Mo Money, Mo Problems:

Planning After the Liquidity Event

By John A. Garner and Michael Sneeringer

You just sold your business, sold a large block of stock, or sold a second home. You call your accountant or estate planning attorney and ask "how do I pay less tax"? Spoiler alert: we wish you would have called us months before the liquidity event.

There are still a few planning techniques in the estate planner's toolbox following a liquidity event. What are they? And are they appropriate for you?

Re-Invest Growth

Converting cash to marketable securities with the potential for future growth could then be used to gift to a Grantor Retained Annuity Trust ("GRAT"). GRATs pay an annuity to the trust creator for a terms of years with the hope that if the asset appreciates in the future, the GRAT will shift the value to descendent-beneficiaries via trusts. You could create a dynasty type trust for descendants as the vehicle to receive the excess of the GRAT, funding the GRAT with a portfolio of stocks and bonds that your financial advisor hopes will appreciate in the future.

Charitably Inclined?

A charitable lead annuity trust ("CLAT") is funded with a large one-time transfer where annual payments are made to a qualifying charity with the remainder being paid to named individuals at the termination of the trust. Upon creation of the CLAT, you would receive a charitable deduction for the present value of the annuity stream passing to charity which could offset some of your gain from the liquidity event.

Another idea is creating a private foundation. You could seed the private foundation with a large gift in year one in order to shield some of your newly created liquidity from taxation while establishing a vehicle for long-term family giving to charity.

An additional possibility is to establish a flip charitable remainder trust ("Flip-CRUT"). An inverse of the CLAT, a Flip-CRUT can be funded with a large one-time transfer but rather than making present distributions to a qualified charity, you (the donor) are the present beneficiary. Since a donor with other assets will not need distributions now, the "flip" feature allows the donor to delay distributions for a period of years or until a triggering event, such as retirement. Until the trust flips, the assets can remain invested. Once flipped, distributions will continue for the donor's lifetime. At the donor's death, the remainder goes to the qualified charity. Although present distributions start and may continue well into the future, the donor receives a charitable deduction in the year the Flip-CRUT is funded.

Estate Planning

If none of the income tax planning techniques appeal to you, estate tax planning should not be ignored. Use of the annual exclusion, using your exemption during your life, and relocating to a tax-favored state, like Florida, can reduce the estate tax bite at your death.

Do Nothing

Depending on your age, you might invest the liquidity now in a growth asset and hold that investment until death so that your beneficial heirs receive a stepped-up income tax basis in that asset upon your death. The thinking here is that your beneficiary can sell or liquidate the asset immediately following your death and have a minimal income tax gain to report on the sale.

Conclusion

At one or more points in your life, you may experience a significant liquidity event. Know your options, but next time consider calling us before the liquidity event.

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