

Evaluating the Alaska Trust's Ability to Shield Assets From the Claims of Creditors

by John Paul Parks

In the November 1997 issue of *Arizona Attorney*, Philip R. Rupprecht described the benefits of creating and funding an international trust as part of an asset protection program.¹ As Rupprecht observed, one of the principal characteristics of foreign law that makes asset protection planning possible is the settlor's ability to create a trust from which the settlor is able to receive benefits and which is also exempt from the claims of the settlor's creditors.² Such a trust is sometimes referred to as a "spendthrift trust" established for the settlor's own benefit. By contrast, in the United States, a spendthrift clause traditionally is invalid to the extent that it applies to the settlor's interest in the trust.³ Under Arizona law, for example, "[i]f the settlor is a beneficiary of a trust created by the settlor and the settlor's interest in the trust is subject to a provision restraining the voluntary or involuntary transfer of the settlor's interest, the restraint is invalid against transferees or creditors of the settlor."⁴ If, in the United States, a settlor establishes a trust and provides that principal or income is distributable to the settlor in the discretion of the trustee, the settlor's creditors historically have been able to reach the maximum amount that the trustee may pay or apply to the benefit of the settlor.⁵ In applying these rules, it does not matter that the settlor had no intention to defraud creditors.⁶

Alaska Breaks Out of the Mold

Recently enacted Alaska legislation, applicable to trusts created on or after April 2, 1997, departs from the traditional United States rule by setting forth terms and conditions under which a settlor may establish a trust for the settlor's own benefit, which is not subject to the claims of the settlor's creditors.⁷ While at first blush the new Alaska legislation may seem to provide an attractive domestic alternative to the international trust as a means of protecting assets from creditors, this article will explain why this is simply not the case. Unfortunately, the ability of Arizona courts to entertain proceedings involving foreign state trusts and Alaska's obligations under the Full Faith and Credit Clause of the United States Constitution combine to make the Alaska trust a significantly less attractive alternative to the international trust.

Requirements Imposed by Alaska Law

Under the Alaska statute, the settlor may transfer property to a trust and provide that the settlor's interest in the trust may not be either voluntarily or involuntarily transferred before the trustee pays or delivers the interest to the settlor (the "transfer restriction").⁸ The transfer restriction is unavailable, however, if the transfer was intended in whole or in part to hinder, delay or defraud creditors;⁹ the settlor may revoke or terminate all or part of the trust without the consent of a person who has a substantial beneficial interest in the trust and who would be adversely affected by the settlor's action (except that "revoke or terminate" does not include a power to veto a distribution from the trust, a testamentary special power of appointment or similar power, or the right to receive a distribution of income, principal, or both in the discretion of a person, including a trustee, other than the settlor);¹⁰ all or a part of the trust's income or principal, or both, must be distributed to the settlor;¹¹ or at the time of the transfer, the settlor is in default by 30 or more days of making a payment due under a child support judgment or order.¹²

Thus, assuming that the settlor has no intention of hindering, delaying or defrauding creditors, and is not in default under a child support judgment or order, the Alaska statute allows the settlor to create the flexible sort of trust described in Rupprecht's article.¹³ For example, the trustee might be given authority to make discretionary distributions among a group of persons consisting of the settlor and the settlor's spouse, descendants, other relations and favorite charitable organizations. The settlor could be given the power to veto trust distributions that the settlor thinks are inappropriate, and through a special testamentary power of appointment, be permitted to exercise significant control over the disposition of the trust assets to be made at the settlor's death. Such a trust is not subject to the rule against perpetuities.¹⁴ Despite these substantial advantages, the trust assets would not, under Alaska law, be available to satisfy the claims of the settlor's present or future creditors.

However, creditors in existence on the date the Alaska trust is created and who assert that the transfer was intended, in whole or in part, to hinder, delay or defraud creditors, are allowed to bring a fraudulent transfer action within four years after the transfer is made or within one year after the transfer is or reasonably could have been discovered, whichever is later.¹⁵ If the creditor's claim did not arise until after the trust was created, the time within which the creditor may bring a fraudulent transfer action is limited to four years after the date of the transfer.¹⁶

The trustee must be an Alaska resident¹⁷, and a provision in the trust instrument designating Alaska law as controlling is "valid, effective, and conclusive" if certain statutory conditions are met.¹⁸

Complying with Alaska Law May Not Be Sufficient

For an Arizona resident, however, merely complying with Alaska law alone may not be sufficient to achieve protection from the claims of creditors. The Alaska statute purports to vest the Alaska court with "exclusive jurisdiction" over the trust,¹⁹ but the Alaska legislature clearly has no power to define or limit the jurisdiction of the Superior Court of Arizona (the "Superior Court"). Arizonans contemplating the establishment of an Alaska trust must therefore be aware of those provisions of Arizona law which permit the Superior Court to exercise jurisdiction over a trust that has its principal place of business in Alaska.

The Arizona Court's Jurisdiction Over Foreign Trusts and Alaska's Obligations Under the Full Faith and Credit Clause

The Superior Court is generally prohibited from entertaining a proceeding with respect to a trust that has its principal place of administration in another state, but it may do so if all appropriate persons could not be bound by litigation in the courts of the other state or "if the interests of justice [otherwise] would be seriously impaired."²⁰ Under the latter exception, "the issue is essentially only one of forum non conveniens in having litigation proceed in the most appropriate forum."²¹ By analogy to the rules governing venue in a civil action, the burden of establishing that Alaska is an inconvenient forum falls on the party making that assertion,²² but the ultimate decision rests in the sound discretion of the Superior Court.²³

If the Superior Court elects to entertain a proceeding involving an Alaska trust, the decision whether to apply Alaska law or Arizona law will be made in accordance with the Restatement (Second) of Conflicts of Laws (the "Restatement"), as Arizona follows the Restatement when resolving choice of law issues.²⁴ Under the Restatement, a trust, whether consisting of personal property or real property, is construed in accordance with the rules of construction of the state designated for this purpose in the trust instrument.²⁵

It is not necessary for the designated state to have any connection with the trust.²⁶ As the well-drawn Alaska trust is virtually certain to contain a provision requiring that the trust be construed in accordance with Alaska law, the Superior Court ordinarily will be bound to apply Alaska law when determining the validity of the transfer restriction. It must be remembered, however, that if the Superior Court has jurisdiction over the subject matter and the parties to the controversy, its judgment will be entitled to full faith and credit in Alaska even if its interpretation of Alaska law is wrong.²⁷ If the Superior Court has jurisdiction over the parties and the subject matter, it might decide, without regard to the validity of the trust, that a transfer to the Alaska trustee, permitted under Alaska law, but having a significant relationship to Arizona,²⁸ is a fraudulent transfer under Arizona law and order appropriate relief in favor of the settlor's creditors. The Alaska court would be required to enforce such a judgment pursuant to its obligations under the Full Faith and Credit Clause. Enforcement of an Arizona judgment in Alaska is facilitated by Alaska's adoption of the Uniform Enforcement of Foreign Judgments Act.²⁹

The Superior Court may exercise jurisdiction over non-residents to the full extent permitted by the Arizona and United States constitutions.³⁰ Even though the trustee of the Alaska trust is, by definition, domiciled in Alaska,³¹ and therefore a non-resident of Arizona, the Alaska trustee is likely to engage in systematic and continuous activities in Arizona as it deals with Arizona beneficiaries and as it solicits other Arizona trust business. Such activities would be sufficient to establish the "minimum contacts" necessary to give the Superior Court in personam jurisdiction over the Alaska trustee.³²

Alaska's duty, under the Full Faith and Credit Clause of the United States Constitution,³³ to recognize and give effect to an adverse judgment rendered by a court in another state if that court had jurisdiction is the principal reason why the international trust still has a significant advantage over the Alaska trust. Many foreign jurisdictions, obviously unencumbered by the Full Faith and Credit Clause, do not recognize judgments rendered elsewhere.³⁴

Practical Disadvantages

An Alaska trust has several practical disadvantages as well. The settlor cannot revoke or terminate the trust (except with the consent of a person who has a substantial beneficial interest in the trust and who would be adversely affected by the settlor's action).³⁵ The settlor cannot have any mandatory right to receive income or principal.³⁶ The settlor's ability to receive distributions of income or principal must be left to the discretion of a trustee or other person who cannot be the settlor.³⁷ The right to veto trust distributions³⁸ or to exercise a special testamentary power of appointment³⁹ does not provide the settlor with any lifetime benefit from the trust property. Therefore, there is the real possibility that money or other property transferred to an Alaska trust will be permanently unavailable to the settlor. Presumably, the settlor will appoint a "friendly" trustee or other person with whom the settlor has an "understanding" concerning the distribution of income and principal, but relationships, attitudes and viewpoints have a tendency to change over time. A trustee or other person authorized to make discretionary distributions of income and principal in whom the settlor has confidence now may die, resign or become incapacitated. In the case of a corporate trustee, the trust officer eventually assigned to the trust may be unborn at the time the trust is created.

The expense of ascertaining and complying with the various requirements of Alaska law and obtaining and compensating a qualified Alaska fiduciary must also be taken into account. The Alaska statute is an untested innovation in the law and is therefore lacking in the stability and predictability that is the hallmark of property law in the United States. A lawyer advising a client should consider the due diligence, investigation and disclosure that is required before the lawyer can properly recommend that the client establish an irrevocable trust some or all of the assets of which will be located in Alaska and from which the client has no mandatory right to receive income or principal.

Ethical Considerations

As noted above, the Alaska trust affords no protection to a settlor who intends to hinder, delay or defraud creditors.⁴⁰ Although Alaska has not adopted the Uniform Fraudulent Transfer Act and provides that fraudulent intent is a question of fact and not a question of law,⁴¹ Alaska case law has developed "badges of fraud" similar to those used in Arizona.⁴² As present creditors may attack a transfer to the Alaska trust within one year after the transfer is or reasonably could have been discovered,⁴³ a person creating an Alaska trust must plan for the possibility that existing creditors will be able to bring a successful fraudulent transfer action at any time. Lawyers who assist clients in the creation and funding of Alaska trusts and other asset protection devices should carefully document the evidence that establishes the lack of any improper

motivation on the part of the client,⁴⁴ because if the transfer is later determined to be fraudulent, the aggrieved creditor may have a tort action against the lawyer for conspiracy to defraud.⁴⁵ In any such action, the attorney-client privilege will be unavailable if the creditor makes out a prima facie case of fraud.⁴⁶

Conclusion

A person who is “nervous”⁴⁷ about establishing an international trust and who has no existing or foreseeable creditor problems may wish to create an Alaska trust as a “rainy day fund,” or to take advantage of Alaska’s modification of the rule against perpetuities, but in my view, the 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.

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ENDNOTES:

1. Rupprecht, “The Increasing Use of International Trusts,” 34 *Ariz. Atty. 22* (November, 1997).
2. Rupprecht, note 1 *supra*; see also, note 3 *infra*.
3. Restatement (Second) of Trusts § 156(1); Bogert & Bogert, *Handbook of the Law of Trusts* § 40 at 154 (5th ed. 1973).
4. *Ariz. Rev. Stat.* § 14-7705(A).
5. *Id.* § 14-7705(B); see also, Restatement (Second) of Trusts § 156(2).
6. Restatement (Second) of Trusts § 156 (Comment a).
7. 1997 Alaska Sess. Laws ch. 6. Although this article is limited to a discussion of the Alaska statute, we note that asset protection legislation subsequently enacted in Delaware, 71 Del. Code ch. 56, applicable to “qualified dispositions in trust” made on or after July 1, 1997, is less beneficial to settlors than the Alaska law. Under Delaware law, for example, existing creditors who hold alimony, child support, wrongful death or personal injury claims against the settlor may reach the “qualified disposition in trust” even if the transfer was made without any intention to defraud them. 12 Del. Code § 3573(a), (c). In Delaware, the settlor also has the ability to subject the qualified disposition to the claims of creditors merely by stating, in writing, that the property which is the subject of the qualified disposition remains the property of the settlor and is available to satisfy a debt incurred by the settlor. *Id.* § 3573(b). These creditor-friendly provisions are not found in the Alaska statute.
8. Alaska Stat. § 34.40.110(a).
9. *Id.* § 34.40.110(b)(1).
10. *Id.* § 34.40.110(b)(2).
11. *Id.* § 34.40.110(b)(3).
12. *Id.* § 34.40.110(b)(4).
13. Rupprecht, note 1 *supra*, at 24.
14. Alaska Stat. § 34.27.050(a)(3).
15. *Id.* § 34.40.110(d)(1)(A)-(B).
16. *Id.* § 34.40.110(d)(2).
17. Pursuant to Alaska Stat. § 13.36.390, the trustee must be (a) an individual who, except for brief intervals, military service, attendance at an educational or training institution, or for absences for good cause shown, resides in Alaska, whose true and permanent home is in Alaska, who does not have a present intention of moving from Alaska, and who has the intention of returning to Alaska when away; (b) a trust company that is organized under Alaska law and that has its principal place of business in Alaska; or (c) a bank that is organized under Alaska law, or is a national banking association, if the bank or national banking association possesses and exercises trust powers and has its principal place of business in Alaska.
18. 1. Some or all of the trust assets must be deposited in Alaska. Assets are deposited in Alaska if they are held in a checking account, time deposit, certificate of deposit, brokerage account, trust company fiduciary account or other similar account or deposit that is located in Alaska.
2. The trustee must be a qualified person, see note 17 *supra*, who is designated as a trustee under the governing instrument or by a court having jurisdiction over the trust.
3. The powers of the trustee identified under (2) above must include or be limited to (a) maintaining records for the trust on an exclusive basis or a nonexclusive basis; and (b) preparing or arranging for the preparation of, on an exclusive basis or a non-exclusive basis, an income tax return that must be filed by the trust.
4. Part or all of the administration must occur in Alaska, including physically maintaining trust records in Alaska. *Id.* § 13.36.035(c).
19. *Id.* § 13.36.035(a).
20. *Ariz. Rev. Stat.* § 14-7205(2).
21. See U.P.C. § 7-203 (Official Comment).
22. See *Dunn v. Superior Court*, 102 *Ariz.* 198, 427 P.2d 516 (1967).
23. See *GAC Properties, Inc. v. Farley*, 14 *Ariz. App.* 156, 481 P.2d 526 (1971); *Arizona Water Co. v. City of Yuma*, 7 *Ariz. App.* 53, 436 P.2d 147 (1968). Again by analogy to the rules governing venue in a civil action, the superior court’s ruling is probably reviewable by special action, but the appellate court is unlikely to interfere absent a clear abuse of discretion. See *Floyd v. Superior Court*, 125 *Ariz.* 445, 610 P.2d 79 (App. 1980). The provision permitting the court to entertain proceedings involving foreign trusts “if the interests of justice [otherwise] would be seriously impaired” is taken from the Uniform Probate Code. U.P.C. § 7-203. At least one state that adopted the basic structure of the Uniform Probate Code evidently thought that the provision gave the trial court too much discretion and deleted it. *Cf.* Fla. Stat. § 737.203.
24. *Landi v. Arkules*, 172 *Ariz.* 126, 835 P.2d 458 (App. 1992).
25. Restatement (Second) of Conflicts of Laws § 268(1), 277(1).
26. *Id.* § 268 (Comment b).
27. See *Baker v. General Motors Corp.*, 66 U.S.L.W. 4060 (U.S. January 13, 1998).
28. See Restatement (Second) of Conflicts of Laws § 6, 145-146.
29. Alaska Stat. § 09.30.200 to 09.30.270.
30. Rule 4.2(a), *Ariz. R. Civ. P.*
31. See note 18 *supra*.
32. See *International Shoe Co. v. Washington*, 326 U.S. 310, 320 (1945).
33. U.S. Const. art. IV, § 1.
34. Rupprecht, note 1 *supra*, at 24.
35. Alaska Stat. § 34.40.110(b)(2).
36. *Id.*
37. *Id.*
38. *Id.*
39. *Id.*
40. See text accompanying note 9 *supra*.
41. Alaska Stat. § 34.40.090.
42. See *First Nat’l Bank v. Enzler*, 537 P.2d 517 (Alaska 1975). *Cf.* *Ariz. Rev. Stat.* § 44-1004(B).
43. See note 15 *supra* and accompanying text.
44. Rupprecht, note 1 *supra*, at 36.
45. *Pearce v. Stone*, 149 *Ariz.* 567, 720 P.2d 542 (App. 1986).
46. *Id.*
47. Rupprecht, note 1 *supra*, at 35.