Recent Estate Planning Developments & Newsletter

December 2013

All of us at Shaftel Law Offices, P.C., wish you and your family a wonderful holiday season and a healthy & prosperous New Year!

Alaska's New Trust & Estate Statutes

IMITATION IS THE SINCEREST FORM OF FLATTERY. Since 1997, Alaska estate and trust attorneys, trust officers, and financial advisors have worked with the Alaska Legislature to improve Alaska's trust and estate laws. The result is that Alaska has some of the most progressive estate planning laws in the nation. In many areas, Alaska was the first state to enact new laws or clarifying provisions, which were then adopted by many other states. Alaskans should be proud because, as Charles Caleb Colton, a nineteenth century cleric, stated, "imitation is the sincerest form of flattery."

Examples include domestic asset protection trusts, which allow the settlor to be a discretionary beneficiary while the assets in the trust are protected from future creditors and are excluded from the settlor's gross estate for federal estate tax purposes. Another Alaska innovation is our optional community property system, which creates a shared ownership between both spouses and allows both spouses' halves of the community property to receive a full adjustment of basis at the death of the first spouse to die. As a result, the surviving spouse can sell appreciated assets with little or no capital gains tax.

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Alaska leads the nation by providing that a charging order is the sole remedy for creditors seeking to collect from a limited partner's interest in a limited partnership or a member's interest in a limited liability company. In addition, Alaska was one of the first adopters of a "decanting" statute, which allows for modification of irrevocable trusts. Alaska is one of only a few states that permit premortem probate of a will or validation of a trust, where the parties anticipate that there may be a contest after death. These are only a few examples of the many new laws, improvements, and clarifications the Alaska Legislature has enacted since 1997.

BEST STATE IN THE NATION. Now, in the 2013 legislative session, the Alaska Legislature has enacted sixteen new concepts, improvements, and clarifications to Alaska's trust and estate laws. These new laws make Alaska the best state in the nation in which to accomplish your estate planning. Senate Bill 65 became effective September 9, 2013, and applies to all trusts, whether created before or after that date, and to administration of all wills where death occurs after that date. Let us examine some of these new changes.

DECANTING. The term "decanting" comes from the winemaker's pouring of wine from one bottle to another in order to separate the wine from sediment. In the trust area, this term refers to the authority of a trustee, one who has discretion to make distributions, to distribute the trust assets to a new trust without the necessity of court approval. A well written decanting statute allows trustees to correct errors, add or remove trustees, extend the duration of a trust, add advantageous administrative provisions and, to some extent, change the dispositive plan of the trust. With respect to dispositive provisions, it is important that the decanting laws be "balanced" so as to protect the settlor's intent with respect to the identity of the beneficiaries and when distributions will be made to them.

Alaska's new decanting statute distinguishes between a trustee who has unlimited discretion to make distributions among the beneficiaries and a trustee with only limited discretion. The latter trustee would be one who can only make distributions subject to a standard, such as distributions for the health, education, maintenance, and support of the beneficiaries. A trustee with limited discretion can only decant to a trust that has the same beneficiaries, has the same shares for the beneficiaries, and has the same standard for distribution.

A trustee with unlimited discretion has greater flexibility and may decant to a new trust for just one or more of the current beneficiaries, and may give a power of appointment to a current beneficiary, which allows that beneficiary to add new beneficiaries to the trust. Decanting can allow a trustee to extend the duration of a trust when appropriate.

Only an authorized trustee, that is, a trustee who is not the settlor or a beneficiary, can decant a trust. Further, the authorized trustee must exercise this power as a prudent person would under the prevailing circumstances. A trustee may not exercise the decanting power if there is substantial evidence of a contrary intent of the settlor. Further, decanting cannot change a current right to mandatory distributions, eliminate a provision granting another person the power to remove a trustee, or jeopardize tax benefits.

Specific procedures have been enacted which a trustee must follow in order to decant a trust. A beneficiary may object to the decanting and challenge it in court.

Do You Want Your Trustee To Have The Decanting Power? A trustee's power to decant a trust has become a very important part of Alaska law. Decanting provisions are default provisions that apply to every trust in existence as well as to those formed in the future. If you want to limit these decanting provisions, or not have them apply at all to your trust, this needs to be stated in the trust instrument. This can be accomplished when the trust is initially drafted or by amending the trust. If you would like to discuss how decanting applies to trusts you have created, please contact us.

COMMUNITY PROPERTY LAWS CLARIFIED. Alaska's optional community property law, first enacted in 1998, has proven to be extremely popular. The vast majority of

married couples opt into this law in order to obtain the shared ownership benefits and the full adjustment of basis at the death of the first spouse to die. Spouses can opt into the community property system by either signing a community property agreement or forming a community property trust.

Our 2013 amendment provides several important clarifications to assist us in administering our community property laws. For example, the 2013 amendments clarify that once spouses properly opt into the system, the designated property is community property regardless of the form of title. This is consistent with how other states resolve title problems relating to community property.

If title to community property provides that at the death of the first spouse all the property will go to the surviving spouse (survivorship ownership), then this survivorship feature is presumed to have been made with the consent of both spouses. This presumption can be overcome by the testimony of one spouse.

If the type of property involved allows for a beneficiary designation, such as a bank account or life insurance, and only one spouse designates the beneficiary, then that designation is effective only for that spouse's one-half interest in the community property. However, such a beneficiary designation by one spouse is presumed made with the other spouse's consent if the beneficiary is the other spouse, an ancestor or descendant of either spouse, or a charity. Again, this presumption can be overcome by the testimony of one spouse.

Gifts by one spouse are limited to the greater of $1,000 or a larger amount if reasonable considering the economic position of the spouses. The new 2013 clarification provides for specific limitations periods during which gifts can be challenged.

LIFE INSURANCE. Life insurance is frequently used as a part of a person's estate planning. It is often advisable to transfer life insurance policies to a life insurance trust, or to have a trustee of a

life insurance trust buy the policy. Life insurance trusts provide organized management of the proceeds, provide asset protection, and prevent the proceeds from being included in the client's gross estate for federal estate tax purposes.

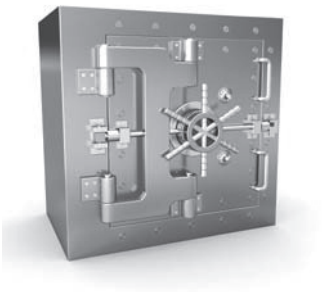
All states provide that, in order to purchase life insurance on someone's life, you must have an "insurable interest." Alaska's existing statute was ambiguous concerning whether a trustee of a life insurance trust had an insurable interest. This has been clarified, along with providing that a person who has an insurable interest in an individual may form a business firm (corporation, limited liability company, partnership) for the purpose of owning the insurance.

Typically, a client, after consulting with his or her insurance agent, will already own a life insurance policy or will already have decided to purchase one as part of the client's planning. As part of the estate planning process, the client may decide that the policy should be owned by a life insurance trust. Someone other than the client is designated as trustee of the trust. Since the decision to purchase the policy has been made previously by the client (with an insurance advisor), it is unfair to impose liability on the trustee who has not been involved in this process. Therefore, the Alaska Legislature adopted provisions which state that a trustee of a life insurance trust is not liable for matters such as whether the policy is a proper investment, the financial strength of the life insurance company, whether to exercise a policy option, or whether to investigate the health of the insured.

These new provisions, which are protective of the life insurance trustee, only apply if the trust instrument expressly adopts them. This is a decision that must be made when the trust is drafted. With respect to existing life insurance trusts, these new protective provisions can apply if the trustee notifies all of the beneficiaries of the trust and they do not object within thirty days.

IMPORTANT! If you want these protective provisions to apply to a trustee of your existing life insurance trust, then notify us so that we can assist you with the proper procedures.

ASSET PROTECTION.



Beneficiary's Interest in IRAs. An employee's interest in a retirement plan is protected from the employee's creditors by federal law, the Employee Retirement Income Security Act. Similarly, almost all states (including Alaska) protect an employee's interest in an IRA from the employee's creditors.

But what happens after the employee dies and the interest is transferred to the employee's spouse or children? For example, suppose you designate your daughter as the beneficiary of your IRA when you die, after your death can your daughter's creditors reach that IRA interest? A creditor could be an ex-spouse in a divorce, or a creditor resulting from an accident, a bad commercial transaction, or professional negligence.

An emerging majority of federal bankruptcy court decisions now protect the beneficiary's interest. What if the lawsuit is brought in state court? The Alaska Legislature has now adopted similar protection for a beneficiary's interest if the lawsuit arises under state law.

Discretionary Interests in an Irrevocable Trust. Asset protection is often one of the central concerns of clients when accomplishing their estate planning. This concern extends not

only to protecting assets during the clients' lifetimes but also providing asset protection for their family members. A substantial body of law exists which provides that if an irrevocable trust has a "spendthrift" clause and/or if the trustee has discretion concerning whether to make distributions, then a creditor cannot reach the assets while they are in the trust. Once assets are distributed to the beneficiary, then the beneficiary's creditors can reach those assets.

However, concern has arisen under various state law provisions about whether a trustee can be forced to make distributions and whether a trustee may directly pay expenses of a beneficiary such as food, housing, and medical expenses.

The Alaska Legislature has clarified this area by providing that a creditor may not force a trustee to make a distribution. Equally important, a trustee may directly pay expenses of the beneficiary. The Alaska Legislature clarified that a beneficiary's discretionary interest in an irrevocable trust is not a property interest or an enforceable right. It is only an expectancy that a creditor of a beneficiary may not attach or otherwise reach.

These new provisions place Alaska in the forefront of the law protecting a beneficiary's interest in an irrevocable trust.

Charging Order Protection for Limited Liability Companies (LLCs) and Limited Partnerships. An "outside" creditor of a member of a LLC or a limited partnership (a creditor whose claim did not arise from the activities of the LLC or limited partnership) cannot reach the assets in the entity, nor can the creditor obtain the member's LLC interest or the limited partner's interest. Rather, the creditor is restricted to obtaining a "charging order" against the member's or partner's interest. A charging order is a court order which says that the creditor can stand next to the member or limited partner and reach distributions when they are made from the business entity.

Alaska was the first state to carefully restrict creditors' remedies to only a charging order. Commentators and several new cases have raised questions about whether the above charging order limitation applies to "equitable" remedies such as a court forming a constructive trust for the benefit of the creditor. Also, several cases have questioned whether the charging order limitation applies to a LLC that has only a single member. The Alaska Legislature has clarified both of these areas. The new statutes provide that the sole remedy characteristic of the charging order applies to both legal and equitable remedies. Also, the charging order sole remedy applies to single member limited liability companies.

Your Asset Protection Planning. Modern, effective asset protection planning for families frequently involves placing assets in LLCs and then transferring those interests (either during lifetime or at death) to a perpetual trust plan for your family. The result is protection of these assets for you, your children, and further descendants. Family members can be trustees and can have flexible powers for investment and distributions.

It is important to emphasize that neither Alaska's laws, nor any other state's laws, protect trust assets from fraudulent transfers. Asset protection planning is only effective if accomplished before a creditor's claim occurs, or if a claim exists, then only if adequate assets are set aside to satisfy that claim.

DIRECTED TRUSTEES. Frequently, clients will desire to have an advisor assist their trustee. The advisor may bring expertise in areas such as investment or when distributions should be made to family members. Concern has arisen about the extent to which the trustee will be liable when the trustee follows the advisor's advice. The new

legislation clarifies that if the trust instrument directs the trustee to follow the advice of a trust advisor, then the trustee is relieved of liability and has no duty to investigate the desirability of the advice. The advisor becomes a fiduciary who must account to the beneficiaries.

Similarly, clients frequently appoint co-trustees. A common example is one trustee whose duties are limited to investment of the trust assets, and another trustee who has administrative and distribution duties. The new legislation expressly provides that a trustee excluded from a certain power must follow the directions of the trustee who holds that power. Excluded trustees are not liable for following the directions or for other actions or inactions of the trustee who holds the power. Again, an excluded trustee has no duty to investigate the correctness of the actions or inactions of the trustee who holds the power. A trustee with the certain powers is the only trustee who must account to the beneficiaries with respect to those powers.

DISPOSITION OF HUMAN REMAINS.

Alaska's existing law left many open questions with respect to the disposition of a person's remains. Who has authority to make disposition decisions? Should the remains be buried or cremated? Where should the burial occur?

These open questions, and others, can result in unfortunate litigation among family members and friends, delay, and potential liability for cemetery organizations or funeral establishments.

The new 2013 legislation enacted Alaska's Disposition of Human Remains Act. As part of your estate planning, you now can sign a form of disposition document. The statute provides the language that should be contained in the document, which can either be a separate document or part of a will or another document. You can designate who you desire to make disposition decisions, and provide for directions for the disposition of your remains. If you fail to sign such a document, then the statute provides a priority of persons who are authorized to make decisions concerning the disposal of your remains.

Your agent's appointment is only effective when the agent signs the document. If the agent fails to act within 48 hours, then the next choice of agent is authorized. Your agent will be liable for the cost of the disposition of remains if your estate or other funds are not adequate.

New Document Available. This new disposition of remains document has now become a standard part of your estate planning. We are available to assist you in the drafting, reviewing, and signing a disposition document.

UNIFORM TRANSFERS TO MINORS ACT (UTMA).

This act is widely used to hold assets that have been gifted or otherwise transferred to someone under the age of 18 years. A custodian is named, who takes charge of the assets and makes distributions to the minor when needed. When the child reaches the age of 18 years (for transfers made by fiduciaries or obligors) or 21 years (for transfers made by gift or will), then the remaining assets are distributed directly to the beneficiary. With respect to custodianships created by gift, existing law allows for the extension of the custodianship for up to age 25 years if the beneficiary is given notice and has the right to compel distribution at age 21 years.

Frequently, clients have formed UTMA accounts but when the time for distribution arrives, they are concerned about the effect that the distribution may have upon the minor. Immaturity, inability to manage assets, a spendthrift problem, and/or alcohol or chemical dependency, may

make it very undesirable or dangerous to have substantial funds distributed to a young person. The new act now allows for extensions beyond the age of 25 years as long as the minor is given notice and has the right to compel outright distribution of the assets at the original age for distribution and at any extended dates.

Procedures Must be Followed. In order to extend distribution, it is important to carefully follow notice, timing, and documentation procedures. We are available to assist you if you have a UTMA account which should be extended for your beneficiary.

UNIFORM PRINCIPAL AND INCOME ACT UPDATED. Alaska last updated its Uniform Principal and Income Act in 2003. At that time, Alaska adopted provisions allowing for the power to adjust, and for conversion to unitrusts. The unitrust concept has been designed to solve a trustee's problem of how to invest trust assets if the directions are to distribute trust income each year. The trustee has an obligation both to the beneficiary who holds the income interest and to the remainder beneficiaries. Does the trustee invest the assets to maximize the net income for the income beneficiary, or to provide growth for the remainder beneficiaries? Perhaps the best example of this dilemma is a marital trust created after the first spouse dies. In order to qualify for the marital deduction, all of the income needs to be paid to the surviving spouse. After the surviving spouse's death, the remaining assets go to the children. To solve this dilemma, a unitrust directs the trustee to distribute a certain percentage of the value of the trust assets each year.

The updated provisions provide a trustee with discretion to choose a unitrust percentage between three and five percent, to choose an averaging period for valuing the assets between three and five years, and to appoint an independent trustee to exercise conversion powers. Further, the new provisions provide authority for initially creating an Express Total Return Unitrust, and applying the unitrust concept to retirement benefits. Finally, a trustee may treat gains as part of the distribution of principal.

Your Estate Planning. If you think the unitrust approach would be helpful for your estate planning, please give us a call. We would be happy to discuss this with you.

VIRTUAL REPRESENTATION. Many estate planning and administration situations require that notice be given to all interested parties. Some of these parties may be incapacitated persons, minors, and unborn descendants. Examples of planning or administration situations include modifications of trusts, guardianships or conservatorships, settlement agreements, and trustee accountings.

Many states permit one person (such as a parent) who has a more immediate interest in a matter to represent others (such as the parent's children, grandchildren, and unborn descendants). This is known as "virtual representation," which means that the persons virtually represented need not be served with legal process and are bound by court proceedings and orders and agreements entered into by the representing party.

Alaska has a broad form of virtual representation which simplifies the legal steps necessary for the above-described types of proceedings. Alaska even allows the settlor of a trust to name a certain person who may represent certain beneficiaries. However, Alaska law was ambiguous concerning whether its virtual representation applied only to court proceedings and orders. The new amendments clarify that Alaska's virtual representation law also applies to nonjudicial proceedings such as the settlement of a trustee's accounting or a

settlement agreement entered into by the parties without court proceedings.

LIFETIME TRANSFERS OF IRA'S TO TRUSTS. Often one of the client's major assets is his or her individual retirement account (IRA). The IRA may have resulted from a rollover of a retirement plan interest after the client's working years, a rollover distribution to a spouse after the employee's death, or an IRA inherited by a child or grandchild.

In order to minimize estate taxes at the client's death, it may be desirable to transfer that IRA interest to an irrevocable trust either by gift or sale. However, in the past this type of planning has not been available because state law has not expressly allowed transfers of IRA interests.

The Alaska Legislature now has enacted a provision which allows for the transfer of IRA interests by the owner of the IRA or a beneficiary who acquired the interest. This opens the door for estate tax minimization planning for IRA interests similar to that used for other types of assets. For example, the IRA interest could be gifted or sold to a grantor trust without acceleration of the inherent income in the IRA. Alternatively, the IRA interest could be used to fund a grantor retained annuity trust (GRAT), again, without accelerating the income of the IRA.

Alaska is the first state to expressly allow for the transfer of IRA interests by the owner or a beneficiary. The income tax consequences will need to be explored with the Internal Revenue Service (IRS) through the private letter ruling approach.

TRUSTS THAT AVOID STATE INCOME TAX. Persons who live in high income tax states frequently form trusts in states like Alaska, which do not have an income tax. They want these trusts to be non-grantor trusts (the income of which is not taxed to the grantor) and they want gifts to the trust to be incomplete gifts (gifts which do not trigger a federal gift tax). Over the years, the IRS has issued favorable private letter rulings with respect to these trusts if they contain certain provisions. Alaska's new act has amended Alaska trust law to facilitate formation of these types of trusts in Alaska.

Our New Paralegal. Cameron C. Nance joined our office in 2013. Originally from West Texas,

he earned a B.A. in political science from Texas A&M (Commerce, TX), and a master's degree in public administration from the University of North Texas (Denton, TX). Cameron spent eight years working for Telecommunications companies in Texas and Massachusetts including, GTE and Verizon. He worked for the Regulatory Commission of Alaska between 2007 and 2012 as advisory staff for Telecommunications matters. Although Cameron arrived to Alaska a bit later in life, he has fallen in love with our state and plans to remain in Alaska.

Cameron's interests include spending time with his family, reading, and gardening. Since 2010 Cameron has been performing live music with his wife throughout Southcentral Alaska.