# Planning for Liquidity Events

Willow Street

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For individuals holding illiquid assets or anticipating a liquidity event, pre-liquidity planning can greatly improve wealth transfer and tax outcomes. In this document, we review strategies and structures to consider when developing wealth transfer plans ahead of a liquidity event.

As with all wealth transfer planning, it is critical to begin the pre-liquidity planning process by clearly defining goals and identifying the objectives to be optimized. Some individuals may prioritize state income tax planning while others may optimize for transfer taxes by reducing the size of their estate and planning for future generations. Additionally, the grantor must consider elements including:

- The *situs* of the trust (the legal jurisdiction in which a trust is established or administered).
- Its *grantor* or *non-grantor status* for income tax purposes. A grantor trust is disregarded for income tax purposes and the grantor pays the income tax; a non-grantor trust is a separate taxpaying entity. There are benefits and drawbacks to each and individuals should consult with legal and tax advisors as to trust income taxation.
- If the gift will be *complete* or *incomplete*. In a completed gift trust, the grantor relinquishes use, ownership, and control over trust assets and the trust is excluded from their taxable estate.

Individuals should collaborate with advisors both to discuss the foregoing and to understand and model the financial implications of the trust structures outlined below.

### COMMON PRE-LIQUIDITY PLANNING GOALS

Prior to a liquidity event, individuals often design and implement trust structures to maximize one of the following desired outcomes:

- ***TRANSFER TAX PLANNING***: Individuals may choose to optimize estate, gift, and generation-skipping transfer tax (GST) tax planning with a bequest for future generations using a fiduciary structure that recognizes asset values at the time of transaction. In this case, individuals gift assets in advance, at pre-transaction discounted values. Settling the trust in a state with a long perpetuities period (e.g., 1,000 years in Wyoming) helps maximize the impact of the GST exemption and potentially minimize other transfer taxes.
- ***STATE TAX OPTIMIZATION***: Individuals residing in high-tax states may seek to maximize the after-tax proceeds of a liquidity event through state tax management. By settling non-grantor trusts in a desirable jurisdiction like Wyoming, individuals may manage state capital gains taxes at the time of the liquidity event and then optimize state income taxes as they deploy of cash proceeds into a post-event investment strategy.

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- ***LONGER-TERM CONTROL***: Individuals may desire to maintain increased involvement in their planning by building a fiduciary control structure with collaborative partners, including family members and trusted advisors (depending on their state of residence). A control structure is meant to provide a framework for managing and overseeing trust administration with care, accountability, and in the best interest of the beneficiaries. Wyoming permits directed trusts, a structure that helps individuals formalize and implement a post-liquidity investment plan while instructing who will be involved in the ongoing investment, administration, and eventual distribution processes for trust assets. Directed trusts allow for a division of the three trustee duties (administration, investment, and distribution) to different individuals or entities, offering families increased control and customization.
- ***QUALIFIED SMALL BUSINESS STOCK (QSBS) PLANNING***: Under IRC Section 1202, individuals may leverage QSBS eligibility for substantial tax efficiencies. Often referred to as "QSBS stacking," this strategy involves settling multiple non-grantor trusts either for the benefit of multiple family members or with distinct planning purposes. The trusts must be non-grantor, as the potential benefit is limited to $10M per taxpayer; non-grantor trusts are separate taxpaying entities. Note that the grantor must have legitimate reasons for setting up multiple trusts.

### COMMON PLANNING STRUCTURES AND OPPORTUNITIES

Many different fiduciary structures are available to help individuals achieve one or more of the goals outlined above. Most strategies rely on non-grantor trusts or completed gift trusts.

As discussed, individuals often opt to move pre-liquidity assets out of their estate and into a completed gift trust so that any future appreciation on those assets is excluded from their estate. A completed gift non-grantor trust — sometimes referred to as a *Wyoming dynasty trust* — may be a desired structure. Pre-liquidity assets are gifted to the trust via annual exclusion gifts, the unified gift and estate tax credit, or a combination of the two, and are often allocated generation skipping transfer tax (GST) exemption. Following the liquidity event, the trust is responsible for paying any income taxes, and as a Wyoming entity, is not generally liable for income taxes in the Grantor's home state. Assets are managed for the benefit of the Beneficiaries of the trust and are generally excluded from the estate tax regime for the lifetime of the trust (up to 1,000 years). The benefits of this structure are state-level income tax management, asset protection, and tax-efficient wealth transfer, especially when used in conjunction with the Wyoming Close LLC to maximize IRC § 2704(b) discounts. Wyoming dynasty trusts are ideal for portions of an individual's assets designated for multigenerational wealth transfer planning. The biggest downside to this structure is that the client may not benefit from or enjoy assets transferred to a Wyoming dynasty trust.

*Spousal lifetime access trusts (SLATs)* and *spousal lifetime access non-grantor trusts (SLANTs)* are Wyoming dynasty trusts that name the grantor's spouse as a beneficiary, which can be efficient structures for transfer tax, and, in the case of SLANTs, state income tax optimization. SLATs and SLANTs are often favored by individuals who desire the transfer tax benefits of completed gift trusts but are not ready to make gifts solely to future generations.

*Grantor retained annuity trusts (GRATs)* may be an attractive structure for individuals with a longer time horizon; they are typically established at least one year prior to an anticipated liquidity event. GRATs allow the grantor to transfer assets out of their estate while retaining an income stream from the trust for a specified period of time, typically two to 10 years. As these

annuity payments are typically a fixed percentage of the initial value of the assets transferred into the trust, GRATs are most often used when trust assets are publicly valued securities or larger-scale enterprises conducting periodic 409A valuations. GRATs offer potential upside from the success of a company after a transaction and minimize the downside risk in the event of underperformance. As GRATs are grantor trusts, they do not offer state income tax optimization and cannot be used for QSBS stacking; they are also not GST exempt because they typically do not involve the direct transfer of assets to skip persons.

*Incomplete gift non-grantor trusts (INGs)* allow an individual to capitalize on additional tax benefits above and beyond what is involved in the exemption, primarily used for income tax planning purposes. INGs are not permitted in all states, but most top trust jurisdictions allow for them; in Wyoming, they are referred to as "*WINGs*." Often structured as grantor trusts for income tax purposes, the grantor can pay income taxes on ING trust income, allowing trust assets to grow without being reduced by income taxes; this can be particularly useful if the liquidity event will result in a significant increase in income tax liability. By structuring the trust as an incomplete gift, the grantor retains certain rights or benefits, such as the ability to change beneficiaries or access trust assets in certain situations. A WING trust is a stand-alone tax entity and is not subject to taxation in the client's home state. As an incomplete gift, a WING trust does not constitute a completed gift for estate tax management and wealth transfer purposes.

While INGs focus on income tax planning, *intentionally defective grantor trusts (IDGTs)* focus on estate tax planning. IDGTs allow an individual to remove assets from their taxable estate, potentially reducing estate taxes. They can be structured to benefit future generations and may also offer asset protection benefits. Transferring assets to an IDGT may enable owners to move more wealth from a business tax-free than through direct gifts. In this strategy, the Grantor often sells assets to the IDGT in exchange for a promissory note, allowing the value of the assets to be fixed for estate tax purposes — any future appreciation of the assets, therefore, occurs outside of the estate. The Grantor pays taxes on the income generated by the trust, but the trust may reimburse the Grantor for capital gains taxes if the assets become liquid at a later point in time.

Finally, individuals who are philanthropically inclined may establish a *charitable lead or charitable remainder trust (CLT or CRT)*. Both structures provide for family and charitable beneficiaries in a tax-efficient way. CLTs are eligible for current income tax deductions, while CRTs provide annuities for life or an extended period of time.

### WYOMING SITUS

Trust situs refers to the legal jurisdiction in which a trust is established or administered; in the US, different states have varying laws and regulations that can impact a trust's management, taxation, administrative flexibility, and privacy.

Many families look to Wyoming as an attractive jurisdiction for wealth transfer planning and tax management, as Wyoming does not impose taxes on income, capital gains, estates, or gifts. While individuals often initially consider Wyoming as an attractive jurisdiction to manage tax exposure, they soon find that Wyoming entities offer enhanced wealth transfer benefits including long duration (1,000 year) trusts, directed trusts, and statutory decanting, which provides a way to reform or modernize the terms of an irrevocable trust. Further, Wyoming trusts are not required to register or report to any governmental entity in the state

and ownership of trust and LLC assets is not a matter of public record. All Wyoming trusts benefit from modern trust statutes and a highly responsive Banking Commissioner and legislature.

Individuals located outside of Wyoming may wish to use Wyoming non-grantor trusts to resitus assets into the state. Often, individuals will employ a Wyoming administrative trustee for a directed trust while maintaining existing investment and other advisory relationships.

### CONCLUSION

The planning themes and structures discussed here reflect what we have seen in our experience working with dozens of clients in anticipation of a liquidity event; this summary is not intended to be an exhaustive list of planning approaches. Pre-liquidity planning can be particularly complex and it is critical to consult with legal and tax advisors to design the wealth transfer plan that is most appropriate for an individual's goals. Legal counsel may suggest additional planning opportunities and structures not covered here. Please contact Willow Street for more information regarding the strategies discussed herein, trust administrative services, or general benefits of Wyoming planning.

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