

# Recent Estate Planning Developments

## Spring 2005

A Summary Provided by the:  
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### THIS EDITION'S EMPHASIS: HEALTHCARE & FINANCIAL PLANNING IN CASE OF INCAPACITY

Status of Federal Estate  
Tax Legislation

Recent IRS Ruling  
Provides Support for  
Conclusion That  
Alaska Trusts  
Will Not be Taxed

Bankruptcy Act  
Amendments  
and Alaska's Domestic  
Asset Protection Trusts

### INTRODUCTION

The subject of healthcare planning for incapacity has been widely discussed in the media lately due to the manner in which healthcare decisions were made for Terri Schiavo and Pope John Paul II. We think that healthcare and financial planning for incapacity should be one of your first and most important steps in your estate planning.

Due to medical advances and increased longevity, many of us will become incapacitated before we die.

- **Who will make healthcare decisions for us if we are unable to do so?**
- **If we are suffering from a terminal condition, do we want "life-sustaining" treatments?**
- **Who will handle our financial matters?**
- **After our deaths, do we want to make anatomical gifts of organs or tissue?**
- **Do we want burial or cremation and, if so, where?**

You can provide your answers to these questions by signing an **Alaska advance healthcare directive** and a **durable power of attorney** for financial purposes. These are the primary subjects discussed in this edition of our newsletter.

We also provide you with updates involving the status of the present federal estate tax law, taxation of Alaska domestic asset protection trusts, which many of you are using, and new bankruptcy provisions dealing with such trusts.

### TERRI SCHIAVO CASE ADVANCE HEALTHCARE DIRECTIVES

The recent Terri Schiavo case has focused public attention on the unfortunate situation that can arise for someone who has not documented his or her wishes regarding healthcare and end-of-life decisions. Amidst the controversy of this case, the media have highlighted just how important it is to make your desires known and provide written authority for someone to act for you. Typically, this is accomplished by signing a healthcare proxy and a living will.

**In Alaska, these are incorporated into one document: an advance healthcare directive.**

A healthcare proxy is a document through which you name the person (your agent) who you want to make healthcare-related decisions for you in the event you are unable to make them for yourself. A living will is a document through which you explain and record your wishes regarding matters such as to what extent you would want medical professionals to use artificial life-sustaining measures to extend your life, and under what conditions, if any, you would not want these measures to be used. It is important that these healthcare documents contain provisions that comply with the privacy rules of the Healthcare Insurance Portability and Accountability Act of 1996 (HIPAA), which has recently been implemented through regulations.

Healthcare proxies and living wills are relatively easy to obtain, but understanding them well enough to put them into effect with confidence and completing them properly is another matter altogether. Some forms for these documents can be difficult to understand and execute properly, especially if they are well-prepared and address the variety of issues involved in detail. By the same token, other forms can seem easy to understand but only because they are ineffectively prepared and do not really offer adequate information and choices. With this in mind, it is generally best to consult a professional when it comes to completing these documents to give yourself the best opportunity to have them accurately and effectively record your wishes.

Fortunately, the Alaska Legislature has rewritten and consolidated the provisions relating to healthcare proxies and living wills into a new form called an advance healthcare directive. This legislation (Alaska Statute 13.52) became effective January 1, 2005.

**Do-Not-Resuscitate Order.** In addition to an Alaska advance healthcare directive, if you so desire, you can ask your physician to complete a “do-not-resuscitate” order (the withholding of cardiopulmonary resuscitation by a healthcare provider) in appropriate circumstances. This is not something that you can complete for yourself.

**Our Advance Healthcare Directive form** is intended to ease difficulties and dispel uncertainty for yourself, your agent, and your loved ones. It not only provides an opportunity to document your feelings regarding healthcare and end-of-life

decisions, but also offers the opportunity to record your wishes regarding anatomical gifts and the final disposition of your remains (burial or cremation). In all of these areas, it enables you to declare both those actions you would want to take place and, just as importantly, to declare what actions you most definitely would not want to take place, should you be in a position where you can no longer make your wishes known on your own behalf.

Family members find such documents to be a tremendous relief because they do not have to wonder whether they are doing what you would want them to do. It truly can be a gift to yourself and to those who may be faced with making agonizing decisions in your place. With a completed directive, you can feel secure in the knowledge that your wishes are on record and will guide your family, your agent, and medical professionals alike.

Thinking about these matters may not be pleasant but, no matter what your age or situation, it is far better to consider these subjects now when they are not urgent rather than putting them off and leaving your desires unclear and undocumented. Everyone should discuss these matters with their spouse, parents, children, physician, religious advisor, or anyone else who is likely to be involved in healthcare or end-of-life decisions. However, over and above these discussions, it is imperative to make sure your decisions are documented in writing. Good communication with loved ones and others who may be involved in these matters, along with written documentation of your specific desires, can provide the key to avoiding conflicts and uncertainty in the future.

**How to Complete an Advance Healthcare Directive:**

- We think planning for incapacity is an **extremely important** part of your estate planning.
- We have placed **additional information** about advance healthcare directives in “question and answer form” **on our website** <[shaftellaw.com](http://shaftellaw.com)>.
- **We are available to assist you** with understanding and completing an advance healthcare directive. We do not charge for our form--only for the legal assistant's time. You may call and schedule an appointment with one of our legal assistants: Leanna, Jack, or Suzanne.

- **If you cannot come in** to complete an advance healthcare directive, for whatever reason, but still desire to sign one now, call us. **We will mail you our form.**
- If you desire, **we will prepare a pocket-size copy** of your advance healthcare directive so that you can carry it in your purse or wallet.

## FINANCIAL PLANNING FOR INCAPACITY

A subject closely related to your healthcare planning is financial planning in case you become incapacitated. If you are no longer able to manage your financial affairs, due to accident or illness, it is important that someone be given the authority to step in and take over for you. This person would then be able to pay your bills and make financial decisions for you until you have recovered or, if you are permanently incapacitated, until your death.

**If No Planning: a Conservatorship.** If you do not accomplish financial planning for incapacity, then the law provides a method to manage your assets. A concerned person may hire an attorney and file a petition with the superior court to have a conservator appointed for you. A hearing would have to be held to determine if, indeed, you are incapacitated. If the court so concludes, then the court will entertain applications for someone to manage your property on your behalf; that is, a “conservator”. This approach is often time-consuming and quite expensive. Therefore, one of the following approaches is greatly superior.

**Use a Durable Power of Attorney.** If you are using a Will as your main estate planning vehicle then we recommend that you also execute a durable power of attorney. This power of attorney will name your agent, who will make financial decisions for you if you are incapacitated. You can make the power of attorney effective immediately or, alternatively, make it “spring into effect” only if you become incapacitated. Your agent is only empowered to act for you according to the powers which you designate in the power of attorney form. You are not giving your agent ownership of property. You remain the owner.

Revocable trusts are generally more effective in dealing with incapacity than powers of attorney.

This is because some institutions (for example, banks, brokerage firms, insurance companies, or government entities) have arbitrary rules concerning when they will recognize powers of attorney. For example, they often will require that the power of attorney be “fresh”, which means that it has been signed within a certain period of time within which your agent is attempting to use it. For this reason, if you are using a power of attorney, we recommend that it be re-signed every several years. Other institutions will only recognize a power of attorney if it is on their form.

**Use a Revocable Trust.** An alternative method is to use a revocable trust. An unmarried individual can use a separate revocable trust, and married individuals in Alaska often use a joint revocable trust. Property is transferred to the revocable trust at the time it is formed. You are the original trustee of your revocable trust. Therefore, you retain complete management and control of the property owned by the trust. You also name successor trustees in case you are incapacitated or die.

If you are incapacitated, then your successor trustee is able to step into your role as manager of the property in the trust. The trustee may then pay your bills and make investment decisions and other financial decisions for you. If you recover, then you resume your position as trustee of the trust.

In summary, planning to deal with possible future incapacity involves financial planning as well as healthcare planning.

## STATUS OF FEDERAL ESTATE TAX LEGISLATION

**2001 Tax Act.** We have previously reported to you, both in our newsletter and on our website, about the 2001 Tax Act and how it affects the transfer tax aspects of estate planning. Under this tax act, the applicable exclusion amount (the amount that you can transfer tax-free at death) is scheduled to increase to \$2,000,000 in 2006 and to \$3,500,000 in 2009. In 2010, the federal estate tax is repealed for one year, and in 2011 the applicable exclusion amount is reduced to \$1,000,000 and the estate tax comes back into effect. This is the so-called “sunset” aspect of the 2001 Tax Act.

**Will There be Permanent Repeal?** There is continuing discussion concerning whether Congress will make the 2001 Tax Act “permanent”. That is, will the one-year repeal of the estate tax be replaced with permanent repeal? The House of Representatives has several times voted in favor of permanent repeal of the estate tax and recently has done so again. However, the key is obtaining Senate approval. In order to obtain Senate approval, sixty senators will need to vote in favor of the legislation. The present “talk on the street” with respect to estate tax repeal is that, if it is going to be accomplished, it must be done in 2005. After that, Congress will be too involved in elections and the administration will thereafter become a “lame duck” administration during which time tax legislation is unlikely. Therefore, this should be an interesting year for federal transfer tax legislative activity.

**RECENT REVENUE RULING  
PROVIDES SUPPORT FOR  
CONCLUSION THAT ALASKA  
DOMESTIC ASSET PROTECTION  
TRUST ASSETS WILL NOT BE  
INCLUDED IN SETTLOR'S GROSS  
ESTATE**

Eight states have now enacted Domestic Asset Protection Trust (DAPT) statutes: Alaska, Delaware, Missouri, Nevada, Rhode Island, South Dakota, Utah, and Oklahoma. A DAPT is an irrevocable inter vivos trust which authorizes an independent trustee, in such trustee's absolute discretion, to make distributions to a class of beneficiaries which includes the settlor. A DAPT is formed under a state law which provides that creditors of the settlor cannot reach the assets in the trust.

**In the Past, the Internal Revenue Service Has Refused to Rule.** When the first modern DAPT law was enacted in Alaska in 1997, a private letter ruling request asked that the Internal Revenue Service rule that contributions to the DAPT would be completed gifts and would be excluded from the settlor's gross estate. Significant authorities existed supporting such a request. The IRS responded by issuing PLR 9837007, which concluded that gifts were complete when made to an Alaska DAPT. However, the IRS refused to rule on the estate tax exclusion issue. No further administrative guidance or case decisions have occurred since that time.

**Revenue Ruling 2004-64.** However, the recent Revenue Ruling 2004-64 provides strong analogous guidance for DAPTs. The Revenue Ruling involved irrevocable inter vivos trusts which were grantor trusts for income tax purposes. The relevant issue discussed in the ruling is whether the trustee's reimbursement of the settlor for income tax which the settlor paid on the trust income constituted “the possession or enjoyment of, or the right to the income from,” the trust assets so that the value of those assets would be included in the settlor's gross estate under I.R.C. § 2036(a)(1). The ruling considered the situation where the trust has a provision which states that the trustee may, in the trustee's discretion, reimburse the settlor. The Internal Revenue Service held that in such a situation, assuming there is no understanding, express or implied, between the settlor and the trustee regarding the trustee's exercise of discretion, the trustee's discretion to reimburse the settlor would not alone cause the inclusion of the trust assets in the settlor's gross estate.

**Academic Commentary.** Professor Jeffrey N. Pennell, of Emory University, at the recent October 2004 Great Western Tax & Estate Planning Conference, pointed out the close analogy between the Revenue Ruling's exclusion of trust assets from the gross estate and the exclusion of the assets of a typical domestic asset protection trust. In a typical DAPT, an independent trustee has absolute discretion concerning whether to make distributions to the settlor. A well-planned DAPT will not involve any express or implied agreements or understandings between the settlor and the independent trustee concerning whether such distributions will be made, nor will a settlor have the power to remove the trustee and name the settlor as a successor trustee. Applicable local DAPT state law will prevent a creditor of the settlor from reaching the trust assets. Therefore, all of the requirements of Revenue Ruling 2004-64 are met.

Applying the conclusion of the Revenue Ruling to DAPTs, since the trustee has discretion whether to distribute assets to the settlor, the settlor has not retained “the possession of, or the right to the income from” the trust assets. As a result, the trust assets will not be included in the settlor's gross estate for federal estate tax purposes. At the above conference, Professor Pennell pointed out that perhaps the Internal Revenue Service is coming around to the conclusion that the assets of a well-planned DAPT will not be included in the settlor's gross estate.

**NEW FEDERAL BANKRUPTCY ACT  
AMENDMENTS AFFECT  
ALASKA TRUSTS, 529 PLANS, AND  
EDUCATION SAVINGS ACCOUNTS**

Congress has recently passed the **Bankruptcy Abuse Prevention and Consumer Protection Act of 2005**. These amendments to the Federal Bankruptcy Code are evidently designed to make it more difficult for persons to declare bankruptcy and have their credit card debt discharged. During the hearings on this new legislation, several witnesses and senators raised the subject of the “**millionaire's loophole**.” They argued that a wealthy person could place substantial assets in a domestic asset protection trust (such as is available under Alaska law), and then later take advantage of the federal bankruptcy law, declare bankruptcy and discharge subsequently incurred debts. As a result, a **new provision** was added to the federal bankruptcy law which provides that if a person who has created a **domestic asset protection trust** declares bankruptcy, then any assets contributed to that trust within **ten years** before the date of filing for bankruptcy will be available to creditors if the person who created the trust made the transfer of assets to the trust “**with actual intent to hinder, delay, or defraud any person** to which the debtor was or became, on or after the date that such transfer was made, indebted.”

From the standpoint of persons who have created, or in the future will create, domestic asset protection trusts, this new amendment does create some uncertainty in the law. **However, it should be difficult for a creditor to establish** that a contribution to a domestic asset protection trust was made with “**actual**” intent to “hinder, delay, or defraud . . .” Most states already have statutes that allow transfers to trusts to be set aside in favor of creditors if the transfers were made with such fraudulent intent. **Most state laws**, including Alaska's, have a **four-year** limitations period rather than this new ten-year period. We have previously reported to you about Alaska's state law which only allows transfers to be set aside if made with an actual intent to defraud a creditor. The grounds of “hinder, delay” which are used in many state statutes have been deleted from Alaska's law.

As of the date of this newsletter, there are pending attempts to clarify this amendment so that it does

not significantly interfere with the legitimate uses of domestic asset protection trusts. We will report to you in a future newsletter concerning whether this clarification is obtained.

In order for a **529 Plan or an Education Savings Account** to be protected from creditors in a bankruptcy proceeding, the following conditions must be met:

- The designated beneficiary of the 529 Plan account must be a child, stepchild, grandchild, or step-grand-child of the debtor for the taxable year for which funds were paid or contributed;
- Amounts paid or contributed to 529 Plan accounts are exempt only to the extent that they do not exceed the limit on contributions under Code § 529(b)(7) with respect to a particular designated beneficiary, as adjusted pursuant to the Consumer Price Index;
- The bankruptcy protection is limited to \$5,000 for all 529 Plan and Education Savings Account accounts for the same designated beneficiary if the funds were not paid or contributed to the account at least 720 days in advance of the bankruptcy petition filing date.




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## OUR WEBSITE

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You may refer to our website <[shaftellaw.com](http://shaftellaw.com)> for a variety of information:

- A “what's new” discussion of developing estate planning subjects;
- A “checklist” for evaluation of your estate planning;
- Estate planning techniques which you should consider;
- New legislation affecting estate planning;
- A “bottom line” discussion of Alaska trusts, their purposes, who should use them, and how to implement them;

- Alaska family limited liability companies;
- Alaska's optional community property system and trusts;
- Our past newsletters;
- Key Alaska estate planning statutes;
- Many articles which we have written about Alaska estate planning techniques.

We hope you will visit our web page at your convenience.

Please e-mail us at <[info@shaftellaw.com](mailto:info@shaftellaw.com)> with your estate planning questions or topics which you would like to see discussed on our website.




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## OUR STAFF

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**OUR ATTORNEYS  
ARE ACTIVELY CONTRIBUTING TO  
THE PROFESSIONAL ESTATE  
PLANNING AND BUSINESS  
COMMUNITY**

Our attorneys are actively participating in estate planning and business education conferences.

Since our last newsletter, **Dave** participated in the Great Western Tax & Estate Planning Conference in Las Vegas in October 2004. He discussed domestic asset protection trusts and how they can be used by nonresidents of Alaska. In May 2005, Dave will participate in the Western Regional meeting of the American College of Trust and Estate Counsel in Seattle. He will participate in a panel discussion of multi-state estate planning techniques.

**Bhree** recently made presentations in the community to a number of real estate professionals. She discussed estate planning fundamentals and the importance of proper funding and implementation of estate planning projects. She also discussed the new advance healthcare directive form and how it

compares to the older healthcare power of attorney or healthcare proxy.

In February 2005, **Chuck** participated in the National Business Institute's conference on limited liability companies and limited liability partnerships in Anchorage. Chuck's presentation addressed taxation of limited liability companies and planning considerations regarding the formation and operation of these business entities which are now the "entities of choice" in Alaska for business, investment, and family planning purposes.




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*We hope the above information is helpful to you. We remain available to help you maintain your estate plan and to add appropriate new techniques when you so desire. If you would like to meet with one of our staff to discuss any of the above subjects, please call.*

### Our Attorneys

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