

Maurice A. Deane School of Law at Hofstra University

## Scholarship @ Hofstra Law

---

Hofstra Law Faculty Scholarship

---

9-2013

### New Alaska Law Will Enhance Nationwide Estate Planning-Part 1

Jonathan G. Blattmachr

Bethann B. Chapman

Mitchell M. Gans

*Maurice A. Deane School of Law at Hofstra University*

David G. Shaftel

Follow this and additional works at: [https://scholarlycommons.law.hofstra.edu/faculty\\_scholarship](https://scholarlycommons.law.hofstra.edu/faculty_scholarship)

---

#### Recommended Citation

Jonathan G. Blattmachr, Bethann B. Chapman, Mitchell M. Gans, and David G. Shaftel, *New Alaska Law Will Enhance Nationwide Estate Planning-Part 1*, 40 Est. Plan J. 3 (2013)

Available at: [https://scholarlycommons.law.hofstra.edu/faculty\\_scholarship/427](https://scholarlycommons.law.hofstra.edu/faculty_scholarship/427)

This Article is brought to you for free and open access by Scholarship @ Hofstra Law. It has been accepted for inclusion in Hofstra Law Faculty Scholarship by an authorized administrator of Scholarship @ Hofstra Law. For more information, please contact [lawscholarlycommons@hofstra.edu](mailto:lawscholarlycommons@hofstra.edu).

Checkpoint Contents

Estate Planning Library

Estate Planning Journals

Estate Planning Journal (WG&L)

Estate Planning Journal

2013

Volume 40, Number 09, September 2013

Articles

**New Alaska Law Will Enhance Nationwide Estate Planning-Part 1, Estate Planning Journal, Sep 2013**

ALASKA LEGISLATION

## **New Alaska Law Will Enhance Nationwide Estate Planning-Part 1**

*This first installment of a two-part article analyzes how recent Alaska legislation expands opportunities for transfers of IRAs to trusts, asset protection, and decanting.*

**Author: JONATHAN G. BLATTMACHR, BETHANN B. CHAPMAN, MITCHELL M. GANS, AND DAVID G. SHAFTEL, ATTORNEYS**

***JONATHAN G. BLATTMACHR is the author of six books and over 500 articles on estate planning and taxation. BETHANN B. CHAPMAN practices law with Faulkner Banfield in Juneau, Alaska, and is a Fellow of the American College of Trust and Estate Counsel. MITCHELL M. GANS is the Rivkin Radler Distinguished Professor of Law at the Hofstra University School of Law. He and Mr. Blattmachr are co-authors of The Circular 230 Deskbook (PLI). DAVID G. SHAFTEL practices law in Anchorage, Alaska, and is a Fellow of the American College of Trust and Estate Counsel. ©2013 by Jonathan G. Blattmachr, BethAnn B. Chapman, Mitchell M. Gans, and David G. ShafTEL.***

Alaska has been one of the most progressive states in revising and clarifying its laws to permit more efficient estate planning. For example, Alaska was the first state to adopt domestic asset protection trust (DAPT) legislation. (A DAPT is an irrevocable trust with an independent trustee who has absolute discretion to make distributions to a class of beneficiaries that includes the settlor.) Among other things, this permits an individual to create a self-settled trust in Alaska in a manner so it should not be included in his or her gross estate at death. <sup>1</sup> Now more than a dozen other states have adopted one or more

variations of the Alaska law. [2](#)

Alaska also was the first state, in modern times, to adopt an "opt in" community property system that may even be used by non-Alaskans who create an Alaska Community Property Trust, which allows both spouses' halves of the community property to receive an adjustment in basis when the first spouse dies. [3](#) Alaska was the leader in 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. [4](#) Alaska is the sole state that provides that a court may decree dissolution of a limited partnership or a limited liability company only if the court determines that it is "impossible" to carry on the business. [5](#) Alaska was the second state (following New York) to adopt a "decanting" statute, which now has been enacted in various forms in approximately 20 states. [6](#) Alaska is one of three states permitting pre-mortem probate of a will (that is, of a living person) that can thwart a post-death will contest. [7](#) Further, because Alaska permits the will of a non-domiciliary of the state to direct original probate there, this pre-mortem probate system can be and has been used by non-Alaskans to avoid post-mortem will contests. [8](#)

In numerous years since 1997, Alaska has adopted legislation to continue to help estate planners provide better planning options for their clients. This year is no exception. Alaska's Legislature has enacted new legislation aimed at continuing the trend. [9](#) This article will discuss these changes and point out how they can be used to achieve enhanced planning opportunities.

## **Lifetime transfers of IRAs to trusts**

It is nearly axiomatic that lifetime transfers, whether direct gifts to loved ones or to irrevocable trusts for their benefit, funding of grantor retained annuity trusts (GRATs), installment sales to grantor trusts, loans of cash or otherwise, are more efficient estate tax planning arrangements than are transfers occurring at death. Many individuals hold interests in individual retirement accounts (IRAs) or other tax-exempt retirement plans almost all of which can be rolled over (that is, transferred) to another IRA. [10](#) Moreover, interests in such plans or accounts often represent a very significant, sometimes a majority, portion of a taxpayer's wealth.

Lifetime estate planning for IRAs or other tax-exempt retirement plans is difficult compared to many other assets, not just because the IRA and plan rules are extremely complicated but on account of limitations on the transfer of interests in qualified plans and IRAs and the fact that the transfer may trigger all of the unrecognized income in the plan or IRA. [11](#) Unfortunately, lifetime transfer planning is thwarted because federal law prohibits the lifetime transfer of interests in qualified retirement plans, and state law usually prohibits the lifetime transfer of IRAs. [12](#) States have adopted prohibitions of transfers of IRAs in order to protect them from claims of creditors of the IRA owner.

Previously, commentators have discussed planning that involves transferring interests in IRAs. They have correctly noted that federal law restrictions on transferability of interests in qualified plans do not apply to

IRAs. **13** Unfortunately, as stated above, state law prohibiting transfers of IRAs prevents such planning.

The Alaska Legislature's new provision allowing the voluntary lifetime transfer of IRA interests solves this planning dilemma. **14** In addition, the acceleration of the inherent income in an IRA should be avoided if the transfer is to an entity (including a grantor trust) that is disregarded for federal income tax purposes.

**15** Consider the planning arrangements discussed below.

**Example.** An individual wishes to use her unused \$5.25 million gift tax exemption but does not have adequate assets to do so other than her IRA. Now she can transfer an Alaska IRA to an irrevocable trust that is a grantor trust with respect to her for her loved ones without accelerating the income.

Alternatively, she could fund a grantor retained annuity trust (GRAT) with her Alaska IRA or make an installment sale of it to a grantor trust, again without accelerating the inherent income in the IRA. Rev. Rul. 85-13 **16** provides that a transfer to a grantor trust is ignored for federal income tax purposes, and the assets in the trust are treated for such purposes as though they are still owned by the grantor.

But since the IRA will still be an IRA for income tax purposes (as the transfer is ignored for such purposes), how are the minimum required distribution (MDR) rules of **Section 401(a)(9)** applied when the IRA is in a trust? **17** The trust (whether it is a revocable trust, **18** a GRAT, or a grantor trust to which it is sold) should direct the trustee to take MDR distributions as "required" by **Section 401(a)(9)**. **19** As these MRDs are taken by the trustee, they will be treated as though they have been received by the grantor, and compliance with the section should be achieved. This is because the existence of the grantor trust is ignored for purposes of federal income tax provisions of the Code, of which the MRD rules are a part.

Another question is how the trustee of a GRAT will make the annuity payments when the trust holds an IRA. Rather than transferring the IRA to a GRAT, it should be transferred to a single-member LLC (which also is an entity that is ignored for federal income tax purposes **20**) and the LLC could be contributed to the trust. The operating agreement of the LLC could provide that interests in it are freely transferable, so the trustee could transfer a membership interest in the LLC to the grantor in satisfaction of the annuity payments.

**Community property state-type treatment.** Next, consider the following planning for a couple where one spouse has a large IRA, and together the spouses have substantial other assets. Couples in this situation who live in a non-community property state often have difficulty adequately planning to fund fully a "credit shelter" or "bypass" trust to use the unused estate tax exemption of the spouse dying first and to take advantage of the surviving spouse achieving maximum income tax benefits with the IRA.

The situation would be more advantageous for a married couple in a community property state that uses the "aggregate" approach of community property ownership and permits the estate of the first spouse to die and the surviving spouse to "pick and choose" (i.e., allocate between themselves) which of their community property assets will be used to fund the dispositions made by the spouse dying first. These spouses have significant planning opportunities where an IRA or a qualified retirement plan is community property.

**Example.** First, consider a couple who live in a community property state. They have never made any taxable gifts, and own two community property assets (and nothing else). One asset consists of property that will enjoy a "step up" in basis under [Section 1014\(a\)](#) ; the other asset is a traditional (non-Roth) IRA. Each asset is worth \$5.25 million, and the first spouse dies in 2013. The personal representative and surviving spouse can "allocate" the assets that received the stepped-up basis to the spouse dying first so those assets can be used to fund his or her credit shelter trust (equal to the \$5.25 million unused estate tax exemption). The IRA would be "allocated" to the survivor. [21](#) Having the surviving spouse be the successor owner of the IRA usually is the best choice for its disposition and, on account of the inherent income liability, is a poor choice for funding a credit shelter trust. [22](#)

As indicated, this type of planning is not available for couples in non-community property states or in those community property jurisdictions that do not use the aggregate approach and pick and choose asset allocation when the first spouse dies. However, that can be achieved if the couple transfers their assets, including the IRA, to an Alaska Community Property Trust which permits the aggregate approach and a pick and choose allocation when the first spouse dies (as the default Alaska law does [23](#) ). Regardless of which spouse is the owner of the IRA, it can be transferred to the Alaska Community Property Trust without triggering income because the owner will continue to be treated as the IRA owner even after the transfer. [24](#)

Although at least some states will not permit lifetime transfers of IRAs (regardless of whether income would be generated by the transfer), this now can be done under Alaska law. Hence, a couple desiring such a beneficial result would transfer the IRAs (or other qualified retirement interests, if permitted) to one or more Alaska IRAs and then transfer these to their Alaska Community Property Trust.

## Stronger asset protection for trust beneficiaries

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 to providing asset protection for their family members. Many states have not adequately provided statutes supporting such asset protection, thus failing to satisfactorily address these questions:

- What type of protection is provided against a "super-creditor," such as the U.S. government pursuing a tax lien?
- Can a creditor compel a trustee to make a distribution to the beneficiary?
- May a trustee pay expenses of a beneficiary rather than distributing assets directly to a beneficiary?
- Can a creditor obtain a court order that would attach or garnish assets or prevent a trustee from making such distributions for the benefit of a beneficiary?
- Would a trustee be held liable for making a distribution for the benefit of a beneficiary?

As is discussed below, Alaska's new legislation answers all of these questions.

The U.S. government, as indicated above, is typically viewed as a super creditor. Thus, where a beneficiary of a trust is indebted to the IRS, the trust's assets may be reachable even though they might be immune from other creditors.

**Example.** A trust instrument mandates that income be paid to the beneficiary. If, under state law, the interest is subject to spendthrift protection, either because of a state statute or a provision in the instrument, [25](#) the beneficiary's creditors, as a general matter, cannot reach the assets while they are held in trust [26](#) -with narrow exceptions for creditors entitled to receive alimony or child support. [27](#) The IRS, in contrast, is not precluded by the spendthrift doctrine from reaching the trust's assets. The spendthrift doctrine, largely a state law creature, yields to federal law as a matter of preemption, permitting the IRS to access the trust's assets irrespective of state law. [28](#)

**Expectancy vs. property interest.** In the case of a discretionary trust, in contrast, the IRS' access to trust assets is more limited. The IRS cannot reach the assets if the beneficiary's interest, as a matter of state law, is a mere expectancy. If, on the other hand, the beneficiary has an enforceable property interest under state law, the IRS is permitted to access the trust's assets. [29](#) This distinction is a rather questionable one in that a beneficiary of a discretionary trust does in general have rights under state law. Put differently, it is difficult to justify treating the beneficiary as having a mere expectancy in the context of assessing the IRS' ability to reach the trust's assets if a beneficiary has a right to sue the trustee. [30](#)

Nonetheless, the courts focus on this distinction in deciding whether the IRS can access the assets of a discretionary trust. [31](#) In deciding whether the beneficiary has an enforceable property right, the courts may examine not only state law but also the language used in the trust instrument. For example, the IRS will emphasize that the instrument uses the word "shall" (i.e., "the trust *shall* distribute such amounts as the trustee deems appropriate"); on the other hand, the beneficiary will emphasize the use of a word like "may" (i.e., "the trustee may distribute ..."). [32](#) It is unfortunate that the outcome could be permitted to turn on the selection of such words. For it seems unlikely that the lawyer drafting an instrument will appreciate the significance of using one word or the other, much less that the settlor would be sensitive to such a subtle difference in language.

Alaska's new legislation should strengthen the position of trust beneficiaries in seeking to resist federal government access to trust assets. First, newly enacted Alaska Statute section 34.40.113 provides, in subsection "b," that a beneficiary's interest in a discretionary trust is a mere expectancy, not a property interest. It goes on to provide that, as a result, a creditor may not reach or otherwise attach the beneficiary's interest. Thus, while under the law of other states the beneficiary might have to litigate this question with the IRS (i.e., whether the beneficiary has an enforceable property right or a mere expectancy under state law), this new provision should be conclusive in any such litigation. This provision may prove to be helpful to beneficiaries not only in terms of dealing with the IRS as a creditor, but also with creditors in general.

**Trustee discretion.** The section also provides, in subsection "h," that a distribution will be deemed to be a matter of trustee discretion-which has the effect of making all of the provisions of the section

applicable-whether the instrument uses the word "shall" or the word "may" and without regard to whether the instrument gives the trustee relaxed discretion (i.e., without regard to whether the instrument provides that the trustee shall have sole discretion, absolute discretion, uncontrolled discretion, or discretion of a similar nature). Thus, in drafting an instrument under Alaska law, one need not be concerned about the impact of using such common language on the property-right-versus-expectancy issue. Like subsection "b," this subsection may also prove to be helpful to beneficiaries when dealing with creditors in general, not just the IRS.

Subsections "c," "d," "e," and "f" provide additional creditor protection to beneficiaries. Subsection "c" provides that a creditor may not interfere with the trustee's exercise of discretion or seek to compel the trustee to make a distribution to the creditor or to the beneficiary. Subsection "d" provides that if, under the instrument, the trustee may make a discretionary distribution of income or principal to a beneficiary, the trustee may instead apply the income/principal for the benefit of the beneficiary. So, for example, the trustee could make a distribution to the beneficiary's landlord in discharge of the beneficiary's rent obligation.

Subsection "e" provides that a creditor may not seek to interfere with the trustee's decision to make such an application of principal/income. Subsection "f" concomitantly provides that the creditor may not obtain a court order that would attach trust assets or otherwise prevent the trustee from making such an application. And subsection "d" provides that the trustee may not be held liable by the creditor for making an application on behalf of the beneficiary. Absent these provisions, creditors might well argue that the trustee does not have authority to apply income/principal in this fashion or that the trustee becomes liable to the creditor in connection with such an application. [33](#) As in the case of subsections "b" and "h," these provisions could be helpful to the beneficiary as against creditors in general, not just the IRS. [34](#)

In summary, Alaska may now have the strongest asset protection for a beneficiary's interest. "Super-creditors" may have a difficult time reaching assets in an Alaska trust. All creditors will not be able to force a trustee to make discretionary distributions directly to a beneficiary. A trustee may make discretionary distributions for the benefit of a beneficiary by paying expenses directly rather than distributing the funds to the beneficiary. A creditor may not obtain a court order that would prevent such distributions on behalf of a beneficiary.

## **Asset protection for retirement plan beneficiary**

An employee's interest in a qualified retirement plan is protected from creditors of the employee by ERISA. [35](#) Many states have enacted a similar protection from creditors and have extended it to an interest in an IRA. [36](#)

However, what happens to asset protection when the employee dies and leaves his or her retirement plan or IRA interest to a beneficiary? Similarly, what happens if the owner of an IRA transfers the owner's interest to, for example, a grantor trust for a beneficiary? [37](#) Is the beneficiary's interest in the retirement

plan or IRA protected from the beneficiary's creditors prior to any distributions or withdrawals?

If a creditor asserts the creditor's claim against a beneficiary in a federal bankruptcy proceeding, the majority of the bankruptcy court cases have held that the Bankruptcy Code protects the beneficiary's interest. [38](#) What is the result if the creditor decides to pursue in state court the creditor's claim against the beneficiary's IRA interest?

The Alaska Legislature decided to provide protection for the beneficiary's interest. Amendments to Alaska Statute 09.38.017 provide very broad protection for an interest in a retirement plan, IRA, and money or other assets payable to a beneficiary from such an interest or account. [39](#) "Beneficiary" is broadly defined to include a person, trust, or trustee who has, before or after the death of a participant or owner, a direct or indirect interest in a retirement plan or IRA (traditional or Roth). [40](#)

This protection from creditor claims for a beneficiary who succeeds to interests in an Alaska IRA (or Roth IRA) by reason of the death of the owner should apply even if neither the owner nor the successor beneficiary resided or resides in Alaska. This is a conflict of laws issue. Which state's law applies-Alaska's or the domiciliary state of the owner or beneficiary? The three courts that have considered this issue with respect to creditor rights in a self-settled trust have relied on the test provided by section 270 of the Restatement (Second) Conflict of Laws. [41](#) This section provides that the law designated by the settlor applies as long as it does not violate a strong public policy of the state with which, as to the matter at issue, the trust has its most significant relationship.

Assuming, for the sake of discussion, that the beneficiary's state of residence has the most significant relationship to the IRA, it appears that no state has a strong public policy against such asset protection. This is because all states provide protection from creditor claims of an owner of an IRA (although in a few states the protection is limited to a dollar amount or other limitation [42](#) ). Hence, it does not seem that there is a viable argument that there is a strong public policy against IRA protection for an owner or beneficiary in that person's state of residence. [43](#)

Alaska follows Arizona, Connecticut, Florida, South Dakota, and Texas, which already have such statutes, [44](#) and joins Missouri, Ohio, and North Carolina which in 2013 enacted similar beneficiary creditor protection. [45](#)

## **Alaska's new decanting statute**

"Decanting" refers to the ability of a trustee who is authorized to invade the principal of an irrevocable trust essentially to change the terms of the trust ("invaded trust") by creating a new trust ("appointed trust") by paying all or a portion of the trust to that new trust or making the payment to any other trust for one, more, or all of the beneficiaries of the invaded trust without a court order or the settlor's or beneficiary's consent. Decanting is a useful estate planning tool and can be used for a variety of reasons, including to:



- Modify the terms of the trust.
- Respond to beneficiary change of circumstances.
- Protect assets for needs-based assistance planning. [46](#)
- Extend the term of a trust.
- Address federal and state tax planning.
- Correct errors in trust drafting. [47](#)

In 1998, Alaska became the second state to adopt a decanting statute. [48](#) Since that time 20 states have adopted decanting statutes. The various state statutes differ in what changes can be made to a trust by decanting, and what power a trustee must have in order to use the decanting authority.

**Use of Alaska law.** Alaska is one of the few states whose decanting statute is applicable not only to a trust governed by the laws of Alaska, including a trust whose governing law has been changed to the laws of Alaska, but also to a trust that has an individual trustee domiciled in Alaska or a trust company with an office in Alaska, provided that the majority of the trustees select Alaska as the location for the primary administration of the trust. [49](#) This allows trustees of trusts domiciled in other states to use Alaska's flexible decanting statute without changing the trust's governing law simply by appointing an Alaska trustee (or co-trustees) and having the trustees agree that Alaska will be the primary place of the trust's administration.

As initially enacted, the Alaska statute authorized a trustee with unlimited discretion to appoint all the assets to a new trust. In 2006, the statute was amended to expand the decanting authority to a trustee whose discretion was limited by a standard, such as an ascertainable standard. The Alaska Legislature has now significantly revised the decanting statute, providing for bifurcated authority based on the trustee's discretion, expressly authorizing a trustee to grant a beneficiary a power of appointment, extend the term of the trust, and authorizing a trustee to decant to an appointed trust to protect public assistance benefits.

The recently adopted Alaska statute is similar to the New York Statute adopted in 2011. [50](#) The statute creates two tiers of decanting power:

- (1) Decanting pursuant to unlimited discretion.
- (2) Decanting pursuant to discretion that is limited under an ascertainable standard. [51](#)

The revised Alaska statute expressly allows a trustee to decant assets from one trust to a new trust that complies with Alaska law to protect needs-based assistance, even though the second trust removes mandatory distribution standards, expands the term of the trust, or eliminates some of the beneficiaries.

[52](#)

Although the new New York and new Alaska statutes are quite similar in many ways, differences are worth noting. For example, under the New York law, a trustee with unlimited discretion to invade may grant a beneficiary a power of appointment under the appointed trust but the permissible appointees may exclude only one or more of the beneficiaries; the settlor; the settlor's spouse; or any of the estates,

creditors, or creditors of the estates of such persons, and cannot expand the class of potential appointees. [53](#) In Alaska, no such broad power of appointment need be contained in the appointed trust; rather, the class of potential appointees can be expanded to include new beneficiaries, provided the trustee had unlimited discretion to invade principal in the invaded trust. [54](#)

**Trustee discretion.** Another potentially important difference relates to the trustee's power to make distributions if the term of the trust is extended and the invaded trust does not grant the trustee unlimited discretion to invade but only pursuant to a standard. Under New York law, the limited standard to make payments to the beneficiary (or beneficiaries) must be the same under the appointed trust as it was in the invaded trust. However, under the new Alaska statute, the trustee of the appointed trust can hold unlimited discretion to distribute during the extended period.

Under the revised Alaska statute, a trustee with unlimited discretion to invade principal of a trust may appoint all or part of the trust principal to a new trust created by either the settlor of the invaded trust, someone else, or the trustees of the invaded trust. The new trust must be for the benefit of one or all of the current beneficiaries of the invaded trust, and the trustee is granted the express power to exclude a current beneficiary from the appointed trust. The trustee may not add beneficiaries in the appointed trust, but may grant a discretionary power of appointment, including a presently exercisable power of appointment, in the appointed trust to one or more of the current beneficiaries of the invaded trust.

The granted power of appointment may expand the class of permissible appointees beyond beneficiaries of the invaded trust. For example, a trustee could grant a current beneficiary of the invaded trust a testamentary power of appointment that is more expansive than the power of appointment in the invaded trust, including one that is presently exercisable so that the beneficiary granted the power could direct distributions to anyone in the class of appointees described in the power granted. [55](#) Because the permissible appointees are not considered beneficiaries of the appointed trust, the addition of these possible recipients of the trust does not violate the provision prohibiting the addition of new beneficiaries in the appointed trust.

A trustee whose authority to distribute principal of the invaded trust that is limited by an ascertainable standard (within the meaning of [Reg. 25.2514-1\(c\)\(2\)](#)) is more restricted in the changes that can be made in the appointed trust. A trustee without unlimited discretion cannot appoint trust principal to an appointed trust unless the current and remainder beneficiaries of the appointed trust are the same, the beneficiaries receive the same share in the appointed trust, and the standard for invading income or principal remains the same. A trustee without unlimited discretion may grant a power of appointment to a current beneficiary but only if the beneficiary had a power of appointment in the invaded trust and the class of permissible appointees are the same as in the invaded trust.

A trustee without unlimited discretion may extend the term of the trust and may grant an additional trustee unlimited discretion during the term of the extended trust. However, the additional trustee's unlimited discretion does not apply to decanting authority which remains subject to the limitations of Alaska Statute 13.36.157(d) through (h). [56](#)

The statute imposes limitations on a trustee's ability to reduce or eliminate a current mandatory distribution of income or principal, a mandatory annuity or unitrust interest, a right to withdraw from the trust provided that the mandatory right has come into effect. [57](#) A trustee, however, can eliminate or reduce a mandatory right during the extended term of the trust. [58](#) For example, if a trust were to terminate when the beneficiary reaches age 30 and then be distributed to him or her outright, a trustee can eliminate the mandatory right in the extended term of the trust provided the assets are decanted to the appointed trust before the beneficiary attains age 30.

**Special needs planning.** Most important to special needs planning, the revised Alaska statute provides the planner with a non-judicial means of modifying the terms of a trust to comply with the applicable needs-based program standard; this allows a beneficiary to benefit from the trust and retain his or her needs-based public assistance. [59](#) A trustee with or without unlimited discretion may decant to a trust with a revised standard for invading income or principal and may remove mandatory income or principal distributions to protect the beneficiary's needs-based public assistance. [60](#) The Alaska statute expressly authorizes decanting to a special needs trust, a pooled trust, or a third-party trust. [61](#)

The revised Alaska statute also:

- Requires that a trustee notify, in writing, beneficiaries of the decision to decant to an appointed trust.
- Expressly provides that a trustee has a fiduciary duty to the beneficiaries when exercising the decanting power.
- Imposes limitations on a trustee's power to decant a trust to protect tax benefits the invaded trust has, even if the trustee's discretion is unlimited. [62](#)

**Required notice.** A trustee may exercise the power to appoint to an appointed trust by a written instrument that is signed, dated, and acknowledged by the trustee. The exercise of the power is effective 30 days after notice of the exercise is provided to the settlor, if living, of the invaded trust, a person having the right, under the terms of the invaded trust, to remove or replace the trustee, and to a qualified beneficiary or a person who may represent and bind a qualified beneficiary [63](#) under Alaska's virtual representation statute. [64](#) The statute, however, allows a settlor to limit who is to receive notice if the settlor has elected to limit trust notices only to beneficiaries who are entitled to mandatory distributions. [65](#)

A beneficiary may object within 30 days of receiving notice. A beneficiary's objection does not prevent a trustee from proceeding with the intended decanting of trust assets to the appointed trust, but a trustee may initiate a court proceeding to obtain a court order approving the proposed decanting. A beneficiary who did not object within the 30-day period may still object to a decanting until the expiration of the limitation period applicable to a report disclosing the decanting. [66](#) Thus, while a trustee may proceed with a decanting after providing notice, a risk remains that a beneficiary could object and file a court proceeding to undo the decanting.

In exercising its decanting authority, a trustee is bound by its fiduciary duty to exercise the decanting power in the best interest of one or more proper objects of the exercise of the power and is required to consider the tax consequences of the proposed distribution. [67](#) The statute limits a trustee's decanting authority if there is substantial evidence of a contrary intent of the settlor and the beneficiary objecting to the decanting establishes that the settlor would not have authorized the decanting in light of the circumstances existing at the time a trustee exercises the power.

When assessing the settlor's probable intent, the provisions of the invaded trust cannot alone be reviewed as substantial evidence of a contrary intent of the settlor. The revised Alaska statute shifts to the objecting beneficiary the burden of establishing that the settlor would not have approved of the proposed change in the appointed trust.

## Conclusion

The changes made by the Alaska Legislature this year provide expanded opportunities for estate and income tax planning for many Americans regardless of where they live. The ability to transfer interests in Alaska IRAs, without sacrificing creditor protection, presents a broad new form of lifetime estate planning for retirement plan assets. The expanded protection from creditor claims for third-party-created trusts (including super-creditors such as the IRS) and inherited IRAs suggest that Alaska be used as the place to create them. The enactment of Alaska's new decanting statute and the ability to have it apply regardless of the law that governs the validity, construction, and effect of a trust presents expanded opportunities to "revise" preexisting trusts to achieve better results than would be available under the trust's current terms.

Part 2 of this article, which will appear in a future issue of Estate Planning, will describe Alaska's expanded authority for directed trustees and advisors, clarification of virtual representation, charging order improvements for limited partnerships and limited liability companies, additional protection for trustees of life insurance trusts, updating of Alaska's Uniform Principal and Income Act, trusts which avoid state income tax, extended terms for UTMA accounts, improvements to Alaska's optional community property system, and other provisions.

### 1

See, e.g., [Ltr. Rul. 200944002](#) . See, generally, Rothschild, Blattmachr, Gans, and Blattmachr, "IRS Rules Self-Settled Alaska Trust Will Not Be in Grantor's Estate," 37 ETPL 3 (January 2010). Under [Section 6110\(k\)\(3\)](#) , neither a private letter ruling nor a national office technical advice memorandum (TAM) may be cited or used as precedent although, under [Reg. 1.6662-4](#) , they may be considered precedent for purposes of avoiding tax penalties in some cases. See [Section 6110\(k\)\(3\)](#) and [Reg. 1.6662-4\(d\)\(3\)](#) .

### 2

The states that have passed DAPT legislation providing asset protection for self-settled trusts currently are Alaska, Colorado, Delaware, Hawaii, Missouri, Nevada, New Hampshire, Oklahoma, Ohio, Rhode Island, South Dakota, Utah, Virginia, and Wyoming. Protection afforded varies significantly among the laws of these states. Also, Arizona, Florida, and Texas have passed narrow self-settled trust provisions. See ACTEC (David G. Shaftel, ed.), "Comparison of the Domestic Asset Protection Statutes, Updated Through June 30, 2012," [http://www.actec.org/public/Documents/Studies/Shaftel\\_DAPT\\_CHART\\_06\\_30\\_2012.pdf](http://www.actec.org/public/Documents/Studies/Shaftel_DAPT_CHART_06_30_2012.pdf).

### 3

See Blattmachr, Zaritsky, and Ascher, "Tax Planning With Consensual Community Property: Alaska's New Community Property Law," 33 Real Prop. Prob. & Tr. J. 615 (Winter 1999); Shaftel and Greer, "Obtaining a Full Stepped-Up Basis Under Alaska's New Community Property System," 26 ETPL 109 (March/April 1999). More recently, Tennessee has adopted opt-in community property for its married couples. Tenn. Code Ann. §35-17-101, *et seq.*

### 4

Alaska Stat. 32.11.340(b); Alaska Stat. 10.50.380(c).

### 5

Alaska Stat. 32.11.380; Alaska Stat. 10.50.405.

### 6

For a list of states, go to [http://www.actec.org/public/Documents/Studies/Culler\\_Decanting\\_Statutes\\_06\\_18\\_2013.pdf](http://www.actec.org/public/Documents/Studies/Culler_Decanting_Statutes_06_18_2013.pdf).

### 7

Alaska Stat. 13.12.530.585.

### 8

Alaska Stat. 13.06.068. See, e.g., Matter of the Last Will and Testament of Eleanor C. Kosow, No. 3AN-11-1358PR (Alaska Superior Ct. 3rd Jud. Dist., 2011).

### 9

2013 Alaska Sess. Laws ch. 45 (SB 65), effective date 9/9/2013, available at <http://www.legis.state.ak.us/PDF/28/Bills/SB0065Z.pdf>.

### 10

Although both IRAs and other retirement plans may provide similar opportunities for income tax deferral on earnings, there are many differences among these plans. Only by transferring interests into a Roth IRA may distributions become income tax free.

### 11

See Choate, *Life and Death Planning for Retirement Plans*, 7th ed. (Ataxplan Publications, 2011).

**12**

Certain limited transfers are permitted, such as to a spouse in the event of a divorce.

**13**

Horwitz and Damicone, "A Decent Proposal," 150 Tr. & Est. 46 (November 2011).

**14**

2013 Alaska Sess. Laws ch. 45 (SB 65), § 40, Alaska Stat. 34.40.118.

**15**

**Rev. Rul. 85-13, 1985-1 CB 184 .**

**16**

*Id.* The planning set forth in this article for IRAs is premised that the decades-long position of the IRS that grantor trusts do not exist for income tax purposes applies for purpose of **Sections 408** and **408A** , which are income tax provisions. However, anyone who questions that premise should not attempt to employ the planning set forth in this part of the article.

**17**

Note that the MRD rules do not apply to a Roth IRA while its owner is alive, so a Roth IRA could be used in lifetime estate planning. **Section 408A(c)(5)** .

**18**

An IRA owner might wish to transfer his or her Roth or non-Roth IRA to a revocable trust for management purposes, as opposed to relying, for example, on a power of attorney.

**19**

Technically, **Section 401(a)(9)** does not require the taking of MRDs, but **Section 4974(a)** imposes a severe penalty if not taken. See **Sections 401(a)(9)** and **4974(a)** .

**20**

**Reg. 301.7701-3 .**

**21**

Cf., e.g., **Ltr. Rul. 199925033** (not precedent), in which a husband and wife created a joint revocable trust with their community property, to which the spouse who died first contributed his or her IRA. When the first spouse died, the IRA was allocated to the survivor and held in a trust that the survivor could revoke at any time. The IRS ruled that the survivor would be treated, pursuant to **Rev. Rul. 85-13** , 1985-1, CB 184, as holding the IRA for federal income tax purposes and, accordingly, could exercise all options available to a surviving spouse who inherits an IRA from his or her spouse. This structure increases the probability of there being assets that have experienced a "step up" in basis under **Section 1014** to be used to fund non-marital deduction dispositions, such as a credit shelter trust. Interests in an

IRA, other than a Roth IRA, constitute the right to income in respect of a decedent under [Sections 691\(a\)](#) and [1014\(c\)](#) which, on account of the inherent income tax liability, is worth less than assets that have a stepped-up basis. See [Sections 1014](#) and [691\(a\)](#) . Cf. [Ltr. Ruls. 200620025](#) and [201116005](#) (however, these involved transfers to grantor trusts by successor beneficiaries to an IRA).

## 22

See, generally, Choate, *supra* note 11, at 208, *et seq.*

## 23

See, e.g., Alaska Stat. 34.77.155.

## 24

This is explained in detail in Blattmachr, Zaritsky, and Ascher, *supra* note 3, at 644-646.

## 25

Typically, in order to secure spendthrift protection, the trust instrument must affirmatively provide for it. See Restatement (Third) of Trusts §58. In New York, on the other hand, the default rule, by statute, is that income interests are spendthrift protected. See N.Y. Est. Powers & Trusts Law 7-1.5.

## 26

See, generally, Camp, "Protecting Trust Assets from the Federal Tax Lien," 1 Est. Plan. & Community Prop. L. J. 295 (2009). See also Restatement (Third) of Trusts §58.

## 27

See Restatement (Third) of Trusts §59 (discussing exceptions to general rule barring creditors access to trust assets).

## 28

See Bank One Ohio Trust Co., [77 AFTR 2d 96-1579](#) , 80 F3d 173, 96-1 USTC ¶50188 (CA-6, 1996), which was cited with approval in Drye, [84 AFTR 2d 99-7160](#) , 528 US 49, 145 L Ed 2d 466, 99-2 USTC ¶51006, 2000-1 CB 863, 99-2 USTC ¶60363 (1999).

## 29

See, e.g., Magavern, [39 AFTR 2d 77-968](#) , 550 F2d 797, 77-1 USTC ¶9249 (CA-2, 1977).

## 30

In Magavern, *id.*, the court acknowledged that, under state law, the beneficiary would have the right to sue the trustee if the trustee failed to properly exercise his or her discretion ("New York law clearly establishes, moreover, that an aggrieved trust beneficiary can enforce his right to trust property or income against a trustee who refuses to exercise his discretion as directed in the trust instrument."). If this is true in the case of all discretionary trusts, it is difficult to conclude, as the court implicitly does, that some discretionary trusts do not confer enforceable property rights on the beneficiary.

**31**

See *id.*

**32**

See *id.*

**33**

See, e.g., *Hamilton v. Drogo*, 150 NE 496 (N.Y., 1926) (holding that, in the case of a discretionary trust, an order of attachment could, subject to certain statutory limitations, prevent the trustee from making a distribution once the trustee reached a decision to make the distribution); see, also, *Sand v. Beach*, 200 NE 821 (N.Y., 1936) (holding that an application of income on behalf of the beneficiary could be reached, subject to certain statutory limitations, by the beneficiary's creditor via execution).

**34**

There is authority to the effect that, even if the beneficiary does not have an enforceable property right, the IRS can reach a discretionary distribution before it is made to the beneficiary. See Michel, [110 AFTR 2d 2012-5335](#), 2012-2 USTC ¶50479, 879 F Supp 2d 291 (DC N.Y., 2012) (reaching this conclusion in a trust governed by New York law, under which a creditor can reach a discretionary distribution before it is made to the beneficiary). It is, however, not clear whether the IRS could invoke this authority where, as under Alaska's new legislation, state law precludes the creditor from reaching a discretionary distribution.

**35**

[29 U.S.C. section 1056\(d\)\(1\)](#) ; [Section 401\(a\)\(13\)](#) .

**36**

See e.g. Alaska Stat. 09.38.017.

**37**

See the above portion of this article with the heading "Lifetime transfers of IRAs to trusts."

**38**

A discussion of these bankruptcy court cases is found in the following circuit court decisions: In re Clark, 714 F3d 559, 55 EBC 1756 , 111 AFTR2d 2013-2482 (CA-7, 2013), held that the bankruptcy trustee could reach the inherited IRA assets. In contrast, *Chilton v. Moser*, [109 AFTR 2d 2012-1375](#) , 674 F3d 486, 2012-1 USTC ¶50250 (CA-5, 2012), In re Hamlin, 465 Bkrptcy. Rptr. 863 (B.A.P. CA-9,. 2012), and In re Nessa, 426 Bkrptcy. Rptr. 312 (B.A.P. CA-8, 2010), held that the inherited IRA was exempt under the Bankruptcy Code.

**39**

2013 Alaska Sess. Laws ch. 45 (SB 65), §§ 1 and 3, Alaska Stat. 09.38.017(a) and (e).

**40**



2013 Alaska Sess. Laws ch. 45 (SB 65), §3, Alaska Stat. 09.38.017(e).

**41**

In re Portnoy, 201 Bkprtcy. Rptr. 685 (Bkprtcy. DC N.Y., 1996); In re Brooks, 217 Bkprtcy. Rptr. 98 (Bkprtcy. DC Conn., 1998); In re Huber, 2013 WL 2154218 (Bkprtcy. DC Wash., 2013).

**42**

About a dozen states place some type of limit, and at least one (Georgia) apparently provides no protection for a Roth IRA from creditors. Ga. Code Ann. §44-13-100(a)(2.1). In California and Maine, only amounts reasonably necessary for the debtor's support are exempt. Cal. Civ. Proc. Code §704.115. Me. Rev. Stat. Ann. tit. 14, §4422(13)(E). In Massachusetts, there is a limit (other than for rollover IRAs) based on the debtor's income for the preceding five years. Mass. Gen. Laws ch. 235 §34A. In Minnesota, it is \$60,000 (adjusted for inflation). Minn. Rev. Stat. Ann. §550.37(24).

**43**

The three bankruptcy cases cited in footnote 41, above, can be further distinguished by the fact that the interest of a successor beneficiary in an IRA cannot be viewed as a self-settled trust-it was created by another (the original owner of the IRA who has died).

**44**

Ariz. Rev. Stat. §33-1126B; Conn. Gen. Stat. §52-321(a); Fla. Stat. §222.21(2)(a); S.D. Codified Laws §43-45-16 (up to \$1million); and Tex. Prop. Code 42.0021.

**45**

S.B. 100, H.B. 374, H.B. 434, 97th Gen. Assem. 1st Reg. Sess. (Mo. 2013); H.B. 479, 130th Gen. Assem. (Ohio, 2013); S.B. 279, 2013-2014 Reg. Sess. (N.C., 2013).

**46**

Needs-based assistance refers to federal, state, or local government programs of benefits or assistance for the elderly or persons with disabilities that have resource or income eligibility requirements, including, but not limited to Supplemental Security Income and Medicaid programs.

**47**

See, generally, Zeydel and Blattmachr, "Tax Effects of Decanting-Obtaining and Preserving the Benefits," 111 J. Tax'n 288 (November 2009). It should be noted that the IRS requested comments about the tax effects of decanting in [Notice 2011-101, 2011-52 IRB 932](#) , available online at [www.irs.gov/pub/irs-drop/n-11-101.pdf](http://www.irs.gov/pub/irs-drop/n-11-101.pdf).

**48**

Alaska Stat. 13.36.157.

**49**

Alaska Stat. 13.36.157 (b); N.Y. Est. Powers & Trusts Law 10-6.6(r).

**50**

N.Y. Est. Powers & Trusts Law 10-6.6. In fact, a bill extremely similar to the new New York statute was introduced in Alaska before being introduced in New York. The principal drafter of both bills was the same person. For a thorough discussion of the New York decanting statute, which will help with understanding many of the provisions in the new Alaska statute in important ways, see Ehrenkrantz, Frankel, and O'Donnell, "New York Enacts Important New Law Governing a Trustee's Power to Pay Trust Assets to a New Trust," 83 N.Y. St. B.J. 38 (November/December 2011).

**51**

2013 Alaska Sess. Laws ch. 45 (SB 65), §9, Alaska Stat. 13.36.157.

**52**

*Id.*, Alaska Stat. 13.36.157(a)-(c).

**53**

N.Y. Est. Powers & Trusts Law 10-6.6(b)(2).

**54**

2013 Alaska Sess. Laws ch. 45 (SB 65), §9, Alaska Stat. 13.36.157(b).

**55**

The IRS has indicated that, in its view, a beneficiary who exercises a special power of appointment in favor of someone else could be treated as making a gift although the IRS has refused to say how such a gift would be valued. Cf. **Ltr. Rul. 200243026** (not precedent). It seems that, if the beneficiary who holds the special power is only eligible and not entitled to any distribution, the value of any gift deemed made by the exercise of the power should be nil. ("The value of the gift is a question of fact....") *Id.* Cf. **Rev. Rul. 75-550, 1975-2 CB 357** . It seems, however, that if the beneficiary's power of appointment is limited to an ascertainable standard relating to health, education, maintenance, and support within the meaning of **Section 2514(c)(1)** , the its exercise in favor of another could not be a gift. See **Section 2514(c)(1)** .

**56**

2013 Alaska Sess. Laws ch. 45 (SB 65), §9, Alaska Stat.13.36.157(f).

**57**

The amended statute also limits the trustee's ability to decant to ensure that certain tax benefits are not lost, to increase a trustee's compensation or limit a trustee's liability or to eliminate a provision granting another person the right to remove or replace a trustee. 2013 Alaska Sess. Laws ch. 45 (SB 65), § 10, Alaska Stat. 13.36.158(i).

**58**

*Id.*

## 59

The New York and Illinois statutes also expressly allow decanting to a trust to preserve needs-based public assistance. N.Y. Est. Powers & Trusts Law 10-6.6(n)(1); 760 Ill. Comp. Stat. 5/16.4.

## 60

A trustee's exercise of the decanting power should not adversely affect the beneficiary's eligibility for public assistance. A trustee is exercising its discretionary power in a fiduciary capacity and subject to specific statutory authority. A trustee is not an agent of the beneficiary even though a trustee has the discretion to use the trust principal for the benefit of the beneficiary. Beneficiary consent is not required. The beneficiary is able to object to an exercise of the decanting power but cannot compel the trustee to exercise the power. If the public agency objects to the decanting, the trustee could seek a court order approving the exercise of the power. See Program Operations Manual System § SI 01120.200B(18).

## 61

A special needs trust is a trust established under 42 U.S.C. section 1396(d)(4)(A); a pooled trust is a trust established under 42 U.S.C. section 1396p(d)(4)(C); and a third-party trust is a trust established by a third party with the assets of the third party to provide for supplemental needs for a person eligible when the trust is created or at a future time for needs-based public assistance. 2013 Alaska Sess. Laws ch. 45 (SB 65), § 11, Alaska Stat. 13.36.215(b)(6), (8), and (9).

## 62

2013 Alaska Sess. Laws ch. 45 (SB 65), §10, Alaska Stat.13.36.158.

## 63

A qualified beneficiary includes a beneficiary, who on the date of the beneficiary's qualification is determined, is entitled or eligible to receive a distribution of trust income or principal or would be entitled to receive a distribution of trust income or principal if the event causing the trust's termination occurs. Alaska Stat. 13.36.390(2).

## 64

Alaska Stat. 13.06.120.

## 65

Alaska Stat. 13.36.080(b) allows a settlor to exempt a trustee from providing notification or information to beneficiaries who are not entitled to current mandatory distributions.

## 66

Alaska Stat. 13.36.100 provides for different limitation periods depending on the information disclosed to the beneficiary and the notice of the right to object. The limitation period could be as short as six months or as long as three years after a beneficiary receives a report disclosing the decanting.

## 67

2013 Alaska Sess. Laws ch. 45 (SB 65), § 10, Alaska Stat. 13.36.158(e).