor trust for other or additional reasons.
33. Code Sec. 1041.
34. As mentioned above, it may be a grantor trust for other or additional reasons.
35. On the validity of a consensual community property law for this purpose, see *Comm'r v. Harmon*, 323 US 44 (1944); and *McCollum v. United States*, 58-2 USTC ¶ 9957 (USDC ND Ok. 1958); and also see Rev. Rul. 77-359, 1977-2 C.B. 24.
36. The IRS seems to accept that separate property converted to community property by agreement is community property for Federal income tax purposes, at least under an opt-out system. *See* Rev. Rul. 77-359, *supra*.
37. If, as suggested by Rev. Rul. 77-359, *supra*, the transmutation of separate to community property is a gift, Code. Sec. 1014(e) may control notwithstanding Code Sec. 1014(b)(6).
38. *See*, Code Sec. 2523(i)(2).
39. Caution should be exercised in converting certain assets to community property, for instance, if one spouse owns a policy of insurance on the life of the other, the conversion presumably will cause the insured spouse to hold an incident of ownership in the policy potentially causing proceeds paid at death to be included in his or her estate. *Cf. Estate of Cervon v. Commissioner*, 111 F.3d 1252 (5th Cir. 1997). It may be inappropriate also for one spouse to convert qualified plan and similar interests into community property. Generally, such interests represent income in respect of a decedent under Code Sec. 691(a) which, under Code Sec. 1014(c), do not receive the income tax-free step-up in basis under Code Sec. 1014(a), but complications of such ownership can arise in the non-participant spouse dies first.
40. *See*, Alaska Stat. 34.75.110(e) (Michie 1998).
41. *See, e.g.*, *Harvey v. United States*, 185 F.2d 463 (7th Cir. 1950).

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