

# Riding the Pre-IPO Wave to Estate Planning

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*This article was co-authored by Withers attorneys Genevieve Larson and Kelina Smith, who are based in our San Francisco office, and was published by The Recorder on May 9, 2019.*

The news has been highlighting the upcoming wave of initial public offerings (IPOs), and as these successful startups are preparing for their impending major liquidity event, there is tremendous buzz focused on how the market will be affected. However, because many startups begin their life cycle with a few founders, a small assembly of initial investors, and a pool of early employees that were likely compensated with equity rather than cash, it is also important to discuss how the interests of the individuals involved will be affected and how these individuals can take advantage of such an event to achieve their personal financial goals in a tax-efficient manner.

In order to illustrate some basic pre-IPO planning considerations, we will follow the example of a typical person whose interests will be dramatically affected by an IPO. Emily is an early employee at a startup that is about to “go public.” When she was hired a few years ago, her compensation was mainly comprised of restricted stock units (RSUs), most of which have vested. Up until now, she has not had liquidity, as she does not have any other major assets. As the company’s stock has been rising in value over the past few years, Emily has heard her colleagues talk about how they are engaging in various levels of planning, but Emily never thought she needed to do the same because she is young, not married (although she is in a long-term relationship) and does not have children. By planning ahead of the liquidity event, Emily can mitigate risks associated with her equity (i.e., income tax, estate and gift tax, and concerns regarding concentrated investments) and put herself in the best position for personal financial success.

Emily should first put together an advisory team, which includes, at a minimum, an accountant, who will make sure that proper tax elections and filings are made, a wealth planner, who can assess Emily’s economic situation and help her to establish her fiscal goals, and a trusts and estate attorney, to make sure an estate plan is in place and to engage in any advanced planning to achieve Emily’s goals. A good advisory team will help Emily to understand what she owns, the rules and restrictions related to such ownership (i.e., transfer restrictions and tax elections), and how she can achieve her fiscal goals. Emily will always need liquidity to maintain her lifestyle, but it is projected that she will have more than enough to meet her needs following the IPO, and she would like to provide for future children and engage in philanthropic endeavors. As Emily has never used any of her lifetime exemption amount (\$11.4 million in 2019), she will be able to take advantage of a multitude of estate planning opportunities.

Before exploring more advanced planning options, Emily should first ensure that she has adequate foundational estate planning documents, which provide for what happens to Emily’s stock (her main asset) in the event of her death or incapacity. Especially because Emily does not have a spouse or children, she should decide who will receive her stock upon her death, or she risks such stock being distributed in accordance with intestate succession laws, she should also decide on who should be in control of her financial and health care decisions in the event of her incapacity.

It is projected that, once the company goes public, Emily’s stock will dramatically increase in value, so it is a great opportunity for Emily to take advantage of removing such appreciation from her estate. Direct gifting of appreciated stock to beneficiaries is the simplest way to do this. Emily would need to use some of her lifetime exemption amount in order to make such gifts and if she is planning early enough, she can use the pre-IPO value of the stock. Any increase in value that would occur following the IPO would happen after the gift is made, when the stock is in the hands of the gift recipient.

Setting up a grantor retained annuity trust (GRAT), which is a common advanced planning technique with assets that will highly appreciate, would allow Emily to pass appreciation to future generations or other beneficiaries, free of gift and estate tax. She would contribute pre-IPO stock to the GRAT, the GRAT would make annuity payments back to her for a term, and any assets remaining in the GRAT at the end of the term (i.e., appreciation) would pass to a remainder trust for the benefit of Emily’s gifts recipients, which could include future children. Because Emily does not have children, it would be prudent for her to include others in the class of beneficiaries of the remainder trust, such as other relatives and charities, to account for the possibility that Emily does not later have children.

When employing various gifting strategies with pre- IPO stock, it is important to remain cognizant of the issues often associated with such assets, such as transfer restrictions that the company has put on such stock and any tax-preferred status of such stock (i.e., qualified small business stock). It is also essential that the advisory team is looking toward any post-IPO issues that could arise with regard to such stock, like any lock-up periods during which stock may not be transferred or sold or taxes that may be due.

It is easy to get caught in the wave and excitement of IPOs but such excitement should lead the individuals impacted to consider their personal financial hygiene and fiscal goals or face a financial wipe-out of opportunity.


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