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PRIVATE WEALTH MANAGEMENT

Topics in Wealth Strategies:

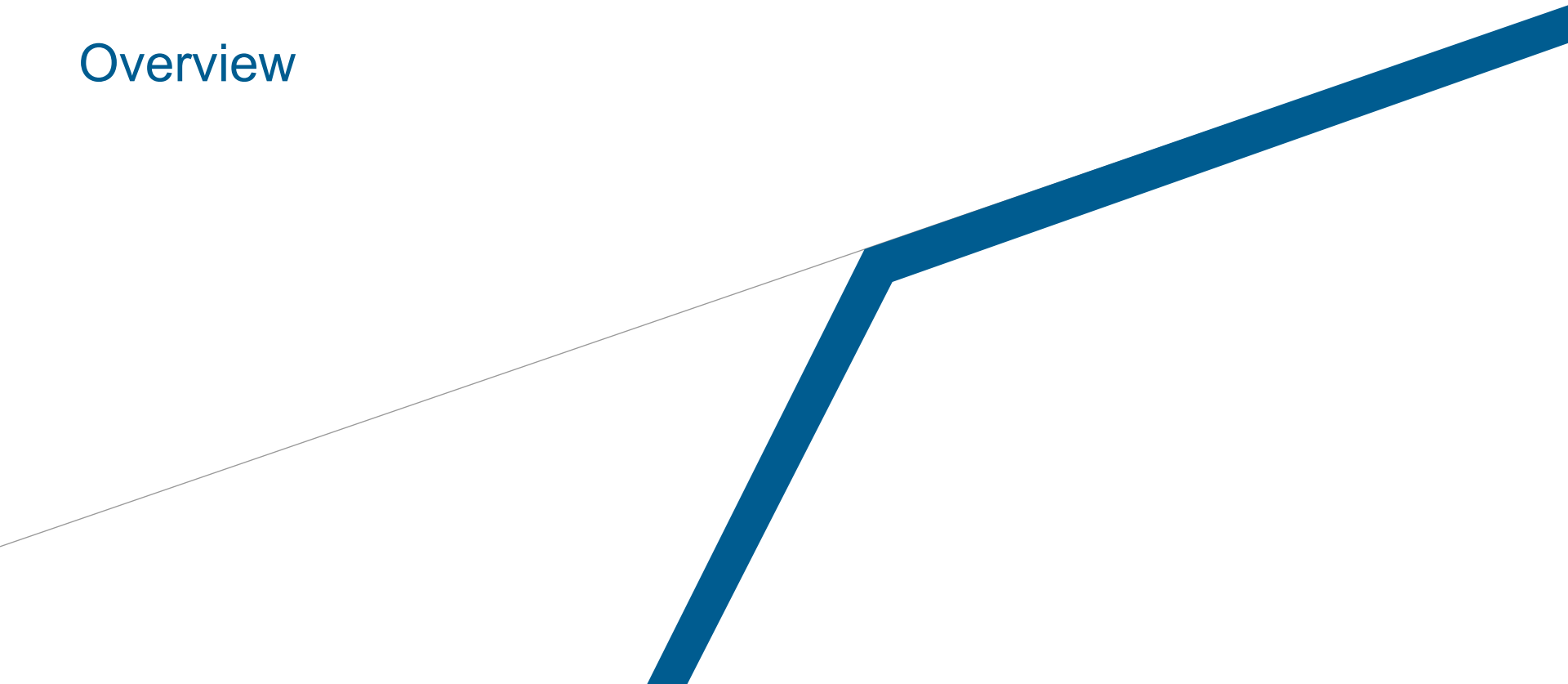
Entrepreneur Toolkit

Wealth and Estate Planning Strategists
Family Office Resources

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PRIVATE WEALTH MANAGEMENT

Overview



Lifecycle of an Entrepreneur

Forming a Business / Angel Round

- Establishing Advisory Relationships
- Business Structure
- Insurance Needs for Business Owners
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Post Liquidity Planning

- Considerations for an Executive Holding Non-Public Stock
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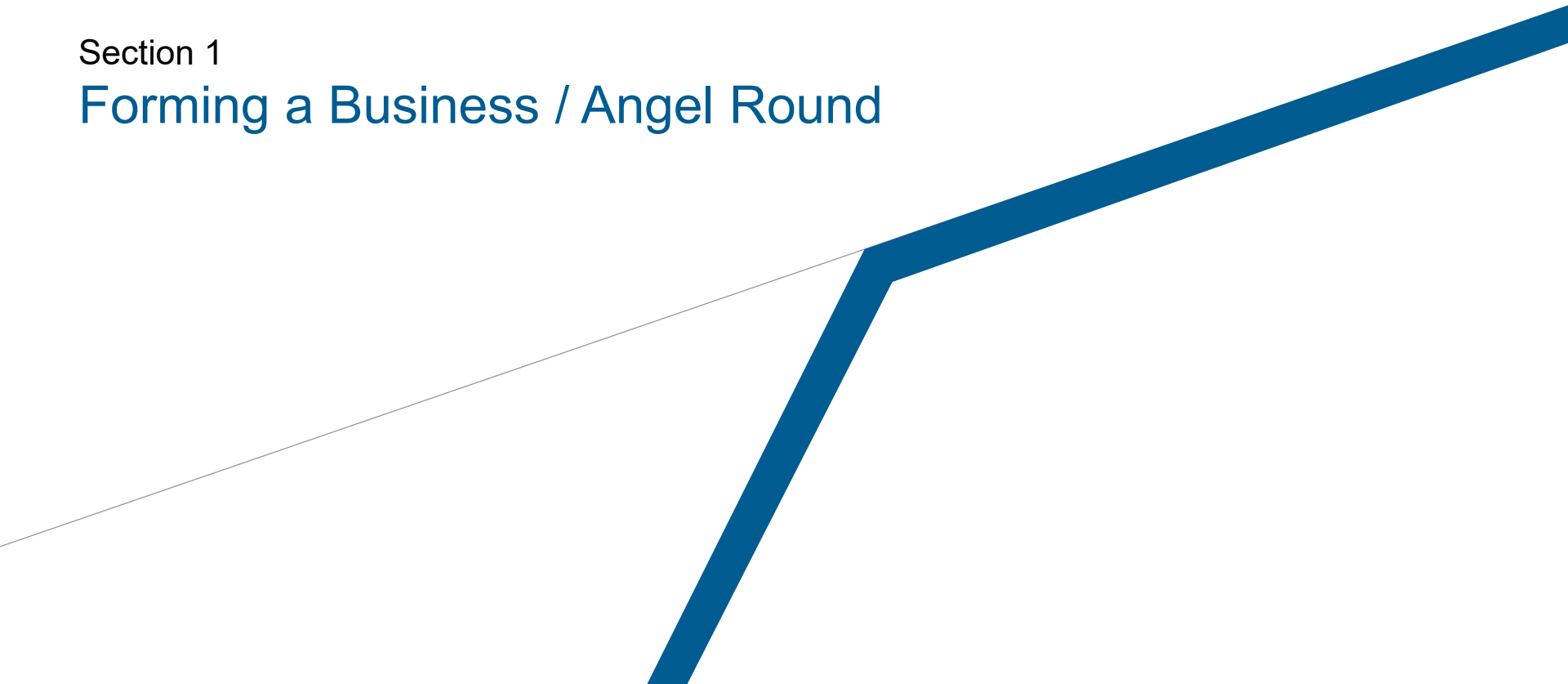
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Section 1

Forming a Business / Angel Round



Establishing Advisory Relationships

Why is it important to establish advisory relationships when starting a business?

- Establishing a strong advisory team that provides legal, tax/accounting, investment banking and financial/investment advice allows business owners to rely on professional experience and expertise working in a coordinated manner to help the entrepreneur.
- A cohesive and responsive team will allow the entrepreneur to focus on the business and provide invaluable information and resources along the way to help one achieve both personal and professional goals.
- A good advisory team can help with both investment goals and broader wealth management needs.

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Business Structure

How should one choose a business structure?

The choice of business structure is a critical strategic decision, with wide ranging impacts, including how profits are taxed, the degree of creditor protection the structure affords business owners, and the range of exit strategies ultimately available. There are a variety of business structures. Below are some of the most common business entities:

General and Limited Partners	• With general partnerships, the various partners control and manage the company. Further, each general partner assumes unlimited liability for the debts of the partnership and can incur obligations on its behalf. In the case of limited partnerships, there are normally one or more general partners who maintain full oversight over the management of the business. Limited partners do not engage in the daily oversight of the business and cannot incur obligations on the behalf of the partnership. Partnerships are a "pass-through" entity and pay no entity level tax on their income, but rather pass through any profits or losses to their partners.
C Corporation	• C corporations are a separate legal entity that exists apart from the business owners. One benefit if that is provides the owner substantial liability protection. As opposed to a "pass-through" entity such as partnership, the owners of a C corporation will be subject to taxation twice, once at the corporate level and then again when earnings are distributed in the form of dividends. Corporations also have the ability to attract investors through the issuance of stock. There may be additional tax benefits afforded by investment in Qualified Small Business Stock "QSBS."
S Corporation	• The primary advantage of S corporations is that they allow income and losses to be passed through to shareholders. Therefore, unlike C corporations, S corporations are only subject to one level of federal taxation. Each state has its own rules regarding how S corporations are taxed. S corporations can have multiple shareholders, but not more than 100. As opposed to C corporations, S corporations can only be owned by individuals, charities, estates and certain types of trusts. Corporations, partnerships and non-resident aliens are not permitted to own stock in S corporations.
Limited Liability Company (LLC)	• Constructs that combine the elements of corporations and partnerships. Members of an LLC have limited liability. An LLC can elect to be taxed as a corporation or as a pass-through entity. As a pass-through entity, LLCs normally pass earnings and losses through to owners in a manner similar to partnerships. As with corporations, members of LLCs benefit from legal protection while participating fully in the operation of the LLC business.

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Insurance Needs for Business Owners

Are there Any Insurance Needs that are Unique to Business Owners During the Formation Phase of the Business?

In many instances..

- The purpose of key man insurance is to help the company survive the blow of losing the person who makes the business work. The company can use the insurance proceeds for expenses until it can find a replacement person, or, if necessary, pay off debts, distribute money to investors, pay severance to employees and close the business down in an orderly manner. In a tragic situation, key man insurance gives the company some options other than immediate bankruptcy
- A buy and sell agreement is an approach used by sole proprietorships, partnerships and closed corporations to divide the business share or interest of a proprietor, partner, or shareholder. The owner of the business interest being considered has to be disabled, deceased, retired or expressed interest in selling. In order to ensure the availability of funds in the event of a partner's death, each party will purchase life insurance policies on the other partners. In the event of a death, the proceeds from the life insurance policy are used to purchase a portion of the deceased's business interest

What are some of the most common types of insurance for business owners?

Term Insurance	Whole Life, Universal Life and Variable Life Insurance	Key Man Insurance	Property and Casualty Insurance
• Life insurance coverage for a period of years- typically used for income replacement purposes in the event of an unforeseen death	• Permanent life insurance coverage often used to fulfill long-term estate planning needs	• Life insurance protection on a key individual(s) within a business with the business named as the beneficiary	• Insurance to protect against losses to property and other tangible assets. The types of coverage may vary depending upon the type of business engaged in and the potential liability exposure

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Estate Planning Coordination for Business Owners

Why is it important to coordinate one's estate plan and the growth of one's business?

- The early stage of a company's growth phase is often a particularly productive time for the owner(s) to conduct in-depth estate planning. Unfortunately, the demands associated with a growing business tend to be all-encompassing. As a result, business owners often fail to create or implement any type of estate plan. In the absence of such a plan, the business owner's exit from the business or untimely demise may have a variety of unanticipated consequences.

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Basic Estate Planning Documents

What basic estate planning documents should one consider?

- One of the greatest challenges that a business owner may face is how best to transition wealth accumulated from the business to future generations
- As the value of a business grows, so does the business owner's potential exposure to estate and gift taxes
- Fortunately, establishing a plan early in the life cycle of the business allows proactive business owners the opportunity to potentially sidestep many of these taxes by creatively distributing ownership interests to family members and other beneficiaries at a time when valuation levels are low

Some of the key basic estate planning documents that a business owner should establish are:

Basic Will	Revocable Living Trust	Durable Power of Attorney	Health Care Directive	Irrevocable Life Insurance Trust
• Outlines distribution of assets upon death	• Avoids probate and distributes assets upon death	• Appoints an agent to make financial decision on your behalf if you become incapacitated	• Appoints an agent to make healthcare decision on your behalf if you are unable to make them for yourself, even if you become incapacitated	• Removes life insurance proceeds from your estate

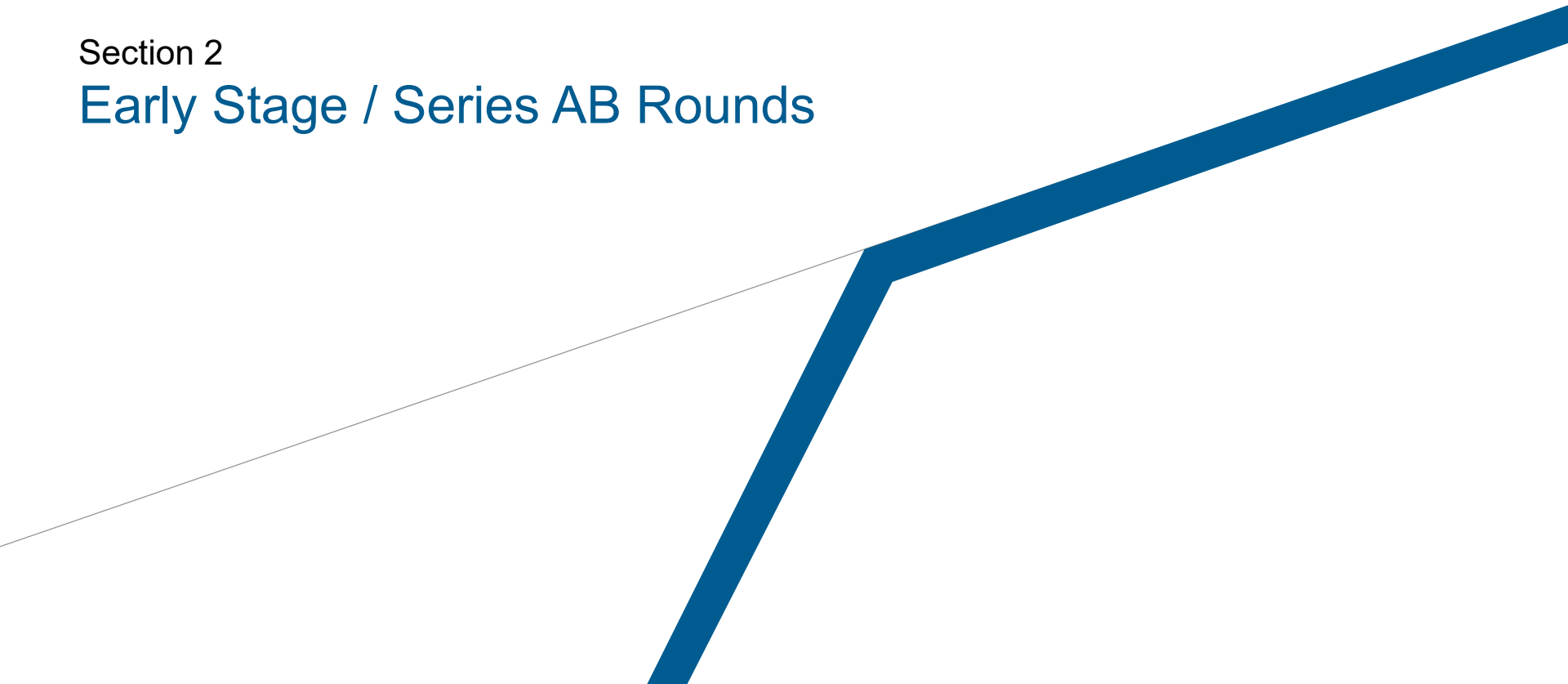
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Section 2

Early Stage / Series AB Rounds



Federal Estate and Gift Tax Planning

What is the current tax landscape with regard to estate and gift tax planning?

- Currently, the applicable federal legislation provides individuals with an opportunity to engage in sophisticated wealth planning – one where the federal estate tax, gift tax and generation-skipping tax (GST) exemption thresholds each exceeds $10 million dollars
- Furthermore, the corresponding maximum federal tax rate is 40% (in those instances where the imposition of tax cannot be completely avoided)
- Business owners who actively plan can leverage sophisticated estate and tax planning and can position themselves to distribute substantial wealth to future generations (should they so desire) with little and possibly no transfer tax consequences

The chart below summarizes the historical federal estate, GST and gift tax exemptions:

CALENDAR YEAR	ESTATE AND GIFT TAX EXEMPTION	GST TAX EXEMPTION	MAXIMUM ESTATE TAX RATE
2013	$5,250,000	$5,250,000	40%
2014	$5,340,000	$5,340,000	40%
2015	$5,430,000	$5,430,000	40%
2016	$5,450,000	$5,450,000	40%
2017	$5,490,000	$5,490,000	40%
2018	$11,180,000	$11,180,000	40%
2019	$11,400,000	$11,400,000	40%
2020	$11,580,000	$11,580,000	40%
2021	$11,700,000	$11,700,000	40%
2022	$12,060,000	$12,060,000	40%
2023	$12,920,000	$12,920,000	40%
2024	$13,610,000	$13,610,000	40%
2025	$13,990,000	$13,990,000	40%
2026	$15,000,000	$15,000,000	40%

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Entrepreneur Basic Estate Planning

If an entrepreneur has a basic estate plan in place, are there additional planning strategies one should consider?

- *As a general rule, estate planning is most effective when undertaken early on within the life cycle of a business. Early on, company valuations tend to be lower and the time horizon remaining until the eventual "exit" from the company can allow an entrepreneur to engage in a broad range of impactful planning activities*

Entrepreneurs Who Undertake Thoughtful Business and Estate Planning May Achieve

A more efficient business transition (via inter-family transfer, IPO or sale)

An increased likelihood of successfully achieving financial and familial goals

A minimization of estate and gift taxes

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Trust Benefits during Business Growth

How can trusts be used to benefit from the (anticipated) appreciation in a company's value during its growth phase?

- *As the value of a company appreciates, it can become increasingly difficult to effectively redistribute the wealth among family members. One solution to this dilemma involves establishing estate planning structures that permit beneficiaries to profit from the appreciation in company value while still minimizing the impact of federal estate and gift taxes*
- *Two planning structures that are commonly used in this regard are Grantor Retained Annuity Trusts ("GRATs") and Intentionally Defective Grantor Trusts ("IDGTs")*

Both Approaches are Especially Popular With Business Owners, Regardless of Whether their Ultimate Exit Strategy is Expected to Consist of

A transfer of the company to family members
An Initial Public Offering ("IPO")
A sale of the company

- In each case, the basic methodology associated with wealth planning consists of gifting ownership interests to beneficiaries while valuations are as low as possible. This approach removes the assets from the estate of the donor(s) and allows for much of the subsequent appreciation in value to accrue on behalf of beneficiaries

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Grantor Retained Annuity Trust (GRAT)

How does a GRAT work?

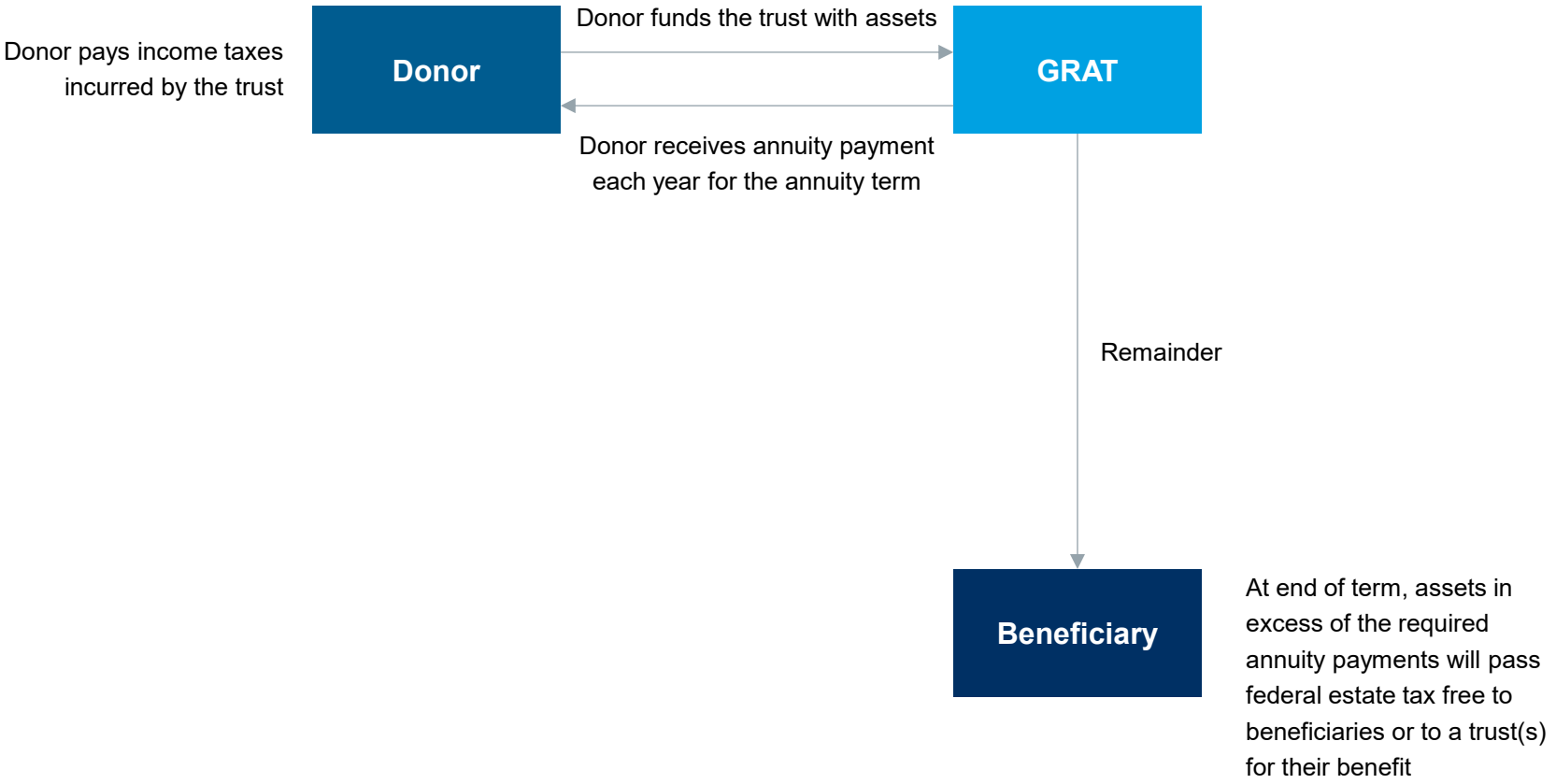
- The donor creates a trust and in it directs that (i) the trust pays the donor an annuity for a fixed period of time and the annuity will generally equal the value of the assets contributed to the trust and (ii) the remainder (whatever is left in the trust at the expiration of the annuity) is paid to one or more designated beneficiaries. The beneficiaries that can be designated include close family members like ancestors, descendants and siblings or trusts for their benefit. The GRAT can be structured so the annuity payment is not a series of equal amounts, but rather increases by up to 20% year to year

- The donor is deemed to make a gift of the remainder interest in the trust to the designated remainder beneficiaries. The value of the taxable gift to the remaindermen is determined by subtracting the value of the donor's retained annuity from the fair market value of the assets transferred to the trust. The value of the annuity is based on an IRS discount rate known as the 7520 rate. The transfer to the trust can be structured so the value of the grantor's retained interest is virtually equal to the market value of the property placed in trust, in which case only a very small taxable gift results ("zeroing out" the GRAT). This small taxable gift will be reported on the donor's gift tax return

- The GRAT can produce estate and gift tax savings if the trust property produces an annual return in excess of the IRS discount rate over the term of the annuity. The donor effectively shifts all of the return on the trust property in excess of the benchmark IRS discount rate to the remainder beneficiaries without making an additional taxable gift. Additionally, the donor will have separately paid any income tax liability of the trust, further leveraging this gifting technique. And if the GRAT is structured so the annuity "grows" by up to 20% per year, more principal can compound for the benefit of the remainder beneficiaries potentially allowing more property to pass to them at the expiration of the donor's annuity

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Grantor Retained Annuity Trust (GRAT)



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Grantor Retained Annuity Trust (GRAT)

"Zeroed-out" Flat Annuity GRAT

- The following is an illustration of a "zeroed-out" flat annuity GRAT funded with $1,000,000 marketable securities. There is no taxable gift on funding the trust (i.e., the value of the annuity stream is still roughly equal to the principal contributed to the trust)
- In this hypothetical scenario, the donor receives an annuity worth $364,458 per year for 3 years and the remainder beneficiaries receive (outright or in trust) assets worth $30,727

ASSUMPTIONS:

Term of Trust	3
Initial Value	$1,000,000
7520 Rate	4.6%
Annual Investment Return	6.0%

KEY OUTPUTS:

Annuity to Donor (%)	36.44580%
Annuity to Donor ($)	$364,458
Remainder @ 6% ROR	$30,727
"Remainder @ 8% ROR	*$76,535*
"Remainder @ 4% ROR	*$0.00*

YEAR	BEGINNING PRINCIPAL	GROWTH	ANNUITY PAYMENT	REMAINDER
1	$1,000,000	$60,000	$364,458	$695,542
2	$695,542	$41,733	$354,458	$372,816
3	$372,816	$22,369	$364,458	$30,727

Hypothetical example is for illustrative purposes only. Not representative of any specific investment.
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Grantor Retained Annuity Trust (GRAT)

"Zeroed-out" Growing Annuity GRAT

- The following example is the same as the "zeroed-out" flat annuity GRAT except the annuity grows 20% per year. There is still no taxable gift on funding the trust (i.e., the value of the annuity stream is still roughly equal to the principal contributed to the trust)
- However, the value of assets passing to the beneficiaries at the end of the term may increase reflecting the potential benefit of having assets stay in the trust longer and generate compounded returns for the beneficiaries. In this hypothetical scenario, the remainder beneficiaries receive assets worth $32,609, or $1,882 more compared to the flat annuity scenario

ASSUMPTIONS:	
Term of Trust	3
Principal	$1,000,000
7520 Rate	4.6%
Annual Investment Return	6.0%
Annuity Growth	20.0%

KEY OUTPUTS:	
Remainder (Growing Annuity) @ 6% ROR	$32,609
Remainder (Flat Annuity) @ 6% ROR	$30,727
Difference	$1,882
Remainder (Growing Annuity) @ 8% ROR	*$81,131*
Remainder (Growing Annuity) @ 4% ROR	*$0.00*

YEAR	BEGINNING PRINCIPAL	GROWTH	ANNUITY PAYMENT	REMAINDER
1	$1,000,000	$60,000	$302,014	$757,985
2	$754,349	$45,261	$362,417	$441,047
3	$432,828	$25,970	$434,901	$32,609

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Grantor Retained Annuity Trust (GRAT)

Rolling GRATS

- Relative to a standard GRAT, so-called “Rolling GRATs” may provide greater opportunity for compounding returns while reducing mortality risk through the creation of a series of sequential short-term GRATs with each subsequent GRAT being funded with an annuity payment from an earlier-created GRAT. The potential compounding benefit results from Rolling GRATs keeping all principal (and interest, in some cases) “at work” over a longer period of time
- The following is an illustration of two sequential two-year rolling GRATs. In this hypothetical scenario, the remainder beneficiaries receive assets worth $35,078, or $4,351 more than they would with one three-year GRAT

ASSUMPTIONS:

Rolling Period	3
Initial Value	$1,000,000
7520 Rate	4.6%
Annual Investment Return	6.0%

KEY OUTPUTS:

"Remainder Trust" Ending Principal	$35,078
3-Year Flat GRAT Remainder	$30,727
Difference	$4,351
“Remainder Trust” Ending Principal @ 8% ROR	*$86,277*
“Remainder Trust” Ending Principal @ 4% ROR	*0.00%*

ROLLING GRATS

YEAR	PRINCIPAL	GROWTH	ANNUITY	REMAINDER
1	$1,000,000	$60,000	$534,759	$525,241
2	$525,241	$31,514	$534,759	$21,996
YEAR	**PRINCIPAL**	**GROWTH**	**ANNUITY**	**REMAINDER**
2	$534,759	$32,086	$285,967	$280,877
3	$280,877	$16,853	$285,967	$11,762

REMAINDER TRUST

YEAR	BEGINNING PRINCIPAL	GROWTH	REMAINDER ADDED	ENDING PRINCIPAL
1	$0	$0	$0	$0
2	$0	$0	$21,996	$21,996
3	$21,996	$1,318	$11,762	$35,078

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Intentionally Defective Grantor Trust (IDGT)

How does an IDGT work?

- The donor creates an irrevocable trust designed to permit an individual to transfer the appreciation of assets in the IDGT with minimal federal gift tax consequences (through the use of a promissory note back to the grantor)
- A donor can establish a trust and the donor or his or her spouse can intentionally retain certain powers with respect to the trust which cause the donor to be treated as the owner of the trust property for federal income tax but not for estate or gift tax purposes. By paying taxes on trust income, the donor, in effect, makes additional transfers to the beneficiaries of the trust, which are not subject to federal gift tax
- The donor can sell assets to the trust in exchange for the trust's interest-bearing promissory note. The interest rate will be based on IRS published rates and is often less than the rate used for GRATs. The note may provide for level payments of principal and interest, be self-amortizing or bear interest only with a balloon payment of principal. No gain or loss is recognized by the donor on the sale to the trust and the repayment of the promissory note has no federal income tax consequences to the donor or the trust, because the donor is treated as the owner of the trust for federal income tax purposes
- The trust should be funded prior to the sale in order to protect it against possible estate tax inclusion. Most commentators suggest that the "seed gift" be at least 10% of the principal amount of the promissory note (but donors should receive individualized tax advice from their tax advisors). The transfer of property to the trust can be made utilizing both the federal gift tax annual exclusion (if the trust is structured properly) or the federal gift tax exemption amount. Once gifts exceed the federal gift tax exemption amount, any additional gifts (other than annual exclusion gifts) are fully taxable. The IDGT can be effective for gifts to grandchildren and other remote descendants if the federal GST exemption is properly allocated to the trust

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GRAT, IDGT, Direct Gifting

What are the circumstances under which one would use a GRAT or an IDGT, versus for example, direct gifting?

- GRATs and IDGTs are both mechanisms that are used to “leverage” the gifting that a business owner seeks to undertake
- This can be useful when the business owner wants to utilize some or none of his or her federal lifetime estate tax exemption amount, perhaps preserving it for other wealth transfer opportunities
- In other cases, the business owner may have exhausted his or her federal lifetime estate tax exemption or the business owner’s net worth is so large that even the full utilization of the unleveraged lifetime exemption amount will not reduce his or her estate in a meaningful way
- In each of these instances, a GRAT or IDGT can be an appealing alternative to direct gifting

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Family Limited Partnership

What is a family limited partnership and how can it provide a planning benefit to entrepreneurs in the early phase of the life cycle?

- A Family Limited Partnership (“FLP”) is a structure that allows individuals to gift limited partnership (“LP”) interests to family members or trust while retaining a general partnership (“GP”) interest for themselves.
- As GPs, the individuals maintain management and investment control over the FLPs underlying assets as well as broad discretionary authority to determine the amount of timing and distributions.
- The meaningful restrictions imposed upon limited partners, as well as their lack of control over the broader FLP structure may provide substantial valuation discounts which, in turn, may minimize the impact of gift and estate taxes that the family might otherwise incur.

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Stock Options and Equity Compensation

*Companies grant 2 kinds of options: **Non-Qualified Stock Options** (NQSOs), the most common type, and Incentive **Stock Options** (ISOs), which offer some tax benefits but also raise the risk of the alternative minimum tax (AMT).*

What are the differences between the various types of stock options and equity compensation?

TYPE	DESCRIPTION
NQSO	• An NQSO is a type of stock option that does not qualify for special favorable tax treatment. When an NQSO is exercised, the spread (difference between strike price and fair market value on date of exercise) is compensation income and reported on an employee's IRS Form W-2. The company will withhold income tax, Social Security tax and Medicare. When the shares are sold, the proceeds are taxed under the rules for capital gains and losses.
ISO	• ISOs qualify for special tax treatment under the Internal Revenue Code and are not subject to Social Security, Medicare, or federal withholding taxes. However, to qualify they must meet rigid criteria under the tax code. It's important to note that ISOs can be granted only to employees, not to consultants or contractors. There is a $100,000 limit on the aggregate grant value of ISOs that may first become exercisable (i.e., vest) in any calendar year. Also, for an employee to retain the special ISO tax benefits after leaving the company, the ISOs must be exercised within three months after the date of employment termination. • After you exercise ISOs, if you hold the acquired shares for at least two years from the date of grant and one year from the date of exercise, you incur favorable long-term capital gains tax (rather than ordinary income tax) on all appreciation over the exercise price. However, the amount by which the fair market value of the stock exceeds the price paid on exercise will be included for purposes of calculating your AMT liability. This can be problematic if you are subject to the AMT on theoretical gains but the company's stock price then plummets, leaving you with a big tax bill on income that has evaporated. ISO taxation is complex. It's important to understand how the alternative minimum tax can affect you.
Restricted Stock Units (RSUs)	• Restricted Stock Units, or RSUs, are a grant of stock units with an unfunded promise to issue a specific number of shares (or a cash payment) at a future time once vesting conditions have been satisfied. Stock-settled RSUs are much more common than cash-settled RSUs (which are subject to unpopular variable accounting), and they are used widely enough to rival the use of standard restricted stock. RSUs are a stock grant in which the stock itself is not issued until both vesting and the release of shares. Generally, restricted stock units are subject to the same tax rules as restricted stock once the shares are received.

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Exercising Incentive Stock Options (ISO)

Hypothetical Illustration: Exercise VESTED in-the-money Options and Hold Stock (As of 01/01/2026)

BULL SCENARIO	TODAY	IN ONE YEAR
Stock Price	25	40
	Exercise Options	Sells Shares
(Acquired Stock)	3,750,000	
Exercise Price	(1,050,000)	
AMT Due	(756,000)	
Total Outflow	(1,806,000)	
Sale Price		6,000,000
Capital Gain Tax Due		(1,836,450)
AMT Credit [2]		756,000
Total Inflow		4,919,550
Net Proceeds		3,113,550
Cost of Capital [1]		(36,120)

	Exercise Options & Sell Shares
(Acquired Stock)	6,000,000
Exercise Price	(1,050,000)
Ordinary Income Tax Due	(2,489,850)
Total Outflow	(3,539,850)
Sale Price	6,000,000
Total Inflow	6,000,000
Net Proceeds	2,460,150
Net Impact of Exercising Early	617,280

BEAR SCENARIO	TODAY	IN ONE YEAR
Stock Price	25	10
	Exercise Options	Sells Shares
(Acquired Stock)	3,750,000	
Exercise Price	(1,050,000)	
AMT Due	(756,000)	
Total Outflow	(1,806,000)	
Sale Price		1,500,000
Capital Gain Tax Due		(166,950)
AMT Credit [2]		166,950
Total Inflow		1,500,000
Net Proceeds		(306,000)
Cost of Capital [1]		(36,120)
AMT Credit [2]		589,050

	Exercise Options & Sell Shares
(Acquired Stock)	1,500,000
Exercise Price	(1,050,000)
Ordinary Income Tax Due	(226,350)
Total Outflow	(1,276,350)
Sale Price	1,500,000
Total Inflow	1,500,000
Net Proceeds	223,650
Net Impact of Exercising Early	23,280

1. "Cost of Capital" represents the interest return forgone on the cash utilized – an expense associated with exercising options early and holding the stock.
2. The amount of AMT Credit available may be less than the additional AMT paid in the year of ISO exercise due to a difference between LTCG tax rate and AMT rate. Note that while one is entitled to an AMT Credit for the additional amount of AMT paid in the year of ISO exercise attributable to such exercise, the amount of the AMT Credit that may be utilized in a given future tax year is limited.
3. "Capital Gain Tax Credit" reflects the potential tax savings one may receive for realizing long-term capital losses.
4. Table produced assuming a federal tax rate of 13%, a state tax rate of 13.3%, and an AMT rate of 28%.

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Gifting of options

Is it possible to gift options?

- Although it is possible to gift options, the approach normally entails a degree of complexity that is not present when gifting shares of the company stock.
- For example, ISOs must, by definition, be non-transferable.
- As a result, gifting opportunities are normally limited to NQSOs.
- Even within the context of NQSOs, gifting can only take place if permitted under the terms of the company stock plan.

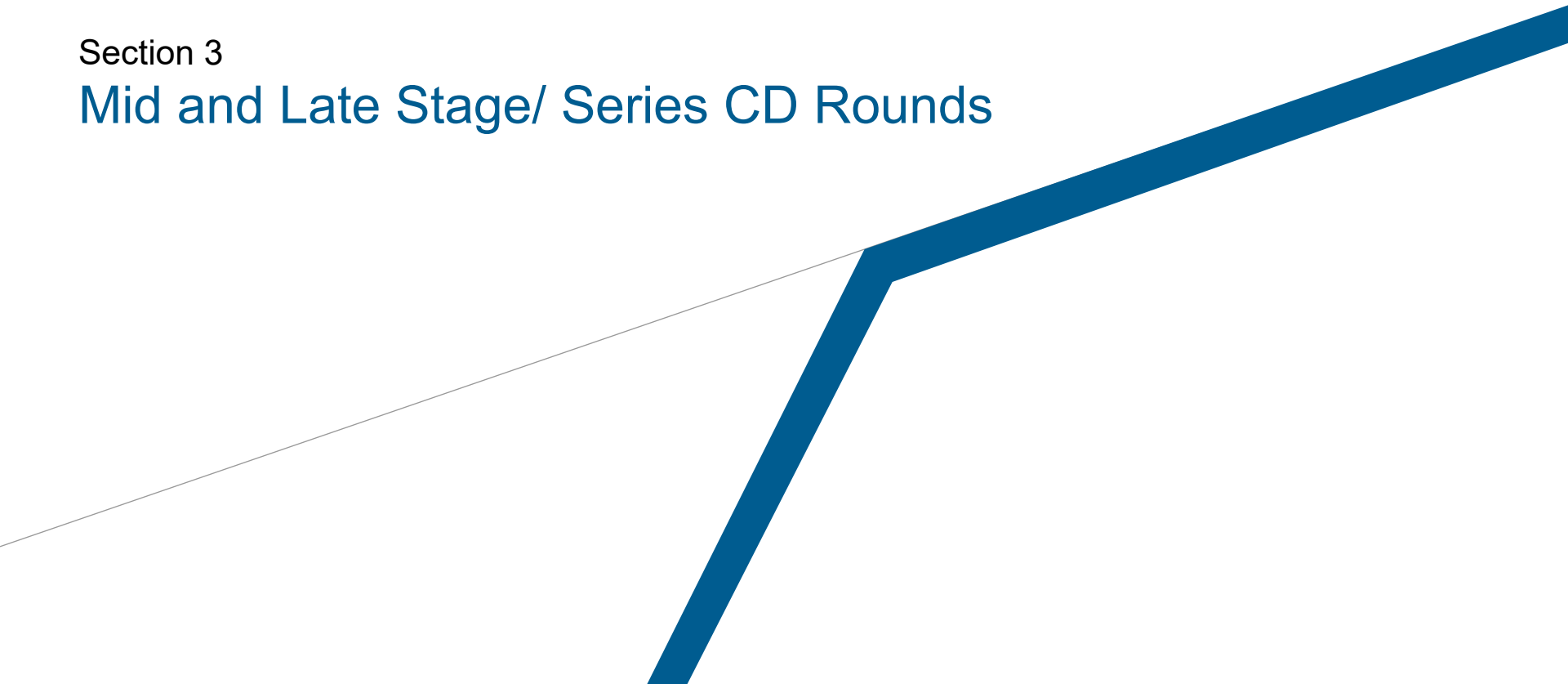
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PRIVATE WEALTH MANAGEMENT

Section 3

Mid and Late Stage/ Series CD Rounds



Lending Solutions

What lending opportunities should an entrepreneur consider during the mid and late stages of the business lifecycle?

- *Morgan Stanley clients may qualify for lending solutions. Lending solutions can help finance almost any personal or business need. Entrepreneurs often need access to a flexible line of credit to manage cash flows, purchase real estate, make improvements or simplify cash management. A comprehensive review of both assets and liabilities is an important exercise to perform at this stage of the business lifecycle.*

Securities Based Lending	Tailored Lending	Morgan Stanley Home Loan Solutions
• Securities based loans may provide access to capital, potentially without having to sell assets, that can be used to pay tax obligations or provide financing for personal or business needs	• Customized borrowing options that can help provide the necessary funding and flexibility as entrepreneurs manage the diversification and expansion of wealth	• Residential mortgage solutions that may help meet home financing goals

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Borrowing against securities may not be appropriate for everyone. Clients must be aware that there are risks associated with a securities-based loan, including possible maintenance calls on short notice, and that market conditions can magnify any potential for loss. For details, please see the important disclosures at the end of this presentation.

Charitable Giving Strategies

What charitable giving strategies should an entrepreneur consider as a liquidity event approaches?

- *There is a range of philanthropic approaches that an individual may wish to consider within the context of pre and post IPO planning. Options include making gifts to private foundations, donor advised funds, community foundations, and public charities. Each option also has unique characteristics from various levels of donor control, varying degrees of flexibility, cost and complexity. The limit on income tax deductions can also vary. Philanthropy should be considered for entrepreneurs during the pre-liquidity and pre-sale planning process.*

Three of the most common charitable planning strategies pre liquidity event include:

Establishing a Charitable Remainder Trust
Forming a Private Foundation
A sale of the company

- Q: What is a Charitable Remainder Trust and how can it benefit an individual engaging in an IPO?
- Q: How does a Private Foundation work?
- Q: What is a Donor Advised Fund?
- Q: Should charitable gifts be made pre or post IPO?

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Corporate Trustee in Family Business Planning

How might a corporate trustee be integrated into a planning structure that involves a family business?

- When establishing a trust for the benefit of family members, the question of who should act as trustee merits particular attention
- Although individuals often appoint a family member or friend to act as trustee, such people often lack the experience or expertise required to understand and undertake their fiduciary duties
- Further, in instances when an individual acting as trustee is also a stakeholder in the family business, the potential conflict resulting from their dual roles can undermine their effectiveness in either capacity
- For these and other reasons, an increasingly popular alternative involves the appointment of a corporate fiduciary to act as sole or co-trustee

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Pre-liquidity Valuation Considerations

What are some of the valuation considerations that an entrepreneur should bear in mind when engaging in pre-liquidity wealth transfer planning?

- Many of the techniques associated with pre-IPO wealth transfer planning involve taking advantage of lower business valuations prior to the liquidity event.
- For federal gift tax purposes, an appraiser may take into account the fact that the business is not publicly traded, and that an ownership interest is therefore considered illiquid.
- If the gifted interest is a minority position (which is the most common scenario), this may also be taken into consideration by the appraiser.
- It's important to note that valuation for federal gift tax purposes may differ from 409A valuations as different factors are considered for each valuation.

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Qualified Small Business Stock

What is qualified small business stock?

- The government gives people incentive to start business in the form of QSBS.
- If their stock qualifies (i.e., if the company is structured as a C-Corp, the shares were received directly from the company at a time it was a qualified small business, and the shareholder meets certain holding period requirements), they may be eligible to have 50-100% of the gain excluded from federal income taxes.
- Shareholders can exclude from federal taxable gain up to the greater of 10x the shareholder's basis in the stock or 10mm (15mm if shares were issued on or after July 4, 2025).
- Option for the benefit with the reinvestment of the proceeds (within 60 days) in another qualifying business.
- To the degree that a qualifying rollover occurs, the original sale will not be currently taxable.
- Ultimately, the gain will be subject to taxation upon disposition; however, the ability to defer taxation for a period of time may be a benefit to the taxpayer.

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Morgan Stanley

PRIVATE WEALTH MANAGEMENT

Section 4

Preparing for a Liquidity Event



Personal Tax Planning

I've spent my life focused on growing this business and not on my personal planning, now that I am contemplating a sale of the company, what tax planning should I be considering?

- *As a primary matter, you should consider your overall wealth and estate plan. If your goal is to transfer wealth to the next generation, consider pre-liquidity estate planning.*

Estate taxation and lifetime transfers

As mentioned earlier, in 2026, estates in excess of $15 million ($30 million for a married couple) are subject to federal estate tax of rates as high as 40% (under current law)

Lifetime transfers can reduce the estate tax exposure

For federal transfer tax purposes, the value of a closely-held business interest is speculative and must be appraised by a professional appraisal company

In arriving at the value of a minority interest in a closely-held business, the appraiser may discount the value to reflect lack of marketability, illiquidity and lack of control

These discounts may enhance estate planning transfers.

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Wealth Transfer Techniques

What are some of the most common wealth transfer techniques that entrepreneurs engage in prior to a liquidity event?

- *Generally speaking, pre-liquidity tax planning falls into two broad categories: federal income tax reduction planning and federal estate tax reduction.*

TYPE	DESCRIPTION
Income Tax Reduction Planning	• Income tax strategies typically involve attempting to accumulate a long-term stock position in the company. Generally speaking, since long-term capital gains rates are lower than ordinary income tax rates, it is better to hold the company stock long-term This means: – It may be better to exercise stock options earlier rather than later in order to keep the tax cost low and start the long-term holding period – An executive may wish to make an 83(b) election upon receipt of restricted stock in order to start the long term holding period – Note that if the company is not successful, you may own stock with a value that is less than the exercise price and tax cost you paid to acquire it
Estate Tax Reduction Planning	• Involve transfer of wealth to children prior to appreciation – These strategies are detailed on a separate slide

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Estate Freeze Transactions

A number of estate planning techniques call for the donor to retain the current value of the transferred asset, while giving away future appreciation. The following are examples of two of the more popular estate freeze transactions:

Sales

- A simple example of an estate freeze is a sale of an asset in exchange for a promissory note. For example, instead of making a gift of a 20 percent interest in a $10 million business, you sell the 20 percent interest to a child and take back a promissory note for its current discounted fair market value (as appraised). The promissory note, in the principal amount of $1.4 million, must bear interest at a minimum rate so as not to be deemed a gift by the IRS. That rate typically is lower than interest rates found on the market. When the business is sold, the child will receive $2 million (or more, if there is greater appreciation above the undiscounted appraised value) and pay off the note with $1.4 million. The excess sale proceeds pass to your child free of gift tax. This strategy can be enhanced by selling the asset to a trust of which you, as donor, are treated as the income tax owner (many refer to this as a "sale to a grantor trust"). In that event, there would be no capital gain recognized upon the sale to the trust in which your child has a beneficial interest, interest payments from the trust would not be taxable income, and you (not the trust or your child) would be required to pay the capital gains tax upon the sale of the business to the third party. Under this structure, you may be able to transfer additional wealth as a result of the valuation and the income tax structure

GRATs

- A grantor retained annuity trust (GRAT) is a trust to which you, as donor, will transfer assets, such as a minority interest in the business. Under the terms of the trust, you will receive an annual annuity for a term of years. In structuring the GRAT, the present value of the annuity stream will equal the value of the transferred assets so that there is no taxable gift (a "zeroed-out" GRAT). For example, if, instead of selling your 20 percent interest for $1.4 million, you transferred a 20 percent interest to a GRAT with a 5-year term, the GRAT would require the Trustee to pay you $280,000 per year (5x $280,000 = $1,400,000). The IRS requires you to include a growth rate in the present value calculation, which is published by the IRS monthly. Similar to the rate for intra-family loans, this rate is typically lower than interest rates found on the market. Therefore, in order to zero-out the GRAT, the annuity must include this assumed rate of growth. If, during the 5-year period, the business is sold, the GRAT will receive cash, and owe you $280,000 a year (plus 4.6%). If the sale proceeds exceed that amount, the excess value may pass to your children free of transfer tax. A GRAT also is a "grantor trust" for income tax purposes, meaning that you would pay the capital gains tax upon sale out of other funds, allowing the pre-tax proceeds to pass to the next generation

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Gifting Techniques

Are there techniques to assist in gifting?

- *Numerous tools exist to assist in gifting. Below is a non-exhaustive list of some of them.*

Outright Gifts

- A donor may decide to make simple gifts to his or her children, or to a trust for their benefit by giving them privately held stock
  - Example: Executive gifts $19,000 (the 2026 annual gift exclusion amount) worth of his company's stock to a trust for his child. One year later, the company goes public and the stock in the trust is now worth $42,000

Use of the Estate Tax Exemption

- A donor may, in addition to the annual exclusion amount, gift assets worth up to the total lifetime Gift and Estate Tax Exemption during their life without incurring gift tax
  - Example: In addition to gifting the $19,000 annual gift exclusion noted above, the same executive gifts $10MM worth of their stock to the child's trust. One year later the company goes public and the stock in the trust is worth $30MM

Estate Freeze Transactions

- A number of estate planning techniques call for the donor to retain the current value of the transferred asset, while giving away future appreciation
  - Two examples of the more popular estate freeze transactions are on the prior slide

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Gifting Techniques (CRT)

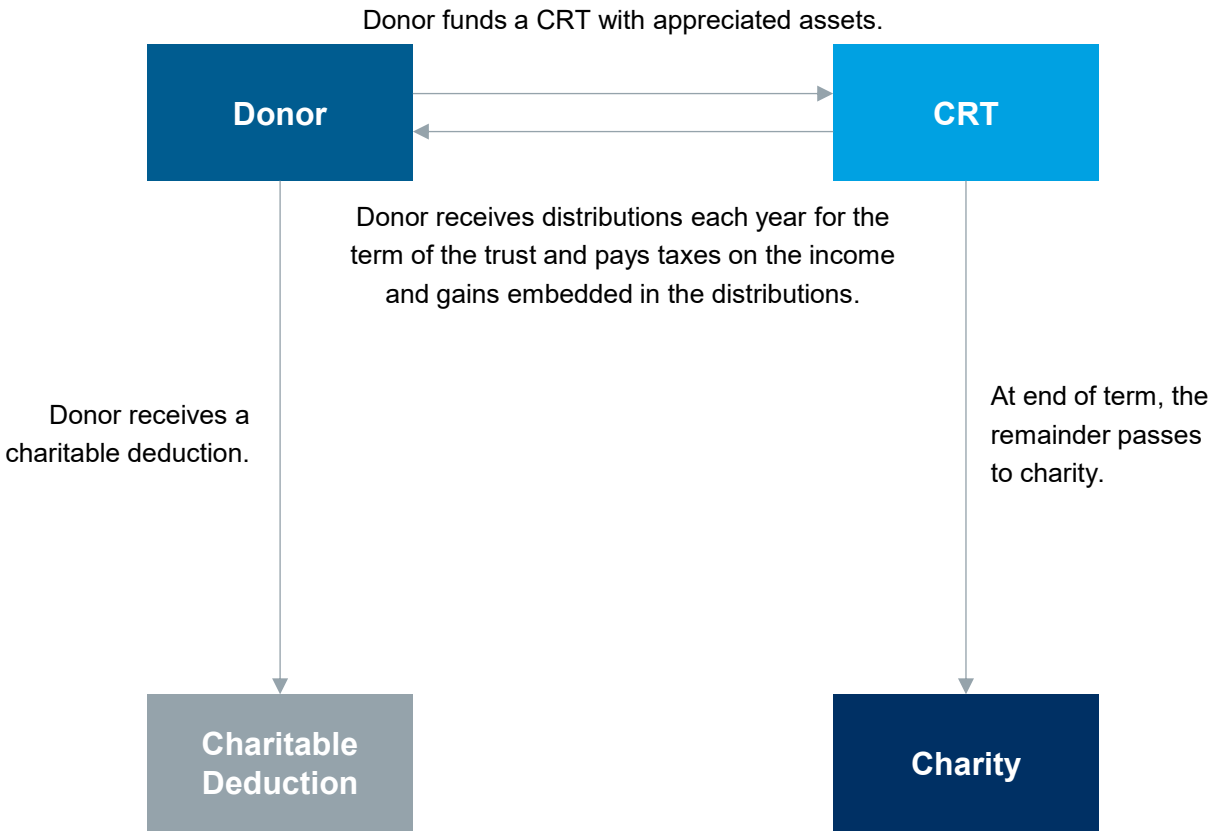
- *An additional income tax planning tool to assist in gifting is a Charitable Remainder Trust.*

Charitable Remainder Trust (CRT)

- Similar to a GRAT, the donor transfers property to a trust that makes an annual annuity payment to the donor for a period of time. In this case, the annuity can be a fixed percentage of the initial value or a fixed percentage of the value of the trust property redetermined annually. The remainder interest will pass to one or more charitable organizations. The remainder interest must be at least 10 percent of the initial gift. If the assets increase in value, any excess will inure to the benefit of charity
- However, the CRT may provide additional income tax benefits. The initial gift of a remainder interest (no less than 10% of the initial value) can generate an income tax deduction
- Moreover, CRTs are tax exempt entities, therefore, there is no immediate capital gains tax upon the sale of the business. Each annual annuity payment to the donor will carry out a portion of the imbedded capital gain
- As a result, additional wealth may be created via the income tax deferral. In this case, the donor can achieve both tax planning and charitable goals simultaneously

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Charitable Remainder Trust (CRT)



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Charitable Remainder Trust (CRT)

Funding a CRUT with Appreciated Assets

- The following is an illustration of a Charitable Remainder Unitrust (CRUT) funded with $1,000,000 in appreciated assets (zero cost basis). The trust has a 5-year term and a 10% charitable deduction. The donor's personal account collects the Unitrust distributions from the CRT
- In this hypothetical illustration, the charity receives a remainder of $139,069 at the end of the term, whereas the personal account has an ending value of $1,023,185

CRT

Gross Principal	$1,000,000
Cost Basis	$0
7520 Rate	4.6%
Term of Trust	5
Unitrust Rate	38.82354%
Annual Investment Gross Return	6.0%
CRUT Remainder	$136,800

YEAR	BEGINNING PRINCIPAL	GROWTH	TOTAL	UNITRUST AMOUNT	REMAINDER
1	$1,000,000	$60,000	$1,060,000	$386,021	$673,979
2	$683,979	$40,439	$724,418	$260,170	$454,248
3	$454,248	$27,255	$481,503	$175,349	$306,153
4	$306,153	$18,369	$324,522	$118,182	$206,341
5	$206,341	$12,380	$218,721	$79,652	$139,069

PERSONAL ACCOUNT
(Initial value reflects tax savings from charitable deduction)

Charitable Deduction	$100,005
Marginal Tax Rate	40.8%
Potential Tax Savings	$40,802
Investment Period	5
Capital Gains Tax Rate	23.8%
Annual Investment Gross Return	6.0%
Ending Portfolio Value	$1,023,185

YEAR	PERSONAL ACCOUNT	NET UNITRUST PAYMENT	AFTER TAX GROWTH	TOTAL
1	$40,802	$294,148	$20,097	$355,047
2	$355,047	$198,250	$33,198	$586,494
3	$586,494	$133,615	$43,207	$763,317
4	$763,317	$90,055	$51,202	$904,574
5	$904,574	$60,695	$57,916	$1,023,185

Remainder @ 8% ROR: $160,965 Personal Account Ending Value @ 8% ROR: $1,136,681
Remainder @ 4% ROR: 119,624 Personal Account Value @ 4% ROR: $919,016
Hypothetical example is for illustrative purposes only. Not representative of any specific investment.
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Executive Pre-Liquidity Charitable Giving

Should a pre-liquidity executive engage in charitable planning?

While a decision to engage in philanthropy is inherently personal, there are good tax reasons to transfer pre-liquidity stock to charity rather than waiting for a liquidity event. Timing, however, is key to success. Compare the following hypothetical scenarios.

- An executive holds stock in their private company. The company sells in an all-cash transaction. The executive incurs long term capital gain tax on the sale of their stock and then makes a gift of $1MM to charity. They receive a $1MM charitable income tax deduction
- An executive holds stock in their private company. A few months prior to a planned sale of the company, the executive transfers $1MM worth of their stock to a public charity willing to accept the stock. Upon sale, the charity pays no tax and receives $1MM. Upon transfer, the executive receives a $1MM charitable income tax deduction. The executive avoids long term capital gain tax on the gifted stock since they did not own it at the time of sale

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- Timing is important. The executive would like to maximize the value of the stock upon transfer to charity, while at the same time avoiding the tax when a sale occurs. A transfer too close to the sale, however, could result in the capital gain on the stock being attributed to the executive even though the charity owned it at the moment of sale
- There are advantages to giving private stock to a public charity rather than a private foundation. A gift of private stock to a private foundation generally results in a charitable income tax deduction limited to cost basis rather than fair market value. A gift of the same stock to public charity results in the deduction being valued at fair market value. It can be difficult, however, to find a public charity to accept such stock. In such a case, the executive may wish to consider a gift to a Donor Advised Fund (“DAF”)

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Public Versus Private Considerations

What considerations are there in a public rather than a private sale?

- *Generally speaking, there are three basic liquidity scenarios: a cash sale, a tax-free stock acquisition (usually by a public company), or an IPO. Each involves different considerations.*

Cash Sale

- A cash sale will trigger long-term capital gains tax on stock held for the requisite holding period, short-term gain on stock held short-term, and ordinary income on option spread if options are cashed out as a result of the sale.

Tax-free Reorganization

- A stock acquisition generally results in shareholders exchanging private stock for fully liquid stock in a public company (assuming it is a public company which acquires the private firm). There is generally no federal income tax effect to this transaction until the shareholders sell shares of the public company. Their tax basis remains the same. However, the shareholders have traded risk in holding their private company stock (a company which they may have controlled) for public market risk and specific risk in the acquiring company (which the shareholders likely do not control). Options may or may not be transferred to the new company as a result of the transaction. If not transferred, they may be cashed out, resulting in ordinary income tax on the options spread.

IPO

- An IPO has no immediate tax effect on a long-term stock position held by an executive of the newly public company. However, several restrictions on sale may be imposed on the executive, preventing him or her from liquidating their position. Options, restricted stock and RSUs are typically unaffected by an IPO, but the fact that there is a public market for the stock can make exercise of options easier. The spread on NQSO exercise is still deemed ordinary income, as is the spread on ISO exercise if the shares are sold in a disqualifying disposition.

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Securing the Family Business For the Next Generation

What strategies are available to a family business that seeks to secure the founders' retirement and continue the business in the hands of the next generation?

- If, instead of going public or engaging in an outright sale of the business, the plan is for the entrepreneur to pass the business to the next generation, such planning should be done prior to appreciation of the stock. Many families find themselves in a difficult position when they realize, after a family business is successful and the founding generation wishes to retire, that the estate and gift tax rules noted above makes it difficult to transfer ownership to the next generation of family members.
- Consequently, it is better to begin to move ownership using (among others) the techniques discussed above sooner rather than later. Also, a family can consider an employee stock ownership plan in order to provide liquidity to the retiring owners on a tax advantaged basis. A family could also consider an installment sale to the next generation, which would allow the purchasers to use the cash flow of the business to pay the retiring owners.

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Business at Death

What will happen to my business at my death?

- Generally, the shareholder or operating agreement of the entity, or a separate “buy/sell” agreement will govern (i) how your equity in the company passes, and (ii) the valuation, liquidation and other rights of your successors in interest.
  - For example, many businesses provide that the equity interests pass under the deceased shareholder’s Will. The governing instruments may give put rights to the beneficiary or provide for mandatory redemption. Voting rights of a beneficiary may be limited so that management of the company remains with the employee shareholders. It is important to identify these provisions in your existing governance documents and review any buy/sell agreement.
- Consider whether additional planning is necessary.
  - For example, will your family want to hold on to the equity in the company or will they need to be cashed out in order to maintain their lifestyle without your current income? If they will need cash, how will the company raise the cash? When a buy-sell agreement is funded with life insurance, a business owner can use the death benefit to purchase the portion of a deceased owner's equity in the business.

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Transition of company at death or prior

How can I plan for a seamless transition of the company at my death or earlier retirement?

- *The key is to have an up-to-date succession plan in place. In order to create a plan, there are a number of considerations regarding the transition of ownership and management, including the following:*

1. Family Business Succession

If the goal is to pass the business ownership and management to family, a succession plan may include:

a) Gifts of equity to children, either outright or in trust, in a tax-efficient manner, similar to preparing for a liquidity event, discussed earlier.

b) Bequests of equity at death along with a liquidity plan for estate taxes.

I. The estate tax generally is due 9 months after the date of death. If the estate consists primarily of illiquid business interests, consider life insurance, the potential for borrowing and any estate tax deferral opportunities for closely held business interests. For example, under current law, if the business represents a significant part of the taxable estate, the executor may be able to defer the tax and pay in instalments over a 10-year period.

II. Consider the allocation of equity among family members. Will each child inherit an equal share? Should the equity pass only to the child who works in the business? Address family conflict issues that may arise based on shared ownership.

2. Management / Employee Succession

If your goal is for employees to continue the business you must have a sound and well-rounded management team. You should plan as far in advance as possible, prepare the company for transition and consider financing options and tax consequences. Methods of transferring ownership to key employees include:

a) Employee Stock Ownership Program (ESOP);

b) Sale to existing or new management (with or without private equity investment); and

c) Gifts to key employees.

3. Governance Issues

a) Will any / all family members participate in management?

b) If employees receive the business, who are the key employees who will oversee day-to-day operations and serve in management positions?

c) How will conflicts be resolved?

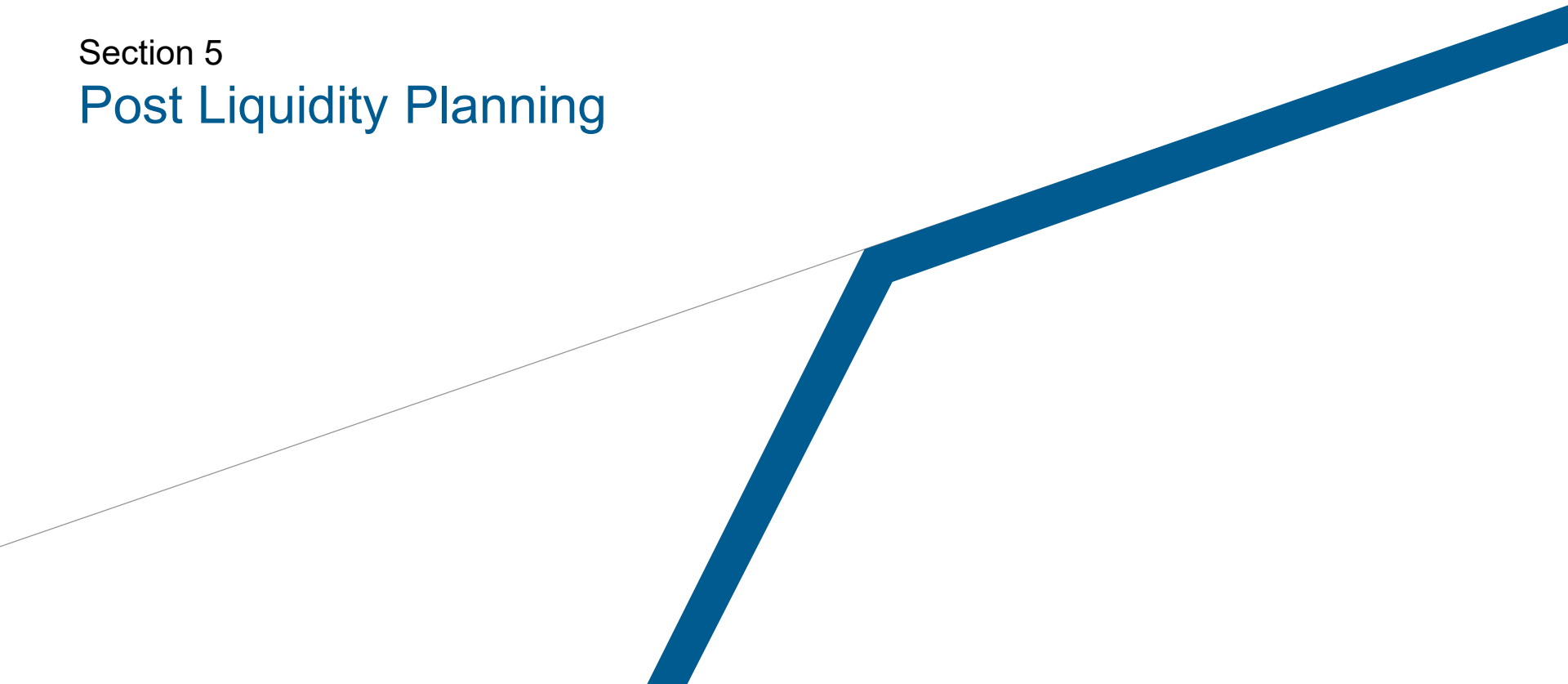
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Morgan Stanley

PRIVATE WEALTH MANAGEMENT

Section 5

Post Liquidity Planning



Considerations for an Executive Holding Non-Public Stock

What considerations are there in a public rather than a private sale?

- *If the executive's company goes public, there are several considerations they should consider, including:*

Whether and how to liquidate the stock in an orderly and tax-efficient manner

- If the executive decides to liquidate, they should be aware of any regulatory (144/16b), corporate (blackout periods) or contractual (lock-up agreements) restrictions which may be imposed on the amount of stock they can sell in any given quarter;
- If possible, they may wish to engage in a hedging transaction to mitigate the risk of holding their concentrated position;
- The executive may wish to consider a 10b5-1 plan to sell stock in an orderly manner and mitigate claims of insider trading;
- Once liquid, the executive may wish to consider re-investing the proceeds to mitigate the risk of their concentrated position. For instance, they may wish to invest away from the sector in which their company operates

How to engage in philanthropic planning that is tax-efficient

- An executive holding public stock can consider gifts to public charities or private foundations;
- The executive may wish to consider the strategies noted above in the pre-liquidity planning section

An Executive Should also Consider:

Family Governance and Wealth Education

Lifestyle Advisory

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Considerations for Liquidated / Cash Position

What are the considerations for a liquidated position?

Considerations for liquid positions include:

Philanthropic planning

Family governance and education

Lifestyle advisory

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Disclosure

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Caution: many estate techniques share the common risk of the loss of control of the assets once the gift of the assets is complete.

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