ALASKA LEGISLATURE COMMITTEE FILES 2007-2008 SL&C 12645

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 9 full time employees; 4 are born & raised Alaskans
- Pays State Corporate Income Tax
- Annually puts hundreds of thousands of dollars into the Alaska Economy
- Have on deposit with local banks (Northrim & Alaska First) tens of millions of dollars
- Over 1,000 clients have come to Alaska from other states

Professionals in Alaska Have Benefited

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

Alaskans have benefited directly from the legislation

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

State Of Alaska

The state of Alaska has received over $2 million in direct revenue

- Increase in Life Insurance Premium Taxes
- Increase Corporate Income Tax
- Increase revenue from LLC & LP filings

All This Has Happened With

No Financial Outlay From

the State

Why the Need to Have Additional Legislation

- Since 1997, the Alaska State Legislature has consistently worked to update and improve laws regarding the use and administration of trusts. As a result, Alaska is considered one of the premier trust jurisdictions in the country.
- But, it is a very competitive environment. In fact, at least seven other states – Delaware, Missouri, Nevada, Oklahoma, Rhode Island, South Dakota and Utah – have enacted legislation similar to our own.
- 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-Residents.
The Implementation of Such a Tax Would Cause Alaska to Lose 99% of the Business It Has Attracted Within one Year. The Business Would Go to a State That Does Not Tax Non-Resident Trusts.

Thank You…

for your prior involvement and
hope for your continued support

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

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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[9], 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.[10] 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*[11], 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*[12], 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.[13]

More recently, in *Paxton v. Commissioner*[14], 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.[15]

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[16]. 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.[17] 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.[18] 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'a 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., *Paoloxzi 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 Mega-trust_: 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 294.
22. 76 T.C. 153 (1981), acq. 1981-2 C.B. 1.
23. See *Comm'r v. Vander Weele*, 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 situs 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).

35. But, see 515 S. *Orange Grove Owners Ass'n v. Orange Grove Partners*, Plaint No. 208/94 (High Ct. Rarotonga, Civil Div., Nov. 6, 1995)

36. *In re Larry Portnoy*, 201 B.R. 685, 695 (S.D.N.Y. 1996).

55. *See, e.g.*, PLR 9352006 (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).

56. *See, generally*, Blattmachr & Slade, "Building an Effective Life Insurance Trust"

continued on page 94

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 9345055 (not precedent).

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).[3] 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

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-

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.[1]

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

ACTEC NOTES

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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

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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.

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 expressl 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,

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 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.

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.

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

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

4. Alaska Stat. 34.75.050 (Michie 1998).
5. *See, e.g.* Alaska Stat. 34.75.1101(e) (Michie 1998).
6. *See, e.g.*, Alaska Stat. 34.75.50(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 Byrt*, 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 577 (1948); *In re Pagan's Estate*, 84 N.Y.S.2d 558 (1948); *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); *Post v. Post*, 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 Henche*, 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. Balch*, 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 Carvon 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 465 (7th Cir. 1950).

Jane Pierson

From: lhulbert [lhulbert@gci.net]

Sent: Monday, April 23, 2007 10:32 AM

To: Jane Pierson

Subject: HB's 195, 196, 197

Representative Ramras,

I would like to support House Bills 195, 196 and 197. I have been in the insurance industry for the last 16 years and have worked closely with legislature including the AK Trust Act, Com. Property Act and the Change to the State Premium Tax. I support these three House Bills as it will improve estate planning opportunities for alaskans and bring new business and revenue to the State.

Linda Hulbert
Agent
New York Life Insurance Company
110 Cushman St.
Fairbanks, AK 99701
907-452-4400
Registered Representative offering securities through NYLIFE Securities Inc. (member NASD/SIPC)

New York Life Insurance Company
701 West 8th Ave., Ste.900
Anchorage, AK 99501
907-279-6471

ALASKA STATUTES
Title 13. Decedents' Estates, Guardianships, Transfers, and Trusts.
Chapter 12. Intestacy, Wills, and Donative Transfers.
Article 5. Wills, Will Contracts, and Custody and Deposit of Wills.

Sec. 13.12.517 Penalty clause for contest.

A provision in a will purporting to penalize an interested person for contesting the will or instituting other proceedings relating to the estate is unenforceable if probable cause exists for instituting proceedings.

(§ 3 ch 75 SLA 1996)

A. S. 13.12.517, AK ST § 13.12.517
Current through all 2006 Legislation, Annotations current through Opinions Decided as of July 1, 2006.

END OF DOCUMENT

AS 13.16.680

ALASKA STATUTES
Title 13. Decedents' Estates, Guardianships, Transfers, and Trusts.
Chapter 16. Probate of Wills and Administration.
Article 12. Collection of Personal Property by Affidavit and Summary Administration Procedure.

Sec. 13.16.680 Collection of personal property by affidavit.

(a) Thirty days after the death of a decedent, any person indebted to the decedent or having possession of tangible personal property or an instrument evidencing a debt, obligation, stock, or chose in action belonging to the decedent shall make payment of the indebtedness or deliver the tangible personal property or an instrument evidencing a debt, obligation, stock, or chose in action to a person claiming to be the successor of the decedent upon being presented an affidavit made by or on behalf of the successor stating that

(1) the value of the entire estate, wherever located, less liens and encumbrances, does not exceed $15,000;

(2) 30 days have elapsed since the death of the decedent;

(3) no application or petition for the appointment of a personal representative is pending or has been granted in any jurisdiction; and

(4) the claiming successor is entitled to payment or delivery of the property.

(b) A transfer agent of any security shall change the registered ownership on the books of a corporation from the decedent to the successor or successors upon the presentation of an affidavit as provided in (a) of this section.

(§ 1 ch 78 SLA 1972; am § 4 ch 80 SLA 1984)

A. S. 13.16.680, AK ST § 13.16.680
Current through all 2006 Legislation, Annotations current through Opinions Decided as of July 1, 2006.

END OF DOCUMENT

AS 13.16.700

ALASKA STATUTES
Title 13. Decedents' Estates, Guardianships, Transfers, and Trusts.
Chapter 16. Probate of Wills and Administration.
Article 12. Collection of Personal Property by Affidavit and Summary Administration Procedure.

Sec. 13.16.700 Settlement directed by court.

When a judge receives information that a person has died in the judge's judicial district leaving an estate of $15,000 or less and no qualified person has appeared to take charge of the assets, the judge may immediately appoint a person, corporation, or attorney to settle the estate in the manner provided for in AS 13.16.680 -- 13.16.695.

(§ 1 ch 78 SLA 1972; am § 5 ch 80 SLA 1984)

A. S. 13.16.700, AK ST § 13.16.700
Current through all 2006 Legislation, Annotations current through Opinions Decided as of July 1, 2006.

END OF DOCUMENT

AS 13.33.101

ALASKA STATUTES
Title 13. Decedents' Estates, Guardianships, Transfers, and Trusts.
Chapter 33. Nonprobate Transfers.
Article 1. Provisions Relating to Effect of Death.

Sec. 13.33.101 Nonprobate transfers on death.

(a) A provision for a nonprobate transfer on death in an insurance policy, contract of employment, bond, mortgage, promissory note, certificated or uncertificated security, account agreement, custodial agreement, deposit agreement, compensation plan, pension plan, individual retirement plan, employee benefit plan, trust, conveyance, deed of gift, marital property agreement, or other written instrument of a similar nature is nontestamentary. This subsection includes a written provision that

(1) money or other benefits due to, controlled by, or owned by a decedent before death must be paid after the decedent's death to a person whom the decedent designates either in the instrument or in a separate writing, including a will, executed either before or at the same time as the instrument, or later;

(2) money due or to become due under the instrument ceases to be payable in the event of death of the promisee or the promisor before payment or demand; or

(3) property controlled by or owned by the decedent before death that is the subject of the instrument passes to a person the decedent designates either in the instrument or in a separate writing, including a will, executed either before or at the same time as the instrument, or later.

(b) An instrument referred to in (a) of this section may designate as a beneficiary, payee, or owner, a trustee named or to be named in the will of the person entitled to make the designation. The designation may be made before or after the execution of the designator's will. It is not necessary to the validity of the underlying trust that there be in existence a trust corpus other than the right to receive benefits or to exercise the rights resulting from the designation.

(c) This section does not limit rights of creditors under other laws of this state.

(§ 12 ch 75 SLA 1996)

A. S. 13.33.101, AK ST § 13.33.101
Current through all 2006 Legislation, Annotations current through Opinions Decided as of July 1, 2006.

HB 205

SENATE COMMITTEE REPORT

DATE: 4/30/07

FURTHER: Judiciary

DATE TURNED IN TO OFFICE: 5/8/07

Labor and Commerce Committee considered CS FOR HOUSE BILL NO. 205(FIN)

HB 205 REAL ESTATE BROKERS/SALESPERSONS

"An Act relating to real estate broker and real estate salesperson licensing; and providing for an effective date."

and recommends:

[ ] be **replaced** with [ ] **SCS** or [ ] **CS** _____ (_____)

[ ] adopt **previous** [ ] **SCS** or [ ] **CS** _____ (_____)

[ ] attached amendment(s)

[ ] adopt _____Letter of Intent

[ ] further referral to _____Committee

SENATE BILL:
[ ] Same Title
[ ] New Title

HOUSE BILL:
[ ] Same Title
[ ] Technical Title Change
[ ] New Title w/ SCR #____

NEW FISCAL NOTE(S):

Department					

PREVIOUS FISCAL NOTE(S):

CED	4/10			✓	

[ ] **APPROPRIATION - no fiscal note**

Burde	Burde	✓			
B Davis	DAVIS	✓			
	Stevens	X			
CHAIR:	Ellis	✓			

ALASKA STATE LEGISLATURE
HOUSE LABOR & COMMERCE COMMITTEE

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Rep Mark Neuman, V-Chair
Rep. Jay Ramras
Rep. Gabrielle LeDoux
Rep. Carl Gatto
Rep. Berta Gardner
Rep. Bob Buch

Sponsor Statement
CS HB 205 (FIN)

HB 205 helps clarify and strengthen a number of items in the current statutes and increases consumer protection in the home buying and selling process.

This legislation will:

- Require real estate brokers to adopt written policies and procedures that would be available to the public on request. The policies and procedures would require all real estate licensees to:
  - Notify their broker or broker designee in the event of any legal dispute or allegations of wrong doing
  - Maintain regular communication with their broker or broker designee
  - Act fairly and honestly in all dealings
  - Comply with all real estate laws

- Increase the number of education hours before a person can be licensed from 20 hours to 40 hours.

- Increase the continuing education hours from 20 hours to 30 hours

- Clarify the issue of operating multiple offices and the responsibilities of a broker that resides out of state.

- Establish that a person indicted for a felony involving moral turpitude can not obtain a real estate license until seven years has lapsed since the completion of the sentence.

The Association of Alaska Realtors strongly supports this bill.

HB

226

SENATE COMMITTEE REPORT

DATE: 5/9/07

FURTHER: Finance

DATE TURNED
IN TO OFFICE: _____

Labor and Commerce Committee considered CS FOR HOUSE BILL NO. 226(FIN)

HB 226 REPEAL TERMINATION OF STEP PROGRAM

"An Act extending the termination of the state training and employment program; requiring a review of the program; and providing for an effective date."

and recommends:

[ ] be **replaced** with [X] **SCS** or [ ] **CS** FOR CSHB 226 (L+C)

[ ] adopt **previous** [ ] **SCS** or [ ] **CS** _____ (_____)

[ ] attached amendment(s)

[ ] adopt _____ Letter of Intent

[ ] further referral to _____ Committee

SENATE BILL:
[X] Same Title
[ ] New Title

HOUSE BILL:
[ ] Same Title
[ ] Technical Title Change
[ ] New Title w/ SCR #_____

NEW FISCAL NOTE(S):

Department	Date	Fiscal	Indet	Zero	FN#
TVR WD/OSC	1/18/08	✓			
DOC WD/LTC	1/18/08	✓			

PREVIOUS FISCAL NOTE(S):

Department	Date	Fiscal	Indet	Zero	FN#

[ ] **APPROPRIATION - no fiscal note**

SIGNATURES AND RECOMMENDATIONS:	PRINTED LAST NAME	DO PASS	DO NOT PASS	NO REC	AMEND
C Bunde	Bunde	✓			
B Davis	DAVIS	✓			
	STEVENS	X			
		✓			
CHAIR:	ELLIS	✓			

25-LS0778\M
Wayne
1/31/08

SENATE CS FOR CS FOR HOUSE BILL NO. 226(L&C)

IN THE LEGISLATURE OF THE STATE OF ALASKA

TWENTY-FIFTH LEGISLATURE - SECOND SESSION

BY THE SENATE LABOR AND COMMERCE COMMITTEE

Offered:
Referred:

Sponsor(s): REPRESENTATIVES COGHILL, Gardner, Doll

A BILL

FOR AN ACT ENTITLED

"An Act extending the termination of the state training and employment program; requiring a review of the program; and providing for an effective date."

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

*** Section 1.** The uncodified law of the State of Alaska enacted in sec. 6, ch. 116, SLA 1996, as amended by sec. 9, ch. 85, SLA 1998, by sec. 47, ch. 86, SLA 2002, and by sec. 1, ch. 86, SLA 2004, is amended to read:

Sec. 6. AS 23.15.620, 23.15.625, 23.15.630, 23.15.635, 23.15.640, 23.15.645, 23.15.651, and 23.15.660 are repealed June 30, **2018** [2008].

*** Sec. 2.** The uncodified law of the State of Alaska is amended by adding a new section to read:

REVIEW OF THE STATE TRAINING AND EMPLOYMENT PROGRAM. The Department of Labor and Workforce Development, in consultation with the entities listed in AS 23.15.645(b), shall work with representatives of entities who are eligible to submit a grant application under AS 23.15.620 - 23.15.660 and who provide industry specific training, on-

the-job training, institutional training, classroom job-linked training, and employment assistance, to conduct a review of the priorities and procedures of the state training and employment program. The group of entities involved in the review must include representatives from organized labor and representatives that are not from organized labor. Following the review, the department shall publish a written report containing its findings and recommendations, including changes, if any, that it recommends be made to state statute and the department's regulations. The department shall deliver the report to the president of the senate and the speaker of the house of representatives on or before the 30th day of each regular legislative session.

* **Sec. 3.** This Act takes effect immediately under AS 01.10.070(c).

ALASKA STATE HOUSE OF REPRESENTATIVES

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Session

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State Capitol
Room 204

REPRESENTATIVE JOHN COGHILL*

Sponsor Statement
State Training and Employment Program (STEP)

The State Training and Employment Program (STEP) was established as a pilot program in 1989 to increase training opportunities for Alaskans affected by fluctuations in the economy or by technological changes in the workplace. Since its inception the program has been reauthorized by the legislature six times. This legislation would make this successful program permanent.

The Department of Labor and Workforce Development's FY 08 budget includes $6.7 million in STEP funding to assure Alaska workers are trained for Alaska jobs.

The target population for the STEP services is adults who may be unemployed or underemployed and who have worked in a job covered by Unemployment Insurance. The STEP serves workers that are Alaska residents, have a good work history and a good probability for success in the training and ultimately the workforce.

The STEP has continually proven itself to be one of the most successful employment and training programs in the state and by larger comparison with federally funded training programs in the Nation. The successes of STEP are reflected in the statistics below;

- As of April 2, 2007 STEP served over 23,619 Alaskans since its inception.
- In FY05, more than 95% of STEP participants were employed within 12 months following program exit.
- In FY05, exiting STEP participants earned more then $73 million in Alaska wages in the year following exit, a 22.6% increase over pre-training earnings.
- STEP exiters saw a 23% reduction in total unemployment benefits paid in the 12 months following exit compared to the 12 months prior to entry into the program.
- STEP provides services that benefit the participants in the long term. About 83.6% of participants that exited STEP in FY02 were still Alaska residents in calendar year 2006 and 80% of the participants had Alaska wage and salary earnings in FY06.

Answers to Questions Regarding HB 226
House Labor and Commerce Committee Hearing
April 18, 2007

Question 1: What is the individual training limit for the State Training and Employment Program (STEP)? Can an individual be trained under STEP more than once?

Answer 1: The individual training limit for STEP is $20,000 every five years and individuals can receive training under STEP more than once. The STEP regulations at 8 AAC 87.090, Limitations on Services, identifies the individual training limit for STEP. As long as an individual has not exceeded the $20,000 training limit within a five-year period they can receive STEP funding more then once.

Question 2: What percent of applicants were awarded grants each of the past several years? What dollar amount did the Department receive in applications in each of those years versus what were actually awarded?

Answer 2:
FY07 Grant Applications and Awards:
34 applications received, 15 awarded, 44% awarded
Total amount requested: $6,787,392
Total amount awarded: $2,479,644 (36.5% of the requested amount)

FY06 Grant Applications and Awards:
43 applications received, 24 awarded, 56% awarded
Total amount requested: $9,692,055
Total amount awarded: $3,340,340 (34.5% of the requested amount)

Question 3: Does the Department assist potential applicants in filling out their applications? What other technical assistance does the Department provide to potential applicants?

Answer 3: The Department does not complete STEP grant applications on behalf of the applicants. The Department does provide technical assistance and advice to applicants in several ways. During the grant solicitation, interested parties are offered the ability to ask specific questions regarding the Request for Grant Applications, which often includes a pre-application teleconference. Department staff answers these questions, which may include information on how certain parts of the application should be completed, such as the budget section. In the Notices of Grant Denial, technical assistance is offered on ways to improve their applications and in identifying alternative funding sources. The Department also receives inquiries throughout the year from parties interested in conducting training or which have training needs and works with those organizations to develop viable projects.

Question 4: How many Alaska apprentices are enrolled for each apprentice category, union versus nonunion?

Answer 4: This information has been requested from the U.S. Department of Labor, Office of Apprenticeship Training and will be provided when received.

Question 5: What amount do union and non-union entities spend on training of "their own" money?

Answer 5: Grantee Contributions can include cash match, in-kind goods and services, and leveraged funds. The contributions are specific to the training project for which they applied.

- In FY 06, unions were awarded $1,732,430 and their grantee contribution was $3,493,254. In FY 06 the non-union grantees were awarded $1,607,910 and their grantee contribution was $957,804.
- In FY 07, unions were awarded $1,779,405 and their grantee contribution was $3,158,069. In FY 07 the non-union grantees were awarded $700,239 and their grantee contribution was $1,074,529.

Question 6: Do administrative expenses exceed 20 percent?

Answer 6: No. Grantees are not subject to the 20% Administrative Cost limitation. The Department adopted for STEP the definition of Administrative Costs included in the Workforce Investment Act programs from the U.S. Department of Labor (see 8 AAC 87.180). Under that definition, all costs incurred by a grantee are considered program costs and include Training or Training Related Supportive Services. Therefore, the limitation on the amount of allowable administrative costs of AS 23.645 (e) applies to those costs incurred by the Department and other state agencies. The Department's administrative expenditures are consistently under the 20% cap.

Question 7: Are STEP funds used to train journeymen?

Answer 7: There are instances where incumbent workers, such as journeymen, require training to:

- update certifications,
- obtain new skills to keep up with technological changes, or
- an employer or a job requires a specific skill or certification.

8 AAC 87.120 (d) Participant Priority, identifies persons who lack skills or whose skills have been outdated by technological changes are eligible for training.

Question 8: Was STEP money used for a trip to Las Vegas for a trustee and spouse?

Answer 8: No, STEP did not pay for a trip to Las Vegas for a trustee and their spouse.

Question 9: Was STEP funding used to pay for an athletic club membership?

Answer 9: Alaska Works Partnership's Women in the Trades program encourages women participants to obtain physical conditioning, if appropriate, during their pre-apprenticeship training to make them more competitive in the apprentice selection process and to be able to meet job related physical requirements, such as the ability to pass physical fitness tests. Women participants are identified as one of STEP's priority populations per regulation 8 AAC 87.120 (b). The grantee negotiated a reduce rate for an athletic club membership for STEP participants. The details of the expenditure for the last two years are detailed below:

- FY07 STEP allocated $3,600 for a reduced rate over 3 weeks at a cost of $120 per week for 10 participants for a Physical Conditioning Program.
- FY06 STEP allocated $11,520 at a reduced rate for 12 sessions at $80 per session for 12 participants. The amount actually expended was $729.

Question 10: Why do some high scoring grant applicants not get funded while some low scoring applications do? Is Division staff adjusting review committee scores?

Answer 10: The allegation that top performers do not get grants is a broad generalization that fails to take into account the requirements of the STEP program, and the responsibility of the department applying both legal standards and policies of the state in determining awards for priority training projects. For example, new applicants or those not familiar with the STEP occasionally are awarded grants at the discretion of the Department. Recently the Department exercised its authority and directed that a training grant be negotiated with Ocean Beauty Seafoods despite a review committee not recommending an award. The Commissioner recognized that $55 million had been invested by the state in revitalizing the fishery industry and that Ocean Beauty Seafoods submitted a request for foreign labor worker certification. By funding this training, the Department supported the state's investment in the seafood industry, mitigated the need to hire foreign workers, and fulfilled the purpose of the STEP, which is to increase training opportunities to the state's workers to protect against fluctuations in the economy and to prepare for technological changes in the workplace.

In another instance, the review committee evaluated the Association of Village Council Presidents' application with a high rank. However, the same committee concluded that the investment would result in supplanting of funds. Staff reviewed the grant application and came to the same conclusion that the funds would supplant existing worker compensation. As a result, even though the proposal was favorably considered by the review committee, the Department could not enter into an agreement that would supplant existing funds as it is prohibited by statute.

It is the responsibility of Department staff to review the grant proposals against the criteria in the Request for Grant Applications and the statute. The review may consider past grant performance, the capacity of the entity to meet due diligence including financial viability, compliance with state laws, debarment and debts to the state, other factors that might increase the likelihood of funding a successful project, and the entity's capacity to negotiate an outcome based grant agreement in compliance with STEP goals and program intent. Based on this review, the staff recommends which entities the

Department should fund as part of a statewide distribution of all training funds for workforce investment. The Commissioner makes a final selection and awards the grant. This process requires the exercise of staff judgment in the application of both legal standards and policies of the agency.

At no time does staff adjust scores from the review committee. It is recognized throughout the process that the review team has no authority to allocate resources, as it is the sole responsibility of the agency to do so.

NOTE: Based on a review of the grant process requested by Commissioner Bishop, the grant process is being revised so that more due diligence review is occurring before grant applications are reviewed by the Grant Review Committee. See enclosed document, entitled "STEP Grants Request for Grant Applications (RGA) Process."

Question 11: Were eligibility criteria missing from individual files?

Answer 11: During FY 06, the Department conducted on-site monitoring of 14 STEP grantees. Of those monitored, 11 had the required documentation in their files to verify the eligibility of the participants. The three that did not maintain all of the required file documentation were required to correct the deficiency by obtaining all of the required documents. These monitoring findings were subsequently resolved. No participants were determined ineligible as a result of the on-site monitoring.

Question 12: How does the Department ensure the grantees are not using STEP funds to supplant existing training money?

Answer 13: Supplanting is an important issue to the Department. The Department relies on a multiple stage process to ensure STEP funds are not supplanted.

- In the first stage applicants are required to sign the grant application assuring that the responsible individual understands that supplanting is prohibited.
- For those proposals selected for award the Department completes a due diligence process that involves review of each grantee's financial status and requires the grantee to certify that supplanting will not occur.
- At the third stage the Department reviews the monthly invoices and back up documentation from the grantees and denies payment on items that are not allowed as part of the grant agreement.
- In the fourth stage the Department conducts on-site monitoring of grantees and asks for back up documentation. In the event of any findings the Department requires the grantee to correct any deficiencies or in the extreme requires the grantee to repay the state for questionable costs.

Question 13: In the last 4 years how many union non-union STEP participants have been trained?

Answer 13:

FY 07: 666 union participants and 114 non-union participants (year-to-date)
FY 06: 1,372 union participants and 286 non-union participants
FY 05: 1,011 union participants and 732 non-union participants
FY 04: 906 union participants and 621 non-union participants

Prepared by the Alaska Department of Labor and Workforce Development,
April 21, 2007

Alaska Department of Labor and Workforce Development
Division of Business Partnerships
STATE TRAINING AND EMPLOYMENT PROGRAM (STEP) GRANTS
REQUEST FOR GRANT APPLICATIONS (RGA) PROCESS
April 2007

RGA Process

- Review boilerplates and revise, if necessary, to align with RGA
- Identify impacts desired and performance outcomes sought
- Draft of RGA approved
- Announcement and distribution of RGA
- Pre-Application Teleconference with potential applicants to respond to Questions (Q & A)
  - **Updated Procedure** – Pre-Application teleconference will include a discussion of updated grant application procedures and performance expectations
- Publish teleconference proceedings and Q & A
- Select independent review committee and prepare instructions
- Receive applications
- Division review of application responsiveness to the RGA
  - **Updated Procedure** – Assure applicants' responsiveness to the RGA requirements and complete new or update existing due diligence on all applications (currently due diligence is done upon notification of intent to award)
  - **Updated Procedure** – Past performance assessment – Applicants that are prior grantees will have their past performance assessed with more scrutiny
- Review Committee Meeting, Application Evaluation
  - **Updated procedure** – Grant Review Committee performs qualitative review of applications.
  - **Updated Procedure** -Division staff review applications for allocation of STEP funds as part of statewide distribution of the Department's training funding for workforce investment.
- Award recommendations to Director and Commissioner based on committee evaluation and division staff allocation recommendations
- Commissioner approves the final awards
- Letters of Notice of Intent to Award and Notice of Denial issued
- Respond to denial inquiries
- Appeals – must be submitted within 10 calendar days of date of Notices of Intent to Award and Denial – appeals are decided within 14 calendar days of receipt
- Issue press release
- Notify Technical Unit for input to Management Information System (MIS)
- Provide technical assistance upon request to non-awardees to improve future applications

Alaska Department of Labor and Workforce Development
Division of Business Partnerships
STATE TRAINING AND EMPLOYMENT PROGRAM (STEP)
GRANT NEGOTIATIONS
April 2007

- Negotiation Areas
  - Project activities
  - Location of training
  - Training timelines and schedule
  - Target population
  - Number to be served
  - Performance measures, method of measurement, targets, products
  - Budget
    - Fund sources
    - Cost categories (e.g. training versus support services)
    - Budget line items (e.g., personnel, travel, contractual, etc.)
    - Matching, in-kind contribution or leveraged funds
    - Reasonableness of costs (value) and specific cost items
    - Consistency with other grants
  - Reporting requirements (content, format and frequency)
  - Period of performance
  - Data collection and input decision (who inputs) and timeliness
  - Advance payments

Employment and Earnings of Existing STEP Participants in FY05 by Vendor
Four Quarters Before and After STEP Participation

Training Vendor	Industry	Number of Participants Served	Number Employed		Earnings		% Change in
			Before	After	Before	After	
Alaska Operating Engineers	Construction	448	442	433	23,666,049	26,612,802	12.5
Alaska Laborers Training Trust	Construction	323	319	312	10,267,093	13,830,548	34.7
Alaska Works Partnership (AWP)	Construction	168	166	160	4,880,787	6,688,434	37.0
Pacific Coast Maritime Consortium	Transportation	122	119	119	4,590,413	5,902,998	28.6
IBEW AK Joint Elec Apprentice	Construction	101	101	101	3,372,320	4,523,760	34.1
Center for Employment Education	Construction	96	95	95	2,717,720	3,681,844	35.5
Rural Alaska Fuel Services	Transportation	75	68	68	1,497,729	1,578,927	5.4
Rural AK Community Action Pgm	Education	69	68	67	1,131,434	1,293,011	14.3
Southern AK Carpenters Training Ctr	Construction	66	57	63	2,551,880	3,139,504	23.0
U of A Fairbanks Kuskokwim Campus	Education	62	60	59	1,014,951	997,575	-1.7
Bethel Native Corp Workers Academy	Technology	56	55	56	765,621	915,791	19.6
AVCP Regional Housing Authority	Construction	52	45	48	381,133	482,113	26.5
Alaska Trowel Trades	Construction	29	29	28	487,130	485,811	-0.3
Delta Mine Training Center	Construction	28	25	28	539,525	968,330	79.5
Fairbanks Carpenter Training Center	Construction	22	21	22	814,483	727,149	-10.7
Southwest Alaska Vocational Ed. Ctr.	Construction	20	17	16	195,816	317,959	62.4
Ak Roofers and Waterproofers Local 190	Construction	17	16	17	414,458	512,996	23.8
Piledrivers Local 2520 - Anchorage	Construction	15	12	14	336,642	615,913	83.0
Fairbanks Painters and Allied Trades	Construction	12	12	12	218,745	250,448	14.5
Northern Industrial Training, LLC	Transportation	12	10	11	91,805	337,756	267.9
Aleutia Inc.	Seafood	11	11	9	150,282	124,802	-17.0
Carlile Transportation System	Transportation	11	10	11	278,160	456,143	64.0
U of A Southeast Ketchikan Campus	Construction	11	10	11	102,058	103,559	1.5

Training Vendors with ten (10) or more participants

Source: Alaska Department of Labor and Workforce Development, Research and Analysis Section

Prepared by Alaska Department of Labor and Workforce Development, Division of Business Partnerships, March 6, 2007

Employment and Earnings of Exited STEP Participants in FY 05 by Place of Residence
Four Quarters Before and After STEP Participation

Place of Residence	Number of Participants	Number Employed		Earnings		% Change in Earnings
		Before	After	Before	After	
Aleutians East	28	23	23	354,207	601,611	69.80
Anchorage	350	333	334	11,194,565	14,004,974	25.10
Bethel	126	117	119	1,714,082	1,888,840	10.20
Bristol Bay Borough	6	6	6	120,288	171,148	42.30
Denali	15	14	14	466,197	771,333	65.50
Dillingham	22	20	20	313,156	383,222	22.40
Fairbanks	350	339	331	12,293,413	15,688,154	27.60
Fairbanks Southeast	66	64	65	2,364,355	3,028,406	28.10
Haines	8	8	8	228,590	227,739	-0.40
Juneau	157	153	150	6,752,684	8,034,909	19.00
Kenai	100	97	96	3,505,302	3,975,786	13.40
Ketchikan	88	85	84	3,056,088	3,598,516	17.70
Kodiak	36	35	33	1,472,226	1,709,272	16.10
Lake and Peninsula	23	21	22	508,668	630,491	23.90
MatSu	181	176	175	7,441,236	8,982,059	20.70
Nome	28	28	28	548,526	574,419	4.70
North Slope Borough	3	3	3	Confidential	Confidential	158.10
Northwest Arctic Borough	10	10	9	213,803	234,659	9.80
POW - Outer Ketchikan	32	28	29	884,486	990,987	12.00
Sitka	12	12	10	304,182	305,378	0.40
Skagway - Angoon	8	7	8	131,315	204,426	55.70
Valdez - Cordova	69	64	65	2,614,548	3,328,455	27.30
Wade Hampton	110	107	107	1,598,005	1,754,228	9.80
Wrangell - Petersburg	28	28	28	696,310	929,955	33.60
Yakutat	2	2	2	Confidential	Confidential	-54.30
Yukon - Koyukuk	25	25	25	652,448	892,191	36.70
Unknown	5	4	3	Confidential	Confidential	-21.20
TOTAL	1,888	1,809	1,797	59,626,752	73,091,224	22.60

Confidential = Specific data is confidential but the amount is included in the total.

Source: Alaska Department of Labor and Workforce Development, Research and Analysis Section

Prepared by Alaska Department of Labor and Workforce Development, Division of Business Partnerships, March 6, 2007

DIVISION OF BUSINESS PARTNERSHIPS
ALASKA DEPARTMENT OF LABOR AND WORKFORCE DEVELOPMENT
State Training & Employment Program (STEP)

Success Story
Southwest and Western Alaska

Clinton, an resident raised in Nondalton, was hired by Northern Dynasty last spring to participate in training supported by a STEP grant from the Alaska Department of Labor and Workforce Development. The STEP grant was a partnership between Northern Dynasty, Inc., Mining and Petroleum Services (MAPS), and the Bristol Bay Campus, UAF. Clinton was one of twelve participants who received Mine Safety and Health Administration (MSHA) training. Clinton continued with on the job training to become a driller's helper. According to the acting foremen on the job, "Clinton is a really hard worker and a quick learner. He has helped out with drilling during many long hours."

DIVISION OF BUSINESS PARTNERSHIPS
ALASKA DEPARTMENT OF LABOR AND WORKFORCE DEVELOPMENT
State Training & Employment Program (STEP)

Success Story
Statewide Services

When Garry first came to an Alaska Job Center in Anchorage he was working in a temporary position as a laborer making between $8 and $10 per hour. He requested funding to attend University of Alaska Anchorage to obtain his Associates of Arts and Sciences in Medical Lab Technology. He already had some college credits that would transfer. Garry did not qualify for a Pell grant, but was determined eligible for STEP services. He was an excellent student, averaging a 3.30 GPA while working evenings and weekends at the Blood Bank to support himself. Within the last week, Garry informed his case manager that he got a full-time, permanent position with South Central Foundation and will starting work as a medical lab technician. He did not state how much he would be making, but his employment research shows starting wages for similar positions range between $15 to $17 per hour.