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ALASKA'S 2006 AMENDMENTS TO ITS TRUST AND ESTATE STATUTES

The 2006 Alaska Legislature has enacted provisions that make possible planning opportunities for residents as well as non-residents of Alaska, and that greatly enhance the administration of both revocable and irrevocable trusts.

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The Alaska Legislature has again responded to suggestions from the estate planning community for improvements to Alaska's trust and estate statutes. Senate Bill 298 enacted a variety of estate planning benefits and techniques, which will be of interest to both Alaska residents and non-residents. Beneficiaries' interests in trusts, whether created by third parties or self-settled, are now protected from property division when a beneficiary divorces. Non-residents, whose states do not provide asset protection for IRAs, can form asset-protected IRAs in Alaska. Alaska's trust "decanting" provisions have been expanded so that they will become more valuable for modifying, or clarifying the term of, irrevocable trusts, when necessary. A claims procedure, similar to that provided for estates by the Uniform Probate Code ("UPC"), has been clarified with respect to assets in revocable trusts. These and other amendments are discussed below.

Divorce: Protection of beneficiary's interest in trust

Many estate planners have assumed that a beneficiary's interest in a third-party created spendthrift trust would be protected from the beneficiary's creditors, including a divorcing spouse. Nevertheless, recent judicial decisions interpreting various state statutes—and commentators' analyses—have raised questions about this assumption. One commentator describes certain cases and theories both in states with equitable division statutes and in community property states. Under these cases and theories, a beneficiary's interest in a trust has been or may be invaded—or at least considered—when the divorce court divides the couple's property.[1] Often, the theories of the courts are based on an interpretation of the applicable state statutes' concept of "property" which may be divided or considered upon divorce.

Alaska's property division statute is based on equitable division, as are the statutes of a majority of states. Alaska's statute[2] authorizes the court to divide the parties' property, whether joint or separate, acquired during marriage or before marriage, when the balancing of the equities between the parties requires it. The statute directs the court to consider "the circumstances and necessities of each party."[3]

An invasion of or consideration of the beneficiary's interest in a trust, in connection with the equitable division of property upon the beneficiary's divorce, will likely frustrate the intent of the settlor of the trust, or the testator of a will that created the trust. For example, consider the situation where a property owner creates a trust for the benefit of his or her descendant. Most often, the settlor would want the trust assets to be used for the benefit of the designated child or grandchild and not invaded and distributed to the beneficiary's ex-spouse, or considered by the court in a way that allows the ex-spouse to obtain more of the beneficiary's other property.

This is an area that is driven by state law. The Alaska Legislature decided to expressly protect beneficial interests in trusts from invasion or consideration in a beneficiary's divorce property division. This protection applies whether the trust is a third-party trust or a self-settled discretionary spendthrift trust created prior to marriage. This new subsection (m) of Alaska Statute 34.40.110 provides:

> If a trust has a transfer restriction . . . , in the event of the divorce or dissolution of the marriage of a beneficiary of the trust, the beneficiary's interest in the trust is not considered property subject to

1 Chorney, "Interests in Trusts in Divorce: What the Settlor Giveth, the Divorce Court May Take Away," 40 *U. Miami Heckerling Inst. on Est. Plan.* ch. 14 (2006).

2 Alaska Stat. § 25.24.160.

3 Alaska Stat. § 25.24.160(a)(4)(G).

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division . . . or a part of a property division . . . . Unless otherwise agreed to in writing by the parties to the marriage, this subsection does not apply to a settlor's interest in a self-settled trust with respect to assets transferred to the trust

(1) after the settlor's marriage; or

(2) within 30 days before the settlor's marriage unless the settlor gives written notice to the other party to the marriage of the transfer.

The Alaska Legislature must have been prescient when it enacted this amendment. At the same time the amendment was being considered, and apparently without knowledge of the amendment, the Alaska Supreme Court was deciding *Krize v. Krize*.[4] In that case, the Alaska Supreme Court held that a trial court may consider a prospective inheritance when deciding how a couple's property should be divided in divorce. The court stated, "[i]nterests that have already vested may be considered as an asset of the beneficiary when the superior court divides the property."

The interest in *Krize* was not as definite as a vested interest of a beneficiary in a trust. Rather, it was the husband's prospective inheritance because he was named a beneficiary in the wills of his parents, who evidently were still alive. The Alaska Supreme Court was apparently unaware of the new legislation. Thus, the Alaska Supreme Court and the Alaska Legislature "passed each other like ships in the night."

Alaska may be the first state to directly address this subject, and to expressly prohibit a divorce court's invasion or consideration of trust interests in divorce property divisions. Alaska law has long provided that a trust governed by its laws is not void, voidable, or liable to be set aside on the ground that it avoids or defeats any right, claim, or interest conferred by law on a person by way of a marital or similar right.[5]

Asset protection for IRAs formed by non-residents

Alaska has amended its spendthrift trust statute so as to provide asset protection for IRAs owned by non-residents of Alaska. Some background may be helpful to explain this amendment.

Since 1997, Alaska law has protected interests in trusts created under Alaska's self-settled trust law from claims of creditors of beneficiaries, including any beneficiary who is a grantor if certain conditions are met.[6] Those conditions include: that neither income nor corpus is required to be distributed to the grantor (with certain exceptions), that the trust not be revocable by the grantor, and that the grantor not hold a general power of appointment (that is, one exercisable in favor of the grantor, the grantor's creditors or estate, or the creditors of the grantor's estate) over the trust. If these conditions are met, the trust interests are protected from claims of the creditors of the grantor-beneficiary. A non-resident of Alaska who forms an Alaska trust for asset protection will rely on the principle that "spendthrift" (or creditor) protection with respect to interests in a trust, not consisting of real estate, is determined by the law that governs the trust.[7]

An IRA may be in the form of a trust or an account.[8] The IRA owner may withdraw property from the trust or account at any time, although amounts withdrawn may be subject to income tax and, in some cases, penalties. In addition, the IRA owner may name the successor beneficiary to take the IRA when the owner dies. The owner may name, among others, his or her own estate; hence, the owner has a general power of appointment over the trust property. Therefore, based on the rights of the IRA owner to take withdrawals at any time and to name successor beneficiaries, an IRA—even if in the form of a trust and created under Alaska law—was not protected from creditors' claims by reason of Alaska's self-settled trust law.

The laws of many states, such as Alaska[9] and New York,[10] protect IRAs from claims of the owner's creditors. But some states, such as California, do not provide any such protection for IRAs. In order to provide such protection to non-residents, Alaska has extended its self-settled trust protection under Alaska Statute 13.40.110 to an "eligible individual retirement account trust." This is an IRA that is in the form of a trust and has a trust company or bank, having its principal place of business in Alaska, as the trustee or custodian. Accordingly, a non-resident who lives in a state that does not provide asset protection for IRAs may create an IRA in the form of an Alaska trust with an Alaska bank or trust company. Then, the non-resident may rely on

4 2006 WL 2458571 (Alaska, 8/25/06).

5 See Alaska Stat. § 13.36.310.

6 See Alaska Stat. § 13.40.110.

7 Restatement (Second) Conflict of Laws § 273. The choice of law issues with respect to asset protection for a non-resident who forms a domestic asset protection trust are thoroughly discussed in a three-part series of articles by Shaftel and Bundy entitled: "Domestic Asset Protection Trusts Created by Non-resident Settlors," 32 ETPL 17 (Apr. 2005); "Domestic Asset Protection Trusts and the Bankruptcy Challenge," 32 ETPL 14 (May 2005); and "Impact of New Bankruptcy Provision on Domestic Asset Protection Trusts," 32 ETPL 28 (July 2005).

8 See IRC Section 408 and Section 408A.

9 Alaska Stat. § 09.38.17.

10 N.Y. Estates, Powers & Trusts Law ("EPTL") 7-3.1.

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Alaska's spendthrift trust protection if a creditor of the non-resident attempts to reach the IRA assets.[11]

Improved decanting for trust modification and clarification

Webster tells us that "decanting" is pouring wine from one glass to another. New York enacted a "decanting" statute, which allows a trustee, who has absolute discretion to make distributions or invasions of trust assets for a beneficiary, to pay the trust assets over to another trust.[12] Subsequently, Alaska, Delaware, and Tennessee enacted similar provisions. This decanting authority may be used to achieve a variety of goals, including: dealing with changed circumstances, modifying administrative provisions, altering trusteeship provisions, extending the termination date of trusts, correcting drafting errors, converting a non-grantor trust to a grantor trust or the reverse,[13] changing the governing law, dividing trust property to create separate trusts, and reducing potential liability.[14]

Alaska's statute as originally enacted, like the New York statute, permitted the invasion in further trust only if the trustee's power to invade was not limited by a standard. The 2006 revisions to Alaska Statute 13.36.157 permit a trustee of an Alaska trust to invade in further trust even if the invasion authority is limited by a standard as long as the invasion standard remains the same. In other words, if the Alaska trust permits invasions for the beneficiary's support and education, the trustee can invade the corpus by paying it over to another trust as long as the invasion standard in the trust to which the corpus is paid remains exclusively for the beneficiary's support and education.

This power to invade in further trust, as long as the invasion standard is not changed, may be exercised even though present distributions are not being made or the conditions for them to be made have not occurred. Thus, a trustee may invade the corpus of a trust with a standard for invasion and thereby change other aspects of the trust, such as appointment of successor trustees, the time that the property remains in trust, and the governing law—as long as the invasion standard is not changed.

The Alaska statute also permits the trust to be extended by an invasion in further trust as long as essentially the term from the inception of the trust from which the invasion is being made does not exceed 1,000 years. Alaska law grants the power to invade in further trust to trusts that were not originally governed by Alaska law if the governing law is changed to Alaska. This permits a trust created under the law of a state that imposes a rule against perpetuities to be "moved" to Alaska and the trust term extended beyond the rule against perpetuities period. Such an extension, however, could cause exemption from generation-skipping transfer ("GST") tax to be lost. If the trust is not GST tax-exempt, this will not be a concern.

Delaware and Tennessee allow decanting to a trust that gives the trustee a different standard for distribution—for example, from a trust that limits a trustee by an ascertainable standard to a trust that gives the trustee absolute discretion.[15] Alaska did not adopt this approach because of concern that such a statute might be construed as providing all trustees with an absolute discretion standard. For example, consider a surviving spouse who is named the sole trustee of a non-marital deduction trust (e.g., a bypass trust). The above type of decanting statute gives the spouse the power (even though not actually exercised) to decant the trust to a trust that gives the surviving spouse absolute discretion to make distributions to herself or himself. The result would be that the surviving spouse has a general power of appointment,[16] and consequently, the value of the trust assets will be included in the surviving spouse's gross estate for federal estate tax purposes.[17]

Revocable trusts: Adoption of UPC claims procedure

If a decedent has used a will as a vehicle for his or her estate planning, the UPC provides an expedient claims procedure during the probate process.[18] If the personal representative (executor) has provided notice to creditors, either by personal service on known creditors or by publication, then creditors

11 See note 7, *supra*. For the potential effect of certain provisions of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 on the creditor protection in bankruptcy of certain self-settled trusts, see Shaftel and Bundy, "Impact of New Bankruptcy Provision . . . ," *supra* note 7. That Act does limit the protection from creditors' claims in bankruptcy for certain IRAs even if state law grants a "blanket" exemption for them. See, generally, Bisignanio and Golden, "It's Not Just About Credit Card Debt," 42nd Annual Advanced ALI-ABA Summer Program (2006).

12 N.Y. EPTL 10-6.6.

13 A grantor trust is one whose income, deductions, and credits against tax are attributed to the trust's grantor. See IRC Section 671.

14 Halperin, "Decanting Discretionary Trusts: State Law and Tax Considerations," 29 Tax Mgmt. Est., Gifts &Tr. J. No. 5 (9/9/04).

15 Del. Code Ann. tit. 12 § 3528; Tenn. Code Ann. § 35-15-816.

16 IRC Section 2041.

17 There may be a counterargument if a state has a statute that provides a default rule that a trustee-beneficiary must be subject to an ascertainable standard (see Alaska Statute 13.36.153). However, then the question exists as to which statute prevails with respect to the trustee's distribution powers—the decanting statute or the standard limitation statute.

18 UPC § § 3-810 through 3-816 (1993); Alaska Stat. § § 13.16.450—.525.

must file a claim within four months of the date of the first publication, or their claims will be barred.[19]

However, in many states, including Alaska, revocable trusts are often used as the central estate planning vehicle. There may be no need to commence a probate proceeding (to have the will proved) and appoint a personal representative. If the fiduciary desires to cut off creditors' claims as quickly as possible, often a probate is "opened" and the claims procedure followed. Then the question arises whether this claims procedure applies only to assets in the probate estate (often of minimal value) or also to the assets in the revocable trust.

In an effort to resolve this issue, the Alaska Legislature enacted Alaska Statute 13.36.368. This new statute generally provides that if a probate is opened and a personal representative appointed, and if the personal representative follows the claims procedure of the UPC, then claims that are allowed or barred against the decedent's estate will also be allowed or barred against the assets of the revocable trust. If a probate is not opened, or if the personal representative fails to follow the claims procedure, the trustee of the revocable trust may file a petition with the court for a determination of claims and follow the general claims procedure of the UPC. Then claims against the revocable trust and against the decedent's estate will be allowed or barred under those procedures. New Alaska Statute 13.16.530 authorizes a trustee to take any action that a personal representative may take under Alaska's UPC claim procedures.

These new Alaska revocable trust claims procedure provisions were patterned after provisions that were proposed in Connecticut several years ago. As of the date of this article, Connecticut had not yet passed such provisions. Alaska law, like that of New York,[20] permits a testator who is not domiciled in Alaska to direct that his or her will be admitted to probate in Alaska.

'Immediate' accounting and discharge for trustees of Alaska trusts

Depending on the jurisdiction, a trustee may not be discharged from any act or omission taken as trustee unless the trustee "accounts" to the beneficiaries. This means that generally, the trustee must present a written statement of each act, transaction, and proceeding the trustee has taken. In some states, the formalities of such an accounting are onerous, involving considerable expense and, in some circumstances, require commencement and completion of a formal legal proceeding in which the trustees, in effect, bring suit against the beneficiaries for a discharge from liability.[21] Until the trustee accounts, which may be a period of many years, there is no discharge of liability of the fiduciary. Moreover, the commencement of such a legal action often results in claims being made against the fiduciary, leading to protracted litigation with considerable risk and cost to the trustee.

The 2006 Alaska legislation has clarified and simplified the rules on limitations of proceedings against trustees, except in the case of fraud by a fiduciary.[22] Alaska's approach adopts some of the provisions of the Uniform Trust Code but adds substantial changes. For example, no formal proceeding by a trustee is required for the trustee to obtain a discharge. Also, despite any lack of adequate disclosure, all claims against a trustee who has issued a final report received by the beneficiaries, and who has informed them of the location and availability of records for examination, are barred unless a proceeding to assert the claims is begun within three years after the receipt of such final report by the beneficiaries.

But the trustee can take more affirmative action and obtain a discharge earlier in time and with respect to an intermediate rather than a final report. A trustee may petition a court, having jurisdiction over the trust, for an order approving a report that adequately discloses the existence of a potential claim. If the trustee serves the report on all beneficiaries to be bound by the report and gives the beneficiaries at least 90 days' notice of the court proceeding, then all potential claims of the beneficiaries against the trustee are barred unless the claims are served on the trustee and filed with the court within 60 days after the beneficiaries receive the report.

Alternatively, a trustee may serve a report on a beneficiary that adequately discloses the existence of a potential claim against the trustee. If the fiduciary informs the beneficiary that a proceeding to assert any claim against the trustee must be commenced by the beneficiary within six months after the receipt of the report, and if the beneficiary fails to assert a claim against the trustee, all such claims of the beneficiary are barred.[23]

A report is treated as adequately disclosing the existence of a poten-

19 UPC § 3-803; Alaska Stat. § 13.16.460.

20 Alaska Stat. § 13.06.068. New York has a similar provision. See N.Y. Surrogate's Court Procedure Act ("SCPA") 1605.

21 See, e.g., N.Y. SCPA, Official Form 13.

22 Alaska Stat. § 13.36.100.

23 The new amendment to Alaska Stat. § 13.36.100(c) changes 24 months to six months.

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tial claim against a trustee if it provides sufficient information to the beneficiary to know of the potential claim or to be expected to reasonably inquire into the existence of a claim with respect to the matter. A report that will result in a discharge after six months of its receipt by the beneficiary (unless the beneficiary makes a claim within that time) is treated as giving the beneficiary adequate notice of the time limitation if the cover page or the top of the first page of the report contains the following language in at least *14-point boldfaced uppercase type:* "By receipt of this report, any action you may have as a beneficiary against the trustee for breach of trust based on any matter adequately disclosed in this report may be barred unless the action is begun within six months after you receive this report. If you have any questions, you may wish to obtain professional advice regarding this report."[24]

This procedure may be beneficial to the beneficiaries as well as to the trustee. The beneficiary is advised in each statement of his or her rights. The requirement of prominently disclosed notice to the beneficiary should enhance the probability of the beneficiary carefully reviewing the statement and enforcing any claim for a disclosed breach of fiduciary duty (such as an improper investment) while the matter is "fresh." Furthermore, if financial activity statements are often sent by the trustees to the beneficiaries, there will be little, if any, need for a "formal" accounting. That may significantly reduce the overall cost of trust administration and decrease the risk of costly litigation.

These new accounting proceedings apply to any trust governed by Alaska law whether created by an Alaska resident or non-resident, and to each trustee whether an Alaska resident or non-resident.

Technical corrections to asset protection statutes

The new amendments also add language to Alaska Statute 13.36.310, which provides creditor protection for both third-party trusts and self-settled discretionary spendthrift trusts. These provisions either correct statutory references or clarify and bolster the asset protection aspects of the statute.

Senate Bill 298 was passed by both houses of the Alaska Legislature on 5/1/06. The Governor signed the bill on 6/15/06. The decanting provisions became effective the day after the Governor's signature. The balance of the provisions of SB 298 became effective 90 days after the date of the Governor's signature.

Conclusion

The 2006 Alaska Legislature has enacted a blend of both planning and administrative trust and estate provisions. Asset protection for Alaska IRAs created by non-Alaskans and for all interests in trust provides planning opportunities for residents as well as non-residents of Alaska. Administration of both revocable and irrevocable trusts has been greatly enhanced by the clarified claims procedure for revocable trusts, improved trust decanting, and the immediate accounting and discharge of trustees. As a result, Alaska continues its leadership in the development of trust and estate law.

Alaska may be the first state to expressly prohibit a divorce court's invasion or consideration of trust interests in divorce property divisions.

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24 Alaska Stat. § 13.36.100(b).