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5 Important Financial Tools To Use When Preparing For An IPO

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An Initial Public Offering (or IPO) is a big step for an entrepreneur to make. Making an initial public offering demonstrates that the business has provided enough value to sell its equity to the public, with the intention of raising significant capital. Successful IPOs also give the public confidence in the company when the offering is priced correctly and share prices rise.

However, there are many complexities that a business owner should consider both prior to and after each IPO, like increased income as well as estate tax liabilities. An IPO may result in a significant windfall for the business owners, and there are five key financial tools that we've used to guide business owners during and after the IPO process; those key financial tools are GRATs, IDGTs, CRTs, 10b5-1 plans, and equity award plans (RSUs).

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GRATs

A Grantor Retained Annuity Trust (or GRAT) is a type of irrevocable trust that is a key estate planning tool. To create a GRAT, the grantor or creator of the trust would contribute assets like pre-IPO stock to an irrevocable trust. From there, the GRAT would give the grantor an income stream, called an annuity, for a specific term like 10 years. Once the GRAT term expires, the funds would pass to the beneficiaries gift tax-free.

This strategy may be most effective for pre-IPO stocks as it can exclude the growth from both income and estate taxes. Many owners have significant shares of stock, which can grow to millions of dollars depending on the stock price. Therefore, it could be prudent to pay taxes on the shares when the price is relatively low. Also, many wealthy entrepreneurs have a high net worth beyond the standard unified credit exclusion of \$22.8 million for married individuals in 2019.

IDGTs

[An Intentionally Defective Grantor Trust \(or IDGT\)](#) is a tool used to lock in the value of assets for estate planning purposes. However, it's intentionally designed so the owner will still pay income taxes on the growth. However, he or she wouldn't pay taxes on the original contribution. The trust could issue a promissory note (i.e., debt) to purchase additional shares. If the growth on the shares surpasses the debt payments, this excess would be excluded from the gift tax and pass to the grantor's beneficiaries.

This tool may seem complex, but it can be broken down into five steps when planning for an IPO.

1. The grantor sells pre-IPO stock shares to the trust, as he or she believes they will appreciate. This transfer would be taxable and might be subject to the gift tax.
2. The IDGT trust can purchase additional stock shares via a promissory note with interest.
3. Repayment from the trust to the owner would occur through this promissory note. The interest rate amount must be equal to at least the [current Applicable Federal Rate \(AFR\) as set by the IRS](#).
4. If the appreciation is greater than the debt payments, the excess value will accrue to the beneficiaries.
5. Lastly, the IDGT trust will terminate after a specific term and the accrued excess value will pass to the beneficiaries' gift tax-free.

CRTs

[Charitable Remainder Trusts \(CRTs\)](#) are a great tool to save on taxes and give IPO funds to charitable causes. Luckily, the IRS has allowed taxpayers to reduce their tax liability through charitable giving. A CRT is similar to a GRAT as both use an irrevocable trust, which cannot be changed, as the first step. CRT contributions provide a source of income to beneficiaries for a certain term and the remaining assets will be distributed to a qualified charity.

A CRT can be a great strategy for those wanting to sell businesses that have a low basis or original cost basis. This is similar to selling an appreciated stock with a low basis, as in both cases, sellers can deduct the fair market of the asset when it's sold and not pay taxes on the gain. Many Baby Boomers want to sell their successful business but don't want to pay egregious amounts of tax to the federal government. Portions of business equity can be allocated toward beneficiaries, with others being allocated toward charities. If the CRT is funded with assets like equity, the owner can deduct up to [30% of their AGI in that year](#). If they fund it with cash, the owners can deduct a higher [60% of their AGI](#).



10b5-1 Plans

There are many rules to follow, both prior to and after an IPO. One important tool to comply with SEC rules is a 10b5-1 plan, which allows certain stockholders to sell large amounts of stock and be compliant with the rules. Some actions to take when drafting a 10b5-1 plan include working with an experienced attorney, setting a plan duration, planning open-window periods, and more.

One important factor to consider is setting an open-window and blackout periods. An open window allows C-level executives to sell a limited amount of shares throughout the year, with a blackout period restricting sales. These two time frames are very important to use in order to prevent insider trading.

It can be overwhelming to manage a business and comply with SEC regulations. Therefore, it's wise to elect a competent and honest compliance manager to oversee 10b5-1 plans. Compliance officers can ensure key business members sell their stock within the guidelines and protect the business's reputation.



Equity Award Plans, Especially RSUs

Equity Award Plans can be a great way to motivate high-performing employees with company stock. There are many options available, with each one having different tax treatments, strengths, and weaknesses. While there are various types of stock plans, [Restricted Stock Units \(RSUs\)](#) are becoming popular.

This plan style is popular because it has a relatively simple tax treatment and the shares will always have value. For example, Non-Qualified Stock Options (NQSOs) have a strike price and spread. This means that if the market value of the stock goes below this strike price, the options will be worthless. However, RSUs will always have some value as they don't have strike prices. Instead, their value is the current market price multiplied by the number of options. This is the main example of RSUs offering more downside protection to employees.



The Bottom Line

IPOs are influential events to the economy and differentiate big businesses from small companies. Done properly, they can increase funding, make the owners wealthy, provide for employees, and give the public healthy investment returns. Yet IPOs are very complex and have many moving parts, which can severely impact the business owner's tax situation. Fortunately, financial tools like GRATs, IDGTs, CRTs, 10b5-1 plans, and equity award plans like RSUs, will ensure both a smooth pre- and post-IPO event.

Are you considering taking a company public and do you want to save on income as well as estate taxes? We can help guide you through every unique situation. Start by booking a free, no-pressure consultation using [this link!](#)

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