



To: Clients

From: Stuart H. Sorkin, Esq.

Re: U.S. Residents Summary Alaska
Trusts

Date: 9/30/2020

This memorandum summarizes the reasons to establish an Alaska Creditor Protected Trust and the steps required to establish an Alaska Trust.

Summary of Alaska Creditor Protected Trusts.

An asset-protection trust under Alaska law, as more fully described below, is a trust that splits the beneficial enjoyment of trust assets from their legal ownership. The beneficiaries of a trust are the beneficial owners of equitable interests in the trust assets, but they do not hold legal title to the assets. Thus this kind of trust fulfills the goal of asset protection planning, i.e. to insulate assets from claims of creditors without concealment or tax evasion. A creditor's ability to satisfy a judgment against a beneficiary's interest in a trust is limited to the beneficiary's interest in such trust. Consequently, the common goal of asset protection trusts is to limit the interests of beneficiaries in such a way so as to preclude creditors from collecting against trust assets.

Alaska was the first US jurisdiction to enact laws allowing protection for self-settled trusts (in 1997) and was shortly followed by Delaware, Nevada, South Dakota and a few others. These trusts are known as *Domestic Asset Protection Trusts* (DAPTs). Usually, a DAPT must comply with the following requirements:

- the trust must be irrevocable and spendthrift;
- at least one resident trustee must be appointed;
- some administration of the trust must be conducted in respective state;
- the settlor cannot act as a trustee.

The Alaska Trust statute has the following additional advantages:

1. There is no state income tax imposed on the Trust's income.
2. An Alaska Trust can last up to 1,000 years.
3. Alaska has a broad Decanting Statute, which allows the modification of an irrevocable

trust.

Potential Risks of Establishing a DAPT.

There are two exceptions to the general rule regarding the creditor protection afforded a DAPT, which may create conflicts of law: (i) states will not recognize laws of sister states that violate their own public policy, and (ii) if the trust owns real property, such property will be governed by the law of jurisdiction that is the property's situs. Additionally, the Full Faith and Credit clause of the Constitution provides that each state must give full faith and credit to the laws of every other state. This means that if a court from another state refuses to recognize the protection of a DAPT and enters a judgment for the

creditor, the creditor may be able to enforce the judgment against the trustee of the DAPT, even if that trustee was located in the DAPT jurisdiction. The efficacy of a DAPT may also be challenged under the Supremacy clause of the U.S. Constitution, under the applicable fraudulent transfer statute, or because the settlor retained some prohibited control over the trust. For these reasons, I strongly recommend that the establishment of an Alaska Trust should be part of drafting a comprehensive estate plan for the settlor to give the settlor a recognized reason why the transfer of assets to the Alaska Trust is not a fraudulent conveyance. One final caution, if the settlor files for bankruptcy within 10 years of establishing a DAPT, then there has been one recent case that has held that a trustee in bankruptcy may be able to reach the assets in a DAPT, when the settlor know of his financial problems before he established a DAPT.

For non-US Settlers, the issues that would seem to apply on a DAPT are: 1) whether a non-US court has jurisdiction over the DAPT; 2) the conflict of US versus non-US laws (i.e., which jurisdiction's laws will apply to the trust and the protection it purports to offer); 3) which fraudulent transfer law would apply; and 4) whether the US state court will recognize the non-US judgment. Additionally, the issue of the Full Faith and Credit clause doctrine of the US Constitution would not apply to a non-US settlor facing a non-US judgment. Creditors of non-US settlers would have to first obtain a judgment in their home jurisdiction and then attempt to enforce that "foreign" judgment in the US against the trustee of the DAPT, who was not a party to the original action. Therefore, except in unusual cases, this would mean that the only issues to litigate would be whether a fraudulent transfer has taken place, and in turn, which jurisdiction's fraudulent transfer laws would apply. Despite that, the non-US creditor must still seek to first have the foreign judgment recognized, because without formal legal acknowledgment of the judgment in the US court, there would be no basis on which to question the transfer.

Terms for an Alaska Trust.

The key decisions that need to be made when establishing a DAPT are the following:

1. Who will serve as trustee in addition to the Alaska Trust Company?
2. Who are the beneficiaries of the DAPT after the settlor death?
3. What are the terms for distribution to the subsequent beneficiaries?

If the Settlor intends to optimize the benefit of the use of an Alaska Trust, then we strongly recommend that upon the death of the Settlor that the assets of the trust remain in sub-trusts established for all the subsequent beneficiaries. The continuation of the Alaska Trust for any subsequent beneficiaries will also provide them with creditor protection, including from a divorce depending on the foreign jurisdiction. Furthermore, since the term of an Alaska trust can be up to 1,000 years, it is the ideal vehicle to establish a family bank for the benefit of the subsequent beneficiaries such as the Rothschild Family established several centuries ago.

In addition, the Alaska Trust must have: (i) named trustee who are independent of the beneficiary(ies), and (ii) the independent trustee's ability to make distributions is limited to an "ascertainable standard." The general definition of an ascertainable standard is "for the reasonable health, education, and support of a beneficiary."

Many clients have concerns regarding the appointment of an independent trustee and fear losing control over the assets. However, the Alaska Trust provides for the establishment of a Trust Committee. The Trust Committee has the ability for any or no reason to fire and hire any Trustee. To maintain the independent status of the trustee, the Trust Committee can only name a trustee who is not the Settlor, a beneficiary or directly related to the Settlor or a beneficiary or has a support obligation for the Settlor or beneficiary. Furthermore, we strongly suggest that the successor trustees should be either an attorney, accountant, financial planner or financial institution. The Settlor/beneficiary will be the initial Trust Committee, thereby giving the Settlor significant indirect control over the assets transferred to the Alaska Trust but allowing the Settlor to maintain the creditor protection benefits. Upon the death of the Settlor/beneficiary, the successor members of the Trust Committee could be the subsequent beneficiaries of the Alaska Trust.

If the settlor is going to optimize the benefit of the use of an Alaska Trust for beneficiaries of the Alaska Trust other than the settlor, I strongly recommend that the sub-trusts established for the other individual beneficiaries be in the form of a “defective” Generation Skip Trust. Where a large estate is involved, or where there is a substantial problem with leaving assets outright to a child, such as the potential for divorce, a need for creditor protection or other personal difficulties, it often makes a lot of sense to establish a generation skipping trust (“GST”) trust because it allows the child access to the inheritance but reduces the Federal estate tax consequences that would accrue to the estates of the next generation on passing assets to their descendants. A GST provides for mandatory distribution of assets to a remote level of descendants (*i.e.*, grandchildren, great grandchildren or charitable entities), thus skipping over an immediate level (*i.e.*, children). A “defective” GST provides that children, grandchildren or other beneficiaries are afforded limited beneficial rights in the income and principal of the GST, according to a broad or narrow ascertainable standard. The reason we refer to this as a “defective” GST Trust is because, while your beneficiaries have a right to the income and principal of the GST Trust to the complete exhaustion of the GST Trust, the beneficiaries do not receive mandatory distributions of principal from a GST Trust. Furthermore, our proposed GST Trust will contain provisions for an automatic conversion to a Special Needs Trust, if any beneficiary becomes disabled (see discussion below).

Federal generation skipping tax (“GST”) applies when a donor conveys in excess of a stated dollar limitation (“GST Limitation”) to a generation beyond the next living generation, for example, skipping over living children in favor of grandchildren, *etc.* (known as a “generation skip”). The GST exemption is the same dollar amount as the unified credit (\$5,490,000 in 2017). In effect, this means that fully utilizing the GST Limitation transfers by means of a generation skip (*e.g.*, to grandchildren, *etc.*) passes without the estate(s) of the skipped generation (*e.g.*, children) ever being exposed to imposition of any estate or gift tax on such a transfer. As to amounts above the GST Limitation, the GST essentially recaptures these prospective savings immediately.

The major requirements a GST Trust must satisfy are (i) the named trustee is independent of the beneficiary(ies), and (ii) the independent trustee’s ability to make distributions is limited to an “ascertainable standard.” A purported GST Trust may be included in the child's taxable estate unless both of the foregoing requirements are met. An example of the language required for an “ascertainable

standard” is the “reasonable health, education and support of the beneficiary.” Accordingly, a beneficiary should not be the trustee or have any rights in a GST Trust, other than, at most, to have a limited right to select or replace a trustee, see next paragraph regarding Trust Committee. Finally, if a beneficiary has a general right to appoint the assets of a GST Trust in the beneficiary’s Will, the GST Trust may be included in the estate of the beneficiary.

If your Trustee cannot serve, and in the event, none of the named successor Trustee(s) are able to serve, then the Trust Committee will select a successor Trustee who must be independent from the settlor and the beneficiaries and I strongly suggest that the Settlor also limit possible successor trustees to be attorneys, accountants, financial planners or financial institutions. The settlor will generally be the initial trust Committee, thereby giving the settlor significant control over the assets transferred to the Alaska Trust while the Settlor are alive and competent. Upon your death, the possible successor members of the Trust Committee would be the then living beneficiaries of the Alaska Trust. If Trust Committee desires that a Trustee be replaced, the Trust Committee can fire the Trustee and, if none of the named successors are able to serve, the Trust Committee will name the successor Trustee.

A Special Needs Trust provides, in summary, that no payments from this type of trust will be made if any person other than the Trustee shall have the right to direct payment on behalf of the disabled child. If a disabled child receives any portion of a Special Needs Trust, such disbursement shall be made solely by the Trustee, and not by any other person, agency or public authority, administrative or judicial, regardless of the capacity in which any other such person or entity is asked or seeks to act. The Trustee is required to take into account the disabled child’s present and future general welfare, other income or resources available to him, or which may be applied for his benefit, including public or private programs and benefits for which he may be eligible, and the effect of payments from a Special Needs Trust on the disabled child’s eligibility for public or private programs and benefits. Furthermore, the Trustee shall first inquire into the availability of other public or private resources and funds. It is intended that this type of trust supplement, rather than substitute for or supplant, benefits available to a disabled child from public or private programs available to her/him. The term "supplement" refers to services that shall be deemed qualitatively or quantitatively superior to services to which such disabled might be limited under public or private programs for which she/he is eligible.

Steps to Complete Formation of an Alaska Trust.

After the Alaska Trust Agreement is prepared, then the Settlor and Trustee will take the following steps:

1. Provide a copy of the draft Trust to the Alaska Trust Company for review and signature;
2. Provide the following completed and execute forms letters required by the Alaska Trust Company, letters and other documentation:
 - A. Executed Solvency Affidavit for the Settlor (This is a critical document to avoid the transfer from being deemed a fraudulent transfer),
 - B. Completed Alaska Trust Form;
 - C. Executed a letter from Settlor regarding AS 13.36.080(b), which provides the duties of a Trustee to make certain disclosures to any beneficiary other than the Settlor/beneficiary;

- D. A copy of the IRS letter issuing TIN to the Alaska Trust,
- E. A notarized copy of the Settlor's Passport;
- F. A notarized copy of the Settlor's Driver's License;
- G. The Alaska Trust Company will open a money market account in the name of the Alaska Trust; and
- H. A check in the amount of \$13,750 payable to the Alaska Trust Company for payment of the account opening fee, 1st year annual fee and the initial \$10,000 deposit.

3. In order to transfer ownership in other assets to the Alaska Trust, the Trustee of the Alaska Trust will open new accounts with financial institutions in the name of the Alaska Trust by providing an executed copy of the Alaska Trust Agreement and the TIN for the Alaska Trust. Each financial institution will have its own accounting opening forms, which may require additional disclosures regarding the Settlor, the Trust and/or the source of funds which are being utilized to fund such account.

I hope that I have answered your questions but if you need further assistance or information, please do not hesitate to contact me.