

VENTURE CAPITAL AND ESTATE PLANNING: IMPORTANCE OF “GETTING IN” AT THE GROUND LEVEL

By: Robert J. Travers, Esq.



You’ve seen the projections from your financial adviser, accountant or estate planning attorney – million of dollars owed to the federal government through estate taxes when you die. You ask yourself – could I have done something different to minimize this potentially enormous tax? How can I stop it from getting even larger?

Unfortunately, most clients do not think about estate taxes until after they have amassed their fortunes. It’s natural to focus on accumulation of wealth – whether that is navigating the growth of a start-up business or purchasing investments with the best appreciation potential – rather than focus on the potential estate tax consequences in the future. But that is where the problem takes root.

A common misconception is that the federal estate tax is a tax on your assets when you die – it is not. The government taxes your right to *transfer* assets to others during lifetime or at death. The greater the value of the transfer, the greater the tax. The estate tax system treats a married couple basically as one unit, so transfers between husbands and wives do not trigger a tax.

Using this basic transfer tax premise, you can see that transferring (giving away) an asset when it is worth less can significantly reduce the amount of potential tax owed under the gift/estate tax system. This can have a dramatic effect on your overall tax liability. For instance, three principals of a software company, who are clients of mine, grew their company from virtually nothing to a \$150 million enterprise (each owning \$50 million). They are coming to me now asking how they can avoid paying millions of dollars in estate taxes upon their death. We are working on some advanced gifting strategies, but it would have been much easier if they came to me earlier.

The key is planning far in advance. Flashback to when my clients were creating their LLC. Each client gives a certain percentage of the business to a trust for the benefit of his family. The interests in trust are non-voting membership interests in the LLC, so that the clients retain absolute voting control of the operations.

What is the benefit? Each client is taxed on the nominal value of the LLC interest at the time it was gifted to the trust. My clients would not have paid any out of pocket tax, but would have used some of their lifetime gift exemption (up to \$5 million) to cover the transfer. Let’s say each client gave 50% of his interest in the LLC to an irrevocable trust when establishing the LLC. Now that the interest in the business has grown to \$50 million, the LLC interests in trust (valued at \$25 million) will not be part of my client’s estate for tax purposes. With a top federal estate tax rate of 40%, each could have saved roughly \$10 million of tax dollars by removing part of the business from their ownership early in the game. The trust could be structured to last for generations, avoiding estate tax at their children’s deaths as well.

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The same reasoning holds true for a speculative investment that has home run potential. If a client invests in a few speculative companies, he may want to consider gifting some percentage of the shares to an irrevocable trust while the stock value is extremely low. If the stock appreciates 5x, all the growth is out of the client’s taxable estate and is available for his family’s financial security. What if the company tanks? The client has used a small amount of his/her \$5 million dollar gift exemption for an asset that is worthless. The client lost that bet, but the downside is minimal. As speculative investors know, it only takes a few home runs to make up for the losers.

I always tell clients never to let a tax issue compromise their non-tax objectives regarding estate planning. However, if one of your objectives is to minimize estate taxes while planning for the financial security of your family, involving your estate planning adviser early in the game can reap great net returns for your family.

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