

TESTIMONY ON SB 2842, SD2, HD1  
RELATING TO PERMITTED TRANSFERS IN TRUST ACT

Friday, March 26, 2010, 12:00 p.m.  
State Capitol, Conference Room 308

HOUSE COMMITTEE ON FINANCE

TO: The Honorable Marcus R. Oshiro, Chair  
The Honorable Marilyn B. Lee, Vice Chair  
Members of House Committee on Finance

I am Stafford Kiguchi representing the Trust Division of Bank of Hawaii and testify in support of Senate Bill 2842, SD2, HD1, which is designed to increase the assets under management by Hawaii's private financial sector, increase state tax revenues, and position the State as a world-class financial management jurisdiction.

For purposes of clarification we would like to offer minor modifications that would:

- Expand the definition of "Permitted Trustee" to ensure all Hawaii banks are included and not only those subject to HRS Chapter 412.
- Define "Grantor trust" and "Non-grantor trust" for purposes of conforming to the IRS Code.
- Include explanatory language to help clarify situations when a non-Hawaii resident receives income or principal from the trust, but making clear that the trustee is not obligated to account for allocations of income or gain on behalf of that beneficiary.

The proposed amendments have been outlined in an edited document provided to the Committee for review. Thank you for the opportunity to testify.

Respectfully submitted,



Stafford Kiguchi  
Senior Vice President  
694-8580

**MEMORANDUM**

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To: The Hon. Marcus Oshiro, Chair of the House Finance Committee

Date: March 26, 2010

Re: Proposed "Permitted Transfers in Trust Act" (SB2842)

Curtis K. Saiki, on behalf of First Hawaiian Bank, hereby submits this written testimony in favor of SB2842. This memorandum is intended to explain some of the modifications we propose to the final version of the Act.

During the House committee hearing process, improvements were identified that will make the Act more effective in achieving its goals. Following this memorandum is the proposed final version of the Act (with differences from the original SB2842 highlighted in yellow). This version was submitted before the last hearing before the House Committee on Consumer Protection & Commerce. In addition to these changes, we also propose technical refinements to (i) §-2's definition of "Permitted trustee;" and (ii) § -12 regarding Taxation, both of which are highlighted in blue.

In its entirety, the proposed changes to the original version of the Bill presented to the Senate include the following:

**§ -2 Definitions.** was amended to add definitions for "cash", "grantor trust", "marketable securities", and "nongrantor trust". In addition, the definitions for "Permitted trustee" and "Permitted property" were amended.

**§ -3 Perfected transfers.** was retitled **§ -3 Completed transfers.** In addition, the word "completed" replaced the word "perfected" in the first sentence of that section.

**§ -4 Permitted trustees.** has been amended to read: "Permitted trustee" means a person, other than the transferor, who is a resident of this State, or a bank or trust company authorized to do business in this state that possesses and exercises trust powers and has its principal place of business in this State.

**§ -5 Trust instrument.** was amended to include an ability of the trustee to terminate a trust that has become uneconomical to administer and renumbering, due to this inclusion, also occurred. At the end of section 5(e), language was added to help resolve disputes between permitted trustees and appointed advisors.

**§ -6 Investments.** Was amended to permit a trustee to invest only in "permitted property" meaning that the only assets that may fund the trust are liquid assets and the only investments permitted in the trust are liquid assets. The reason for this was to (a) simplify the act and (b) to ensure that property that might generate other complicating

taxed such as real estate rentals (leading to GET) are not permitted as investments under the Act.

Slight errors in reference were corrected in **§ -7 Retained interests of transferor.**

**§ -9 Limitations on permitted transfers.** was amended to add language to protect lenders who were misled in believing that the assets of the trust were under the dominion and control of the borrower/transferor at the time the loan was originated.

**§ -12 Taxation.** was amended to clarify the following goals:

- ✓ Income or gains distributed to Hawaii beneficiaries will be taxed by Hawaii at the beneficiary level;
- ✓ Income or gains accumulated for Hawaii beneficiaries will be taxed by Hawaii at the trust level;
- ✓ Consistent with current Hawaii law, income or gains distributed to or accumulated for the benefit of non-Hawaii beneficiaries will not be taxed by Hawaii; and
- ✓ The trustee is not required to track accumulations of income or gains attributable to non-Hawaii beneficiaries.

Also regarding § -12, your committee previously changed “one percent” to “\_\_\_\_\_ percent” as part of your proposed changes to the bill. We assume the committee envisioned either (i) dropping the tax; or (ii) settling on a tax percentage figure in conference. In our humble opinion, we believe that any figure greater than 1% may have a chilling effect on the market that will make the Act uncompetitive. For your information, states that have similar acts do not charge any tax on the initial transfer of assets into their state. As it stands, the pertinent text of the attached proposed final version reads “one percent” rather than “\_\_\_\_\_ percent.”

Please let us know if you have any questions regarding this memorandum or regarding the attached modified Permitted Transfers in Trust Act. Thank you for your support.

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## A BILL FOR AN ACT

RELATING TO THE PERMITTED TRANSFERS IN TRUST ACT.

**BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF HAWAII:**

SECTION 1. Hawaii relies heavily on the travel industry as an economic engine. Because of instabilities in that industry, the State must seek out other sources of revenue to help stabilize the current budget crisis and fuel future economic growth. Hawaii can build on proven domestic and international estate and financial planning methodologies to amend its laws for the purpose of attracting foreign-source capital.

The intent of this Act is to offer incentives to high net-worth individuals throughout the United States and throughout the world to transfer a portion of their liquid net worth into this State for asset and trust management. This Act is designed to increase the assets under management by Hawaii's private financial sector, increase state tax revenues, and position the State as a world-class financial management jurisdiction.

SECTION 2. The Hawaii Revised Statutes is amended by adding a new chapter to be appropriately designated and to read as follows:

**"Chapter**

**PERMITTED TRANSFERS IN TRUST**

§ -1 **Short title.** This chapter shall be known and may be cited as the Permitted Transfers in Trust Act.

§ -2 **Definitions.** As used in this chapter:

"Cash" means United States currency.

"Claim" means a right to payment, whether or not the right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured.

"Creditor" means, with respect to a transferor, a person who has a claim.

"Debt" means liability on a claim.

"Former spouse" means a person to whom the transferor was married where the marriage was dissolved before the time of the permitted transfer.

"Grantor trust" shall mean a trust described in sections 671 thru 679 of the Internal Revenue Code of 1986, as amended.

"Marketable securities" means securities that are (1) exchanged on a governmentally regulated exchange within the

United States including, but not limited to, common stock, bonds, mutual funds, or exchange traded funds and (2) permitted to be held by a fiduciary under the laws of Hawaii. Notwithstanding the foregoing, "marketable securities" shall not include real estate or any interests in corporations, partnerships, and limited liability companies that are not publicly traded.

"Non-grantor trust" shall refer to any trust that is not a "grantor trust" as herein defined.

"Permitted property" means cash, marketable securities, life insurance contracts, and non-private annuities.

"Permitted transfer" means a transfer of permitted property by or from a transferor to a permitted trustee by means of a trust instrument, regardless of whether consideration is exchanged.

"Permitted trustee" means a person, other than the transferor, who is a resident of this State, or a bank or trust company authorized to do business in this State that possesses and exercises trust powers and has its principal place of business in this State.

"Person" means a natural person.

"Spouse" means a person to whom the transferor is married at the time of the permitted transfer.

"Transfer" means the disposition, conveyance, or assignment of permitted property to a permitted trustee or the exercise of a power that causes the disposition, conveyance, or assignment of permitted property to a permitted trustee.

"Transfer tax" means the tax described in section -12.

"Transferor" means an owner of permitted property; a holder of a power of appointment that authorizes the holder to appoint in favor of the holder, the holder's creditors, the holder's estate, or the creditors of the holder's estate; or a trustee who directly or indirectly makes a disposition of permitted property.

"Trust instrument" means an irrevocable instrument appointing a permitted trustee for the permitted property that is the subject of a disposition.

**§ -3 Completed transfers.** The transfer of permitted property under this chapter shall be deemed completed following the completion of all of the following:

(1) The delivery of permitted property by the transferor to the permitted trustee and the written acceptance of the permitted property by the permitted trustee;

(2) The delivery by the transferor to the permitted trustee of a signed and notarized certificate of solvency

that states that the amount of the transfer is equal to or less than twenty-five per cent of the transferor's net worth and that the transfer will not result in delay, defrauding, or hindrance of a creditor who is known or knowable to the transferor at the time of the permitted transfer with a claim against the property that is subject to the transfer; and

(3) The filing of the appropriate form with the Hawaii department of taxation and payment of the attendant transfer tax.

**§ -4 Permitted trustees.** (a) A permitted trustee shall be a person, other than the transferor, who is a resident of this State, or a trust company authorized to do business in this State and to act as a trustee subject to supervision by the department of commerce and consumer affairs and pursuant to the mandates of HRS Chapter 412.

(b) If a permitted trustee of a trust ceases to meet the requirements of subsection (a) and there remains no trustee that meets the requirements, the permitted trustee shall be deemed to have resigned as of the time that the trustee no longer meets the requirements of subsection (a). At that time, the successor permitted trustee provided for in the trust instrument shall become the permitted trustee of the trust. In the absence of any successor permitted



trustee provided for in the trust instrument, a trust advisor or protector provided for in the trust instrument shall appoint a successor permitted trustee. In the absence of an appointed trust advisor or protector, a Hawaii court of competent jurisdiction, upon application of any interested party, shall appoint a successor permitted trustee.

(c) A permitted trustee may appoint an investment advisor to manage the assets of the trust fund; provided that administrative and non-administrative fiduciary responsibility shall remain vested, as against beneficiaries of the trust, with the permitted trustee.

**§ -5 Trust instrument.** (a) A trust instrument shall be irrevocable and shall expressly incorporate the laws of this State governing the validity, construction, and administration of the trust.

(b) The trustee, in its discretion, may terminate any trust if and when its fair market value has declined to the extent which would make it uneconomical, imprudent or unwise to continue to retain such trust and shall pay and distribute such trust to the persons then entitled to mandatory or discretionary income distributions as the trustee in the trustee's absolute discretion shall decide.

(c) A trust instrument shall not be deemed revocable on account of the inclusion of:

(1) A transferor's power to veto a distribution from the trust;

(2) A power of appointment other than a power to appoint to the transferor, the transferor's creditors, the transferor's estate, or the creditors of the transferor's estate that may be exercised by will or other written instrument of the transferor effective only upon the transferor's death;

(3) The transferor's potential or actual receipt of income, including rights to income retained in the trust instrument;

(4) The transferor's annual receipt of a percentage not to exceed five per cent of the initial value of the trust assets or its value determined from time to time pursuant to the trust instrument or of a fixed amount that on an annual basis does not exceed five per cent of the initial value of the trust assets;

(5) The transferor's potential or actual receipt or use of the trust's principal due to the discretionary action of a permitted trustee or to a provision in the trust instrument that governs the distribution of principal; provided that any included provision shall not

confer upon the transferor a substantially unfettered right to the receipt or use of the principal;

(6) The transferor's right to remove a permitted trustee or advisor and to appoint a new permitted trustee or advisor;

(7) The transferor's potential or actual receipt of income or principal to pay income taxes due on income of the trust if the trust instrument includes a provision allowing or directing the use of trust funds to pay income taxes due or if the permitted trustee acts in the permitted trustee's discretion to allow payment of income taxes due on the trust income; or

(8) A permitted trustee's authority pursuant to discretion, direction, or the transferor's exercise of a testamentary power of appointment to pay all or any part of the transferor's debts outstanding at the time of the transferor's death, the expenses of administering the transferor's estate, or any estate or inheritance tax imposed on or with respect to the transferor's estate.

(d) A trust instrument may provide that the interest of a beneficiary of the trust, including a beneficiary who is the transferor of the trust, may not be transferred, assigned, pledged, or mortgaged, whether voluntarily or involuntarily, before the permitted trustee actually

distributes the property or income to the beneficiary. Any provision of this type contained in the trust instrument shall be deemed to be a restriction on the transfer of the transferor's beneficial interest in the trust that is enforceable under applicable nonbankruptcy law within the meaning of section 541(c)(2) of the Bankruptcy Code, 11 U.S.C. section 541(c)(2), or any successor provision.

(e) A transferor may appoint, through the trust instrument, one or more advisors or protectors including, but not limited to, the following:

(1) Advisors who have authority under the terms of the trust to remove and appoint permitted trustees, advisors, or protectors;

(2) Advisors who have authority under the terms of the trust to direct, consent to, or disapprove of distributions from the trust; and

(3) Advisors, including the transferor beneficiary of the trust, who serve as investment advisors to the trust.

(f) If a permitted trustee and an advisor are acting, whenever there shall be a dispute, deadlock, or difference of opinion between them, the transferor may direct that the determination of the advisor shall be binding upon the permitted trustee, but that the permitted trustee shall bear no liability or accountability for any act or transaction

entered into as a result of the enforcement of the advisor's privilege if the permitted trustee dissents in writing.

(g) If a trustee of a trust existing prior to the enactment of this chapter proposes to make a permitted transfer but the trust instrument does not contain a power of appointment that conforms to section -5(c)(2), the trustee may deliver an irrevocable written election to have section -5(c)(2) apply to the trust and the nonconforming powers of appointment shall be deemed modified to the extent necessary to conform with section -5(c)(2). The irrevocable written election shall include a description of the original transferor's powers of appointment as modified and the original transferor's written consent to the modification. Consent of the original transferor to a modification of powers of appointment shall not be considered to be a permitted transfer.

(h) If, in any action brought against a trustee of a trust that results from a permitted transfer, a court declines to apply the law of this State in determining the validity, construction, or administration of the trust, or the effect of a spendthrift provision of the trust, the trustee, immediately upon the court's action and without the further order of any court, shall cease to be trustee of the trust and a successor trustee shall thereupon

succeed as trustee in accordance with the terms of the trust instrument. If the trust instrument does not provide for a successor trustee or does not provide for an advisor or protector with powers to appoint successor trustees, a Hawaii court of competent jurisdiction shall appoint a successor permitted trustee upon the application of any beneficiary of the trust under any terms and conditions that the court determines to be consistent with the purposes of the trust and with this chapter. Upon the removal of a trustee pursuant to this section, the trustee who has been removed shall have no power or authority other than to convey the trust property to the successor trustee.

§ -6 **Investments.** Nothing in this chapter shall prohibit a permitted trustee from diversifying trust assets; however, a permitted trustee shall be authorized to invest only in "permitted property" as defined herein.

§ -7 **Retained interests of transferor.** (a) A permitted transfer shall be subject to this chapter notwithstanding a transferor's retention of any or all of the powers and rights described in section -5(c) and notwithstanding the transferor's service as investment advisor pursuant to section -5(e)(3).

(b) The transferor shall have only the powers and rights specifically conferred by the trust instrument.

Except as permitted by sections -4(b) and -5(c), a transferor shall have no rights or authority with respect to the property that is the subject of a permitted transfer or to the income from property that is the subject of a permitted transfer. Any agreement or understanding purporting to grant or permit the retention of any greater rights or authority shall be void.

§ -8 **Avoidance of permitted transfers in trust.** (a) No claim, including an action to enforce a judgment entered by a court or other body having adjudicative authority, by a creditor against property that is subject to a permitted transfer that arises after a permitted transfer and no claim by a creditor to avoid a permitted transfer shall be brought at law or in equity for attachment or other provisional remedy unless the permitted transfer was made with actual intent to defraud, hinder, or delay the creditor.

(b) An allowable claim under subsection (a) shall be extinguished unless:

(1) The creditor's claim arose before the permitted transfer was made and the action is brought on the latter of the date of the permitted transfer or the date of the enactment of this section; or

(2) The creditor's claim arose concurrent with or subsequent to the permitted transfer and the action is brought within two years after the permitted transfer is made.

(c) In any action described in subsection (a), the burden to prove intent to defraud, hinder, or delay by clear and convincing evidence shall be upon the creditor.

(d) For purposes of this section, a permitted transfer that is made by a transferor who is a trustee shall be deemed to have been made as of the date that the property that is the subject of the permitted transfer was originally transferred via a trust instrument that meets the requirements of this chapter to the transferor or the transferor's predecessor in interest.

(e) Notwithstanding any law to the contrary, a creditor or other person who purports to have a claim against property that is the subject of a permitted transfer shall have only the rights, with respect to a permitted transfer, as are provided in this section and sections -9 and -10.

(f) No creditor or any other person shall have any claim or cause of action, including but not limited to an action to enforce a judgment entered by a court or other body having adjudicative authority, against a trustee or an



advisor described in section -4(c) or against any person involved in drafting, preparing, executing, or funding a trust or in counseling the parties to a trust that is the subject of a permitted transfer if, as of the date of the action, the action would be barred under this section.

**§ -9 Limitations on permitted transfers.** The limitations contained in section -8 on actions by creditors to avoid permitted transfers shall not apply to:

(1) Any person to whom the transferor is indebted on account of a family court-supervised agreement or family court order for the payment of support or alimony to the transferor's spouse, former spouse, or children, or for a division or distribution of property to the transferor's spouse or former spouse, but only to the extent of the debt and not to any claim for forced heirship, legitime, or elective share; or

(2) Any person who suffers death, personal injury, or property damage on or before the date of a permitted transfer; provided that the death, personal injury, or property damage is determined to have been caused in whole or in part by the tortious act or omission of either the transferor or another person for whom the transferor is or was vicariously liable to the extent of the transferor's liability or vicarious liability.

(3) Any lender who extends a secured or collateralized loan to the transferor based on the transferor's or the transferor's agent's express or implied representation that the assets of a trust established under this Chapter would be available as security against the loan in the event of the transferor's default thereon.

**§ -10 Effect of avoidance of permitted transfers. (a)**

A creditor may avoid a permitted transfer pursuant to section -8 only to the extent necessary to satisfy the transferor's debt to the creditor at whose instance the transfer has been avoided, together with costs, including attorneys' fees, as allowed by a court.

(b) In an action pursuant to subsection (a) to avoid a permitted transfer:

(1) If a court finds that a trustee has not acted with intent to defraud, hinder, or delay the creditor in accepting or administering the property that is the subject of the permitted transfer:

(A) The trustee shall have a first and paramount lien against the property that is the subject of the permitted transfer in an amount equal to the entire cost, including attorneys' fees, properly incurred by the trustee in the defense of the action or proceedings to avoid the permitted transfer; and

(B) The permitted transfer shall be avoided subject to payment of proper fees, costs, preexisting rights, claims, and interests of the trustee and of any predecessor trustee who has not acted with intent to defraud, hinder, or delay the creditor; and

(2) If the court is satisfied that a beneficiary of the trust has not acted with intent to defraud, hinder, or delay the creditor, the permitted transfer shall be avoided subject to the beneficiary's right to retain any distribution made prior to the creditor's commencement of an action to avoid the permitted transfer. For purposes of this paragraph, it shall be presumed that a beneficiary did not act with intent to defraud, hinder, or delay the creditor merely by creating the trust or by accepting a distribution made in accordance with the terms of the trust.

(c) A creditor who brings an action pursuant to section 18 to avoid a permitted trust shall have the burden of proving by clear and convincing evidence that a trustee or beneficiary acted with intent to defraud, hinder, or delay the creditor; provided that, in the case of a beneficiary who is also the transferor, the burden on the creditor shall be to prove by a preponderance of the evidence that the transferor-beneficiary acted with intent

to defraud, hinder, or delay the creditor. Mere acceptance of permitted property by a trustee shall not constitute evidence of intent to defraud, hinder, or delay a creditor.

(d) Notwithstanding any other provision of this chapter, a creditor shall have no right against the interest of a beneficiary to a trust based solely on the beneficiary's right to authorize or direct the trustee to use all or part of the trust property to pay:

(1) Estate or inheritance taxes imposed upon or due to the beneficiary's estate;

(2) Debts of the beneficiary's estate; or

(3) Expenses of administering the beneficiary's estate; unless the beneficiary actually directs the payment of taxes, debts, or expenses and then only to the extent of that direction.

**§ -11 Multiple transfers.** If more than one permitted transfer is made by means of the same trust instrument:

(1) The making of a subsequent permitted transfer shall be disregarded in determining whether a creditor's claim with respect to a prior permitted transfer is extinguished as provided in section -8; and

(2) Any distribution to a beneficiary shall be deemed to have been made from the latest permitted transfer.

§ -12 Taxation. (a) The transferor shall pay to the State a one per cent tax on all permitted transfers.

(b) A nongrantor trust established under this Chapter shall be subject to income tax in Hawaii; provided, however, that to the extent that the beneficial interest in such nongrantor trust shall be held by a beneficiary or beneficiaries residing outside this State, any income or capital gains accumulated for the benefit of such nonresident beneficiary or beneficiaries shall be excluded from Hawaii income tax for that year.

(c) A trustee of a nongrantor trust established under this Chapter shall not be required to track accumulated income and or gains attributable to a nonresident beneficiary.

(d) Notwithstanding any discretionary distribution provisions to the contrary, where the percentage interests of the beneficiaries are indeterminable based on the provisions of the trust, the trustee shall allocate accumulated income and gains equally among all beneficiaries then entitled to distributions of income.

(e) Hawaii resident taxpayers who receive actual or constructive distributions of income or principal from trusts shall be subject to all applicable taxes on that income."

SECTION 3. Section 525-4, Hawaii Revised Statutes, is amended to read as follows:

"~~§~~525-4~~§~~ Exclusions from statutory rule against perpetuities. Section 525-1 shall not apply to:

(1) A fiduciary's power to sell, lease, or mortgage property, and the power of a fiduciary to determine principal and income;

(2) A discretionary power of a trustee to distribute principal before termination of a trust;

(3) A nonvested property interest held by a charity, government, or governmental agency or subdivision, if the nonvested property interest is preceded by an interest held by another charity, government, or governmental agency or subdivision;

(4) A property interest in or a power of appointment with respect to a pension, profit-sharing, stock bonus, health, disability, death benefit, income deferral, or other current or deferred benefit plan for one or more employees, independent contractors, or their beneficiaries or spouses; ~~or~~

(5) A property interest, power of appointment, or arrangement that was not subject to the common-law rule against perpetuities or is excluded by any other applicable law~~[-]~~; or

(6) A trust described in Chapter , permitted transfers in trust act."

SECTION 4. Statutory material to be repealed is bracketed and stricken. New statutory material is underscored.

SECTION 5. This Act shall take effect on July 1, 2010; provided that section 2 shall apply to permitted transfers made after the effective date of this Act.

**Report Title:**

Permitted Transfers in Trust Act; Rule Against Perpetuities

**Description:**

Creates the Permitted Transfers in Trust Act to govern transfers of currency, bonds, and securities from a transferor to a trustee by means of an irrevocable trust instrument. Specifies that the rule against perpetuities does not apply to transfers pursuant to the Permitted Transfers in Trust Act. (SD2)

*The summary description of legislation appearing on this page is for informational purposes only and is not legislation or evidence of legislative intent.*