PLANNING IN ADVANCE OF A LIQUIDITY EVENT

What to Consider and When

From an estate planning perspective, a liquidity event presents an opportunity to transfer an asset (such as stock) while the value is relatively low and thereby completely avoid estate and gift taxes on appreciation occurring after the transfer.

What to Consider.

There are several techniques that may make sense prior to a liquidity event.

- Simple Gifts. Transfer the asset into the name of the donee.
- Simple Gifts to Trusts. Transfer the asset into a simple irrevocable trust for the benefit of children or other beneficiaries.
- GRATs. Transfer the stock into a grantor retained annuity trust. This type of trust transfers only the appreciation after the date of transfer, and the taxable gift can be "zeroed out." This is a very powerful (and popular) gift and estate tax avoidance technique.
- Sale to Intentionally Defective Grantor Trust. Like the GRAT, this is a transfer of appreciation by means of an irrevocable trust. Unlike the GRAT, a small taxable gift is required at the outset. The benefit over a GRAT is that the gift can be made tax-free to grandchildren and lower generations. A GRAT is tax-free only to children.

There are some downsides to making these transfers:

- Legal Fees. For the trust techniques, an attorney will need to draft the documents. Depending on your attorney's fee schedule, the complexity of your situation, and the technique you employ, these costs can range anywhere from one or two thousand dollars up to tens of thousands of dollars.
- Income Tax Basis. Assets transferred by gift do not get a new, stepped up income tax basis unlike assets held at death.
- Living Needs. Assets transferred by gift generally become unavailable to the transferor. As a result, the amount to be transferred needs to be carefully considered.

When to Consider Planning.

The earlier the better. There are several reasons why earlier is better:

- Valuation. As an impending IPO or other event draws closer, the value of the stock will tend to increase and thereby reduce the effectiveness of the planning.
- Practical Considerations. Typically the client will become very busy as the transaction takes shape. The amount of time available for tax planning will fall sharply. Further, multiple steps may be required for a given technique.
- Cost. Rushed planning tends to cost more than planning that is not rushed.

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