NOTES

SELF-SETTLED SPENDTHRIFT TRUSTS AND THE ALASKA TRUST ACT: HAS ALASKA MOVED OFFSHORE?

This Note examines the 1997 Alaska Trust Act, focusing on the provisions which permit trust settlors to create self-settled spendthrift trusts. It first provides a brief background on the historical treatment of such trusts, both domestically and overseas. The Note then describes the mechanics of the Act and attempts to discern the purposes and motives behind the legislation. Finally, it discusses several hurdles in the path of enforcement of the spendthrift provisions of the trusts, and concludes that the trusts may be more effective as an estate planning tool than as a true asset protection device.

I. INTRODUCTION

On April 1, 1997, Alaska Governor Tony Knowles signed House Bill 101[1] (the "Alaska Trust Act" or the "Act") into law. The bill was sponsored by state Representative Al Vezey, who explained that the bill was the result of his efforts to find a way to stimulate economic development in Alaska and establish Alaska as a global financial center.[2] The Act has four primary goals: first, to

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1. The full title of H.B. 101 is "An Act relating to certain irrevocable transfers in trust, to the jurisdiction governing a trust, to challenges to trusts or property transfers in trust, to the validity of trust interests, and to transfers of certain trust interests; and providing for an effective date."

2. *See Trusts and Property Transfers in Trust: Hearing on HB 101 Before the House Labor and Commerce Comm.*, 20th Legis., 1st Sess. (Alaska 1997),

permit the establishment of self-settled spendthrift trusts[3] under Alaska law (an "Alaska Trust"); second, to establish the conditions under which a choice of law provision selecting Alaska law to govern a trust would be effective; third, to amend Alaska's already debtor-friendly fraudulent transfer laws with respect to such trusts by establishing time limits on fraudulent transfer actions; and finally, to abolish Alaska's statutory rule against perpetuities for trusts established in the state.

Before the passage of the Act, every jurisdiction in the United States agreed that as a matter of public policy, spendthrift provisions in trusts were void as to creditors of the settlor. Such protection was available only offshore, in jurisdictions such as the Cayman Islands or Bermuda. The proponents of the Alaska Trust Act hoped to attract millions of dollars worth of trust investment (and the administrative fees that accompany it) to Alaska by providing protection previously available only offshore.

This Note seeks to explain the mechanics of the new trusts and examine their effectiveness in terms of both asset protection and estate planning. First, this Note will examine the historical treatment of spendthrift trusts, both domestically and overseas. Second, it will provide an overview of the mechanics of the Act as well as discuss its goals and purposes. Finally, this Note will discuss the effectiveness of the trusts in achieving its various goals, and concludes that many questions remain regarding each of the Act's purported benefits.

II. HISTORICAL BACKGROUND

A. Traditional Domestic Treatment of Spendthrift Trusts

A clause in a trust document restricting the beneficiary's ability to voluntarily or involuntarily transfer his interest in the trust serves multiple purposes and is generally enforceable.[4] First, if the settlor seeks to provide a steady stream of income for the beneficiary, the settlor can ensure that the beneficiary will not

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available at the Alaska State Legislature Home Page (visited Nov. 6, 1999) <http://www.legis.state.ak.us> [hereinafter House Hearings].

3. A self-settled trust is a trust that names the settlor as a beneficiary. A spendthrift trust protects the trust assets from creditors of the beneficiary. A "self-settled spendthrift trust" is a trust that does both.

4. *See* GEORGE G. BOGERT & GEORGE T. BOGERT, LAW OF TRUSTS § 40, 147 (5th ed. 1973).

transfer his interest in receiving distributions from the trust.[5] Second, by including a spendthrift provision (or, in some states, by merely making the distributions discretionary), the settlor guarantees that creditors cannot reach the beneficiary's interest.[6]

Spendthrift provisions, however, are increasingly unenforceable. Although several jurisdictions have held that a spendthrift provision shields the interest of the beneficiary from spousal or child support claims,[7] the Supreme Court of Mississippi recently held that a beneficiary's interest is not immune from attachment to satisfy the claims of the beneficiary's intentional or gross negligence tort creditors.[8] In *Sligh v. First National Bank of Holmes County,* the plaintiff filed suit against the trustee of a spendthrift trust in an attempt to compel payment of a judgment entered against the beneficiary of the trust.[9] The judgment had been entered as a result of the beneficiary's failure to appear to answer charges of gross negligence arising from an automobile accident.[10] The lower court granted the defendant's motion to dismiss on the grounds that "a tort judgment creditor may not garnish the trustee of a spendthrift trust in which the tort judgment defendant is a mere lifetime discretionary income beneficiary, nor are the assets of such trust subject to the claims of the tort judgment creditor."[11] In Mississippi, the courts had long held that the limitations imposed by the grantor should be recognized and upheld.[12] The *Sligh* court, in a 7-2 decision, found that the public policy considerations invoked to uphold the enforceability of spendthrift provisions "do not weigh in favor of enforcing spendthrift trust provisions as against the claims of tort creditors or those found liable for gross negligence."[13] The policy rationale was simple:

5. *See* Adam J. Hirsch, *Spendthrift Trusts and Public Policy: Economic and Cognitive Perspectives*, 73 WASH. U. L.Q. 1, 2 (1995).

6. *See id*.

7. *See* BOGERT & BOGERT, *supra* note 4, at 156.

8. *See* Sligh v. First Nat'l Bank of Holmes County, 704 So. 2d 1020 (Miss. 1997).

9. *See id*. at 1023.

10. *See id*. at 1022.

11. *Id*. at 1023.

12. *See* Calhoun v. Markow, 151 So. 547, 549 (Miss. 1933); Leigh v. Harrison, 11 So. 604, 606 (Miss. 1892). However, the Mississippi courts had also recognized the well-established rule that such protection may not be afforded when the beneficiary is the settlor himself. *See* Guaranty Nat'l Bank v. Walter E. Heller & Co., 204 So.2d 856 (Miss. 1967); *see also infra* notes 23-47.

13. *Sligh*, 704 So. 2d at 1027.

> Public policy deems it so important to deter the commission of intentional torts or acts of gross negligence, that we allow victims of gross negligence or intentional torts to recover damages above and beyond what is necessary to compensate them for their injuries, *i.e.*, punitive damages. However, the intended deterrent effect would be completely lost upon individuals whose interests are immune from the satisfaction of such claims.[14]

Although at least one commentator has suggested that the rule in *Sligh* was decided on "an extremely attractive set of facts to challenge the established doctrine,"[15] the court noted that "[l]egal scholars for years have called for the recognition of a public policy exception to the spendthrift trust doctrine in favor of tort judgment creditors."[16] Regardless, the rule established by *Sligh* is clear. In Mississippi, "a beneficiary's interest in spendthrift trust assets is not immune from attachment to satisfy the claims of the beneficiary's intentional or gross negligence tort creditors, and . . . such claims take priority over any remainder interest in such assets."[17]

Other states have limited the effect of spendthrift provisions by statute. The Louisiana Trust Code provides that a court

> may permit seizure of any portion of the beneficiary's interest in trust income and principal in its discretion and as may be just under the circumstances if the claim is based upon a judgment for . . . [a]n offense or quasi-offense committed by the beneficiary or by a person for whose acts the beneficiary is individually responsible.[18]

Georgia has passed a similar statute, which provides that a spendthrift provision prohibiting involuntary transfers is not valid as to tort judgments, alimony, or child support claims.[19] The California Probate Code limits the protection of spendthrift provisions to the amount "necessary for the education and support of the beneficiary."[20] Any remaining interest "may be applied to the satisfaction of a money judgment against the beneficiary."[21] Other states have similar provisions.[22] Thus, the Alaska Trust Act, which attempts to give greater force to spendthrift provisions, was

14. *Id*. at 1028.

15. Ronald R. Volkmer, *Tort Creditor's Access to Spendthrift Trust,* 25 EST. PLAN. 187, 187 (1998).

16. *Sligh*, 704 So. 2d at 1026 (citing several law review articles calling for such an exception).

17. *Id*. at 1029.

18. LA. REV. STAT. ANN. § 9:2005 (West 1991).

19. *See* GA. CODE ANN. § 53-12-28(c) (1996).

20. CAL. PROB. CODE § 15307 (West 1991).

21. *Id*.

22. *See, e.g.*, MICH. COMP. LAWS ANN. § 555.13 (West 1988); N.D. CENT. CODE § 59-03-10 (1999); S.D. CODIFIED LAWS § 43-10-13 (Michie 1999).

passed in a legal environment in which the trend was a weakening of such provisions.

B. Self-Settled Spendthrift Trusts

As mentioned above,[23] one exception to the validity of spendthrift trusts recognized in virtually every U.S. jurisdiction is the rule allowing creditors to reach the interest of the beneficiary of a spendthrift trust when the beneficiary is the settlor of the trust.[24] This rule is imposed by statute in many states and judicially imposed in others.[25] The Second Restatement of Trusts lays down the rule that is applied by nearly every jurisdiction:

> (1) Where a person creates for his own benefit a trust with a provision restraining the voluntary or involuntary transfer of his interest, his transferee or creditors can reach his interest.
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> (2) Where a person creates for his own benefit a trust for support or a discretionary trust, his transferee or creditors can reach the maximum amount which the trustee under the terms of the trust could pay to him or apply for his benefit.[26]

Thus, even where distributions to the settlor are at the discretion of the trustee, a creditor may reach the total amount that the settlor could receive from the trust. This amount could conceivably entail the entire trust.

The rule against self-settled spendthrift trusts finds its roots in a 1487 English statute, which states that "[a]ll deeds of gift of goods and chattels, made or to be made in trust to the use of that person or persons that made the same deed or gift, be void and of none effect."[27] This rule does not depend on the settlor's intent (or lack

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23. *See supra* note 12.

24. *See* BOGERT & BOGERT, *supra* note 4, § 40; AUSTIN W. SCOTT & WILLIAM F. FRATCHER, 2A THE LAW OF TRUSTS § 156 (4th ed. 1987).

25. *See, e.g.*, IND. CODE ANN. § 30-4-3-2 (West 1994) ("[I]f the settlor is also a beneficiary of the trust, a provision restraining the voluntary or involuntary transfer of his beneficial interest will not prevent his creditors from satisfying claims from his interest in the trust estate."); N.Y. EST. POWERS & TRUSTS LAW § 7-3.1 (1992) ("A disposition in trust for the use of the creator is void as against the existing or subsequent creditors of the creator."); TEX. PROP. CODE ANN. § 112.035 (West 1995) ("If the settlor is also a beneficiary of the trust, a provision restraining the voluntary or involuntary transfer of his beneficial interest does not prevent his creditors from satisfying claims from his interest in the trust estate.").

26. RESTATEMENT (SECOND) OF TRUSTS § 156 (1971).

27. SCOTT & FRATCHER, *supra* note 24, § 156 at 168 n.4 (citing 3 Hen. 7, ch. 4 (1487) (Engl.)).

thereof) to defraud creditors existing or future.[28] There is ample case law suggesting that this rule is well-settled.[29]

The Massachusetts Supreme Court has explained the simple rationale behind the rule:

> This rule promotes a valid public policy: A person ought not to be able to shelter his assets from his creditors in a discretionary trust of which he is the beneficiary and thus be able to enjoy all the benefits of ownership of the property without any of the burdens.[30]

In his treatise on trusts, George T. Bogert explained further:

> [T]o hold otherwise would be to give the unexampled opportunity to unscrupulous persons to shelter their property before engaging in speculative business enterprises, to mislead creditors into thinking that the settlor still owned the property since he appeared to be receiving its income, and thereby to work a gross fraud on creditors who might place reliance on the former prosperity and financial solidity of the debtor. In some cases there would be an actual intent to cheat or hinder creditors but it would be secret and could not be proved.[31]

Thus, Alaska's adoption of a statute that permits trust settlors to protect assets from creditors while retaining an interest in the trust intentionally creates an exception to a very well-established rule.[32]

Although the rule is well-settled, its application has not been entirely uniform. There are discrepancies from state to state on the issue of what constitutes a self-settled trust.[33] Furthermore, some early tax cases suggest that creditors may not reach the assets of a trust where the settlor is one of multiple discretionary

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28. *See id*.

29. *See, e.g.*, *In re* CRS Steam, Inc., 217 B.R. 365, 371 (Bankr. D. Mass. 1998); *In re* Nagel, 580 N.W.2d 810, 811 (Iowa 1998); Coster v. Crookham, 468 N.W.2d 802, 809 (Iowa 1991); *In re* Hertsberg, 578 N.W.2d 289 (Mich. 1998); BOGERT & BOGERT, *supra* note 4, § 40; SCOTT & FRATCHER, *supra* note 24, §156.2. *But see* Richard W. Hompesch II et al., *Does the New Alaska Trust Act Provide an Alternative to the Foreign Trust*, J. OF ASSET PROTECTION, July/Aug. 1997 at 9 n.1 (1997) (citing possible statutory and common law exceptions).

30. *Nagel*, 580 N.W.2d at 811; *see also* John E. Sullivan III, *Gutting the Rule Against Self-Settled Trusts: How the New Delaware Trust Law Competes with Offshore Trusts*, 23 DEL. J. CORP. L. 423, 426 (1998); James T. Lorenzetti, *The Offshore Trust: A Contemporary Asset Protection Scheme*, 102 COM. L.J. 138, 139 (1997).

31. BOGERT & BOGERT, *supra* note 4, § 40.

32. It should be noted that there are limited exceptions to the rule against self-settled spendthrift trusts, specifically within the realm of retirement trusts. For a more detailed discussion, *see* Sullivan, *supra* note 30, at 428-32.

33. *See* Elena Marty-Nelson, *Offshore Asset Protection Trusts: Having Your Cake and Eating it Too,* 47 RUTGERS L. REV. 11, 31 n.105 (1994).

beneficiaries.[34] In one case, for example, the settlor established an irrevocable trust naming himself and his wife as beneficiaries until their passing, with the principal to be distributed to his children when they reached the age of twenty-five.[35] Distributions to him and his wife were left to the unfettered discretion of the trustee.[36] The Commissioner of the IRS held that the transfer was a completed gift and subject to a gift tax because a mere "hope or passive expectancy" of income from the trust was not sufficient to constitute a retention of a right.[37] Recognizing the validity of spendthrift trusts generally, the United States Court of Appeals for the Second Circuit upheld the Commissioner's decision:

> [T]here is no New York decision holding that the rights of creditors would differ from those available to them in a case where the trust is set up by a third party if the exercise of a power for his benefit is wholly dependent upon the discretion of the trustee.[38]

The court, interpreting New York law, distinguished the case from those relied upon by treatises and the Restatement, stating that "[i]n the principal ones at least there was no beneficiary other than the grantor or his estate in whose favor the power might be exercised at the option of the trustee."[39] Concluding that "the law of New York respecting the right of . . . creditors to reach the income of the trust is in doubt,"[40] the court upheld the decision of the Commissioner to tax the transfer to the trust as a completed gift.

However, New York law on the subject became much less in doubt forty years later when the Appellate Division, an intermediate state court, decided *Vanderbilt Credit Corp. v. Chase Manhattan Bank.*[41] In *Vanderbilt,* a creditor sought to reach the assets of a trust established by the debtor of which the debtor was a beneficiary.[42] The trust was irrevocable and contained a spendthrift provision.[43] Distributions of trust income to the settlor were mandatory, while the trustee could, at his discretion, distribute

34. *See* Herzog v. Commissioner of Internal Revenue, 116 F.2d 591 (2d Cir. 1941).
35. *See id*. at 592-93.
36. *See id*. at 593.
37. *Id*.
38. *Id*. at 594.
39. *Id*.
40. *Id*.
41. 473 N.Y.S.2d 242 (N.Y. App. Div. 1984).
42. *See id*. at 245-46.
43. *See id*.

portions of the trust principal as well.[44] The court held that the creditor could reach not only the debtor's interest in distributions of income from the trust, but the trust corpus itself, as the settlor retained a discretionary interest in the corpus.[45] The court relied on the well-known rule against self-settled spendthrift trusts:

> [W]hen a person creates for his own benefit a discretionary trust, his creditors can reach the maximum amount which the trustee under the terms of the trust could pay to him or apply for his benefit, even though the trustee in the exercise of his discretion wishes to pay nothing to the beneficiary or to his creditors, and even though the beneficiary could not compel the trustee to pay him anything.[46]

In spite of the presence of other beneficiaries,[47] which was the distinguishing factor relied upon in the Second Circuit case, the court refused to enforce the spendthrift provision even where the beneficiary/settlor was a discretionary beneficiary. Thus, what appeared to be an exception to the rule against self-settled spendthrift trusts was eliminated. There is very little law suggesting that the rule is anything but uniformly accepted domestically.

C. Overseas Asset Protection Trusts

As a means to avoid the rule against self-settled spendthrift trusts, Americans seeking strong asset protection have increasingly turned to offshore asset protection trusts ("OAPT's").[48] These trusts, which are established under the laws of certain foreign jurisdictions with laws favorable to the protection of assets from future creditors, provide the dual benefit of strong spendthrift protection while permitting the settlor to control and benefit from the property held in trust.[49] It has been estimated that over one trillion dollars of foreign trust funds are held in asset protection trusts.[50]

Regardless of ethical or public policy concerns, the placement of assets in OAPT's presents many practical barriers between a creditor and the assets held in trust.[51] However, OAPT's are not

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44. *See id*. at 245.
45. *See id*.
46. *Id*. at 245-46.
47. The corpus of the trust was to be paid to the settlor's children upon her passing. *See id*. at 245.
48. *See* Marty-Nelson, *supra* note 33, at 13.
49. *See id*.
50. *See id*. at 13-14.
51. *See id*. at 59-61.

without risks and costs, such as problems associated with political instability and the expense of establishing and administering an offshore trust.[52] The Alaska Trust Act is an attempt to attract trust investment in the state of Alaska by providing the protection of offshore trusts without the risks of dealing with a foreign jurisdiction.

III. The Alaska Trust Act of 1997

A. Overview

The primary effect of the Act was to rewrite Alaska Statutes section 34.40.110. The new statute permits the settlor of a trust to provide that "the interest of a beneficiary of the trust may not be either voluntarily or involuntarily transferred before payment or delivery of the interest to the beneficiary by the trustee."[53] The statute makes no exception for cases in which the beneficiary in question is the settlor himself.

The rewritten section further provides that such a transfer restriction prevents anyone (expressly including present and future creditors) from satisfying a claim out of the beneficiary's interest except under any of the following conditions: (1) the transfer establishing the trust "was intended in whole or in part to hinder, delay, or defraud creditors or other persons;"[54] (2) the trust permits the settlor to "revoke or terminate all or part of the trust without the consent of a person who has a substantial beneficial interest in the trust;"[55] (3) the "trust *requires* that all or part of the trust's income or principal, or both, must be distributed to the settlor;"[56] or (4) the settlor is in default of making a child support payment at the time of the transfer establishing the trust.[57]

The above limits on the availability of an enforceable spendthrift provision are not absolute. The Act establishes that a transfer restriction is still valid if the settlor retains the right to veto a distribution from the trust or the right to receive distributions from the income or corpus of the trust at the discretion of a person other than the settlor, such as a trustee.[58] The statute also establishes a time limitation on actions brought under the

52. *See id*. at 66-71.
53. Alaska Stat. § 34.40.110(a) (LEXIS 1998).
54. *Id*. § 34.40.110(b)(1).
55. *Id*. § 34.40.110(b)(2).
56. *Id*. § 34.40.110(b)(3) (emphasis added).
57. *See id*. § 34.40.110(b)(4).
58. *See id*. § 34.40.110(b)(2).

fraudulent conveyance laws.[59] A person who was a creditor when the trust was created and is attempting to satisfy a claim by reaching the assets of the trust may only do so if the action is brought within four years after the allegedly fraudulent transfer was made or "one year after the transfer is or reasonably could have been discovered by the person."[60] A person who becomes a creditor subsequent to the establishment of the trust may only bring an action within four years after the transfer is made.[61] Alaska's fraudulent conveyance statute was amended to incorporate the new statute of limitations imposed by the new law.[62]

The Act also abolished the rule against perpetuities[63] for essentially all trusts by amending Alaska Statutes section 34.27.050(a) to include situations where "the interest is in a trust and all or part of the income or principal of the trust may be distributed, in the discretion of the trustee, to a person who is living when the trust is created."[64] A trust could conceivably qualify for the abolition of the rule against perpetuities by giving the trustee the discretion to distribute one cent of the income or principal of the trust to anyone who is alive at the time of the creation of the trust, while keeping the rest of the trust's assets in perpetuity.

The Act also established that a choice of law provision in a trust document designating Alaska law to "govern the validity, construction, and administration of the trust"[65] and subjecting the trust to the jurisdiction of Alaska courts is valid as long as three conditions are met. First, some or all of the trust assets must be deposited in Alaska and administered by a "qualified person."[66] A "qualified person" includes "an individual whose true and permanent home is in" Alaska,[67] a trust company that has its principal place of business in Alaska,[68] or a bank that "possesses and exercises trust powers and has its principal place of business

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59. *See id*. § 34.40.110(d)(1).
60. *Id*. § 34.40.110(d)(1)(B).
61. *Id*. § 34.40.110(d)(2).
62. *See id*. § 34.40.010.
63. "The rule prohibiting a grant of an estate unless the interest must vest, if at all, no later than 21 years after the death of some person alive when the interest was created." BLACK'S LAW DICTIONARY (7th ed. 1999).
64. ALASKA STAT. § 34.27.050(a)(3).
65. *Id*. § 13.36.035(c).
66. *Id*. § 13.36.035(c)(1).
67. *Id*. § 13.36.390(1)(A).
68. *See id*. § 13.36.390(1)(B).

in" Alaska.[69] Second, the powers of the Alaska trustee must include maintaining the records for the trust and preparing or arranging for the preparation of income tax returns that must be filed by the trust.[70] Finally, part of the administration must take place in Alaska, including the physical maintenance of trust records.[71] Once a trust contains such a state jurisdiction provision designating Alaska law, the "validity, construction, and administration of [the] trust . . . are determined by the laws of" Alaska.[72]

The Act further grants exclusive jurisdiction to Alaska courts over "proceedings initiated by interested parties concerning the internal affairs of trusts," including trusts with valid choice of law provisions as described above.[73] The statute also permits Alaska courts to entertain proceedings involving trusts registered or having their principal place of administration outside of Alaska as long as the requirements of section 13.36.035(c) are met.[74] Thus, an out-of-state settlor could establish an Alaska Trust merely by putting such provision in the trust documents and maintaining some of the trust's assets in Alaska.[75] The Alaska trustee need only administer those assets[76] and maintain records and prepare tax returns on a nonexclusive basis.[77] The statutory requirements for access to the protection afforded by the Alaska Trust Act are in fact quite minimal.

B. Desired Effects

The potential benefits to the settlor of a self-settled spendthrift trust are two-fold. First, the settlor retains the obvious benefits of protecting assets from creditors while maintaining access to the assets, although such access is limited. The drafter of the legislation, Jonathan G. Blattmachr, and several estate planning lawyers have written a series of articles touting the benefits of the newly available Alaska Trusts.[78]

69. *Id*. § 13.36.390(1)(C).
70. *See id*. § 13.36.035(c)(3).
71. *See id*. § 13.36.035(c)(4).
72. *Id*. § 13.36.035(d).
73. *Id*. § 13.36.035(a).
74. *See id.* § 13.36.035(c).
75. *See id.* § 13.36.035.
76. *See id*. § 13.36.035(c)(1).
77. *See id.* § 13.36.035(c)(3).
78. *See, e.g.*, Douglas J. Blattmachr & Richard W. Hompesch II, *Alaska v. Delaware: Heavyweight Competition in New Trust Laws*, 12 PROB. & PROP. 32, 38 (1998) ("Delaware tried to match the Alaska Trust Act but fell short.");

Citing "substantial concerns held by Americans about the potential of financially devastating legal judgments,"[79] and a "trend over the last 100 years in the trust law of this country . . . to make trusts weaker and weaker,"[80] proponents of the Act have touted the asset protection provided by a self-settled spendthrift trust. Although neither the Alaska nor the similar Delaware statutes[81] will enforce the spendthrift provisions in trusts if the transfer to the trust was fraudulent,[82] the trusts afford protection that had previously been available only by placing money in offshore trusts.[83]

Perhaps even more important than protecting assets from creditors are the potential tax benefits of a self-settled spendthrift trust.[84] Ordinarily, the assets of a self-settled trust would be included in the settlor's estate at his death and would therefore be subject to estate taxes. However, the IRS has held that inclusion in a decedent's estate is largely determined by creditors' access to those assets.[85] While the IRS has not yet held whether assets in an Alaska or Delaware self-settled spendthrift trust will be subject to

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Hompesch, *supra* note 29, at 16 (concluding that Alaska is an "attractive trust situs"); Jonathan Blattmachr et al*., Alaska's Revision of its Trust Act, Which Sets Out to Permit Trusts to Preserve Assets and Reduce Taxes, May Have Implications for Trust Planning Nationwide*, THE NAT'L L. J., June 16, 1997, at B5 ("The new Alaska Trust Act offers a new tool in accomplishing the dual goals of asset protection and tax reduction."); Jonathan Blattmachr et al., *New Alaska Trust Act Provides Many Estate Planning Opportunities,* 24 EST. PLAN. 347, 347 (1997) [hereinafter Blattmachr, *New Alaska Trust Act*] (stating that the Act "provides new estate planning opportunities for clients throughout the entire country").

79. Hompesch, *supra* note 29, at 9; *see also* Sullivan, *supra* note 30, at 442 ("The Act . . . legitimizes the contemporary urge to shelter assets from future lawsuits and to protect wealth from a litigation system that many Americans deem to be both excessive and illogical." (referring to Delaware's similar legislation)).

80. House Hearings, *supra* note 2 (comments of Representative Al Vezey).

81. *See infra* notes 93-97 and accompanying text.

82. *See* ALASKA STAT. § 34.40.110(b)(1) (LEXIS 1998); *see also* DEL. CODE ANN. tit. 12, § 3572(a) (Supp. 1998) (limiting actions brought for a remedy against property in the trusts to those brought under Delaware's Uniform Fraudulent Transfer Act).

83. *See* Marty-Nelson, *supra* note 33.

84. *See* Carol King, *Dynasty and Asset Protection Trusts Find New Home in Alaska*, NAT'L UNDERWRITER LIFE & HEALTH, Nov. 3, 1997 (quoting Richard Hompesch II as stating that "[t]he creditor protection is simply the means to estate planning").

85. *See infra* notes 157-165 and accompanying text.

estate taxes,[86] proponents of the trusts have suggested that a settlor will be able to avoid estate taxes on such assets.[87] Thus, an Alaska Trust, working as intended, would provide not only protection from creditors, but would permit the settlor to enjoy the benefits of an interest in trust assets, without paying estate taxes on those assets upon his passing.

C. Purposes

The motivation of the legislature in enacting the Alaska Trust Act is quite clear. The sponsor of the bill described it as the result of his "desire to find out what needs to happen to make Alaska, and particularly Anchorage, a financial service center for the world."[88] The statute is designed to ensure that the Alaskan financial service industry reaps the benefits of the expected influx of trust capital to Alaska. As noted above, in order to qualify for the protections of the Alaska Trust, a trust must keep some of the trust's assets in Alaska, and the trust must be administered by an Alaskan trustee or trust company.[89] The Alaska trustee also has the responsibility of preparing tax statements,[90] a service for which the trustee would presumably be paid. Representative Vezey himself noted that "the management fees are substantial."[91]

The Senate Judiciary Committee considering House Bill 101 heard testimony from a trusts and estates practitioner supporting the bill. He testified that it was a means to bring a "clean industry" to Alaska in the same way Delaware has attracted corporations and South Dakota has attracted central processing for credit card companies by modifying their laws.[92]

86. *See* Priv. Ltr. Rul. 9837007 (Sept. 11, 1998) (holding that a transfer to such a trust is complete for gift tax purposes, but expressly withholding judgment on the inclusion of the assets in the settlor's estate for estate tax purposes).

87. *See, e.g.,* Blattmachr, *New Alaska Trust Act, supra* note 78, at 357 ("[T]he new law . . . permits the grantor to make transfers to the trust that . . . may be excludable from the grantor's gross estate.").

88. *Trusts and Property Transfers in Trust: Hearing on HB 101 Before the Senate Judiciary Committee*., 20th Legis., 1st Sess. (Alaska 1997), available at the Alaska Legislature Home Page (visited Nov. 6, 1999) <http://www.legis.state.ak.us> [hereinafter Senate Hearings] (comments of Representative Al Vezey).

89. *See* ALASKA STAT. §13.36.035(c) (LEXIS 1998).

90. *See id.* § 13.36.035(c)(3).

91. *See* Senate Hearings, *supra* note 88 (comments of Representative Al Vezey).

92. *Id*.

Shortly after Alaska passed its Trust Act, Delaware passed a similar piece of legislation.[93] However, the Delaware law permits certain classes of creditors to reach the beneficiary/settlor's interest,[94] which has important tax implications that will be discussed later.[95] For example, the Alaska Act states that a transfer restriction prevents present and future creditors from reaching the assets of the trusts only if the settlor is not in default by thirty or more days of making a child support payment at the time of the transfer.[96] The protection afforded by the Delaware Act, however, does not apply to indebtedness that arises out of an agreement or court order for the payment of spousal or child support, regardless of whether such indebtedness arises before or after the transfer into the trust is made.[97]

IV. DISCUSSION

Much of the literature regarding Alaska Trusts has been generated by practitioners with a vested interest in the availability of the trusts to out-of-state settlors.[98] Not surprisingly, their conclusions generally have been quite positive.[99] However, Alaska Trusts may not be the panacea envisioned by the Act's drafters. Most of the treatment of the Alaska legislation and similar efforts in Delaware by academics, the mass media, and other practitioners has been more critical of the motives behind the Alaska

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93. *See* DEL. CODE ANN. tit. 12, §§ 3570-76 (Supp. 1998).

94. *See id*. § 3573 (Supp. 1998); *see also* Martin M. Shenkman, *Warming up to an Alaska Trust*, NEW JERSEY LAWYER, Nov. 23, 1998, at 7 (interview with Douglas J. Blattmachr).

95. *See infra* notes 157-163 and accompanying text.

96. *See* ALASKA STAT. § 34.40.110(b)(4) (LEXIS 1998).

97. *See* DEL. CODE ANN. tit. 12, § 3573(1); *see also* Sullivan, *supra* note 30, at 450-51.

98. For example, John E. Sullivan III is a private attorney whose concentrations include asset protection planning; Douglas J. Blattmachr is the President and CEO of the Alaska Trust Co.; Jonathan G. Blattmachr is a private attorney in New York who drafted the legislation; Richard W. Hompesch II is a private attorney in Anchorage, Alaska, who practices estate planning, probate, and tax law, and who testified before the Alaska Legislature to urge passage of the legislation; Gideon Rothschild is a private attorney in New York whose practice includes trusts and estates, asset protection, and probate law; and Richard S. Thwaites, Jr. is Chairman of the Alaska Trust Company and was actively involved in the enactment of the Alaska Trust Act.

99. *See supra* note 78.

Legislature's actions and skeptical about the advertised benefits of the Alaska Trusts.[100]

When operating as intended, an Alaska Trust would theoretically provide to the Alaskan or out-of-state settlor the dual benefits of asset protection and estate tax relief, while permitting the settlor to maintain a beneficial interest in the trust during his lifetime. In addition, such a trust would be perpetual. While these benefits may indeed be attainable, the effect of the establishment of such trusts is untested and unclear. First, in terms of asset protection, Alaska Trusts may be susceptible to the fraudulent conveyance laws of other states. Further, the case law on the effect of a choice of law provision in the bankruptcy context does not clearly answer the question of whether such a provision in an Alaska Trust would be enforceable. Thirdly, the tax benefits of a self-settled spendthrift trust are far from guaranteed. Finally, the effect of the abolition of the rule against perpetuities is unclear, particularly with respect to land situated outside of Alaska. Each of these points will be considered in turn.

A. Asset Protection

1. *Fraudulent Transfer*. Although the Act contained provisions designed to protect Alaska Trusts from fraudulent conveyance actions, they may be susceptible to charges that transfers into the trusts constitute fraudulent conveyances, particularly in out-of-state courts. Before passage of the Alaska

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100. *See, e.g.,* Amy Lynn Wagenfeld, Note, *Law For Sale: Alaska and Delaware Compete for the Asset Protection Trust Market and the Wealth That Follows*, 32 VAND. J. TRANSNAT'L L. 831, 874 (concluding that Alaska and Delaware have sacrificed "well-settled concepts of fairness in creditors' rights issues" in order to "bolster [their] econom[ies] and bring revenue into the state[s]"); Karen Gebbia-Pinetti, *As Certain as Debt and Taxes: Estate Planning, Asset-Protection Trusts, and Conflicting State Law,* SC60 ALI-ABA 179 (1998) (concluding that the trusts are vulnerable to challenge with respect to fraudulent transfer laws); Brigid McMenamin, *Flimsy Shelters*, FORBES, Sept. 8, 1997, at 94 (warning that the Alaska Trusts may be vulnerable to both creditors and the IRS); Leslie C. Giordani & Duncan B. Osborne, *Will the Alaska Trusts Work?*, 3 J. ASSET PROTECTION 7 (1997) (discussing the vulnerability of Alaska Trusts to the "full faith and credit" clause of the United States Constitution); John Paul Parks, *Evaluating the Alaska Trust's Ability to Shield Assets From the Claims of Creditors*, ARIZ. ATT'Y, Nov. 1998, at 31 ("[T]he right of the Arizona Superior Court to entertain proceedings involving Alaska trusts on forum non-conveniens grounds and Alaska's obligation to adhere to the Full Faith and Credit Clause cause the Alaska trust to compare unfavorably to the international trust as a means of avoiding the claims of creditors.").

Trust Act, Alaska already had more stringent fraudulent transfer laws than most other U.S. jurisdictions. As it did even before the Act, the Alaska fraudulent conveyance statute[101] requires a demonstration of actual intent to defraud.[102] Specifically, the statute voids transfers "made with the intent to hinder, delay, or defraud creditors . . . with the like intent, as against the persons so hindered, delayed, or defrauded."[103] The majority of American states have adopted the Uniform Fraudulent Transfer Act ("UFTA"),[104] which permits a finding of constructive fraud:

> (a) A transfer made or obligation incurred by a debtor is fraudulent as to a creditor, whether the creditor's claim arose before or after the transfer was made or the obligation was incurred, if the debtor made the transfer or incurred the obligation:
>
> > (1) with actual intent to hinder, delay, or defraud any creditor of the debtor; or
> >
> > (2) without receiving a reasonably equivalent value in exchange for the transfer or obligation, and the debtor:
> >
> > > (i) was engaged or was about to engage in a business or a transaction for which the remaining assets of the debtor were unreasonably small in relation to the business or transaction; or
> > >
> > > (ii) intended to incur, or believed or *reasonably should have believed* that he would incur, debts beyond his ability to pay as they became due.[105]

Thus, in the majority of American jurisdictions, fraudulent transfer laws not only include those transfers made with specific fraudulent intent, but also those made without receiving equivalent value where the transferor should have believed that they would incur debts beyond their ability to pay. The Bankruptcy Code also proscribes constructively fraudulent transfers in section 548[106] and further permits a trustee in bankruptcy to avoid any transfer that is "voidable under applicable law."[107]

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101. *See* ALASKA STAT. § 34.40.010 (LEXIS 1998).

102. *See, e.g.*, Summers v. Hagen, 852 P.2d 1165, 1169 (Alaska 1993) (holding that "to prove liability for participation in a fraudulent conveyance scheme, a plaintiff must establish . . . [t]he specific intent of each participant in the scheme to hinder, delay and defraud a creditor of one who participated in the scheme.").

103. ALASKA STAT. § 34.40.010 (LEXIS 1998).

104. *See* Gebbia-Pinetti, *supra* note 100, at 217.

105. UNIF. FRAUDULENT TRANSFER ACT § 4, 7A U.L.A. 301 (1984) (emphasis added).

106. *See* 11 U.S.C. § 548(a)(1)(B) (1994).

107. *Id*. § 544(b).

The intent requirement of fraudulent transfer laws is often determined through the use of circumstantial evidence, often called the "badges of fraud."[108] A badge of fraud has been defined as "a fact tending to throw suspicion upon the questioned transaction, excites distrust as to bona fides, raises an inference that a conveyance is fraudulent and by its presence usually requires a showing of good faith."[109] Commonly identified badges of fraud include:

(1) The lack or inadequacy of consideration;
(2) The family, friendship, or other close relationship among the parties;
(3) The retention of possession, benefit, or use of the property in question;
(4) The financial condition of the defendant both before and after the transfer in question;
(5) The existence or cumulative effect of a pattern of transactions or a course of conduct after the onset of financial difficulties; and
(6) The general chronology of events.[110]

The third badge in the list above may be particularly applicable for transfers to Alaska Trusts. Minimal compliance with the requirements of the statute (which would permit, for example, the retention of veto power over distributions from the trust) may be found to be insufficient to escape the grasps of the fraudulent conveyance laws of creditor-friendly jurisdictions.

The Alaska Trust Act further restricts the state's already limited fraudulent transfer law by imposing a statutory time limitation on challenges to Alaska Trusts.[111] Although the statute appears to make challenges to transfers to Alaska Trusts as fraudulent very difficult, the Legislature's attempt to shield the trusts from such challenges was probably in vain as applied to out-of-state settlors. Alaska's stringent standards for fraudulent transfer actions would probably not apply to such settlors. Challenges to transfers to Alaska Trusts are quite distinct from challenges to the validity of the spendthrift provisions of the trusts themselves.[112]

In a 1989 Massachusetts case, a trustee in bankruptcy brought a claim pursuant to section 544(b) of the Bankruptcy Code to avoid

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108. *See* Marty-Nelson, *supra* note 33, at 53.

109. *In re* Reed, 566 P.2d 587, 589 (Wyo. 1977) (citing Mohar v. McLelland Lumber Co., 501 P.2d 722 (Idaho 1972)).

110. *See* Marty-Nelson, *supra* note 33, at 54 (citing *In re* May, 12 B.R. 618, 627 (Bankr. N.D. Fla. 1980)).

111. *See supra* notes 59-62 and accompanying text.

112. *See* Gebbia-Pinetti, *supra* note 100, at 243.

an allegedly fraudulent transfer.[113] The Bankruptcy Court applied the "most significant relationship" test found in the Restatement (Second) of Conflicts of Law to determine whether to apply Connecticut or Massachusetts law,[114] giving little weight to a provision in the allegedly fraudulent security agreement stating that Connecticut law would govern the agreement:

> The choice-of-law clause carries little weight in the context of this adversary proceeding. The parties to a contract can specify which forum's law will govern their contract, and courts often follow their choice because both parties to the contract, and therefore to the suit on the contract, have agreed upon the choice. But this is a fraudulent conveyance action, not a contract action. And one of the parties to this suit—the Trustee, who stands in the shoes of the creditors—was not a party to the contract. The parties to a contractual conveyance cannot in their contract make a choice-of-law that binds creditors who allege that they were defrauded by the conveyance. The choice-of-law binds only parties to the contract, not the Trustee or the creditors.[115]

The court dismissed the debtor's reliance on the Restatement (Second) of Conflicts of Law, which states that "[t]he law of the state chosen by the parties to govern their contractual rights and duties will be applied"[116] as applying only "to suits between parties to a contract regarding their rights and duties under the contract."[117] The court went on to apply the "most significant interest" test without regard to the choice-of-law provision in the security agreement. Thus, a bankruptcy trustee will more likely avoid a transfer into an Alaska Trust if the transfer was fraudulent under the laws of the state with the most significant relationship to the assets and the debtor. In a case where the settlor has satisfied only the minimal requirements under the Alaska Trust Act, the most significant relationship is unlikely to be with Alaska.[118] By analogy, a court in the non-bankruptcy context will apply a similar analysis to a fraudulent conveyance action by a creditor seeking to reach assets of a settlor who is not in bankruptcy. For example, one commentator suggests the situation of an Illinois debtor who transfers assets to a friend in Alaska and is subsequently sued by an

113. *See In re* Morse Tool, 108 B.R. 384, 385 (Bankr. D. Mass. 1989).

114. *See id*.

115. *Id*. at 386.

116. RESTATEMENT (SECOND) OF CONFLICTS OF LAW § 187 (1971).

117. *Morse*, 108 B.R. at 386.

118. For a more detailed analysis of fraudulent transfer and choice-of-law doctrine as applied to Alaska and Delaware self-settled trusts, *see* Gebbia-Pinetti, *supra* note 100, at 241-59.

Illinois creditor seeking to recover the assets as a fraudulent transfer under Illinois law.[119] Even if the debtor and his friend have agreed that the transfer would be governed by Alaska law, it is highly unlikely that a court would give effect to their attempt to bind the creditor to Alaska fraudulent transfer law.[120]

An out-of-state court is likely to hear a fraudulent conveyance action regarding an Alaska Trust in spite of the Act's purported grant of exclusive jurisdiction to the Alaska courts over "proceedings initiated by interested parties concerning the internal affairs of trusts."[121] First, it is unclear whether a fraudulent conveyance action falls under the heading of "internal affairs" of a trust. Second, the Restatement is quite clear that "[a] state may entertain an action even though the state of the applicable law has provided that action on the particular claim shall not be brought outside its territory."[122] In a fraudulent conveyance action, Alaskan law may not even be the "applicable law" in the first place.

Finally, the full faith and credit clause of the United States Constitution[123] would require that Alaska give full effect to the judgment of an out-of-state court that a transfer to an Alaska Trust was a fraudulent conveyance. The only possibly applicable exception recognized by the Restatement is likely irrelevant. Section 103 declares that a state need not recognize or enforce the judgment of another state if such recognition or enforcement would "involve an improper interference with important interests" of the state being asked to enforce the judgment.[124] The comment to the Restatement provision describes the application of this exception as "extremely narrow."[125] A state's "strong public policy" against enforcement of the claim will not suffice to constitute interference with important interests.[126] The full faith and credit clause distinguishes the protection of the offshore trusts from the protection of an Alaska Trust. The above analysis fully applies to an offshore trust except for the enforceability of the judgment of another state. A transfer to an offshore trust would be

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119. *See id*. at 247.

120. *See id*.

121. ALASKA STAT. § 13.36.035(a) (LEXIS 1998).

122. RESTATEMENT (SECOND) OF CONFLICTS OF LAW § 91 (1971).

123. *See* U.S. CONST. art. IV, §1 ("Full Faith and Credit shall be given in each State to the public Acts, Records, and judicial Proceedings of every other State.").

124. RESTATEMENT (SECOND) OF CONFLICTS OF LAW § 103 (1971) (amended 1989).

125. *Id*. cmt. a.

126. *Id*. § 117.

far more impervious to attachment by creditors because of the judgment's unenforceability.

2. *Direct Challenges to Enforceability*. A successful action by a creditor to reach the assets of an Alaska Trust under out-of-state fraudulent transfer law has serious implications for the ability of the trusts to provide the asset protection touted by the Act's proponents. However, the effect of such vulnerability on the tax benefits of the trusts is unclear.[127] A direct challenge to the validity of the spendthrift provision of an Alaska Trust, on the other hand, would have far more serious implications than a fraudulent transfer in terms of the tax benefits of a spendthrift trust.[128]

A challenge to the spendthrift provision is likely to arise in the bankruptcy context, where a court must decide if the assets held in an Alaska Trust are part of the debtor's estate for purposes of bankruptcy. This determination has yet to be made by a bankruptcy court, and is crucial to the success of the trusts as a viable means of asset protection. Section 541 of the Bankruptcy Code[129] provides the guidelines for inclusion and exclusion of assets in the debtor's estate in bankruptcy and states in seemingly clear language that "[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."[130] This section has traditionally been applied to protect valid spendthrift trusts[131] and allow access to trusts where a spendthrift provision is unenforceable.[132] If a court gives effect to a choice of law provision in trust documents selecting Alaska law to govern, then the spendthrift provision will have the desired effect of shielding the trust assets from the creditors of the settlor. However, case law suggests that a court may be unwilling to allow the debtor/settlor simply to select the "applicable nonbankruptcy law."[133]

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127. *See* Gebbia-Pinetti, *supra* note 100, at 257-59.

128. *See id*. at 258-59.

129. *See* 11 U.S.C. § 541 (1993).

130. *Id.* § 541(c)(2) (1993).

131. *See, e.g., In re* Montgomery, 104 B.R. 112, 116-18 (Bankr. N.D. Iowa 1989) (holding that alienation restrictions in an annuity plan were valid under New York law and therefore excluded the debtor's beneficial interest in the annuity plan from his estate).

132. *See, e.g., In re* Robbins, 211 B.R. 2, 4-5 (Bankr. D. Conn. 1997) (holding that an annuity containing a spendthrift clause was self-settled and unenforceable under Connecticut law and therefore constituted property of the debtor's estate).

133. *In re* Portnoy, 201 B.R. 685 (Bankr. S.D.N.Y. 1996); *In re* Rothery, 200 B.R. 644, 650 (B.A.P. 9th Cir. 1996); *accord, e.g., In re* Consolidated Capital Equities Corp., 143 B.R. 80, 84 (Bankr. N.D. Tex. 1992) ("A suit to avoid a

The debtor in a recent New York case, *In re Portnoy*, established a trust in the Jersey Channel Islands, and transferred his assets to that trust in 1989.[134] The trust, which contained a transfer restriction and named Portnoy (the settlor) as a beneficiary, purported "to vest exclusive jurisdiction over the trust's interpretation in the Jersey courts."[135] In 1990, one of Portnoy's creditors filed suit, and in 1991 obtained a judgment against him.[136] In 1995, the creditor, having never received any payment from Portnoy, learned of the existence of the offshore trust and filed suit alleging that the transfer of assets to the trust constituted a fraudulent conveyance.[137] The state court directed Portnoy to make weekly installment payments to the creditor, and after Portnoy's motion for a stay pending appeal failed, he filed a chapter 7 bankruptcy petition.[138]

One of the creditor's claims for relief depended on a determination of whether the debtor concealed a property interest in the trust.[139] Property interests are created and defined by local law, leaving the court to determine "which local law will supply the substantive rule."[140] Portnoy contended that the court should give effect to the provision in the trust declaring that it was to be governed by Jersey law.[141] The court identified Jersey's interest "in determining what rights remain in the settlor of a trust under its law,"[142] and noted that "[b]oth federal and New York choice of law principles generally respect a designation in a trust which provides that a certain law will be applied to interpret it."[143] However, the court concluded "that New York has the weightier concern in determining whether or not whatever rights Portnoy retained after he formed the trust could be considered to constitute a property interest."[144] To reach this conclusion, the court applied New York's strong public policy against self-settled spendthrift trusts, noting that this policy did not depend on the debtor's insolvency at the

fraudulent conveyance is not a suit on a contract and is not governed by a contractual choice of law provision.").

134. *See Portnoy*, 201 B.R. at 689.

135. *Id*.

136. *See id*. at 690-91.

137. *See id*. at 691.

138. *See id*.

139. *See id*. at 695-96.

140. *Id*. at 696.

141. *See id*.

142. *Id*. at 696-97 (footnote omitted).

143. *Id*. at 697 (citation omitted).

144. *Id*. at 698.

time of the creation of the trust.[145] The court further noted that "it is not at all clear what the policy behind the Jersey amendment is except, perhaps, to augment business."[146]

While *Portnoy* was not decided under section 541, a bankruptcy or other court could apply similar reasoning to render the spendthrift provision of an Alaska Trust unenforceable as against creditors of the settlor. Proponents of the trusts conclude that "[t]he *Portnoy* case appears to be the exception, based quite apparently on its exceptional facts, to the general rule that the grantor or settlor of a trust can specify and thereby control what law governs spendthrift protection of a trust."[147] The facts of *Portnoy* were indeed damning,[148] but the import is clear. The policy against self-settled spendthrift trusts is potentially strong enough to overcome a trust provision selecting the law of another jurisdiction to govern the interpretation of the trust.

As an example of the application of section 541(c), a 1989 Iowa case[149] provides an interesting contrast to *Portnoy* because the court gave full effect to a provision dictating that the validity and effect of the annuity were to be determined under New York law even though neither party even suggested that New York law might apply.[150] The court, however, did not determine whether the spendthrift provision would have been enforced under Iowa law. This case, and other similar cases, where a Bankruptcy Court has found that a choice of law provision is valid and enforceable in dictating "applicable nonbankruptcy law," suggest that a court may be more willing to give effect to such provisions in the absence of bad faith and where the laws selected are those of a domestic jurisdiction.

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145. *See id*.

146. *Id*. at 700 (citation omitted).

147. Hompesch, *supra* note 29, at 12.

148. For example, Portnoy created the trust less than eighteen months after obtaining a loan from the creditor and two months after learning that his business was in trouble. *See In re* Portnoy, 201 B.R. 685, 689 (Bankr. S.D.N.Y. 1986). Further, Portnoy retained the right to remove and replace the trustee at will, *see id*., which supports the court's apparent finding that Portnoy was more than a mere beneficiary of the trust. Portnoy also attempted to protect his earned income by depositing it into accounts in his wife and daughter's names, and asserted during a settlement conference before the creditor's discovery of the trust that his assets "were all gone" because of expensive experimental cancer treatments. *Id*. at 690.

149. *See In re* Montgomery, 104 B.R. 112 (Bankr. N.D. Iowa 1989).

150. *See id.* at 115; *see also In re* Fink, 153 B.R. 883 (Bankr. D. Neb. 1993) (enforcing choice of New York law in similar annuity).

It has also been suggested that a creditor in a bankruptcy court could contend that the legislative history of the Bankruptcy Code suggests that section 541(c) was intended to apply to traditional spendthrift trusts that are established by third parties for the benefit of the debtor.[151] This argument provides a creditor with another arrow in his quiver should the bankruptcy judge decide that the applicable nonbankruptcy law would otherwise be that chosen by the settlor of the trust.

Outside the bankruptcy context, a non-Alaskan court may similarly choose not to enforce the spendthrift provision of an Alaska Trust because it violates a strong public policy of the forum state. Section 187 of the Restatement (Second) of Conflicts of Law dictates the circumstances under which a court should refuse to apply the law chosen by parties to a contract:

> (a) the chosen state has no substantial relationship to the parties or the transaction and there is no other reasonable basis for the parties' choice, or
>
> (b) application of the law of the chosen state would be contrary to a fundamental policy of a state which has a materially greater interest than the chosen state in the determination of the particular issue and which, under the rule of § 188, would be the state of the applicable law in the absence of an effective choice of law by the parties.[152]

The comments to section 187 state that a court should "not refrain from applying the chosen law merely because this would lead to a different result than would be obtained under the local law of the state of the otherwise applicable law."[153] Section 188, which is used to determine the applicable law in the absence of an effective choice by the parties to a contract, sets out five factors that are used to determine the jurisdiction with "the most significant relationship"[154] to the contract: the place of contracting; the place of negotiation of the contract; the place of performance; the location of the subject matter of the contract; and the domicile, residence, nationality, place of incorporation, and place of business of the parties.[155]

Although by no means certain, it is likely that the home state of a non-Alaskan settlor will be the jurisdiction with the most significant relationship to the contract under section 188. Without

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151. *See* Giordani & Osborne, *supra* note 100, at 12 (citing HR Rep. No. 595, 95th Cong., 1st Sess. 369 (1977)).

152. RESTATEMENT (SECOND) OF CONFLICTS OF LAW § 187(2) (1971).

153. *Id*. § 187 cmt. g.

154. *Id*. § 188(1).

155. *See id*. § 188(2).

explicitly stating its intention, the court in *Portnoy* essentially applied the test suggested by the Restatement in determining that the Channel Islands policy was contrary to the strong public policy of New York, which had a materially greater interest in the determination of the issue. The Alaska Trusts have generally been recommended for those seeking a "rainy day" sort of fund, rather than those seeking the strong asset protection available overseas.[156] If this is indeed the typical settlor, it is unlikely that a bankruptcy court faced with the task of determining the validity of a spendthrift provision will be presented with facts as extreme as those in *Portnoy,* and therefore more likely that the provision will be enforced.

B. Tax and Estate Planning Benefits

Internal Revenue Code section 2036 provides the rule for the inclusion or exclusion of a decedent's interest in a trust from the value of his estate for estate tax purposes:

> The value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise, under which he has retained for his life or for any period not ascertainable without reference to his death or for any period which does not in fact end before his death —
>
> > (1) the possession or enjoyment of, or the right to the income from, the property, or
> >
> > (2) the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom.[157]

On its face, the provision would seem to indicate that any retention of control or enjoyment of the assets would result in inclusion of those assets in the debtor's estate for estate tax purposes. Tax courts have generally held that where distributions to the settlor are at the unfettered discretion of the trustee, a transfer is "complete for tax purposes."[158] The transfer is not complete, though, if state law permits creditors of the settlor/beneficiary to reach the assets of the trust for satisfaction of their claims.[159] However, the Seventh Circuit has held that where there is no right

156. *See, e.g.*, Parks, *supra* note 100, at 31.
157. 26 U.S.C. § 2036(a) (1994).
158. Estate of German v. United States, 7 Cl. Ct. 641, 643 (1985) (quoting Outwin v. Commissioner, 76 T.C. 153, 162 (1981)).
159. *See id.*

to compel the trustee to pay (i.e. the settlor is a discretionary beneficiary), the trust estate should not be included in the gross estate, regardless of the ability of the settlor's creditors to reach the corpus of the estate.[160] Thus, it is unclear to what extent a creditor's ability to reach the assets held in trust will determine the inclusion or exclusion of those assets in the settlor/beneficiary's gross estate.

The exclusion of assets from a settlor's gross estate is unlikely to be an automatic consequence of the transfer of those assets to an Alaska Trust. In a private letter ruling, the IRS held that a transfer to a trust resembling an Alaska Trust naming the settlor and his living descendants as beneficiaries was complete for gift tax purposes.[161] In doing so, however, the IRS stated, "We are expressly not ruling on whether the assets held under the Trust agreement at the time of Donor's death will be includible in Donor's gross estate for federal estate tax purposes."[162]

Although no conclusion can be drawn from the IRS's withholding of judgment on the estate tax issue, it indicates, at the very least, that it is a close question that may be subject to case-by-case determinations. The determination should resemble that made by a bankruptcy judge ruling on whether the assets belong in the debtor/settlor's estate. The decision will depend not simply upon the choice of law by the settlor, but upon the degree of control retained by the settlor. For example, the absence of other beneficiaries during the settlor's life or a retention of the power to veto distributions to other beneficiaries during the settlor's life would be strong evidence that the settlor enjoyed the benefits of the trust assets up to the point of his death and that the assets should, therefore, be included in his gross estate for estate tax purposes.

Similar legislation which was recently passed in Delaware is less likely to provide the above-described estate planning advantages because it permits certain classes of creditors to reach the assets of the trust. Specifically, the Delaware statute does not apply to any person to whom the settlor is indebted as a result of an order to pay child support or alimony, regardless of whether the indebtedness was incurred before or after the transfer into the

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160. *See In re* Estate of Uhi, 241 F.2d 867, 869-70 (7th Cir. 1957); *see also* Skinner's Estate v. United States, 316 F.2d 517, 520 (3d Cir. 1963) (holding that the assets of a trust should be included in the settlor's estate only because of evidence of an agreement between the settlor/beneficiary and the trustee that the trustee's discretion would be exercised exclusively in favor of the settlor for her life).

161. *See* Priv. Ltr. Rul. 9837007 (Sept. 11, 1998).

162. *Id*.

trust.[163] By comparison, the Alaska Trust Act provides for a child support exception that applies only if the indebtedness arose *before* the transfer into the trust.[164] The protections of the Delaware legislation are similarly unavailable to a settlor as against a tort creditor if the claim arose before the establishment of the trust.[165] Such access to the property held in trust may prevent the settlor from claiming that the transfer is complete for estate tax purposes.

C. Abolition of the Rule Against Perpetuities

The rule against perpetuities has been described as a "technicality-ridden legal nightmare, designed to meet problems of past centuries that are almost nonexistent today."[166] While this sentiment may be shared by most law students, there are many who place a great deal of importance on the continued impact of the rule, which is simply a rule against remoteness of vesting. In his testimony before the Alaska Senate Judiciary Committee, Jeffrey Schoenblum, Professor of Law at Vanderbilt, warned that the lack of a rule against perpetuities was a contributing factor in the downfall of the Ottoman Empire.[167] The Committee, however, decided not to adopt an amendment to the Act that would exempt real property from the abolition of the rule.[168] Alaska thus joined South Dakota,[169] Delaware,[170] Idaho,[171] and Wisconsin[172] in the group of states that has eliminated or substantially limited the rule against perpetuities. An exception for real property may not have even made much difference, however, as settlors could place the interest in the land in a corporation (which may last in perpetuity), and transfer the shares of the corporation into the trust.[173] However,

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163. *See* DEL. CODE ANN. tit. 12, § 3573(1) (Supp. 1998).

164. *See* ALASKA STAT. § 34.40.110(b)(4) (LEXIS 1998).

165. *See id*. § 3573(2).

166. W. Barton Leach, *Perpetuities Legislation, Massachusetts Style*, 67 HARV. L. REV. 1349, 1349 (1954).

167. *See* Senate Hearings, *supra* note 88.

168. *See id*.

169. *See* S.D. CODIFIED LAWS § 43-5-8 (Michie 1997) (stating simply that "[t]he common-law rule against perpetuities is not in force in this state").

170. *See* DEL. CODE ANN. tit. 25, § 503 (Supp. 1998) (abolishing the common-law rule against perpetuities and requiring only that real property held in trust be distributed to the beneficiaries after 110 years as though the trust terminated).

171. *See* IDAHO CODE § 55-111 (1994) (extending the common-law rule against perpetuities for twenty-five years).

172. *See* WIS. STAT. ANN. § 700.16 (West Supp. 1998) (extending the common-law rule against perpetuities for thirty years).

173. *See* Senate Hearings, *supra* note 88.

because even proponents of the Act do not recommend that non-Alaskan land be placed in Alaska Trusts, the abolition of the rule will not have significant effect on land outside of Alaska.[174]

V. CONCLUSION

The Alaska Trust Act was conceived not out of sympathy for the victims of an increasingly litigious society, but rather to attract the fees that accompany the management and administration of trusts. The protection allegedly afforded by the trusts runs contrary to well-established public policy in nearly every other U.S. jurisdiction. Regardless of the reasoning behind the legislation and the ethical issues implicated by the use of Alaska Trusts, the Alaska Trust Act will, at the very least, place significant hurdles in the path of creditors seeking to reach trust assets and potentially shield them entirely. Yet, satisfying the minimum requirements of the Act will not automatically provide the protection promised, as a court may consider the assets sufficiently within the settlor's dominion to allow creditors to reach them. On the other hand, when the facts are more benign, a court may give full effect to the choice of law provision in an Alaska Trust and prevent creditors from attaching trust assets. The uncertainty of the effectiveness of Alaska Trusts as true asset protection devices renders their use as such quite risky and inadvisable.

As an estate planning tool, however, the outlook is brighter, although still somewhat unclear. Presumably, the IRS will soon rule on the excludability of trust assets from a settlor's gross estate for federal estate tax purposes. Again, the determination will depend on the degree of control exercised by the settlor over the trust assets. All that is clear is that much remains unclear with regard to the Alaska Trusts. A potential settlor seeking the asset protection and estate planning benefits promised by the proponents of the trusts would be well advised to exercise caution.

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174. *See* E-mail from Richard Hompesch II, Hompesch & Associates (on file with author).