

## 2 Asset Protection: Dom. & Int'l L. & Tactics § 14A:2

Asset Protection: Domestic and International Law and Tactics | June 2020 Update

### Part II. DOMESTIC ASSET PROTECTION

#### Subpart C. Other Planning Opportunities

#### Chapter 14A. Domestic Asset Protection Trusts

### § 14A:2. Alaska

#### The Alaska Trust Act<sup>1</sup>

In 1997, Alaska's Legislature enacted the foundational statutes which became the basis for Alaska's domestic asset protection trust. Alaska was the first state to enact modern and effective domestic asset protection trust statutes.<sup>2</sup> In subsequent years, thirteen other states have followed suit. There are now sixteen states that allow for the formation of domestic asset protection trusts. Alaska's legislature has continued to improve domestic asset protection trust legislation, as well as related asset protection and administrative statutes.<sup>3</sup> For example, Alaska was the first domestic asset protection trust state to enact protection for advisors assisting in the formation of domestic asset protection trusts,<sup>4</sup> appropriate due diligence procedures,<sup>5</sup> clarified statutes of limitation dealing with fraudulent transfers,<sup>6</sup> restrictive charging order protection for limited partnerships and limited liability companies, decanting,<sup>7</sup> and optional community property with associated asset protection.<sup>8</sup> Alaska's approach has been balanced maximizing fair asset protection and qualification for federal estate tax exclusion, without being overbroad and extreme, so as to invite a court to avoid application of Alaska's statutes. The core statutes for Alaska domestic asset protection trusts are found in [Alaska Statutes 13.36.035\(c\)](#), [13.36.310](#), and [34.40.110](#).

#### Special Fraudulent Transfer Issues

The avoidance of fraudulent transfers is crucial for an effective domestic asset protection trust statutory plan. Alaska is the only domestic asset protection trust state not to have enacted the Uniform Fraudulent Transfer Act. As a result, Alaska avoids the ambiguous provisions of the uniform act which uses terms such as “hinder” and “delay,” and has uncertain limitation periods dealing with discovery of the transfer. In order to set aside a transfer to an Alaska domestic asset protection trust on the grounds the transfer was fraudulent, the creditor must establish that the settlor had an intent to defraud.<sup>9</sup> Such intent must be established by clear and convincing evidence.<sup>10</sup>

The general statute of limitations period to set aside a transfer to an Alaska domestic asset protection trust is four years after the transfer was made.<sup>11</sup> Alaska has resisted the temptation to shorten this limitation period in order to maintain a balanced, reasonable approach and increase the probability of enforcement by the courts. More specifically, if a creditor became a creditor subsequent to the transfer to the trust, then a fixed four-year limitation period applies.<sup>12</sup> If the creditor was existing prior to the transfer to the trust, a claim must be brought within the later of four years after the transfer is made or one year after the transfer is or reasonably could have been discovered by the creditor.<sup>13</sup>

The “discovery” exception is found in the Uniform Fraudulent Transfer Act which exists in all other domestic asset protection trust states as well as in Alaska. However, this “discovery” exception creates considerable uncertainty because the discovery

could occur many years after a transfer. The Alaska legislature provided certainty in this area by adding provisions which only exist in Alaska. The Alaska statutes state that the reasonable discovery exception only applies if the creditor:

- 1) can demonstrate, by a preponderance of the evidence, that the creditor asserted a specific claim against the settlor before the transfer; or
- 2) files another action, ... against the settlor that asserts a claim based on an act or omission of the settlor that occurred before the transfer, and the action described in this sub-subparagraph is filed within four years after the transfer.<sup>14</sup>

### **Special Spendthrift Provisions**

The Alaska domestic asset protection trust statute expressly provides that its spendthrift clause is a transfer restriction described in section 541(c)(2) of the federal bankruptcy code.<sup>15</sup> That federal bankruptcy code provision provides: “A restriction on the transfer of a beneficial interest of the debtor in a trust that is enforceable under applicable nonbankruptcy law is enforceable in a case under this title.” As a result, if a beneficiary voluntarily declares bankruptcy or is involuntarily forced into bankruptcy, the beneficiary's interest in an Alaska domestic asset protection trust, funded without a fraudulent transfer, will not be considered property of the bankruptcy estate controlled by a bankruptcy trustee.

### **No Other Agreements**

Alaska's domestic asset protection trust statutes make it clear the only distributions allowed are those stated in the trust instrument. An agreement or understanding, express or implied, between the settlor and the trustee that attempts to grant or permit the retention of greater rights or authority than is stated in the trust instrument is void.<sup>16</sup> The purpose of this provision is to prevent a third party from arguing that alleged agreements not stated in the trust instrument should be considered by a court with respect to creditor claims or tax consequences.

### **Discretionary Trust Provisions**

Alaska's new discretionary trust provisions qualify and strengthen asset protection in Alaska.<sup>17</sup> As long as the trustee has discretion to make distributions to a beneficiary, then a creditor may not force a distribution nor can a creditor compel a trustee to exercise the trustee's discretion to make a distribution.<sup>18</sup> Even if a beneficiary has an outstanding creditor, a trustee with discretion may pay income or principal to a third party for the benefit of the beneficiary.<sup>19</sup> That is, the trustee may directly pay the beneficiary's expenses or bills. A trustee is not liable to a creditor for paying income or principal on behalf of the beneficiary.<sup>20</sup> A creditor of a beneficiary may not maintain an action or proceeding that interferes with the trustee's discretion to apply income or principal on behalf of the beneficiary.<sup>21</sup> A creditor of a beneficiary may not obtain an order of attachment or similar relief that would prevent a trustee from making a discretionary payment to a third party on behalf of the beneficiary.<sup>22</sup>

If the trustee has discretion to make distributions to a beneficiary, then the beneficiary has an interest in the trust that is a discretionary interest.<sup>23</sup> The Alaska statutes provide that a discretionary interest in an irrevocable trust is not a property interest or an enforceable right. It is an expectancy that a creditor of a beneficiary may not attach or otherwise reach.<sup>24</sup> This is a significant clarification of Alaska law and may be important with respect to Internal Revenue Service liens. Existing federal law appears to only allow the Internal Revenue Service to foreclose liens on property rights.<sup>25</sup>

### **Steps to Settlement**

The Alaska Legislature wanted to make Alaska's domestic asset protection trusts available both to residents and nonresidents. Therefore, suggested contacts with Alaska were enacted in order to establish situs for an Alaska trust. These contacts are as follows: (1) some or all of trust assets deposited in state; (2) an Alaska administrative trustee whose powers include maintaining records and preparing or arranging for the preparation of income tax returns (can be non-exclusive); and (3) part or all of the trust administration occur in Alaska.<sup>26</sup>

### **Due Diligence Affidavit**

Alaska was the first state to require the settlor of a domestic asset protection trust to execute an affidavit establishing facts which support the conclusion that transfers to the domestic asset protection trust are not fraudulent.<sup>27</sup> This is another example of the fairness and reasonableness of Alaska's asset protection statutes, which ultimately will be very important when the courts are interpreting and applying these provisions.

### **Duration**

Alaska's trusts have an allowable duration of up to 1,000 years.<sup>28</sup> This certain duration, rather than total abolition of the rule against perpetuities, was enacted in order to avoid arguments brought up by commentators that total abolition might have the effect of triggering the Delaware Tax Trap.<sup>29</sup>

### **Use of Trust Property**

A trustee may allow a beneficiary to use or occupy real property or use tangible personal property owned by the trust without compromising the asset protection for such property.<sup>30</sup>

### **No Income Tax**

Alaska does not assert income tax against trusts formed by residents or nonresidents.

### **Federal Tax Rulings**

Settlors of Alaska trusts are the only taxpayers who have been successful in obtaining favorable private letter rulings from the Internal Revenue Service.

*Completed Gift.* A primary purpose of a domestic asset protection trust may be transfer tax minimization. To implement this planning, gifts to the trust need to be completed gifts. The first of the favorable rulings was obtained in 1998 and held that the settlor's transfer to the Alaska domestic asset protection trust was a completed gift.

In [Priv. Ltr. Rul. 9837007](#), an Alaska resident proposed to create a self-settled trust for the benefit of herself and her descendants. The trustee was given discretion to distribute income and principal to a class of beneficiaries which included the settlor. The Service held:

Based on the representation that there is no express or implied agreement between the Donor and the Trustee as to how Trustee will exercise its sole and absolute discretion to pay income and principal among the beneficiaries, we conclude that the proposed transfer by Donor of property to Trustee to be held under the Trust agreement will be a completed gift for federal gift tax purposes.

*Exclusion From Gross Estate.* Subsequently, [Rev. Rul. 2004-64](#), [2004-2 C.B. 7](#), provided strong inferential support for the conclusion that assets of a well-planned domestic asset protection trust will not be includible in the settlor's gross estate for federal estate tax purposes. In [Priv. Ltr. Rul. 200944002](#), an Alaska settlor was successful in obtaining a letter ruling approving that conclusion. The Service found little difficulty in repeating its favorable ruling that the transfer to the trust was a completed gift: “In this case, Grantor has retained no power to reconstitute beneficial title or reserved any interest to name new beneficiaries or change the interests of the beneficiaries. Consequently, we conclude that Grantor's transfer of \$X to trust will be a completed gift of \$X.” The Service then turned to [Rev. Rul. 2004-64](#) and discussed its analysis. This analysis seems unnecessary, as the trust itself prohibited the trustee from reimbursing the settlor for income taxes paid with respect to the trust's assets. But then, in one additional sentence the IRS finally takes an express position concerning domestic asset protection trusts and the estate tax, and the position is favorable: “In addition, the trustee's discretionary authority to distribute income and/or principal to Grantor, does not, by itself, cause the Trust corpus to be includible in Grantor's gross estate under § 2036.”<sup>31</sup>

### Settlor's Retention of Interests and Powers

A settlor of an Alaska trust may retain interests in a (1) charitable remainder trust; (2) total-return trust; (3) grantor retained annuity trust or grantor retained unitrust; (4) qualified personal residence trust; (5) individual retirement account; and (6) ability to be reimbursed for income taxes attributable to trust.<sup>32</sup>

A settlor of an Alaska domestic asset protection trust may retain the power to veto distributions and may retain non-general lifetime and testamentary powers of appointment.<sup>33</sup> These retained powers facilitate the formation of an Alaska domestic asset protection trust which has as its primary purpose asset protection and not estate tax minimization. By retaining these powers, gifts to the trust are incomplete for federal transfer tax purposes. As a result, the settlor may transfer assets to the trust which are substantially greater than the settlor's remaining applicable exclusion amount under the federal transfer tax system without incurring transfer tax liability.

A settlor may retain the right to appoint or remove trustees, trust protector, and advisors, and may retain the right to serve as a co-trustee or advisor.<sup>34</sup>

### Fiduciaries

An Alaska administrative trustee is either a resident individual or a trust company (or a bank) that has its principal place of business in Alaska.<sup>35</sup> A trustee of an Alaska domestic asset protection trust has authority to make distributions whether or not governed by a standard.<sup>36</sup> In addition to an Alaska administrative trustee, an Alaska domestic asset protection trust can have nonresident trustees and may have trust protectors and trustee advisors.<sup>37</sup> A settlor may be an advisor to the trustee if the settlor does not have trustee powers over discretionary distributions.<sup>38</sup>

*Protection for Attorneys, Trustees, Advisors, and Others.* Protection is provided for attorneys, trustees, and other persons involved in the creation and administration of the trust and who are involved in funding limited partnerships and limited liability companies.<sup>39</sup> A trustee is given a lien against the trust assets for costs and fees which the trustee incurs in order to defend the trust assets against claims.<sup>40</sup>

*Discharge of Trustee's Liability.* To facilitate the procedure for providing an accounting and discharging a trustee from liability, Alaska statutes provide three approaches. First, the trustee can petition the court and have the accounting and discharge reviewed at a hearing.<sup>41</sup> Alternatively, the trustee discharge is provided six months after the trustee provides an accounting that adequately

discloses claims.<sup>42</sup> If neither of the above approaches are used, then the trustee's liability is discharged three years after the trustee issues a report to the beneficiaries.<sup>43</sup>

### **Decanting and Modification of Alaska Trusts**

Alaska is the first domestic asset protection trust state to enact decanting statutes. Alaska's decanting laws have been amended several times and provide a balanced, thoughtful approach for an out-of-court procedure to make changes to trust provisions.<sup>44</sup> In addition, Alaska has numerous court supervised procedures for modification of trust provisions.<sup>45</sup>

*Moving Trusts to Alaska.* Alaska's statutes facilitate the movement to Alaska of trusts which have been formed in other states. The situs of a trust originally formed in another state may be moved to Alaska by appointment of an Alaska administrative trustee and registration of the trust in Alaska.<sup>46</sup> The administrative trustee may serve along with nonresident trustees. The Alaska administrative trustee must satisfy the residence requirements and must have the powers prescribed in the paragraph below and the residency described above in this paragraph. The governing law of a trust formed in another state may be changed to Alaska. This is accomplished by decanting the trust, if a majority of the trustees select Alaska as the location for the primary administration of the trust.<sup>47</sup>

### **Exception Creditors**

The only exception to asset protection contained in the Alaska domestic asset protection trust statutes is if the settlor was 30 days or more in default of making a child support payment at the time the settlor transferred assets to the trust.<sup>48</sup> Therefore, this exception can be ascertained at the time the trust is funded. If the settlor is not so in default, then this exception becomes irrelevant. This is in contrast to a number of domestic asset protection trust states which have continuing exceptions (e.g., tort claims) after the funding of the trust. Those domestic asset protection trust states run the risk that the Internal Revenue Service will argue that gifts to the trust are not complete for gift tax purposes. The rationale for such an argument is that the settlor has retained control over the transferred assets by retaining the ability to fail to pay the exception creditor and therefore relegating that creditor to the trust funds.<sup>49</sup>

*Divorce.* In the divorce setting, Alaska does not provide an exception which would allow a spouse to make a claim against the trust's assets for alimony. With respect to property division upon divorce, as long as the assets were transferred to the trust 30 days or more prior to the marriage, then the assets in the trust are not considered property subject to division nor can they be considered in the property division process if a settlor and his or her spouse divorce.<sup>50</sup>

The thirty day exception only applies in case a settlor divorces, and not to another beneficiary of the domestic asset protection trust. For example, if the settlor's grandchild is a beneficiary, and divorces, then the grandchild's interest in the trust is not considered property subject to division nor can it be considered as part of the division process.<sup>51</sup> If the beneficiary's divorce occurs in the courts of another state, a creditor may argue Alaska's property settlement statutes are not applicable but rather the property settlement law of the other state should apply. However, in interpreting the latter law, the intent of the settlor and Alaska law may be considered by the court in the other state.

*Forced Heirship, Legitime, or Elective Share.* A claim for forced heirship, legitime, or elective share is prohibited by the Alaska domestic asset protection trust statute as long as the transfer of the assets occurred 30 days before marriage.<sup>52</sup>

*Strong Noncontestability Clause.* Alaska statutes provide that a trust's noncontestability clause is enforceable even if probable cause exists for the contest.<sup>53</sup>

*Limited Partnerships and Limited Liability Companies: Charging Order Only Creditor's Remedy.* Assets are often transferred into a limited partnership or a limited liability company and interests in those entities are transferred into an Alaska domestic asset protection trust. Alaska was the first state to rewrite its statutes to clarify that a charging order is the only remedy of a creditor of a limited partner or member of a limited liability company.<sup>54</sup> This restriction applies to both legal and equitable remedies.<sup>55</sup>

## Case Law

There are two cases involving Alaska domestic asset protection trusts. The first is *Battley v. Mortensen*, which occurred in an Alaska bankruptcy proceeding.<sup>56</sup> This was the first reported case to deal with a domestic asset protection trust. The court held that Mortensen's funding of the trust fell under [section 548\(e\) of the Bankruptcy Code](#) as a fraudulent transfer to a self-settled trust made within ten years prior to his bankruptcy filing.

The second case, *Waldron v. Huber*, occurred in a bankruptcy proceeding in the state of Washington.<sup>57</sup> The court held the Alaska domestic asset protection trust invalid under a conflict of laws analysis, and concluded that Washington had a strong public policy against asset protection for self-settled trusts. The case was not appealed.

## Conclusion

Alaska was the first state to enact effective domestic asset protection trust statutes, and the Alaska Legislature has continued to improve those statutes over the years. Alaska's approach has been fair and balanced, avoiding extreme or “gimmicky” provisions. When selecting a state in which to form a domestic asset protection trust, a key factor should be whether the statutes, as a whole, are reasonable and equitable both to the debtor and to the creditor. Why? Because ultimately the test of a state's statutory plan will be how the courts interpret and enforce those statutes—and those courts may be those of the state of formation, or courts of other states with jurisdiction.

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## Footnotes

- 1 David G. Shaftel has been practicing law in Anchorage, Alaska, since 1970. He was born and raised in California, where he obtained an A.B. degree from Stanford University (1964) and his J.D. degree (1967) from Boalt Hall, at the University of California (Berkeley). In 1977, Dave obtained an LL.M.(Taxation) degree from New York University. Since that date he has been in private practice in Anchorage.
- 2 Prior to 1997, only two states had arguably domestic asset protection trust statutes: Missouri ([Mo. Rev. Stat. §§ 456.5-505](#)) and, arguably, Colorado ([Colo. Rev. Stat. §§ 38-10-111](#)). These two original statutes are terse and only indicate a public policy.
- 3 Amendments to Alaska's asset protection and trust administration statutes have been enacted in 1998, 2000, 2001, 2003, 2004, 2006, 2008, 2010, 2013, and 2014.
- 4 [Alaska Stat. § 34.40.110\(e\)](#).
- 5 [Alaska Stat. § 34.40.110\(j\)](#).
- 6 [Alaska Stat. § 34.40.110\(b\)\(1\) and \(d\)](#).
- 7 [Alaska Stat. §§ 13.36.157, 13.36.158, and 13.36.159](#).
- 8 [Alaska Stat. §§ 34.77.010 to 34.77.995](#).
- 9 [Alaska Stat. § 34.40.110\(b\)\(1\)](#).
- 10 [Alaska Stat. § 34.40.110\(b\)\(1\)](#).
- 11 [Alaska Stat. § 34.40.110\(d\)](#).
- 12 [Alaska Stat. § 34.40.110\(d\)\(2\)](#).
- 13 [Alaska Stat. § 34.40.110\(d\)\(1\)](#).

14 Alaska Stat. § 34.40.110(d)(1)(B).  
15 Alaska Stat. § 34.40.110(a).  
16 Alaska Stat. § 34.40.110(i).  
17 Alaska Stat. § 34.40.113.  
18 Alaska Stat. § 34.40.113(c).  
19 Alaska Stat. § 34.40.113(d).  
20 Alaska Stat. § 34.40.113(d).  
21 Alaska Stat. § 34.40.113(e).  
22 Alaska Stat. § 34.40.113(f).  
23 Alaska Stat. § 34.40.113(i).  
24 Alaska Stat. § 34.40.113(b).  
25 See 26 U.S.C.A. § 6321; U.S. v. Craft, 2002-2 C.B. 548, 535 U.S. 274, 122 S. Ct. 1414, 152 L. Ed. 2d 437, 2002-1 U.S. Tax Cas. (CCH) P 50361, 89 A.F.T.R.2d 2002-2005 (2002); and Drye v. U.S., 2000-1 C.B. 863, 528 U.S. 49, 120 S. Ct. 474, 145 L. Ed. 2d 466, 99-2 U.S. Tax Cas. (CCH) P 51006, 99-2 U.S. Tax Cas. (CCH) P 60363, 84 A.F.T.R.2d 99-7160 (1999).  
26 Alaska Stat. § 13.36.035(c).  
27 Alaska Stat. § 34.40.110(j).  
28 Alaska Stat. § 34.27.051.  
29 I.R.C. § 2514(d) and I.R.C. § 2041(a)(3).  
30 Alaska Stat. § 34.40.110(a).  
31 A full discussion of the above letter rulings may be found in Shaftel, IRS Letter Ruling Approves Estate Tax Planning Using Domestic Asset Protection Trusts, J. Tax'n (Apr. 2010), p.213.  
32 Alaska Stat. § 34.40.110(b)(3).  
33 Alaska Stat. § 34.40.110(b)(2).  
34 Alaska Stat. § 34.40.110(f) and (h).  
35 An Alaska administrative trustee is a "qualified person," defined by Alaska Stat. § 13.36.390(3). The Alaska administrative trustee must have the trustee powers described in Alaska Stat. § 13.36.035(c).  
36 Alaska Stat. § 34.40.110(m)(1).  
37 Alaska Stat. § 13.36.370, 13.36.375; Alaska Stat. § 34.40.110(f), (g), (h).  
38 Alaska Stat. § 13.36.370, 13.36.375; Alaska Stat. § 34.40.110(f), (g), (h).  
39 Alaska Stat. § 34.40.110(e).  
40 Alaska Stat. § 13.36.310(c).  
41 Alaska Stat. § 13.36.100(b).  
42 Alaska Stat. § 13.36.100(c).  
43 Alaska Stat. § 13.36.100(a).  
44 Alaska Stat. §§ 13.36.157, 13.36.158, 13.36.159.  
45 Alaska Stat. § 13.36.345 Modification or termination of irrevocable trusts because of unanticipated circumstances; AS 13.36.350 Reformation to correct mistakes in irrevocable trusts; AS 13.36.355 Construction or modification of trust to achieve settlor's tax objectives; AS 13.36.360 Modification or termination of irrevocable trust by consent; Alaska Stat. § 13.36.365 Uneconomical irrevocable trust.  
46 Alaska Stat. § 13.36.043.  
47 Alaska Stat. § 13.36.158(n).  
48 Alaska Stat. § 34.40.110(b)(4).  
49 See the discussion in Rothschild, Blattmachr, Gans and Blattmachr, "IRS Rules Self-Settled Alaska Trust Will Not be in Grantor's Estate," 37 Est. Plan. No. 1 (Jan. 2010).  
50 Alaska Stat. § 34.40.110(l).  
51 Alaska Stat. § 34.40.110(l).  
52 Alaska Stat. § 13.12.205(b).  
53 Alaska Stat. § 13.36.330.  
54 Alaska Stat. § 10.50.380; Alaska Stat. § 32.11.340.

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Alaska Stat. § 10.50.380; Alaska Stat. § 32.11.340.

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In re Mortensen, 2011 WL 5025288 (Bankr. D. Alaska 2011), by the Alaska Bankr. Ct.

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In re Huber, 493 B.R. 798 (Bankr. W.D. Wash. 2013).

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