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Private Wealth 2021

USA

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Law and Practice

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1. TAX

1.1 Tax Regimes

The most important US tax regimes to consider for wealthy individuals are US income tax and transfer taxes – ie, estate, gift, and generation-skipping transfer (GST) taxes. While both regimes treat US citizens and “residents” differently to non-residents, the definition of residency is different for income and gratuitous transfer taxes.

Additionally, most (but not all) states impose an income tax on state residents and on non-residents with income sourced to that state and some localities impose a local income tax. Similarly, some states also impose state-level transfer taxes. If it is determined that there is a US transfer tax issue, therefore, the same issue should be considered from a state law perspective.

Income Tax

The USA generally imposes a “worldwide” income tax regime on all “US persons”, which includes all US citizens (regardless of their place of residence), along with all “US residents”. This means that US income tax is generally imposed on all taxable income of a US person, regardless of the source of the income.

Those who are not “US persons” are instead taxed only on US-source income, with an important distinction made between US-source income from a “US trade or business” and that which is not from a US trade or business. Several specific US tax provisions treat foreign investment in the USA favourably for those who are not in a US trade or business.

Residence status

The question of US residence status is determined by the Internal Revenue Code (IRC), but is also affected by income tax treaties between the

USA and other countries. Under the IRC, persons with US “permanent resident” immigration status (ie, a US “green card”) are automatically classified as US residents for income tax purposes. In addition, persons without a green card who meet the “substantial presence test” under Internal Revenue Service (IRS) regulations are classified as US residents for income tax purposes. It is important to emphasise that an individual’s immigration status (ie, being on a non-resident or temporary visa, or in a visa-waiver programme) generally does not prevent them from attaining “US resident” status for income tax purposes (although certain categories, such as students and diplomats, are special exceptions).

The substantial presence test is a mechanical test applied by counting the number of calendar days that an individual was present in the USA (for any part of the day) during a given calendar year, along with the two calendar years preceding that.

There are some limited statutory exceptions for individuals who otherwise meet the substantial presence test. Particularly, the “closer connection exception” applies in cases where an individual is present in the USA for less than 183 actual days in the calendar year, and that person has both a “tax home” (a technical tax term generally meaning the individual’s primary residence) in another country and an overall “closer connection” to that other country. Exceptions also exist for students and teachers, as well as other individuals.

Beyond the statutory exceptions, if an individual is determined to be a US resident under the IRC, but the individual is also considered an income tax resident under the laws of another country, then the applicability of the “tie-breaker” rule under a US income tax treaty should be considered.

Citizens and residents

US income tax is imposed on “US persons” on a “worldwide” basis, meaning that all taxable income, as defined under US law, is subject to tax, regardless of the source of the income.

One notable exception to this rule is the “foreign-earned income exclusion” which is available for US persons residing abroad. This exclusion applies only to “earned income” and is limited in amount (USD108,700 in 2021, plus a deduction or exclusion for certain housing expenses).

Non-residents

Foreign persons (ie, those who are not “US persons”) are generally only taxed on certain US-source income. Two broad regimes apply to foreign persons, depending on how the income is earned in the USA:

- income from a “US trade or business” (or business with a permanent US establishment if a treaty applies), which is taxed on a net-income basis and requires the filing of a US tax return; or
- generally, all other income (referred to as “Fixed, Determinable, Annual or Periodic” or “FDAP” income), which (to the extent that it is taxable) is taxed under a withholding regime on a gross income basis, with a generally applicable tax rate of 30%.

Income from the sale of US real estate (and certain entities owning US real estate) is generally deemed to be from a US trade or business, but a gross-basis withholding tax also generally applies in such sales. US source income from personal services (eg, income attributable to an employee’s services while the employee is in the USA) is generally deemed to be US trade or business income, provided that there is a narrow statutory exception available if the compensation attributable to time in the USA is under USD3,000, and US tax treaties generally provide

a broader exception if the employee is a resident of a treaty partner.

There are several key income tax considerations for foreign investors in the USA:

- residents of tax treaty partner countries may enjoy significantly reduced withholding rates on things like interest, dividends and royalties;
- a “portfolio interest exemption” often applies so that foreign lenders to US borrowers are exempt from tax on the interest income; and
- a sale of corporate stock by a foreign person is generally not considered US source income and is thus not taxed, provided that the corporation is not considered a US real property holding company.

Real Estate Owned by Non-Resident Non-citizens

Current income (eg, rent) from US real estate owned by a foreign person is taxed differently than the sale proceeds from disposal of an ownership interest in US real estate (including ownership in entities where a primary asset is real estate – ie, a US real property holding company).

For current income, if the foreign person is not considered to be in a “US trade or business” with respect to the real estate (eg, the foreign person is merely collecting rent from property on a “triple net lease”), then the rent is generally subject to the withholding regime for FDAP described above (with a general withholding rate of 30%). That said, such a foreign owner may instead elect to treat the real estate as a US trade or business and pay tax on a net income basis (including getting the benefit of depreciation deductions on the real estate as applicable). If the real estate does constitute part of a US trade or business, then the net income taxation regime applies automatically. To be taxed on a

net income basis, the foreign person must file a US tax return.

With respect to sales of ownership in US real estate, foreign persons are deemed to be in a US trade or business under the Foreign Investment in Real Property Tax Act (FIRPTA), but such sales are also subject to a requirement for the purchaser to withhold 15% of the gross sale proceeds under FIRPTA. In order to be taxed on a net gain basis (including qualification for more favourable long-term capital gain rates), the foreign seller must file a US tax return.

In addition, gratuitous transfers by foreign persons of US real estate during life or at death are subject to gift or estate tax, as further described below.

For these reasons, foreign persons often choose to hold US real estate in a US corporation, and, in order to avoid US estate tax, hold the stock in the US corporation through a foreign corporation. Structured properly, the US real estate can be sold by the US corporation (with the corporation paying the corporate rate, currently 21%, on the gain from the sale), then the net after-tax proceeds can be distributed in liquidation of the corporation without additional US tax on the foreign owner.

Application of Income Tax to Trusts

For foreign persons looking to establish a trust in the USA, whether for US beneficiaries or not, a popular structure is for the foreign person to establish a US “grantor” trust, which is a type of trust that is treated as being owned by the grantor for income tax purposes, meaning that the trust itself is not a taxable entity. A trust with a foreign grantor is only treated as a “grantor” trust in limited circumstances. If the trust is treated as a “grantor” trust, the foreign grantor is deemed the owner for income tax purposes, meaning the trust assets would only be taxable by the USA

with regard to certain US-source income. A US “grantor” trust structure for the benefit of US beneficiaries is attractive when compared to the alternative for US beneficiaries of a foreign trust since US beneficiaries of foreign trusts often pay income tax on trust distributions, along with an additional “throwback” tax for previously accumulated and undistributed trust income.

Gratuitous Transfer Taxes

US gift tax applies to lifetime transfers of assets, while estate tax applies to transfers occurring or deemed to occur at death, and the GST tax applies to transfers that are deemed to “skip” a generation, with the overall scheme intended to tax the transfer of wealth to each generation.

Residence

“Residence” for the purposes of US gratuitous transfer taxes is, confusingly, not the same as “US resident” status for income tax purposes. Residence for gratuitous transfer tax purposes is based on the concept of “domicile”. This means the place where an individual both:

- resides; and
- plans to continue to reside indefinitely.

Once the domicile is established, it does not change unless a new domicile is established (by residing somewhere and intending to remain indefinitely).

Application to residents

US gift tax applies to all lifetime gratuitous transfers by a US citizen or resident that are not covered by an exclusion, exemption or deduction. Estate tax applies under separate rules that define an individual’s “gross estate”, which includes property owned at death, but also several categories of property over which the decedent held certain rights, benefits or powers at death.

For practical purposes, gift and estate tax are imposed at a flat 40% rate for US citizens and residents who exceed the lifetime exemption. An important distinction is that gift tax is imposed on a “tax exclusive” basis (the tax is paid out of the grantor’s other assets and not the gifted assets), while estate tax is imposed on a “tax inclusive” basis, because it is paid out of the estate funds. As a result, it is generally more tax efficient to make taxable gifts than to have a taxable estate.

Exclusion

A key exclusion for gift tax purposes is the “annual exclusion” of up to USD15,000 (for 2021, indexed for inflation) per donee that a donor can give away without any requirement to file a gift tax return or use exemption.

Deduction

The key deduction for gift and estate tax purposes is the marital deduction, which is an unlimited deduction for gifts to US-citizen spouses. Certain types of trusts also qualify for the marital deduction. For non-citizen spouses, there is only a USD159,000 (for 2021, indexed for inflation) annual exclusion for gift tax purposes, but there is an unlimited marital deduction if assets for the non-citizen spouse are paid into a specific type of trust. There is also an unlimited gift and estate tax deduction for gifts to qualifying charities.

Exemption

The lifetime exemption for US estate and gift tax is currently USD11.7 million (for 2021, indexed for inflation) per donor. Gifts are not subject to gift tax until the exemption is exhausted, but a gift tax return must be filed for any gift that uses the exemption. A separate USD11.7 million exemption is available for GST tax purposes.

Application to non-residents

Non-resident non-citizens (“foreign persons”) are subject to US gift tax, in general, only on

transfers of US real estate and other tangible property situated in the USA. Importantly, gift tax does not apply to a gift of stock in a US corporation by a foreign person. Estate tax has a broader reach for foreign persons, and importantly, stock in a US corporation is subject to estate tax. For this reason (and other reasons), a foreign person may choose to hold US stock through a foreign “blocker” corporation. The lifetime exemption of USD11.7 million is not available to foreign persons, rather foreign persons get no gift tax exemption (other than the USD15,000 annual exclusion) and only get a USD60,000 estate tax exemption.

1.2 Stability of the Estate and Transfer Tax Laws

Transfer Tax Exemptions

US transfer tax exemptions were doubled as part of the legislation passed at the end of 2017. With this increase, the combined estate and gift tax exemption is USD11.7 million per individual transferor for 2021 (indexed to inflation) and the GST tax exemption is the same amount. This doubling of the exemptions is scheduled to sunset after 2025, at which point, the exemptions will be half of the previous year’s amount (still adjusted for inflation).

With the Democratic Party in control of both houses of Congress and the White House, many expect changes in the transfer tax area in the coming years. While current proposals from the White House do not include immediate changes to the transfer taxes themselves, there is a good chance that decreases in transfer tax exemptions and increases in transfer tax rates (currently 40%, with some proposals to increase the rates for large estates to 55% or more) will be on the table for tax law changes later in 2021. The current proposal from the White House does include a provision to apply the income tax to the “built in gain” on an asset when it is transferred as a gift or at death, and to also apply an income

tax to the built-in gain inherent in trust assets on a periodic basis.

Other Tax Changes

Other substantial changes to the tax laws are being considered by the Biden administration and Congress, which could be passed later in 2021 with a Democratic majority. These include major changes to the corporate and international tax regime, such as increasing the corporate tax rate and imposing a global minimum tax, with OECD co-operation being sought on the latter.

More directly relevant to private wealth owners is a proposed increase in the preferential long-term capital gains rate to match the “ordinary income” rate for income in excess of USD1 million for the year. The increase would be from 20% to 37% as proposed, with an effective date retroactive to April 2021, and a further increase of the top rate to 39.6% in 2022. The existing 3.8% net investment income tax would also apply to US persons, on top of the capital gains rate.

As mentioned above, another major proposed change is to apply the income tax to the built-in gain on assets when the asset is given away during life or at death, or transferred to a partnership or non-corporate entity. The proposal would also tax the built-in gain on assets held in a trust or other non-corporate entity at least every 90 years, such that assets that have been held in trust since 1940 would be taxed on built-in gain in 2030. The built-in gain is measured by reference to fair market value, but the fair market value would be modified to ignore most valuation discounts that normally apply in family entity structures. The tax at death would be paid in instalments over 15 years, but there is not an instalment provision for lifetime gifts or trusts.

In addition, the Biden administration has proposed large increases in funding and staffing for the IRS for the purposes of administering and

enforcing the tax laws. There would also be an increase in the gathering and sharing of information with the IRS. In particular, there is a proposal to have financial institutions report detailed information regarding the activity in each financial account they administer to the IRS. A stated goal of the changes at the IRS is to greatly increase the rate of audits for the wealthy, which have fallen substantially in recent years.

A variety of other tax changes have been proposed by Democratic members of Congress. The Democratic majority in the Senate is also razor thin (with the Vice President as tie-breaker in a 50/50 Senate), and current Senate filibuster rules constrain what this majority can accomplish. As a result, the timing and degree of implementation of these proposals is very uncertain.

Planning for Uncertainty

Many wealthy individuals are taking advantage of the large current exemptions in an effort to “lock in” the increased exemptions before they potentially return to lower levels (whether after the sunset in 2025 or sooner). This is accomplished through lifetime gifting, often to trusts, to take advantage of the increased GST tax exemption as well.

1.3 Transparency and Increased Global Reporting

FATCA

The USA does not participate in the OECD’s Common Reporting Standard (CRS), instead relying on the FATCA reporting regime. The USA has intergovernmental agreements (IGAs) with many countries for the purposes of enforcing FATCA rules, with the USA agreeing to exchange information with its IGA-partner countries. The terms of FATCA unilaterally compel many foreign financial institutions (FFIs) to provide information to the USA, because the USA imposes a punitive 30% withholding tax on US-source income

and on the sale of US property if the FFI does not comply.

FBAR

Under the Foreign Bank and Financial Account Reporting (FBAR) Law, the USA also requires that all US persons annually report their direct and indirect financial interests, as well as signatory or other authority, over foreign financial accounts, if the aggregate value of such accounts exceeds USD10,000 at any time during the year.

Other Disclosures

Banks in the USA are subject to expansive know-your-client requirements, which results in significant disclosure of beneficial ownership and control when a US bank account is opened.

In addition, the Corporate Transparency Act (CTA), which became law on 1 January 2021, will create a federal reporting regime that requires US corporations, limited liability companies, and other entities formed through a state filing to report their beneficial ownership and control to the federal government. There are exceptions for certain types of entities included in the CTA. Regulations to implement the CTA are forthcoming, and those regulations will govern the time at which the rules will apply to newly-formed and existing entities.

2. SUCCESSION

2.1 Cultural Considerations in Succession Planning

Given the diversity across and within its geographic regions, it is hard to point to any particular cultural factors that impact succession planning in the USA. There is a large ongoing generational wealth transfer from the large generation of ageing “baby boomers” (the generation born after World War 2) to their children, who are largely in their twenties to early forties.

Culture is changing in the USA, leading to greater social acceptance of non-traditional families that are more diverse than the second marriages or single-parent households previously considered non-traditional. These non-traditional families include same-sex parents, more than two parents, and children born through non-traditional means. The law has slowly been taking stock of these new social norms. See **8. Planning for Minors, Adults with Disabilities and Elders** for examples of some of these cultural and legislative changes.

As the definition of what constitutes a family continues to evolve, so have clients’ testamentary plans. Specifically, clients are moving from incentive-focused to results-oriented trust provisions that exercise less control over their descendants’ actions and focus more on creating a financially literate, responsible beneficiary. Results-oriented trusts focus strongly on the trustee-beneficiary relationship, transparency, communication and promoting the beneficiary’s growth and autonomy.

2.2 International Planning

When beneficiaries reside abroad, it is vital to closely examine the laws of the state of residency to see if such laws will impact planning. For example, a beneficiary who receives assets upon termination of a trust may be subject to significant income taxes on them in other jurisdictions. Or the fact that a trust beneficiary or fiduciary resides in a specific country may result in the application of that country’s laws to all or a portion of such trust.

2.3 Forced Heirship Laws

Any forced heirship is determined at the state level. Most states under “common law” property regimes have requirements for a spouse’s share of the estate, wherein the spouse may elect a certain percentage of the estate. States with “community” property regimes generally provide

that each spouse is deemed to own half of all property acquired during the marriage, regardless of how legal title is held.

Only the state of Louisiana has a forced heirship regime for certain descendants.

As to foreign forced-heirship laws, the trust laws in a number of states could allow a foreign person to establish a US trust to avoid the application of forced heirship to the trust property.

Generally, all of the foregoing rights of a surviving spouse can be waived in a valid prenuptial or postnuptial agreement, such as described in **2.4 Marital Property**.

2.4 Marital Property

There are two primary forms of marital property in the USA, common law and community property. While there are similarities between these forms, such as a presumption that all property acquired during marriage is deemed marital property, there are numerous and significant distinctions between them. Moreover, there is no uniformity in the application of either form by and among US states. For example, in some jurisdictions a creditor of one spouse may have recourse against the entire community property, while other states would limit such exposure to only the debtor-spouse's one-half interest in the community property. The proper identification of the character of property has a significant impact on estate planning especially where community property is transferred to a trust of which the non-transferring spouse is a beneficiary or serving as a trustee.

Prenuptial Agreements

Prenuptial agreements addressing property rights at death or divorce and, in a majority of states, spousal support, are generally enforceable. Usually, for a prenuptial agreement to be enforceable, it must be in writing and entered

into voluntarily. As with all contracts, there must be consideration, and with a prenuptial agreement, the marriage itself is sufficient consideration. Although independent legal advice is not always required for both parties, the existence of it for both parties is a favourable factor in determining the enforceability of the prenuptial agreement. Full financial disclosure by both parties is also a requirement in some states. The majority of states will evaluate whether the process that led to the prenuptial agreement's execution was fair to both parties.

Postnuptial Agreements

Rather than a single statute or case explicitly authorising postnuptial agreements, the majority of states have a combination of statutes and cases that, when taken as a whole, authorise the use of postnuptial agreements, which are not incident to a divorce. The postnuptial agreement is designed with preservation of the existing marriage in mind, but covers the same topics as a prenuptial agreement. Generally, the criteria for a valid postnuptial or prenuptial agreement are the same.

2.5 Transfer of Property

Property transferred during a person's lifetime is done on a carry-over basis, that is, the basis as it existed in the hands of the transferor. At death, the basis in an asset gets a step-up (or step-down, as applicable) to date-of-death value, though certain assets do not qualify for this adjustment.

2.6 Transfer of Assets: Vehicle and Planning Mechanisms

See **3.1 Types of Trusts, Foundations or Similar Entities**.

2.7 Transfer of Assets: Digital Assets

The 2015 Uniform Fiduciary Access to Digital Assets Act, Revised (Digital Act), has been enacted in most US states. The Digital Act gov-

erns access to an individual's digital assets, such as online accounts, email and social media, upon an individual's incapacity or death. While a fiduciary, such as an executor, trustee, conservator or an agent under a power of attorney, traditionally had the right only to manage tangible property, with the Digital Act, a fiduciary's access and management of assets is extended to digital assets.

3. TRUSTS, FOUNDATIONS AND SIMILAR ENTITIES

3.1 Types of Trusts, Foundations or Similar Entities

The most common entities utilised in estate planning are trusts; however, there is a wide range of types of trusts that can be used. Common examples of trusts typically incorporated in tax and estate planning are revocable trusts, incomplete non-grantor trusts, intentionally defective grantor trusts, self-settled asset protection trusts and special purpose trusts. For charitably inclined clients, charitable remainder trusts and charitable lead trusts can be extremely useful to incorporate into their estate plan.

Recent developments concerning trusts revolve around the ability of an individual state to subject a trust to its taxation regime when the trust's connection with the state is minimal. In addition, recent state court cases have ruled that assets held in trust created for an individual's benefit by their parents might be subject to division in the event of such individual's divorce.

3.2 Recognition of Trusts

While most states do not recognise trusts as separate and distinct legal entities, nearly all states recognise and respect the legal relationship created as a result of a trust agreement. Specifically, a trust is not the legal owner of assets, rather the owner of the assets is the trust

tee who holds the assets "in trust" and not in an individual capacity. Most states acknowledge that assets held by a trustee are not subject to the claims of a trustee's creditors since the assets do not belong to the trustee in their individual capacity. Similarly, liabilities arising from the trust property are obligations of the trust and recourse is limited to the trust assets. Therefore, in usual circumstances, a trustee is typically not personally liable for any liabilities and/or obligations arising from trust assets.

3.3 Tax Considerations: Fiduciary or Beneficiary Designation

When a US citizen or US resident is named as a fiduciary of a foreign trust or is included in the class of beneficiaries of a foreign trust, it is likely there will be one or more reporting requirements imposed, some of which can be quite stringent. Moreover, the penalties for failing to adhere to such reporting requirements can be substantial and may continue to be imposed until such requirements are met. While a beneficiary who is either a US citizen or resident will be subject to US income tax on distributions from a foreign trust (both actual distributions and deemed or constructive distributions), whether a foreign trust with a US citizen or resident serving as trustee is subject to US taxation is dependent on the specific facts and circumstances. Of course, one should review all applicable tax treaties to see what impact, if any, they have on the taxation of the trust and/or beneficiaries.

When a Donor Serves as a Fiduciary

When the donor of a trust or a beneficiary is also serving as a fiduciary, unintended tax consequences may arise. Specifically, when a donor of a trust serves as a fiduciary, it is likely the donor will be treated as the "owner" of the trust for income tax purposes, making the donor personally responsible for the trust's income tax liabilities. While this might initially appear to be detrimental, since the donor is deemed the "owner"

of the trust, transactions between the donor and the trust are not recognised. Thus, a sale of assets by a donor to one of these trusts will not cause any gain recognition by the donor. Moreover, since the donor is legally responsible for the trust's tax liability, the donor's payment is not deemed a gift to the trust. Therefore, the donor's payment of the trust's taxes is, in essence, a tax-free gift, and this also permits the assets to grow on a tax-free basis. Unfortunately, however, when the donor is also serving as a fiduciary, it is possible for the assets of the donor to be subject to US estate tax upon the donor's death depending on the terms of the trust.

When a Beneficiary Serves as a Fiduciary

Unlike a donor, when a beneficiary serves as a fiduciary this will normally have no impact on the income tax treatment of the trust. However, depending on the specific powers held by the beneficiary, in their fiduciary capacity, the assets of the trust may or may not be subject to US estate tax upon the beneficiary's death, and distributions made by the beneficiary in their fiduciary capacity may be treated as taxable gifts by the beneficiary.

3.4 Exercising Control over Irrevocable Planning Vehicles

Recent evolutions in the law applicable to trusts permit significantly more flexibility in modifying trusts. Specifically, most US states now permit for the trustee and beneficiaries to modify an otherwise irrevocable trust, although judicial approval of any such modification may be required. In addition, most states now permit the assets of a trust to be distributed to a newly created trust, resulting in such assets being held, administered and distributed in accordance with the new trust agreement (commonly referred to as "decanting"). Lastly, it is becoming more common for a trust to include a trust protector who is to be given various, and sometimes quite broad, powers concerning the trust, often

including the power to amend or modify a trust to achieve the intended results or in a manner which is in the beneficiaries' best interests. While trust protectors have historically been used, many states have recently enacted new laws specifically authorising the office of trust protector. Of course, careful thought should be given to tax considerations prior to any modification, decanting or the exercise of any powers held by a trust protector.

4. FAMILY BUSINESS PLANNING

4.1 Asset Protection

Asset protection methods commonly used include the following.

Domestic Trusts

Domestic trusts include domestic asset protection trusts (DAPTs), which are trusts where the same individual may be both settlor and beneficiary without vitiating creditor protection. DAPTs are only allowed in a limited number of states, with certain states, such as Delaware, Nevada, South Dakota and Tennessee, viewed as prime jurisdictions.

Limited Liability Companies

Business entities such as limited liability companies (LLCs) provide a level of creditor protection. LLCs are often used for either "inside out" creditor protection (protection from claims of the LLC's creditors) or "outside in" creditor protection (where creditors of an LLC's owner cannot reach the LLC's assets and are stuck with an undesirable "charging order" against LLC distributions, if any are ever made).

Foreign Asset Protection Trusts

Foreign asset protection trusts are also used, although the cost and tax complexity involved

in foreign trusts is often prohibitive when compared to using a DAPT.

Creditor-Exempt Assets

Increasing creditor-exempt assets, including certain retirement accounts, “homestead” property, life insurance or titling certain assets jointly with a spouse, is another form of asset protection. These protections vary widely depending on the state of residence.

4.2 Succession Planning

Wealthy families employ a combination of trusts and family entities to accomplish their succession-planning goals in a tax-efficient manner.

Family Entities

Family entities (often in a limited partnership or limited liability company) are used to centralise and formalise investment decision-making, separate beneficial ownership from control, pool investment assets, streamline the transfer of assets, reduce family conflict, establish ground rules and protect assets from creditors and other interlopers. As described below, a properly structured family entity may also give rise to valuation discounts, making transfers of such assets more tax efficient.

Irrevocable Trusts

Trusts are used, often in combination with family entities, to accomplish succession planning in a tax-efficient manner. Transfers of interests in family entities, with valuation discounts, can be made through a combination of gifts and sales, with sales to trusts especially attractive due to the artificially low minimum interest rates the IRS allows families to use for an instalment sale.

Irrevocable trusts are also employed in tax-efficient transactions involving annuity or “unitrust” interests, such as a grantor-retained annuity trust (GRAT), a charitable-lead annuity trust (CLAT) or a charitable-remainder unitrust trust (CRUT).

Private Trust Companies

Families with substantial wealth often seek a more permanent solution to family governance and succession planning by forming a private trust company (PTC). A PTC is formed by the family to serve as a trustee of trusts that are in some way related to the family, and may also serve in an investment advisory or family office type role. Certain states, such as Nevada, South Dakota and Tennessee, have become preferred jurisdictions in which to establish a PTC due to favourable trust laws, tax laws and regulatory environments.

4.3 Transfer of Partial Interest

A transfer of a partial interest in a properly structured entity may be subject to valuation discounts due to a lack of control and/or marketability for estate and gift tax purposes. The IRS has previously proposed rules (since withdrawn) to curtail these discounts for family entities, and the IRS has also been successful in litigation of some cases arguing that the full value of a poorly structured family entity should be included as part of a taxable estate. It could be the case that the Biden administration will attempt to re-issue the withdrawn proposed regulations in some form, or otherwise crack down on valuation discounts by seeking legislation with the same or greater effect.

5. WEALTH DISPUTES

5.1 Trends Driving Disputes

Bases for Disputes

Most disputes involving estates and trusts commonly arise from the exclusion of one or more potential beneficiaries, typically children of the decedent, from either the entire estate or from a particular asset. Another common source of disputes is ambiguity in the documents, potentially causing preferential treatment to one or more beneficiaries. This latter category includes

bequests to charities or to private foundations. It is also common for a challenge of estate plans and documents to be made on the basis of undue influence or fraud, usually coupled with an allegation of lack of mental capacity, such as dementia. Finally, some challenges are based upon improper execution in order to set the last will and testament aside and rely upon the law of intestate succession or a prior last will and testament.

Procedure

Almost all litigation involving estates and trusts is governed by state or territorial law and court procedures vary significantly between jurisdictions. It is therefore imperative to engage the services of an attorney located in the jurisdiction where probate will occur who specialises in this type of litigation.

In Terrorem Clauses

Many, if not most, estate documents contain what is commonly referred to as a “no contest” or “forfeiture” clause. Under these clauses, a challenger to the estate document will forfeit any rights they may otherwise have under the document if they contest the validity of the document. The enforceability of these clauses varies widely among jurisdictions.

Fiduciary Exception to Attorney-Client Privilege in Trusts and Estates

States typically allow extensive discovery in civil disputes. Normally exempt from discovery are communications between a party to the litigation and that party’s attorney. These communications may occur either during or prior to the litigation. However, some states have developed what is referred to as the “fiduciary exception” to attorney-client privilege. The fiduciary exception prevents a fiduciary from asserting attorney-client privilege to prevent the disclosure of attorney communications regarding the fiduciary’s duties and responsibilities. The basis of this exception

is that the duty to administer the trust solely for the benefit of the beneficiaries takes precedence over the privilege.

Federal Statute 28 USC Section 1782

The most significant exception to the procedure outlined above is the federal statute entitled “Assistance to foreign and international tribunals and to litigants before such tribunals”. This statute has become more widely used after a US Supreme Court decision in 2004. Under the statute, as interpreted by the US Supreme Court, an order may be obtained from a federal district court compelling either testimony or documents. The order may be obtained by any interested party or by a foreign tribunal to compel a person either residing in or merely “found” within the jurisdiction of that federal district court to give testimony or produce documents. If an order is sought by an interested party and not a tribunal, the matter is governed by the Federal Rules of Civil Procedure.

5.2 Mechanism for Compensation Claims against Fiduciaries

Fiduciaries are held to the highest standard for the performance of their duties. This means that the fiduciary is liable not only for reckless or wilful misconduct but also for ordinary negligence. The courts will normally give a prevailing beneficiary what are known as “compensatory damages.” Compensatory damages seek to “make the prevailing party whole” by restoring the loss caused by the misconduct. Although rare, particularly egregious conduct by a fiduciary may result in “punitive damages” which are a form of punishment.

Disputes among Beneficiaries

The most common result in a dispute among beneficiaries is to divest the assets from the putative recipient and then vest those assets into the aggrieved party. Attorney’s fees are not normally awarded.

6. ROLES AND RESPONSIBILITIES OF FIDUCIARIES

6.1 Prevalence of Corporate Fiduciaries

While, arguably, family members and friends are more often tasked with serving as trustees, it is not uncommon for clients to utilise a corporate fiduciary to serve in this capacity. While several factors impact the decision to use an individual as a trustee as opposed to a corporate fiduciary, the most common reasons given for reluctance to use a corporate fiduciary are cost, administrative bureaucracy and the individual's personal knowledge of the beneficiaries and the trust creator's beliefs/values, as well as a pre-existing relationship between the trustee and beneficiaries. However, the use of corporate fiduciaries as trustees has accelerated in recent years as states have enacted statutory laws permitting trust administration duties to be bifurcated between advisers. For example, it is now possible for a corporate fiduciary to be responsible for all facets of trust administration other than exercising discretionary distribution powers, which is given to an individual trustee. Corporate fiduciaries have slowly become more accepting of this bifurcation of administrative roles due to the enactment of state laws which specifically eliminate the corporate fiduciary's liability and oversight role for those tasks which are given to an individual trustee.

Standard of Conduct

While a corporate fiduciary is held to the same standard of conduct as an individual trustee, corporate fiduciaries are often nonetheless evaluated differently. For example, while a co-trustee may delegate certain functions to another co-trustee, the fact that the delegating co-trustee is a corporate fiduciary will have an impact on determining whether such delegation is prudent; similarly, a corporate fiduciary with a special skill or expertise (eg, investment acumen) is required

to use such skill/expertise when serving as a trustee.

6.2 Fiduciary Liabilities

In general, the laws of most states expressly provide that the liabilities and/or obligations incurred by a trustee due to its ownership, management and/or control of a trust property in a fiduciary capacity are enforceable solely against trust property and no such liability and/or obligation is imposed on the trustee, personally. However, when the liability and/or obligation arises due to the active and wrongful conduct of a trustee, most states will hold the trustee personally liable.

"Excluded Fiduciaries"

While indemnification provisions are included in trust agreements, a new trust structure has started to be incorporated which completely eliminates a trustee's liability for certain tasks. A "directed trust" is a trust where the trustee is expressly excluded from having a certain power or powers, which are instead given to another individual (who may or may not be a fiduciary). In this situation, the trustee is referred to as being an "excluded fiduciary" with respect to the power(s) it is expressly prohibited from having and, as such, the trustee is completely relieved of any and all liability arising from any exercise (or non-exercise) of such power by the appropriate power holder, as well as for any responsibility to oversee such power holder.

6.3 Fiduciary Regulation

The creator of a trust is generally given wide latitude to provide specific guidance on the investment and management of trust property. However, in the absence of any such guidance, most states require a trustee to exercise reasonable care and skill and to invest and manage assets as a prudent investor would, taking into consideration the terms of the trust and its purpose.

6.4 Fiduciary Investment

As discussed in **6.3 Fiduciary Regulation**, most states impose a prudent investor standard on trustees which governs the review of a trustee's investment actions. It is generally understood that this prudent investor standard was significantly influenced by modern portfolio theory. However, the prudent investor rule is not intended to serve as an objective standard of investment performance; rather, the inquiry is to evaluate whether, reviewing the entire portfolio, the trustee's investment and management decisions furthered the purpose of the trust and struck a balance between risk and return which was appropriate for the trust, given its specific purpose. One specific aspect of prudent investment is a duty to diversify investments so as to avoid the risks associated with concentrated investment positions. However, this duty of diversification is not absolute, as it might be wholly appropriate for a trustee to use it to maintain a concentrated position, such as where the position is an equity interest in a closely held business, or where the divestiture of investment might cause significant tax liabilities.

With respect to operating businesses, the laws of most states will grant a trustee various powers to enable them to better manage and administer businesses, including actively operating companies. Nonetheless, where it is intended that a trust owns an interest in a business, careful consideration must be given when drafting the trust agreement to avoid any unintended consequences. For example, only qualifying trusts may hold ownership interests in certain business entities.

7. CITIZENSHIP AND RESIDENCY

7.1 Requirements for Domicile, Residency and Citizenship Residence

US immigration law creates a variety of paths to establish lawful permanent residence in the USA, which are too numerous and complex to discuss in full. The general categories of immigration are family-based (based on a family relationship with US permanent residents or citizens) or employer-based (based on the sponsorship of an employer or on investment in a job-creating enterprise).

Lawful permanent residents maintain their permanent resident status unless they complete the naturalisation process to become a citizen or lose/abandon their status. Permanent resident status may be lost if a removal order is issued by an immigration judge or if conditions on status are not removed. It is possible to abandon status by moving to another country to live permanently, by remaining outside the USA for an extended period, by failing to file US tax returns or by declaring oneself to be a "non-immigrant" on US tax returns.

Permanent residents may apply for a re-entry permit before leaving the USA to establish that they do not intend to abandon their permanent resident status. A re-entry permit allows for admission back to the USA after travelling abroad for up to two years without having to obtain a returning resident visa.

Citizenship

In general, an individual must reside in the USA as a lawful, permanent resident for five continuous years before becoming eligible for US citizenship. In addition to other application requirements, an individual must also be physically present in the USA for two-and-a-half years out

of the five-year residency. Applicants for naturalisation must also pass an English and US civics exam.

Non-resident Programmes

In addition to immigrant visas (ie, permanent residence), the USA has a variety of non-immigrant visas (and a visa-waiver programme) generally for the purpose of establishing temporary residency in the USA. Typical categories include temporary workers, business travellers and students.

7.2 Expeditious Citizenship

Truly expeditious citizenship is only available in certain extremely narrow circumstances – eg, for family members of state department personnel and US armed forces deployed abroad.

An expeditious way to establish permanent residency in the USA, which can lead to US citizenship, is as an immigrant investor qualifying for the “EB-5” programme. This programme requires a certain level of investment and job creation in a US enterprise. Currently, the required investment is USD1.8 million (or USD900,000 in certain areas that are struggling economically), increased from USD1 million and USD500,000 respectively in 2019. In addition, immigration through the EB-5 programme is conditional for a period of two years, at the end of which time, the enterprise in which the immigrant invested must continue to be viable.

8. PLANNING FOR MINORS, ADULTS WITH DISABILITIES AND ELDERS

8.1 Special Planning Mechanisms

Two recent changes in US law, the Achieving a Better Life Experience (ABLE) Act of 2014 and the Setting Every Community Up for Retirement Enhancement (SECURE) Act of 2019, contain

special provisions that should be reviewed when planning for individuals with disabilities.

ABLE permits states to create savings programmes for eligible individuals with disabilities. The first USD100,000 in an ABLE account is disregarded for purposes of determining an individual’s eligibility for supplemental security income (SSI); however, assets in an ABLE account exceeding USD100,000 are counted as resources for purposes of determining SSI eligibility. Even if an individual’s SSI payments terminate due to excess resources in an ABLE account, an individual otherwise eligible for Medicaid will retain eligibility for Medicaid regardless of the ABLE account balance.

Effective 1 January 2020, SECURE provides that statutorily defined “eligible designated beneficiaries” who are disabled or chronically ill can receive a life expectancy payout of retirement benefits through the use of an applicable multi-beneficiary trust. Routinely, most beneficiaries of retirement benefits receive five-to-ten-year payouts of inherited retirement benefits.

The Relevant Terms Explained

Individualised planning for minors or adults with disabilities requires an understanding of the relevant terminology. While an attorney who does not specialise in special-needs planning and elder law is not likely to have many clients who qualify for means-tested government benefit programmes like supplemental security income and Medicaid, it is likely that their clients will have family members who qualify. These clients may wish to provide for these family members who survive them. Whether or not a planning attorney chooses to engage in this type of planning, the attorney should understand certain terms and what those terms mean in the special-needs estate-planning context.

Social Security disability insurance (SSDI)

SSDI is a benefit programme available to individuals with a disability who either have sufficient work history prior to becoming disabled or are entitled to receive benefits by virtue of being a dependent or survivor of a disabled, retired or deceased insured worker. A recipient of SSDI is not subject to a “means” test in which their assets are evaluated. After two years of SSDI eligibility, the beneficiary will qualify for Medicare benefits. COVID-19 “long haulers” have started filing claims for SSDI due to their inability to work as a result of lingering side effects of COVID-19. Eligibility for SSDI benefits as a COVID-19 “long-hauler” remains unclear.

Supplemental Security Income (SSI)

SSI is a means-tested benefit programme available to low-income individuals who are disabled, blind or elderly and have limited income and few assets.

Medicare

Medicare benefits are available to all those 65 and older, provided only that they would be entitled to receive social security benefits if they chose to retire, whether or not they actually are retired; and to those under age 65 who have been receiving SSDI for at least two years.

Medicaid

Medicaid differs from Medicare in that it is run by state governments and is based on financial eligibility requirements rather than age.

Self-settled (first party) special needs trusts

Self-settled (first party) special needs trusts, sometimes called “d4A trusts”, are established by the beneficiary or someone acting on the beneficiary’s behalf, and the trust’s assets will be treated as established by the beneficiary. These trusts must include a payback provision directing the trustee, if the trust contains funds on the death of the beneficiary, to pay back anything

the state Medicaid programme has paid for the beneficiary in every state in which the beneficiary has received Medicaid services.

Third-party special needs trusts

Third-party special needs trusts are the types of trusts that clients can create for beneficiaries with special needs. The assets in these trusts are treated as though they do not belong to the individual with the disability, and therefore, if properly administered, do not affect the beneficiary’s eligibility for means-tested government benefits such as SSI and Medicaid. If an individual receives an inheritance outright from a well-meaning family member, the only trust that can be created is a self-settled special needs trust, not a third-party special needs trust, even though the funds came from a third party.

8.2 Appointment of a Guardian

In most states, the court appoints a guardian to make healthcare and other personal decisions for a ward and appoints a conservator to make financial decisions for the individual. These relationships are subject to court supervision and require, at the very least, an annual status report submitted by the guardian and/or conservator of the ward.

If a person is acting on behalf of another under a valid power of attorney, then such appointment and the acts performed on behalf of the individual pursuant to that power of attorney are not subject to court supervision.

8.3 Elder Law

It is fairly common to encounter children who are concerned with providing for their elderly parents in the event the parents survive the child. Thus, the class of beneficiaries in many estate documents may include not only the donor’s descendants, but also the donor’s parents and, possibly, siblings, so as to provide a source of funds which may be used to cover their medical

and living expenses. With people living longer, it is becoming more common to consider terminating trusts during the parents' lifetime so that assets can be distributed to the children. Additionally, with increased longevity, certain government benefit programmes are relied upon more, and perhaps for longer periods of time, than was previously the case.

Medicaid Eligibility

As an example, Medicaid is available to, among others, elderly individuals who meet certain health and financial eligibility requirements. These qualifying individuals can receive government assistance for nursing home care for as long as those eligibility requirements are met. Upon the Medicaid recipient's death, the state Medicaid programmes must recover from a Medicaid enrollee's estate the cost of certain benefits paid on behalf of the Medicaid recipient, including nursing facility services, home and community-based services, and related hospital and prescription drug services.

Medicare

Medicare is a federal health insurance programme for individuals 65 or older, and for which individuals generally pay privately.

Social Security Benefits

Social Security retirement benefits are offered at "full retirement age" which is between age 66 and 67 years. Individuals may, however, start receiving benefits as early as 62 or as late as 70. According to the Social Security Administration, "[m]ore than one in three 65-year-olds today will live to age 90, and more than one in seven will live to age 95." Social Security retirement benefits last as long as the individual lives, often outlasting an individual's savings and other sources of retirement income.

SECURE Act

Before the SECURE Act, which became effective in 2020, individuals with certain retirement plans, such as a 401(k) or IRA, were required to begin withdrawing minimum amounts each year after they turned 70.5 years. However, the Act increases that age to 72 for the simple reason that Americans are living and working longer beyond traditional retirement ages.

COVID-19 – CARES Act

The Coronavirus Aid, Relief and Economic Security (CARES) Act signed into law in March 2020 is an economic relief package designed to provide assistance to those affected by the COVID-19 pandemic.

CARES allows individuals having valid COVID-19-related reasons to take an early distribution from certain retirement plans of up to USD100,000 per person (not per account) without paying the 10% penalty on early withdrawal.

The CARES Act also suspended required minimum distributions for 2020.

9. PLANNING FOR NON-TRADITIONAL FAMILIES

9.1 Children

Children Born out of Wedlock

A child born out of wedlock has the right to inherit under intestate statutes from both parents. In 2018, the most recent statistics available from the Centers for Disease Control and Prevention showed that 39.6% of all births were to unmarried women. As childbirth out of wedlock is far from uncommon, the law is relatively well settled in this area; however, states vary in the proof they require to establish paternity. Generally, states require one of the following:

- a court order of paternity;

- a statement of paternity signed by the father;
or
- the father holding out to the public that he is the child's father.

Adopted Children

A significant number of state intestacy statutes include an adoptive child as a child of the adoptive parent for the purposes of intestate succession. For example, the adopted child is often seen as a child of the adoptive parents for all purposes of intestate succession, yet the adopted child no longer retains rights to inherit from their natural parents. Certain states do, however, permit the adopted child to inherit from their natural parents as well. In these state jurisdictions, the natural parents and natural relatives may not, however, inherit from the child they gave up for adoption.

Posthumously Conceived Children

The common law rule is that a posthumously conceived child cannot be a child of the decedent, but individual states have taken various approaches. *Woodward v Comr*, 760 NE2d 257 (2002) involved a surviving spouse and parent of a posthumously conceived child arguing for mother's and child's benefits under the Social Security Act. The question to the Massachusetts Supreme Judicial Court was whether posthumously conceived children enjoyed the inheritance rights of natural children under Massachusetts law of intestate succession. The court concluded that posthumously conceived children should be included in the term "children" under the intestacy statute if the following requirements are met:

- there is a genetic relationship between the child and the decedent;
- the surviving parent proves the decedent's affirmative consent to posthumous conception;

- the surviving parent proves the decedent's affirmative consent to support a child of posthumous conception; and
- prior notice of posthumous conception was given to all parties.

Some states have statutes on the issue of posthumously-conceived children. California, for example, has enacted a law which provides that the posthumously conceived child must show certain conditions are met in order to be treated as a child of the decedent, including that "the decedent, in writing, specifies that his/her genetic material shall be used for the posthumous conception of a child."

Surrogate Children

Surrogacy law is unsettled in the USA. Despite this uncertainty, it is not uncommon for a couple to contract with a surrogate to carry the couple's embryo in the surrogate's womb, creating two possible mothers, the genetic and the gestational.

In approximately one third of the states, legislatures have enacted statutes addressing surrogacy, the majority of which fall into one of three categories:

- the contracts are legislatively prohibited;
- there is a prohibition on traditional surrogacy in which the surrogate is the genetic mother; and
- both traditional and gestational surrogacy are authorised.

9.2 Same-Sex Marriage

Same-sex marriage is recognised in all 50 states. The first step towards marriage equality for same-sex couples came on 26 June 2013, when the Supreme Court of the USA ruled that the Defense of Marriage Act (DOMA), Section 3, defining marriage for federal law purposes as between a man and a woman, was unconstitu-

tional. *United States v Windsor*, 570 US 12, 133 S Ct 2675 (2013). Exactly two years later, the Supreme Court ruled that the US constitution provided that all states were required to validate same-sex marriages from other states and permit same-sex marriage within their own borders. *Obergefell v Hodges*, 135 S Ct 2584 (2015).

Planning options previously unavailable to same-sex couples are now available to these couples who choose to marry. These include, among others, gift splitting, marital deduction planning, joint income tax filing, tax-free gifts to each other, portability and surviving spouse status of an inherited IRA or ERISA-qualified plan.

10. CHARITABLE PLANNING

10.1 Charitable Giving

Subject to applicable limitations, current US tax law generally allows certain US taxpayers (ie, individuals, trusts, estates and corporations) to take a US federal income tax deduction for charitable contributions made to non-profit organisations exempt from US federal income taxation as organisations described in Section 501(c)(3) of the IRC (US Charitable Organizations or USCO). Deductions for charitable contributions made to USCOs are also allowed for US gift and estate tax purposes.

USCOs are most commonly classified as either public charities or private foundations. USCOs are typically classified as public charities based on the fact that they receive financial support from a broad base of donors or based on the nature of their activities (eg, a hospital, college or university, etc). USCOs are classified as private foundations when they receive too much support from one donor or a small group of donors and they are typically controlled by members of a family or a small group of individuals.

For federal income tax purposes, donors' contributions to public charities are deductible up to 60% of their adjusted gross income (AGI) for cash contributions and up to 30% of AGI for contributions of long-term capital gain property. Contributions to private foundations are deductible up to 30% of AGI for cash contributions and up to 20% of AGI for long-term capital gain property.

High net worth individuals and their tax advisers frequently engage in US federal income, gift and estate tax planning to derive the tax benefits offered by charitable contribution deductions while simultaneously achieving their charitable, benevolent and philanthropic goals.

10.2 Common Charitable Structures

Other than outright transfers of money or property to USCOs, structures utilised for US charitable planning commonly involve certain types of trusts, namely charitable lead trusts (CLT) and charitable remainder trusts (CRT). A pervasive type of CLT is a charitable lead annuity trust, which is designed to pay an annuity to a charitable beneficiary for a specified term of years and to pay out the remainder to a non-charitable beneficiary upon the expiration of the annuity term. A frequently utilised CRT is a charitable remainder annuity trust, which is a split-interest trust structured to hold assets for the benefit of non-charitable beneficiaries during their lifetimes by paying them an annuity, and to distribute the remaining assets to one or more USCOs upon the death of the last non-charitable beneficiary. These types of trust structures ultimately enable the grantor(s) to derive a tax benefit at the trust's creation, while permitting the non-charitable beneficiaries of the trust to retain a lifetime benefit from, or reversionary interest in, the trust's assets.

Contributed by: John Bunge, Aaron Flinn, Jill Mastroianni and Mike Yopp, Waller

Waller has more than 250 attorneys in three states, who assist clients in complex transactional, regulatory and litigation matters. The firm has a national reputation in healthcare and financial services and boasts robust practices in private equity and real estate. Waller was named one of the best law firms for women by www.workingmother.com and has received recognition as one of the USA's leading firms for recruiting, retaining and supporting legal tal-

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