NewEdge WEALTH

Onward: Navigating Your Wealth After an Entrepreneurial Exit

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"By failing to prepare, you are preparing to fail."

That quote above from Benjamin Franklin highlights the reality that taking the time to carefully plan and prepare will pay dividends down the road by increasing the chances of success and avoiding pitfalls.

Throughout our **Onward Series** at NewEdge Wealth, we have emphasized the critical importance of long-term planning when it comes to an entrepreneur selling their company. This focus on planning extends far beyond the logistical aspects of the sale itself; it involves careful mental preparation for the transition into post-sale life — a process that should ideally begin well before the actual sale occurs.

Just like meticulously crafting a business plan to guide the company's growth, it is essential to approach post-sale planning with the same level of intentionality and forethought. While the sale of a successful business represents a monumental personal and financial milestone for an entrepreneur, it also ushers in a new set of financial planning challenges to optimize and protect that newfound wealth.

It's easy to become enamored with the topline sale price, but it's crucial to understand that two offers with the same headline number can result in vastly different final proceeds after taxes and fees. Therefore, determining a target for the desired net proceeds and strategizing how to manage that wealth should be a key priority *before* the sale process begins, if possible.

This whitepaper outlines vital considerations entrepreneurs should make before an exit event, including:

- Addressing significant capital gains tax liability through tax-deferral strategies like earning interest pre-payment, utilizing qualified opportunity zones and Qualified Small Business Stock, and timing of the transaction. These are vital to maximizing net proceeds.
- Strategic estate planning using advanced tools like irrevocable trusts (i.e., IDGTs, GRATs, ILITs, dynasty trusts), leveraging valuation discounts, and gifting/charitable strategies which can substantially reduce the taxable estate exposure. The window for using these techniques to your advantage often disappears once the process of a transaction begins.
- Managing the transition of expenses previously handled through the business, including healthcare/Medicare, rolling over retirement accounts, reviewing life insurance needs, and establishing pass-through entities.
- Establishing a comprehensive "life after the business" plan aligned with the family's values by defining legacy goals, engaging the rising generation in financial education, and formalizing family governance.

Open and ongoing communication with professional advisors specializing in working with ultra high net worth entrepreneurs is key to ensuring there can be a lasting wealth transition and that all the appropriate legacy planning, tax optimization, and wealth preservation strategies are in place before the sale process even begins.

Addressing Capital Gains Tax

The eventual sale represents a monumental liquidity event for entrepreneurs who have built and nurtured a company over many years. However, it also may trigger significant capital gains tax implications that demand careful planning and strategy.

Assuming the business was held for more than a year before the sale, any realized profits are considered long-term capital gains. While benefiting from preferential tax rates compared to ordinary income, these rates can still be substantial depending on your income level. Additionally, certain high-income entrepreneurs may be subject to the 3.8% net investment income tax (NIIT) on a portion of their capital gains. Specifically, the 3.8% NIIT applies if your net investment income for the tax year exceeds $200,000 for single/head of household filers or $250,000 for married filing jointly.

The taxable gain from the sale of a company is calculated as the final sale price minus the total capital invested in starting and operating the business over its lifetime. For most founders who have held their companies for decades, this results in a very low basis relative to the lucrative sale price, translating to a considerable capital gain exposure.

While fully avoiding capital gains taxes is challenging unless a portion of proceeds is donated to charity, there are strategies to defer or maximize the timing of this tax liability:

Earn Interest on the Capital Gains Amount Before Payment

Work with a CPA to project the estimated capital gain amount. Then, invest this sum in conservative, interest-bearing vehicles like Treasury bills until taxes are due (e.g., April 15th following the sale year if sold earlier that year). For example, if the proceeds from the sale of a company are received in the month of May, taxes on those proceeds may not be due until April 15th of the following year at the earliest. With 1-year Treasury Bills (as of June 2024) yielding approximately 5.19%, there is an opportunity to, at the very least, earn some interest on the funds before having to submit payment on the gains.

Utilize a Qualified Opportunity Zone (QOZ)

For entrepreneurs who don't require immediate liquidity from the total sale proceeds of their company, investing the capital gains portion into a Qualified Opportunity Zone can provide significant tax advantages.

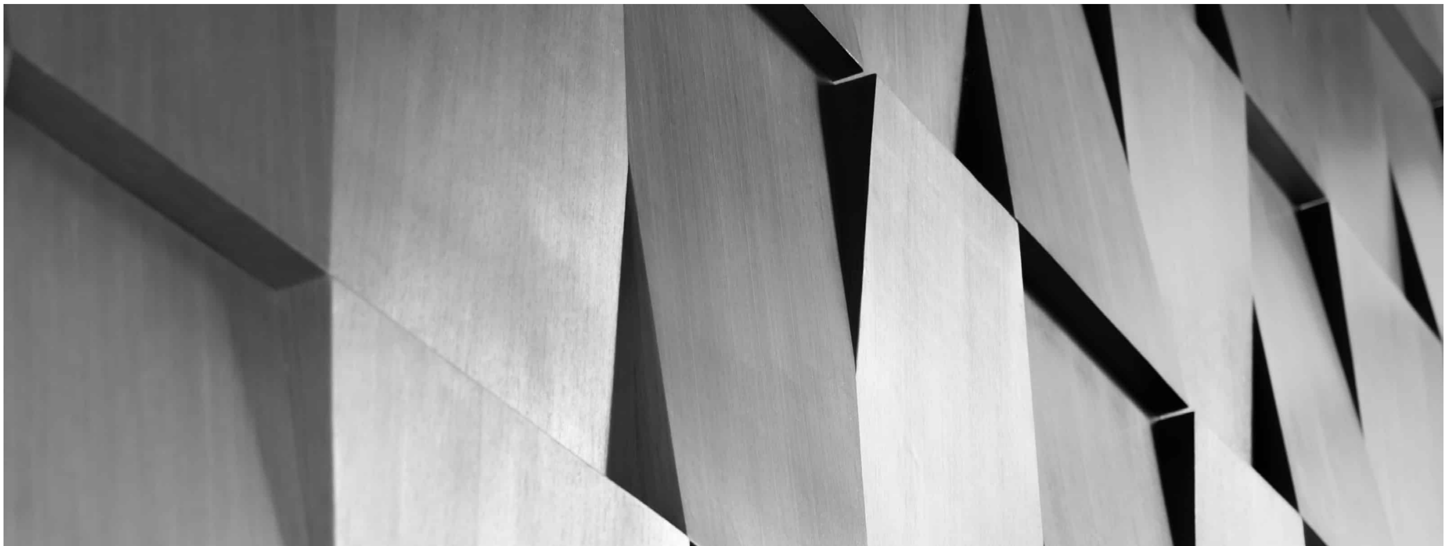
The QOZ program, enacted in 2017 under the Tax Cuts and Jobs Act, incentivizes investments into designated low-income urban and rural communities through tax benefits. By investing prior capital gains into a Qualified Opportunity Fund (QOF) that deploys capital into QOZ properties or businesses, investors can:

- Temporarily defer paying any capital gains tax on the original investment until December 31, 2026, at the earliest, or until the QOF holding is sold, whichever comes first.
- Reduce the taxable portion of the original gains by 10% if the QOF is held for five years and 15% if held for seven years.
- Potentially eliminate capital gains taxes entirely on any appreciation from the QOF investment itself after holding for at least ten years.

Under the current tax code, this program is set to expire on December 31, 2026, so entrepreneurs completing an exit now would only be able to defer capital gains payments until the end of 2026 and would not meet the 5-year holding period to achieve the 10% reduction. However, pending legislation in Congress, the Opportunity Zones Transparency, Extension, and Improvement Act - H.R. 5761, aims to extend the temporary deferral period through 2028. Given that there is already movement in extending the deadline now, there is the potential for future legislation that would further extend in order to hit the 5, 7, or 10-year holding periods.

For entrepreneurs facing a substantial capital gain from an exit event, the ability to defer taxes and eliminate future appreciation from being taxed provides a powerful wealth preservation strategy — if the proper holding periods are adhered to.

It's important to note that QOZ investments carry their own risks beyond tax implications. Careful vetting of QOFs and close guidance from tax and investment advisors experienced with QOZs is critical to maximize the benefits while mitigating potential downsides.



Utilizing Qualified Small Business Stock (QSBS)

The Qualified Small Business Stock (QSBS) income exclusion, also called the 1202 exclusion due to its tax code section, allows startup founders and their investors to exclude the greater of $10 million in long-term capital gains or 10 times basis, provided the shareholder meets certain requirements:

- The company is an active business and not an excluded business type.
- 1202 stock is issued by a domestic C Corporation after August 10, 1993, and the investor must acquire the 1202 stock directly from the C Corporation ("original issuance").
- Gross assets must not exceed $50 million before or immediately after the 1202 stock is issued.
- The holding period is greater than or equal to five years. If a QSBS is sold prior to the 5-year period, it may still be able to benefit if the proceeds are invested in a new qualifying QSBS within 60 days.

QSBS shareholders can be individuals, trusts which pay their own taxes (non-grantor trusts), partnerships, or S corporations, but not other C corporations. QSBS stock can be transferred at death or gifted to individuals or into trusts without voiding the "original issuance" requirement. When received as a gift, the recipient's holding period (and basis) tacks onto the original basis and holding period of the original QSBS stock owner.

To maximize the tax-free gains that can be realized under the QSBS exclusion rules, there is a strategy called "QSBS Stacking" which refers to the strategy of gifting or transferring QSBS shares to an irrevocable non-grantor trust, which acts as its own taxpayer and enables the trust to qualify for its own QSBS tax exclusion. An example would be any irrevocable Trust which pays its own taxes and benefits others. By stacking investments across multiple qualifying entities (individual, trust, etc.), investors can effectively multiply the $10 million exclusion limit. However, it's crucial to carefully follow the QSBS rules, including the holding period requirements, working investment amounts into each company's $50 million asset test, and avoiding redemptions or hedging transactions that could disqualify the QSBS treatment. Additionally, state-specific rules may differ, so consulting with tax professionals is advisable when implementing this strategy. Proper documentation and adherence to the complex QSBS provisions are essential to maximize the tax benefits successfully.

Managing the Impact of the Sale on Your Estate Plan

Strategic estate planning becomes paramount for entrepreneurs on the verge of a transformative liquidity event like the sale of their business. The proceeds from such a transaction represent the culmination of years of hard work and sacrifice and could set the stage for a multi-generational legacy. However, for this to occur, there needs to be some planning before a liquidity event to minimize this liability and ensure assets are passed on efficiently to the beneficiaries of their estate down the road rather than being eroded by estate taxes upon passing.

Understanding Current Estate Tax Rates and Exemptions

Entrepreneurs must carefully consider federal and state estate tax regulations when developing a comprehensive plan to protect assets after a liquidity event. At the federal level, the estate tax currently imposes a flat 40% rate on the portion of a deceased person's estate that exceeds the prevailing exemption amount. As of 2024, this exemption stands at $13.61 million per individual. However, this exemption level is only temporary under current laws. The Tax Cuts and Jobs Act of 2017 substantially increased the exemption from its prior $5.49 million level, but this enhancement is set to expire at the end of 2025. Without new legislation, the exemption will revert to pre-2018 levels on January 1, 2026, adjusted for inflation. This impending reduction in the exemption could have significant consequences for entrepreneurs who delay estate planning after a liquidity event.

In addition to navigating the federal estate tax system, entrepreneurs must also consider their state of residence's estate and inheritance tax policies. While there is no federal inheritance tax, some states impose separate inheritance taxes on amounts received by certain beneficiaries.

Understanding the interplay between federal and state estate taxes is crucial for entrepreneurs facing a liquidity event. Entrepreneurs can achieve substantial tax savings by structuring asset transfers and developing strategies to maximize available exemptions. With careful planning and professional guidance, entrepreneurs can proactively minimize estate taxes and preserve more of their hard-earned wealth for their intended beneficiaries and philanthropic endeavors.

The Power of Irrevocable Trusts

At its essence, effective estate planning strives to minimize the value of assets subject to estate tax. Individuals can sidestep the hefty 40% federal tax (plus potential state taxes) by successfully transferring assets out of their estate. Taking proactive measures to shrink the size of a taxable estate becomes imperative, especially when anticipating a significant liquidity event such as an entrepreneur's sale of a business, which usually comes with a very low-cost basis.

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Irrevocable trusts emerge as a vital tool in achieving this objective of reducing taxable estates. As the name suggests, these trusts permanently remove assets from one's estate and control. While relinquishing future control is a trade-off, the assets now reside outside the taxable estate, and any future appreciation occurs beyond the estate's purview.

Here are several pivotal ways in which an entrepreneur with ownership in a private company can leverage irrevocable trusts to diminish the size of their taxable estate:

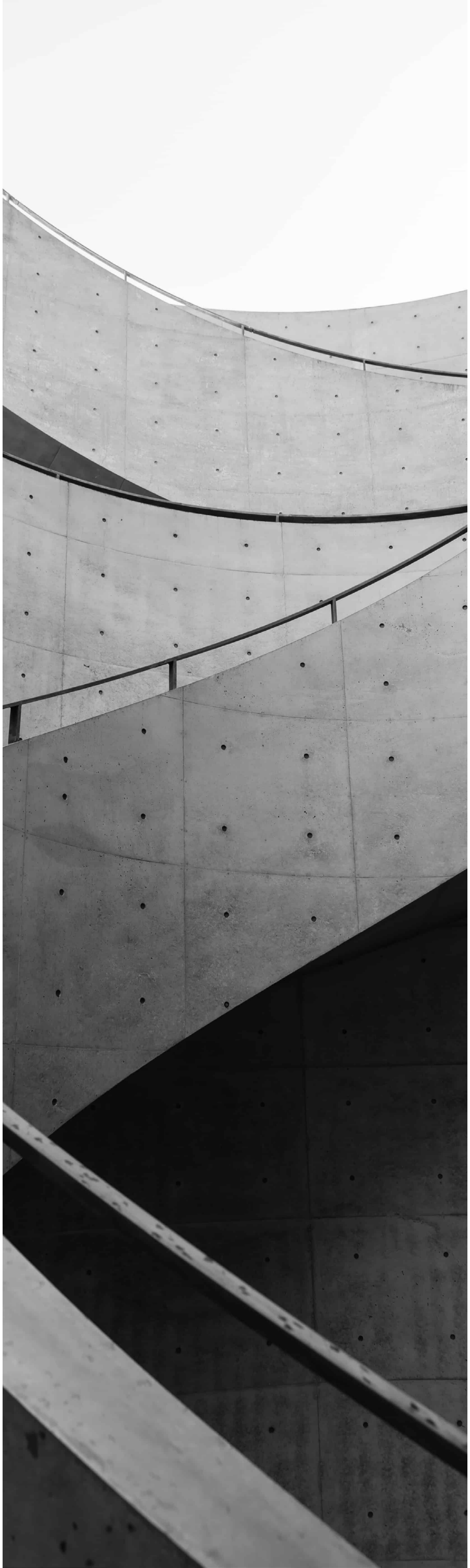
1. **Transfer Ownership Interests to an Intentionally Defective Grantor Trust (IDGT):** An IDGT allows the entrepreneur to transfer appreciated ownership interests in their company out of their taxable estate while still paying income taxes on the trust's earnings. This allows the transferred assets to grow unencumbered by income taxes outside the estate.

2. **Utilize a Grantor Retained Annuity Trust (GRAT):** With a GRAT, the entrepreneur transfers company ownership to the trust but retains an annuity payment for a set term (e.g., 2-5 years). Any appreciation above the annuity amount passes to the beneficiaries of the GRAT without gift or estate tax implications at the end of the term.

3. **Create an Irrevocable Life Insurance Trust (ILIT):** An ILIT is designed to own and control life insurance policies. The entrepreneur can transfer the company's ownership interests to the ILIT to facilitate purchasing life insurance. Upon their passing, insurance proceeds flow to beneficiaries' estates tax-free.

4. **Establish a Dynasty Trust:** For the ultimate multi-generational asset protection, a dynasty trust can hold ownership interests and appreciated assets for beneficiaries across several generations while avoiding transfer taxes.

5. **Take Advantage of Valuation Discounts:** Ownership interests transferred to an irrevocable trust can potentially qualify for valuation discounts by being minority interests in a privately held business, thus transferring more value out of the taxable estate.



The key advantage of using these irrevocable trust strategies is removing highly appreciating company ownership from the entrepreneur's taxable estate before a significant liquidity event like an exit or sale. Careful planning and consultations with a financial advisor, tax experts, and estate attorneys are required to understand use, tax, and distribution implications.

Leveraging Gifts and Charitable Strategies to Shrink the Taxable Estate

For entrepreneurs and owners of privately held companies with significant personal wealth tied up in the value of a successful business, strategic gifting and charitable planning represent powerful tools for reducing estate tax exposure. Owners can use the annual gift tax exclusion to gift portions of their company ownership or other assets up to the annual federal gift tax exclusion amount ($17,000 per recipient in 2024) without incurring gift taxes. Over time, this can transfer significant wealth out of the estate.

There are several approaches to using gifting and charitable strategies to shrink the size of a taxable estate:

1. **Donor Advised Funds (DAFs):** Funding a DAF with privately held company interests or a portion of sale proceeds allows for an immediate tax deduction while providing ongoing charitable grant-making capabilities.
2. **Charitable Lead Trusts (CLTs):** CLTs pay annual amounts to charities for a set term, after which remaining assets pass to heirs with reduced/eliminated gift taxes.
3. **Private Foundations:** Establishing a private foundation and transferring company interests allows for perpetual family philanthropic involvement while providing estate tax benefits.
4. **Charitable Remainder Trusts (CRTs):** Assets are transferred to a CRT, which provides income for life or a term to the donor(s) before the remainder passes to designated charities. Additionally, CRTs can be used for deferral of business sale income. If a business is sold inside a CRT, this could result in a deferral of capital gain income on the sale of the business.
5. **Gifting of Appreciated Interests:** Directly gifting privately held company interests to qualified charities avoids capital gains taxes on the appreciation.

Careful coordination between legal, tax, and charitable advisors is essential to implement these strategies to ensure that IRS rules are followed and full tax benefits are realized. However, when leveraged appropriately, gifting and charitable planning strategies allow business owners to reduce their taxable estates while supporting their legacies.

Managing Expenses After a Business Sale

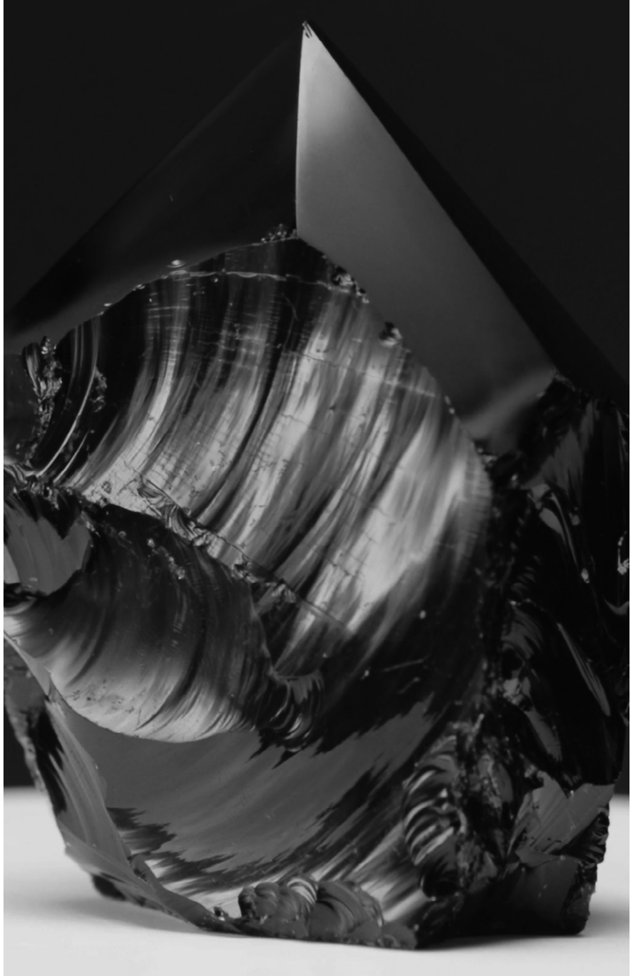
For entrepreneurs, strategically using their private company to defray various expenses offers significant tax advantages and financial efficiencies. A wide range of costs, including health insurance premiums, retirement contributions, home office expenses, vehicle expenses, travel expenses, and professional services from attorneys, accountants, consultants, and other business-related advisors, can potentially be handled through the company's operations. This approach not only streamlines the management of these expenses but also unlocks valuable tax deductions and savings.

However, this advantageous situation is inherently tied to the ongoing operation of the business itself. Upon the sale or exit from the private company, these tax-planning opportunities may dissipate, as the expenses can no longer be funneled through the business entity. Instead, they are transitioned into direct personal living expenses for the entrepreneur, potentially resulting in a higher overall tax burden and reduced cash flow efficiency.

Consequently, as entrepreneurs approach a liquidity event, such as the sale of their company, it becomes imperative to carefully evaluate and plan for the management and funding of expenses in the post-exit phase. Proactive strategies may include:

- **Establishing a Family Office or Investment Partnerships:** These pass-through entities can continue facilitating tax-advantaged expense handling. By meeting specific requirements, family members can be hired as employees, granting them access to health insurance and other benefits akin to those provided by the business.

By anticipating and addressing this transition early, entrepreneurs can seamlessly adapt to their post-exit financial landscape, preserving the hard-earned wealth generted through their business endeavors while maintaining access to necessary services and resources.



- **Investigating Medicare Eligibility:** For entrepreneurs over 65 approaching the sale of their private company, Medicare eligibility and planning become vital in managing post-exit healthcare costs. At age 65, entrepreneurs may become eligible for Medicare coverage, provided they've paid Medicare taxes for at least ten years. This federal health insurance program can replace employer-sponsored or private health plans post-exit but requires careful timing of enrollment, estimating premiums and supplemental costs, and planning for long-term care.

- **Rolling Over a 401(k):** When business owners sell their privately held company, it's crucial to consider the fate of existing 401(k) or other qualified retirement plan accounts established through the business. A common path is to roll over the balance into an Individual Retirement Account (IRA), maintaining the tax-advantaged status of the funds while gaining flexibility and investment options. Alternatively, if planning to operate a new business post-exit, entrepreneurs could consider a new Solo or Individual 401(k) plan and roll over funds accordingly.

- **Reviewing Your Life Insurance Coverage:** While entrepreneurs may already possess life insurance policies tied to their company's buy-sell agreement or key-man provisions, enhancing coverage with policies tailored to benefit their families and tackling potential estate tax liabilities head-on is imperative. Permanent life insurance policies, such as whole life or universal life, offer a tax-free death benefit to beneficiaries, providing essential liquidity and income replacement. In scenarios where the entrepreneur's estate confronts a significant tax burden upon their passing, a strategic life insurance solution like a "second-to-die" or survivorship policy can effectively alleviate this liability. Crafted to align with projected estate tax exposure, these plans furnish beneficiaries with the necessary liquidity to settle outstanding taxes, eliminating the need to liquidate valuable assets prematurely.

By anticipating and addressing this transition early, entrepreneurs can seamlessly adapt to their post-exit financial landscape, preserving the hard-earned wealth generated through their business endeavors while maintaining access to necessary services and resources.

Establishing a "Life After the Business" Plan with Family

As business owners approach a transformative transaction, ensuring the entire family understands the profound impact this will have on their lives is paramount. This pivotal moment presents an invaluable opportunity to define or redefine the family's lasting legacy goals. This vision can encompass making an enduring impact through strategic philanthropy, fostering financial education across generations, aligning investments with cherished values, and more. Openly discussing these aspirations is crucial for unifying the family around a shared purpose.

In developing a comprehensive "life-after" strategy, several key considerations should be carefully evaluated:

- **Living for Today:** Conduct a thorough assessment of current and projected future expenses in the post-transaction landscape. The expense assessment must include not only managing day-to-day expenditures but also accounting for potential shifts as certain costs like vehicles, travel, and healthcare may no longer be channeled through the business entity. Additionally, new priorities may emerge, such as fulfilling travel aspirations, acquiring a second home, or pursuing other significant acquisitions. These decisions will directly influence the investment strategy to ensure adequate cash flow to sustain the desired lifestyle.

- **Planning for Tomorrow:** A liquidity event of this magnitude warrants a comprehensive review and update of estate planning documents, including wills, trusts, powers of attorney, and beneficiary designations. This ensures that these critical instruments accurately reflect your current wishes and align with the new stage of life following the business transition.

- **Engaging the Next Generation:** If you have children or grandchildren, leverage this transition as an opportune moment to initiate their financial education. Involve them in discussions surrounding financial responsibility, investment principles, philanthropic planning, and other key wealth management concepts. Early exposure and involvement can foster a strong foundation for preserving and growing the family's wealth across generations.

- **Formalizing Family Governance:** Establishing formal governance structures can provide invaluable guidance and oversight for families with substantial liquid assets. This may include creating a family office, codifying investment policies, crafting philanthropic mission statements, and implementing decision-making frameworks. Such formalized processes ensure a cohesive approach to managing and perpetuating the family's wealth.

By seizing this business exit as a catalyst, families can comprehensively organize their new financial reality, intentionally prepare the rising generation, and effectively translate their hard-earned wealth into a values-driven, multi-generational legacy. Careful planning and open communication during this transition are paramount to ensuring the family's purposeful and impactful future.

How NewEdge Wealth Can Help

This report has covered several important considerations for entrepreneurs approaching the sale of their business. It highlights the crucial need for proactive planning and preparation to effectively manage the newfound wealth resulting from a liquidity event and establish a lasting legacy, including:

1. Addressing capital gains taxes and strategies to defer or minimize this liability, such as utilizing qualified opportunity zones and Qualified Small Business Stock.

2. Managing the impact of the sale on the entrepreneur's estate plan, understanding estate tax rates and exemptions, and leveraging irrevocable trusts to reduce the taxable estate.

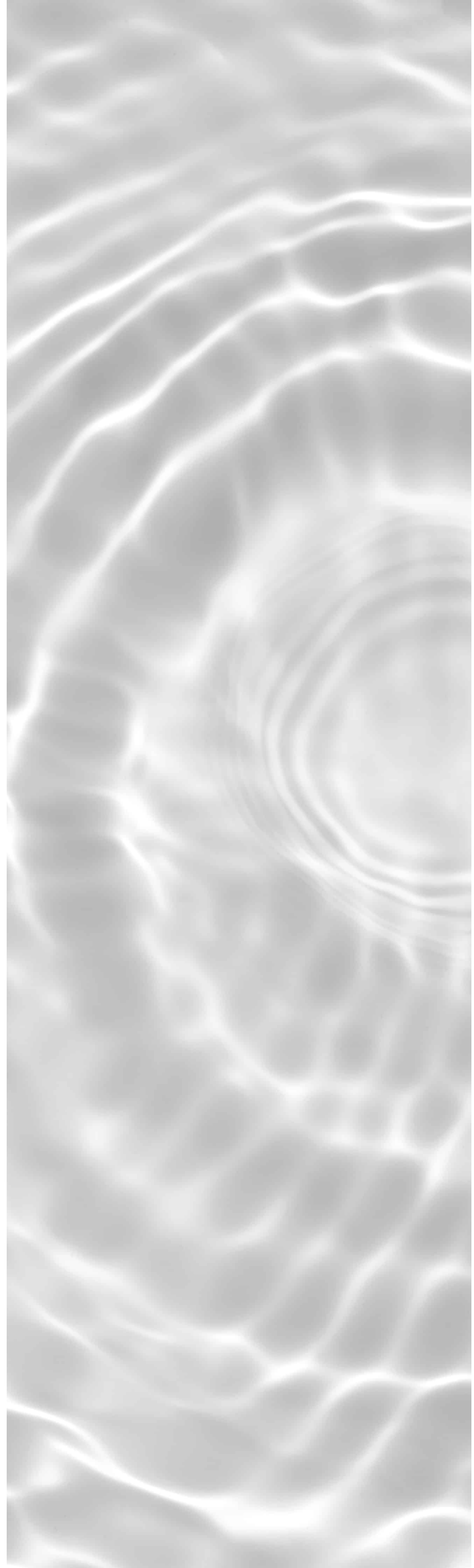
3. Leveraging gifting and charitable strategies, like donor-advised funds and private foundations, to shrink the taxable estate while supporting philanthropic goals.

4. Planning for the transition of expenses previously handled through the business, including healthcare, retirement accounts, and life insurance needs.

5. Establishing a comprehensive "life after the business" plan with the family, redefining legacy goals, engaging the next generation, and formalizing family governance structures.

The overarching message emphasizes the importance of intentional planning and open communication with professional advisors and family members to ensure a seamless transition into post-sale life, preserve wealth for future generations, and translate financial success into a purposeful, values-driven legacy.

NewEdge Wealth specializes in working with ultra high net worth families and entrepreneurs and has guided many clients through this process. Our expertise lies not only in managing wealth but also in helping clients utilize their wealth to establish a lasting legacy aligned with their values and goals. By offering comprehensive strategies and advice across various domains, such as estate planning, tax optimization, philanthropy, and family governance, NewEdge Wealth can assist entrepreneurs in navigating the complexities of a liquidity event and translating their financial success into a multi-generational impact.



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