ASPIRIANT

Living the dream.

Four steps to turning your sweat equity into enduring wealth.

Entrepreneurs spend much of their lives transforming a vision into a thriving business. Most will get only one opportunity to turn the equity they've created into wealth. It doesn't matter if your company is going through a merger or acquisition, bringing in outside capital through an equity or debt recapitalization, or going public through an IPO these liquidity events can change the financial trajectory of your life.

Liquidity events can be transformative for entrepreneurs, but going through the process of trying to fully capitalize on the opportunities can also be overwhelming. In addition to continuing to focus on running the business, entrepreneurs preparing for a liquidity event must now start thinking about issues such as taxes, estate planning, portfolio diversification, and risk management.

At Aspiriant, we have helped numerous business founders and executives prepare for liquidity events and use the wealth to achieve their personal goals and dreams. From pre-transaction meetings to map out a vision for their financial lives to implementing the plan after the transaction has been completed, we are passionate about guiding entrepreneurs through each step of the process.

While each situation is unique, we've identified four actions all leaders can take to help transform their sustained investment of passion and energy into personal wealth:

1. Plan early. Think holistically.
2. Build your team of experts.
3. Get smart about taxes.
4. Orchestrate and implement your long-term plan.

1. Plan early. Think holistically.

Planning is essential to success. The earlier you start, the more control you'll have.

With liquidity events, as with most things in business and in life, planning is essential to success, and time is your most valuable asset. The earlier you begin thinking about what you would like your life to look like after the transaction and what you want to accomplish with the wealth, the more flexibility and control you will have in shaping the events before and after the transaction.

It is important to realize that finances are just one aspect of the equation when it comes to planning for a transaction. A liquidity event is a major life event and managing the emotional and psychological aspects of this transition is just as important as minimizing the tax impact and maximizing your return on investment.

As you begin planning for a transaction, a wide range of questions will arise. It is especially important to answer these specific questions:

What are my core values and priorities?

Along with new opportunities, a large infusion of liquid wealth creates a new set of pressures and challenges for entrepreneurs. Identifying your values and priorities before the wealth arrives can be extremely helpful in managing these challenges.

For some people, their top priorities might be financial security and passing wealth to children, grandchildren, and beyond. Others might prioritize using the wealth to improve society through philanthropy or to start another company. And others might retire early and spend as much time as possible traveling and visiting with friends and family. For many people, their list may include all of these things.

There are no right or wrong answers to these questions, and, in fact, your priorities might change as you get closer to the transaction. But taking inventory of your values and priorities is a vital first step in providing a high-level roadmap for your wealth management plan.

Managing the emotional aspects of new wealth is just as important as minimizing the tax impact.

What do I want my career to look like after the transaction?

One of the most over-looked aspects of planning for a liquidity event is thinking about what you want your career to look like after the transaction. Entrepreneurs who sell their companies often go from being totally immersed in running the company to being on the sidelines or having a significantly diminished role. The transition from owner/executive to former-owner/executive can be extremely challenging from a psychological standpoint. This is especially true for entrepreneurs who are relatively young and not ready to retire when the liquidity event occurs.

In many cases, there will be opportunities for the entrepreneur to remain very involved in the company as part of the management team or the board of directors. In fact, the buyer may require the existing management team to stay on for a certain number of years as part of the purchase agreement. In other cases, the new owners will want to bring in their own management team and prohibit the entrepreneur from working in a related industry for a set number of years. The spectrum of possible scenarios is quite broad, so it is important for you to think about what you want to do with your career before heading into the negotiations. If your goal is to retire once the transaction is completed, you need to think about what you will do with your newfound time.

What specific goals do I want to achieve?

Once you have identified your priorities, both in terms of your wealth and your career, you can start identifying the specific actions that will help you achieve your higher-level goals. For example, if your goal is to travel more, how many trips do you want to go on each year and what type of trips do you want to take? Or, do you want to purchase a vacation home or a boat? If your goal is to support your children and grandchildren, how much support do you want to provide? Do you want to provide money for the down payment of a home or the entire purchase price? If you want to fund grandchildren's college educations, does this mean tuition for public schools or private schools? And if you have philanthropic goals, what percentage of your wealth do you want to give and how many different charities do you want to support?

You don't need to have every detail mapped out ahead of time. But the process of thinking through these questions will help you create a clearer picture of how to best use your wealth. Also, it may be helpful to put your goals into two categories: "core" and "stretch." Core goals are ones that you definitely want to accomplish, and stretch goals are ones that you want to achieve with any wealth that remains after the core goals are achieved.

How much do I need to fund those goals?

Once you have identified your goals, you can work with your wealth manager to actually put a price tag on that vision. Doing so will allow you to know how much after-tax wealth you need to accomplish your goals. Knowing this number can be extremely helpful in planning for and managing a liquidity event. It can inform your decision during negotiations about what valuation is acceptable for you, and it can help you think about what you would be able to achieve under a range of valuation outcomes.

Conversely, not knowing "your number" can leave you in a holding pattern when it comes to wealth planning and pulling the trigger on a transaction. We have found that the process of quantifying your goals is extremely powerful in helping entrepreneurs think strategically about their options.

Are there any tax benefits that can be achieved by acting now?

As we will discuss in greater detail below, a critical part of the planning process is understanding how much wealth the transaction will generate after taxes have been paid. While the nominal amount of the transaction is what many people focus on, the entrepreneur's after-tax proceeds are much more important from a wealth management perspective.

For many entrepreneurs, the most tax-efficient way to achieve their goals involves taking steps six months or more before the transaction is completed (though much can be done later even after the event has occured). This is particularly true when the entrepreneur is focused on transferring wealth to younger generations. Because the value of the owner's shares typically increases upon the completion of the transaction, transferring shares to a trust or using other gifting techniques before the transaction can significantly increase the amount of wealth that can be transferred without incurring gift or estate tax. For executives who have received stock options, there may be opportunities to reduce the taxes on the eventual sale of the stock by exercising the options before the transaction.

It is crucial to have a team of professionals who can support you throughout the process.

2. Build your team of experts.

Planning for a liquidity event is a multifaceted process and many of the steps involve highly technical questions related to taxes, cash flow projections, securities laws, trusts and estates, and other financial planning topics. It is crucial to have a team of professionals who can guide you through these questions and help you focus on the right things.

Some firms use a "financial quaterback" model where the advisor coordinates and works with all the other advisors on your financial team, even if they are external. Some firms have all members of an essential team in house.

At a minimum, *your* wealth management team should comprise the following types of professionals:

Wealth manager

In many cases, your wealth manager will serve as the "quarterback" of the team, working with you through every step of the process and focusing on how all of the different pieces fit together. In addition to helping you identify and quantify your goals, the wealth manager will develop the high-level plan for achieving those goals, construct a diversified investment portfolio, and work with the other specialists to determine the best strategies for executing the plan.

Estate planning attorney

Most high net-worth individuals will use trusts, wills, gifts, and other estate planning techniques to accomplish their wealth-transfer and philanthropic goals in a tax-efficient manner. In addition to minimizing taxes, estate planning is essential to ensure that assets pass to your heirs according to your wishes and are protected from creditors to the greatest extent possible. Each state has different laws related to wealth transfer, so it is important to work with an attorney who is experienced working with business owners in your state.

Tax advisor

Valuing the company's shares, analyzing the tax implications of the transaction, and understanding the tax laws related to any potential investment strategies are among the most critical elements of liquidity planning. An accountant or other tax professional will work with your other advisors to make these assessments.

Because each of these advisors brings a different perspective to the issues you are facing, having your team in place well before you begin the transaction process can be very helpful. Beyond this core group, your team may also include advisors who specialize in areas such as risk management, sales of public equity by corporate insiders, philanthropy, and working with younger generations. When evaluating potential advisors for your team, it is important to look for professionals who have experience working with entrepreneurs and executing planning related to liquidity events.

Timely planning can keep the tax man away from your hard-earned rewards.

3. Get smart about taxes

To say that taxes have a major impact on the ultimate amount of wealth generated by a liquidity event is an understatement. High net-worth individuals may be subject to multiple layers of taxation, and each level can take a significant bite out of the total pie.

In planning for a liquidity event, a critical step is working with your tax advisors to understand whether the proceeds will be taxed as ordinary income or as long-term capital gains. At the federal level, the top marginal rate on ordinary income is 39.6% And at the state level, rates can be as high as California's 13.3%. Long-term capital gains, which are gains on assets held more than one year, reach 23.8% when you include the surtax that is part of the Affordable Care Act.

Money that is passed to heirs may be subject to an additional layer of taxation via the estate tax, which applies to transfers made at the donor's death, or gift tax, which applies to transfers made while the donor is still alive. At the federal level, the first $5.49 million per individual or $10.98 million per married couple of an estate or gift is exempt from taxation, but every dollar above that is taxed at 40%. Many states impose wealth-transfer taxes, as well.

There are many strategies that entrepreneurs can use to reduce the tax impact of liquidity events and increase the amount of wealth that they and their families get to keep:

Creating a trust with your children and other heirs as the beneficiaries can be a tax-efficient way to transfer assets.

Transferring wealth to younger generations

If you own shares of a company or other assets that you think will appreciate in value, transferring some of your ownership in your company before any transcation to a trust with your children, grandchildren, or other heirs as the beneficiaries can be an effective way to transfer the assets in a tax-efficient manner. Using trusts can also protect the assets from creditors and give you some control over how the assets are used by your heirs. Some of the most common trusts used by entrepreneurs include: grantor retained annuity trusts, intentionally defective grantor trusts, and dynasty trusts.

Contributing to charities

Liquidity events create powerful opportunities to support causes that matter to you. Liquidity events also create significant tax bills in the year of the transaction. Charitable gifts, in addition to making a difference in your community, can also be an effective way to lower your income tax bill. There are several charitable gifting strategies, including donor-advised funds, charitable remainder trusts, charitable lead trusts and private foundations.

Selling company stock

Many executives of startups and other high-growth companies receive a significant portion of their compensation in the form of stock options or restricted stock units (RSUs). If you have received these forms of compensation, it is important to understand the tax consequences and the rules related to vesting. There are techniques worth considering to increase the portion of this income that is treated as long-term capital gains rather than ordinary income. With obstacles such as lock-up periods, SEC rules and company restrictions, it is especially important for executives of companies that are already public or considering an IPO to work closely with their wealth and tax advisors to develop a plan for managing stock

4. Orchestrate and implement your long-term plan.

While many of the most critical elements of liquidity planning take place before the transaction, the decisions that you and your team make afterward to implement the plan are every bit as important.

In addition to executing any retirement, wealth transfer, and charitable strategies described above, post-transaction should focus on the following elements:

Building and maintaining a diversified portfolio

Entrepreneurs are used to managing the risks of having most of their wealth tied up in their companies, but once the liquidity event occurs, you need to begin thinking about other types of risk. Stocks, bonds, and alternative assets, such as real estate and private equity, each present a unique set of risks. You need to work with your wealth manager to create a portfolio that is diversified across asset classes in a way that produces enough income for your lifestyle needs and enough growth for your longer-term goals — all within your risk tolerance.

Protecting your wealth and identity

When your net worth suddenly increases, so too do your insurance needs and risk exposure. Entrepreneurs who complete a high-profile liquidity event may be more likely to be the target of lawsuits and identity theft. Work with your wealth advisors to make sure you have adequate property and casualty and umbrella insurance in place. Trusts can be useful tools for protecting assets from creditors. You may want to work with security specialists to ensure that your home and your digital information are adequately protected.

Reviewing estate documents

Documents related to wills, trusts, power of attorney, and other elements of your estate plan should be reviewed regularly. This is especially true following a major life event, such as marriage or the birth of a child, or a significant change in your financial situation. It is important to work with your advisors to ensure that these documents adequately reflect your new circumstances.

Committing to regular reviews

Managing wealth is an ongoing process. Your plan should evolve and adapt to changes in market conditions, as well as to new developments in your personal situation. The priorities and goals you established in the months leading up to the transaction may change as you go through life. Meeting regularly with your wealth manager helps ensure that the plan remains tailored to your evolving needs.

It's never too early — or too late — to plan.

Your schedule — and your brain — are jammed. Sometimes the biggest obstacle to planning is simply getting started. So just do it. It's never too early — or too late — to start talking with advisors who've been through the process. You'll get answers to your questions, including some questions you may not have even considered. Together, you and a seasoned advisor will identify all the puzzle pieces, and start putting them in place.

You've worked hard for years. Now's the time to maximize your return on all that sweat equity and start living your and your family's dream. You've earned it.

To start a conversation with Aspiriant, call Cammie Doder at 415.371.7888, or write her at cdoder@aspiriant.com.

About Aspiriant

Aspiriant is one of the country's most respected independent wealth management firms. We work extensively with entrepreneurs, executives and their families to help turn liquidity events into major inflection points in their lives. Unlike niche firms, we give clients access to experts in all areas of wealth management, including financial planning, investing, tax strategy, estate planning and more. Our specialists collaborate to orchestrate every aspect of our clients' complex financial lives before, during and after a liquidity event. Learn more about the Aspiriant client experience at aspiriant.com.