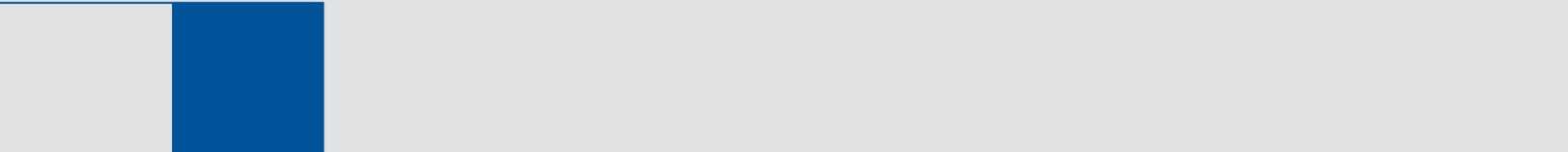


South Dakota's Situs Advantages Over Alaska

STERLING | TRUSTEES

THE POWER OF INDEPENDENT THINKINGSM



With so many states across the nation vying for their share of the multi-billion dollar trust industry, experienced professionals and family advisors must determine which situs is the best fit for their HNW and UHNW clients. While South Dakota is a top-tier trust situs and industry pioneer, many states across the nation have followed its lead to create a landscape in which trust assets thrive. Alaska has demonstrated its dedication to being among the top-tier situs designations by enacting trust-friendly legislation and successfully attracting trust business from around the world. However, because the subtle distinctions of law can have significant client impact, it has never been more important for wealth planning professionals and advisors to understand state trust laws and how they affect clients and their beneficiaries. Trusts established in favorable jurisdictions provide the most effective means of wealth transfer for generations while eliminating current and future federal or state gift and death taxes and state income taxes. South Dakota laws remain the most progressive in the nation, providing exclusive estate planning and tax-saving benefits not available in most other states.

That stature is largely due to a unique collaboration. Each term, the governor appoints new members to a trust task force whose sole purpose is to work with state legislators to proactively monitor industry trends and adjust state laws accordingly. This collaboration is exclusive to South Dakota and gives trust industry leaders the distinct ability to be directly involved with the development of trust laws.

This commitment and support from the highest levels of state government continually strengthen South Dakota's position as the top destination for trust situs. Grantors, beneficiaries and their trusted advisors will ultimately be better served by establishing trust structures in South Dakota thanks to these subtle but key distinctions.

SOUTH DAKOTA



ALASKA



PERPETUAL TRUSTS

In 1983, South Dakota was the first state in the nation to abolish the Rule Against Perpetuities (RAP), recognizing the advantages of dynasty trusts by allowing trusts to last perpetually for all assets. [SDCL § 43-5-8]

South Dakota was also the first to adopt a Trust Protector statute in 1997 (maximizing flexibility of the trust for generations). [SDCL § 55-1B-6]

In 1991, Alaska also effectively eliminated their RAP, providing a 1,000-year duration for the vesting or termination of a property interest in trust assets. This legislation, albeit eight years after South Dakota's abolition of the RAP, evidences Alaska's resolve to compete as a top-tier trust jurisdiction. [AK § 34.27.051]

STRENGTH OF STATE

On the basis of its solvency in five separate categories, South Dakota ranks second among U.S. states for fiscal health. South Dakota has between 4.76 and 6.78 times the cash needed to cover short-term obligations, well above the U.S. average. Revenues exceed expenses by 2 percent, with an improving net position of \$106 per capita. In the long run, South Dakota has a net asset ratio of 0.34. Long-term liabilities are lower than the national average, at 8 percent of total assets, or \$650 per capita. Total unfunded pension liabilities that are guaranteed to be paid are \$13.32 billion, or 32 percent of state personal income.

[Mercatus Research, Mercatus Center at George Mason University, Arlington, VA]

Alaska ranks 11th among U.S. states for fiscal health, with 17.07 to 17.92 times the cash needed to cover short-term obligations. However, much of this revenue is part of the Alaska Permanent Fund and is not readily available for spending. Falling oil prices weaken Alaska's budgetary position significantly. Revenues only cover 52 percent of expenses, with a worsening net position of -\$6,946 per capita. In the long run, Alaska has a net asset ratio of 0.77. Long-term liabilities are higher than the national average in per-capita terms at \$8,670 per capita but lower than the national average when measured as a percentage of total assets. Total unfunded pension liabilities that are guaranteed to be paid are \$37.33 billion, or 91 percent of state personal income. OPEB are \$8.48 billion, or 21 percent of state personal income.

[Mercatus Research, Mercatus Center at George Mason University, Arlington, VA]

STATE INCOME AND CAPITAL GAINS RATES

There have been no state income taxes, personal or corporate, in South Dakota since 1942. The South Dakota Constitution prohibits any new taxes or increases in taxes without a voter initiative or two-thirds approval of both state legislative branches. [SD Constitution Article XI, 14]

Alaska has no state income or capital gains tax. Rather, 85% of the state budget is supplied by taxes on oil and gas revenue. Weakening demand and declining production will eventually lead to diminished oil revenue that the state will need to replace with other sources of tax revenue, or it will be forced to drastically cut services and other state spending. The implications of receding revenue make Alaska's current state tax advantages less than reliable long term as the state is forced to seek alternate sources of budget funding. There is a distinct possibility that Alaska may be forced to implement state income or capital gains taxes in the not-so-distant future.

PRIVACY

There is a permanent seal of privacy in South Dakota for trust documents that would otherwise be part of the record in any judicial proceeding. This seal attaches automatically and lasts in perpetuity. [SDCL § 21-22-28]

Alaska law declares that any notice or filing of a petition, summary of formal proceedings, and dispositional order or modification or termination of dispositional order are available for public inspection and can only be sealed upon court order for good cause. The sealing of Alaska court records may be achieved pursuant to a court order, but in the absence of a formal request of the court, the records will be deemed public. [AK 13.26.013]

SOUTH DAKOTA



ALASKA



CREDITORS CLAIMS

If the settlor is foreseeably solvent, South Dakota trusts are shielded from new claims of creditors of the settlor after two years of a transfer to the trust. A window of six months from discovery of the transfer is provided for existing claims, if longer. For self-settled trusts (for the benefit of the settlor) that are "qualified dispositions," there are exceptions for debts of spousal/child support and the division of marital property existing before the transfer. For third-party trusts (not self-settled), there are no such exceptions.

[SDCL § 55-1-44] [SDCL § 55-16-10; 16]

In Alaska, creditors can reach trust assets up to four years after the transfer to trust or one year after the transfer is or reasonably could have been discovered by the creditor. Alaska's "lookback period" is twice that of South Dakota, doubling the length of exposure to a creditor's cause of action or claim for relief against the trust assets. This temporal distinction could have disastrous implications, specifically for clients in high-risk professions or those who are anticipating major life changes.

[AK Stat § 34.40.110]

ASSET PROTECTION

South Dakota has a thorough statute with respect to the protection of trust assets and avoidance of claims, specifically addressing (i) numerous arguments made in court cases and disputes, (ii) weaknesses caused by the Restatement of Trusts (scholarly positions on legal aspect of trust law), (iii) inadvertent/ill-advised actions of trust settlors and beneficiaries, (iv) withholding otherwise mandatory distributions from the trust to a beneficiary and (v) vulnerable provisions and drafting errors in trust documents.

[SDCL § 55-1-25, 32, 33, 38, 39]

Alaska is currently ranked eighth in the nation as it relates to asset protection. On a percentage scale, Alaska's weighted score of 82.5 is notably lower than South Dakota's score of 98. Based on Alaska's four-year lookback period, exception creditors and affidavit of solvency required for new transfers, its asset protection capabilities are significantly less than those available in several other states, including South Dakota.

[Steve Oshin's 11th Annual Domestic Asset Protection Trust State Rankings Chart, April 2020]

QUIET TRUSTS

There are detailed provisions in the South Dakota statute for the trust settlor, trust instrument and trust advisors (i.e., trust protector) to restrict or eliminate information to trust beneficiaries and to keep the trust instrument and trust actions quiet. The South Dakota statute directly addresses the ability to restrict the right of a beneficiary to receive a copy of the trust instrument and the right of the settlor, trust protector or trust advisor to retain the power to change the beneficiaries' rights to trust information.

[SDCL § 55-2-13]

Alaska does permit quiet trusts, but the restriction on the right of a beneficiary to be informed may only last until the death or incapacity of the requestor. This is a significant material limitation, effectively rendering the gold standard of "grantor's intent" meaningless beyond grantors quietus. In South Dakota, the silence of a quiet trust can outlive the grantor, enduring even in death.

[AK Stat § 13.36.080]

SPECIAL PURPOSE ENTITIES

South Dakota is the only state providing express legislative support for Special Purpose Entities. The 2011 law specifically permits individuals to serve in trust roles (i.e., investment advisor, distribution advisor, trust protector) for a particular family through an entity (i.e., a limited liability company) for their liability protection without meeting formal Department of Banking regulations and requirements. This feature gives individuals more comfort in serving and taking on these trust advisor roles. New Hampshire law provides limited protection for a "qualified trust advisor," but leaves the "entity" question unresolved (RSA 383-C:12-1201 and 1202). Delaware and Wyoming permit "trust protector companies," but these entities aren't recognized by statute.

[SDCL § 51A-6A-66]

Alaska recognizes SPEs indirectly but does not expressly address them in statute. The SPE entity structure represents a significant advantage in many sophisticated and unique estate plans, and the lack of statutory guidance in Alaska may result in exposure to a damaging judicial challenge or unnecessary IRS scrutiny. An SPE statute provides a level of predictability and security not available in states that have not addressed them directly by law.

SOUTH DAKOTA



ALASKA



DIRECTED TRUSTEES

The directed trustee model is a predominant trust company structure in South Dakota, limiting trustee fees while allowing trusted family advisors to control the distributions and investment decisions of the trust assets. Per the South Dakota Department of Banking, approximately 68% of South Dakota trust business is through a directed trustee out of a total of 1.7M trust accounts.

Alaska's directed trust statute provides that "the trustee does not have an obligation to review, inquire, investigate, or make recommendations or evaluations with respect to the exercise of a power of the trustee if the exercise of the power complies with the directions given to the trustee."

[AK §13.36.375]

Taken literally, this language fails to relieve a trustee from liability for actions of a trust director that do not require action by a trustee. If, for example, a trust director exercises a power to amend a trust, the statute would not relieve the trustee for failing to advise the beneficiaries about the amendment, because by its terms the statute only covers "the exercise of a power of the trustee" and not the exercise of an independent power of the director that requires no action by the trustee.

The Alaska statute also fails to cover non-exercises (as distinct from exercises) of the powers of a director or trustee.

RELIABILITY

In *re Cleopatra Cameron Gift Trust*, 931 N.W.2d 244 (S.D. 2019), the South Dakota Supreme Court affirmed a circuit court's decision concluding that the validity of a trust's spendthrift provision prohibiting direct payments of a trust beneficiary's child support obligation to her ex-husband was indeed recognized by South Dakota law. The court effectively sided with the trustees who had stopped paying support claims to the ex-husband because those payments had been mandated when the trust was previously situated in California. This case is widely accepted as one of the most favorable creditor protection cases in recent history.

In *Toni 1 Trust v. Wacker*, 2018 WL 1125033 (Alaska, Mar. 2, 2018), the Alaska Supreme Court affirmed the dismissal of a declaratory judgment lawsuit brought by the trustee of an Alaskan Domestic Asset Protection Trust, which sought to declare that fraudulent transfer judgments entered in Montana and the U.S. Bankruptcy Court (which voided transfers to the Alaska-sitused DAPT) were void and unenforceable because Alaska courts could not restrict the forum for decisions relating to transfers to self-settled trusts formed under Alaska law exclusively to themselves. The assets funding the Alaska-sitused DAPT were subject to judgments by both the U.S. Bankruptcy trustee and the Montana court. Some pundits opine that this case may cast doubt on the ability of Alaska-sitused trusts to offer enforceable protection to shield trust assets from claims of creditors.

FORETHOUGHT

South Dakota updates its trust law statutes annually through its highly effective Governor's Task Force on Trust Administration Review and Reform, which is very responsive to the legal and advisor community. Examples of new trust laws in recent years in South Dakota include Community Property Trusts in 2016 (allowing nonresidents to get a full step-up in income tax basis of assets upon the death of one spouse), the 2016 Family Advisor (allowing for trusted family advisors to participate on the trust advisor team without taking on the fiduciary responsibility) and 2006/2008 Purpose Trusts of unlimited duration (trusts for pets, vacation homes or any non-charitable purpose without a beneficiary).

[SDCL § 55-17-5]

The Alaska Trust Act of 1997 significantly changed the trust services landscape in the Frontier State. The Act essentially abolished the rule against perpetuities, placed a time limit on actions brought under fraudulent conveyance laws, permitted the establishment of self-settled spendthrift trusts, and validated trust document choice of law provisions designating Alaska's exclusive jurisdiction.

[AK § 13.36]

SOUTH DAKOTA



ALASKA



DECANTING

For existing trusts, South Dakota has the most flexible and highly ranked trust decanting statute, allowing for the expansion of a trust to a fully discretionary trust (adding the ability to distribute for any reason or purpose) and allowing for the inclusion/exclusion of any beneficiaries (both current and future can be changed). This provides much more opportunity for future planning for estate/gift tax and income tax purposes for a family.

[SDCL § 55-2-15]

Alaska's decanting statutes lack flexibility. There are three crucial limitations on decanting an Alaska-sitused trust. First, a trust with an ascertainable standard may not be decanted into a discretionary trust structure. Second, as it relates to a mandatory income interest, the trustee is not permitted to decant into a trust that substantially alters or removes that interest. Finally, the trustee of an Alaska-sitused trust may not decant into a structure that accelerates a remainder beneficiary's interest. These limitations represent potential for significant client impact by effectively reducing the trust's ability to evolve with the needs of its beneficiaries. South Dakota's decanting statutes recognize the inherent value in a trust's ability to adapt to changing circumstances, providing robust language to serve the best interests of beneficiaries.

[AK § 13.36.157-159; AK § 13.36.215]

PREMIUM TAX ON PRIVATE PLACEMENT LIFE INSURANCE

For trusts that purchase private placement life insurance, South Dakota has the lowest insurance premium tax at 8 bps (.008%) on premiums in excess of \$100,000 for both policies held by the trust or in a limited liability company (LLC) owned by the trust.

[SDCL § 10-44-2]

Alaska lawmakers recently passed SB 246, reducing private placement tax to 8 bps (.008%) on net direct premiums in an effort to increase Alaska's competitiveness as a premier trust situs. The premium tax issue becomes important when considering entities like LLCs in private placement life insurance programs. Properly sitused LLCs avail clients to lower premium taxes and allow clients to be classified as "qualified purchasers" for securities law purposes.

[AK § 21.09.210 (m)]

About the authors



Antony Joffe is President of Sterling Trustees, a South Dakota chartered trust company with over \$5 billion of assets under administration. Sterling acts solely as an independent trustee and does not manage any investment assets. The company has a particular focus on working with wealthy families that wish to domesticate offshore trusts to the US. Sterling Trustees is a member of STEP.

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As an attorney, Nicole Byrum brings a unique perspective to her position as trust officer – partnering with her clients and their advisors to craft strategic trust vehicles which provide asset protection, governance and long-term wealth transfer. After a brief stint practicing law, she transitioned into global trust services before joining the Sterling team at our Sioux Falls, SD, headquarters. Nicole earned a JD from the University of South Dakota School of Law and a BA from the University of Washington. She also earned the Certified Trust and Financial Advisor (CTFA) designation from the ABA.

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One in a series of whitepapers authored by
the independent trust administration firm of

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