Be Wary of Certain Claims Concerning the New Alaskan Trust!
By Stephen H. Telford

Have you heard any of the uproar about the new Alaskan trust? If you have, do you wonder whether it is really the estate planning and asset protection panacea many are claiming it to be? Or is it luring many into a liability trap with a false sense of security?

As you may have heard or read, Alaska (and now Delaware) have passed legislation which is supposed to protect assets in the same manner as an offshore APT. (An asset protection trust created in a foreign country is commonly known as an offshore APT.) Other states are considering following suit. This recent enactment of trust legislation has created a great deal of excitement in the area of estate planning and asset protection. Why? Trust law is steeped in tradition, and changes of this magnitude or nature are very rare. Some planners are so excited by this new development that they are even going so far as to call it the estate planning tool of the decade. Watch out! The alleged benefits of such trust legislation may be greatly overstated.

For example, one of the claims which is being made is that under this new legislation, a person can create a trust in Alaska or Delaware to removes assets from that person's estate for transfer tax purposes while at the same time allowing the assets to be returned to that person in a time of financial need. After the recent changes in the law, a trust created in Alaska or Delaware can also theoretically last forever. However, this type of "rainy day" planning has been available for some time now, and it can currently be achieved in several states, including Idaho, through traditional trust drafting techniques without going to the expense of creating and maintaining a trust in Alaska or Delaware. In that regard, no state legislation will ever be able to pull rank on existing federal estate or gift tax law, and all of the recent improvement to the federal transfer tax law are available to every state in the union, including Idaho.

When everything is said and done, all this talk about estate or gift tax savings may simply be a bunch of "hype" (and perhaps a disguise for the actual agenda). The real issue here is not one of new developments in the area of federal transfer tax law. It is an issue of asset protection. The proper query is: do the Alaskan and Delaware trust law changes offer any significant improvements in terms of asset protection? To answer this question, the basic benefits of an offshore APT have to be reviewed to see how the newest versions of the stateside trusts compare. Typically, an APT created in a properly selected offshore jurisdiction can provide asset protection because the offshore jurisdiction refuses to recognize an adverse judgment rendered in another country. This means that an unwanted creditor who has successfully obtained a judgment here will have to go the foreign jurisdiction where the APT was created to litigate the adverse claim all over again. While these additional costs and the "distance" problem will most certainly level the playing field, the real benefit comes from the fact that the foreign jurisdiction's legal process will make it extremely difficult, if not impossible, for the unwanted creditor to prevail.

The difficulties created by the procedures in certain foreign jurisdictions include three important factors. The first is the time limit for setting aside a fraudulent conveyance. By way of explanation, a fraudulent conveyance is a transfer which is made while claims are pending or expected. Therefore, the key to an effective APT is to transfer assets to the APT at a time when the "waters are calm". Once the transfer is made, hopefully no claims will arise or be anticipated until after the time period has run. Consequently, selecting a jurisdiction with a favorable time limit for setting aside such a transfer can be critical. In some offshore jurisdictions, this time limit has been greatly reduced. Interestingly, the time periods for setting aside fraudulent conveyances in both Alaska and Delaware are at least two or three times as long as the time limits in certain offshore jurisdictions.

The second factor is that many offshore jurisdictions require an unwanted creditor to prove that a claim is valid ***and*** that a particular transfer of property into the offshore APT was ***fraudulent*** in nature ***beyond a reasonable doubt***. This is the same standard of proof which is required in criminal courts in the United States. This is a very heavy burden for a disgruntled plaintiff to carry, particularly in an offshore jurisdiction which may not permit contingency fees for attorneys, as many of them do. An example of the difficulty of this standard of proof is the O.J. Simpson trial. Contrast this standard with the ***preponderance of evidence*** standard, which simply means that the "scales of justice" need only be tipped against a person, however so slightly, to lose in court.

The third factor involves spendthrift protection legislation. Several offshore jurisdictions have enacted laws which allow the person who is creating an APT to be a beneficiary with spendthrift protection. This means that the person administering the APT can refuse to make distributions to a beneficiary at a time when an unwanted creditor is "knocking on the door" to collect on an unfavorable judgment arising from a claim of negligence in an automobile accident, a claim of breach of contract in a business deal gone sour, or a claim of misrepresentation in real estate transaction long since consummated, as well as any other unexpected claim. This type of asset protection can be significant when inadequate or no liability insurance coverage is available. In the right offshore jurisdiction, a person can receive most (if not all) of the benefit from the APT and still retain a great deal of control over its administration, despite the inclusion of spendthrift protection. Until the Alaskan and Delaware legislation, nothing even close to this level of retained benefit and control was available onshore.

In that regard, the new trust legislation in Alaska and Delaware provide this last form of asset protection relief only in a very limited fashion. Basically, such legislation permits a person to create a trust with spendthrift protection so long as that person is merely eligible, but not entitled, to receive distributions from the trust. The Alaskan legislation also specifically indicates that spendthrift protection will not be available to protect trust assets from unwanted creditors where the person creating the trust retains a power to revoke or terminate the trust, in whole or in part, without the consent of a person who has an adverse interest. It is also unavailable where trust income and principal ***must*** be distributed to the person creating the trust. These types of powers may be retained by the person creating an offshore APT in a properly selected jurisdiction without compromising its asset protection.

The conclusion to be drawn is that the new Alaskan and Delaware trusts simply cannot provide the same barrier of protection, or plethora of benefits, which are offered by an offshore trust created in a place such as the Cayman or Cook Islands, or the Bahamas or Nevis. In the area of asset protection planning, the new legislation in Alaska and Delaware have definitely turned a stateside asset protection trust from an open fox hole into a covered bunker, but the offshore APT is still the brick fortress in the area of asset protection. This bold statement is verified by the fact that courts in Alaska or Delaware are required under the Full Faith and Credit Clause of the United States Constitution to recognize and enforce a judgment rendered in all 50 states. In addition, Alaska and Delaware trusts are subject to the extensive powers and long reach of the Bankruptcy Courts of the United States. In contrast, the US Bankruptcy Courts have no jurisdiction over an offshore APT. Consequently, one of the main advantages of an offshore APT is that it places the person who is creating the APT into the position of knowing that no matter what a court in Alabama, California, Mississippi or New Jersey may do (all states which are known for favoring recovery of persons making claims), it will carry no weight in a properly selected offshore jurisdiction.

Are there times when it makes sense to go "north to Alaska" to create a trust? Yes. There are at lease three situations where such planning may be appropriate. First, a person may be concerned with the political stability of an offshore jurisdiction or uncomfortable with such person's unfamiliarity with the legal system in an offshore jurisdiction. Consequently, one may obtain a greater comfort level in Alaska than offshore. Second, the new reporting requirements for foreign trusts which were added to the Internal Revenue Code in 1996 will not apply to an Alaskan trust. Anyone who wishes to avoid such reporting requirements may want to consider creating an Alaskan trust instead of going offshore. Third, hostility has been expressed by some US Bankruptcy courts towards offshore APTs. While hostility may still be present in a situation involving the creation of an Alaskan asset protection trust, it may not rise to the same level of hostility as one involving an offshore APT. The reduced hostility level may result from Alaska's long time period for setting aside fraudulent conveyances, as well as the fact that the assets in the Alaskan trust will always be subject to the jurisdiction of US courts. However, in a time of crisis when the "wolves" are in hot pursuit of assets, it may be these same factors which will cause a person to wish an offshore APT had been used to preserves a "net egg" for just such a "rainy day" in place of an Alaskan trust so vulnerable to attack.

What is the bottom line? Before you jump on the Alaskan trust bandwagon, you should carefully consider whether it will really meet your expectations and needs. If you are not sure, you should consult with a qualified professional and adviser to help you look before you leap.

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