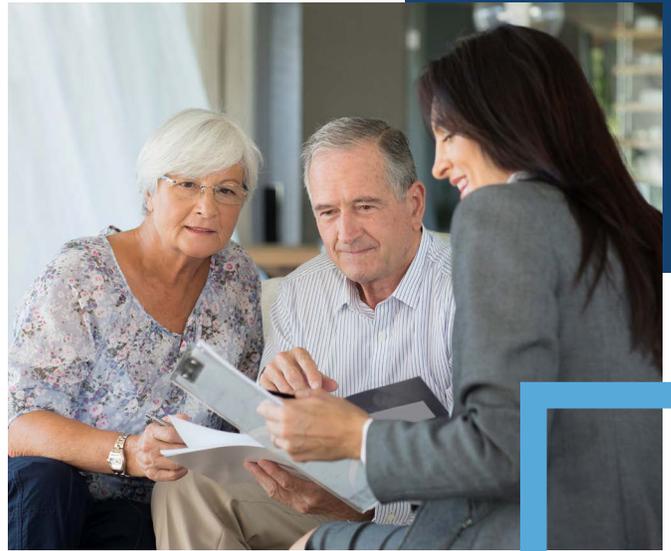


Pre-Transaction Estate Tax Planning



Critical Timelines

The most significant factor in pre-sale gifting is executing transfers before a “value inflection point” occurs, which creates a step-up in valuation that reduces the efficiency of the gift.

- **The “Value Arbitrage” Strategy:** Valuation arbitrage exploits the disconnect between a private asset’s current compliance value (qualified appraisal) and its future realizable value (exit price).
- **The 6-to-12 Month Buffer:** To withstand IRS scrutiny under the “Step-Transaction” or “Anticipatory Assignment of Income” doctrines, substantive time should pass between the gift and the sale.

Ideal Timing:

Transfers should be completed at least 6 to 12 months before an anticipated sale.

The “Risk” Requirement:

Gifts should be made while there are still unresolved contingencies (e.g., due diligence, regulatory hurdles). If a deal is “practically certain” to close, the IRS may tax the donor on the proceeds even if the stock was gifted.

Strategic Valuation Discounting

Valuation discounts allow equity interests to be transferred at values significantly lower than their pro-rata share. This strategy reflects the economic reality that fractional, illiquid private interests are worth less than controlling, liquid public interests.

The Hierarchy of Discounts

Appraisers apply discounts sequentially: control adjustments (DLOC) are assessed first, followed by marketability adjustments (DLOM).

- **Discount for Lack of Control (DLOC):** Reflects a minority shareholder's inability to influence strategy, compel liquidation, or declare dividends.
 - **Typical Range:** 15%–30%
 - **Key Drivers:**
 - **State Law:** Supermajority requirements (e.g., 66.6%) may give minority interests "blocking power," reducing the discount
 - **Swing Vote:** Small interests (e.g., 2%) that break ties between block holders reduce the DLOC
 - **Voting Rights:** Non-voting stock warrants a discount regardless of economic value
- **Discount for Lack of Marketability (DLOM):** Accounts for the risks and costs of converting private interests to cash compared to public securities.
 - **Typical Range:** 20%–40%
 - **Quantitative Models:**
 - **Chaffe:** Uses "at-the-money" put options; best for lower volatility
 - **Finnerty:** Uses average strike price options; generally caps the discount at ~32.3%
 - **Longstaff:** Uses "look-back" options to estimate the discount's upper boundary
 - **Volatility:** Higher market volatility (VIX) increases option prices, justifying a higher DLOM

The Multiplier Effect

Discounts are multiplicative, not additive. The second discount applies to the value remaining after the first.

- **Formula:** $1 - [(1 - DLOC) \times (1 - DLOM)]$
- **Example:** A 10% DLOC and 20% DLOM result in a 28% total discount (not 30%). For a \$1,000,000 pro-rata interest, the taxable value becomes \$720,000.

Substantiation and Defensibility

To withstand IRS scrutiny, valuations must rely on empirical data rather than "rules of thumb."

- **Mandelbaum Factors:** Qualitative adjustments must address specific criteria, including dividend policy, financial health, and transfer restrictions.
- **409A Presumption of Reasonableness:** For early-stage companies (<10 years old), a qualified independent appraisal (often a 409A valuation) shifts the burden of proof to the IRS. While not a statutory "Safe Harbor" for gift tax purposes, consistent use of 409A methodologies provides a defensible baseline.

Common Gifting and Transfer Strategies

1. Intentionally Defective Grantor Trusts (IDGTs) with Installment Sales

This strategy allows a grantor to “freeze” the value of the estate while transferring future appreciation to heirs tax-free.

- **Strategy:** The grantor sells business interests to an irrevocable trust in exchange for a promissory note. The trust is “defective” for income tax purposes, meaning the grantor pays the income taxes on trust earnings, effectively making an additional tax-free gift to the beneficiaries.
- **Benefits:** It avoids the mortality risk associated with GRATs (assets remain outside the estate even if the grantor dies early) and allows for the allocation of GST exemption for multi-generational planning.
- **Timeline Requirement:** The grantor should “seed” the trust with a gift equal to at least 10% of the purchase price prior to the sale to establish the trust’s economic substance.

2. Grantor Retained Annuity Trusts (GRATs)

A GRAT allows a donor to transfer asset appreciation to beneficiaries with little to no gift tax liability.

- **Strategy:** The grantor transfers assets to a trust and retains an annuity for a specific term. If the asset outperforms the IRS Section 7520 hurdle rate, the excess growth passes to heirs tax-free.
- **Zeroed-Out GRAT:** This structure sets the annuity value equal to the initial contribution, resulting in a near-zero taxable gift.
- **Timeline Requirement:** This is a short-term wealth transfer tool (typically 2–10 years). The grantor must survive the annuity term; otherwise, the assets revert to the taxable estate. It requires annual valuations of the business interest.

3. Spousal Lifetime Access Trusts (SLATs)

- **Strategy:** A grantor creates an irrevocable trust for the benefit of their spouse (and potentially other descendants). This removes assets and future appreciation from the grantor’s estate while allowing the spouse access to distributions.
- **Timeline Requirement:** SLATs must be funded with the grantor’s “separate property.” In community property states, spouses must agree in advance to partition property, which can take time to document legally.
- **Reciprocal Trust Doctrine Warning:** If both spouses create SLATs for each other (reciprocal trusts), they should be created in different calendar years or with substantially different terms to avoid the IRS uncrossing them and including the assets in the estates.

4. QSBS “Stacking” with Non-Grantor Trusts

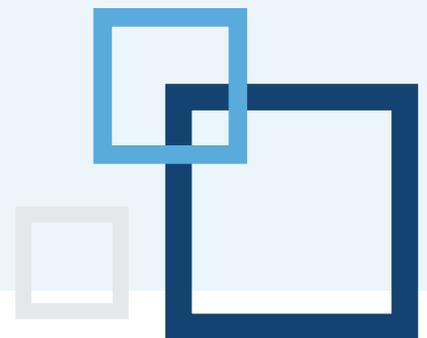
The OBBBA expanded Section 1202 Qualified Small Business Stock (QSBS) benefits, increasing the exclusion cap to \$15 million (indexed for inflation starting in 2027) for stock acquired after July 4, 2025.

- **Strategy:** A founder can multiply the \$15 million exclusion by gifting shares to multiple non-grantor trusts (e.g., one for each child). Each trust, as a separate taxpayer, can claim its own exclusion.
- **Timeline Requirement:**
 - **Holding Period:** Under OBBBA, shares held 3 years get 50% exclusion; 4 years get 75%; and 5+ years get 100% exclusion.
 - **Rollover:** If a sale occurs before the holding period is met, proceeds can be rolled over into new QSBS within 60 days under Section 1045 to defer gain.
- **Legacy QSBS (Pre-July 4, 2025, Issuances):** Stock acquired prior to the OBBBA effective date remains subject to the previous statutory regime:
 - **Exclusion Cap:** Limited to the greater of \$10 million or 10x cost basis.
 - **Holding Period:** Strict 5-year cliff required for any exclusion (no partial exclusion for 3 or 4 years).
 - **Asset Cap:** Company gross assets must have been under \$50 million at the time of issuance.
 - **Planning Note:** Founders of pre-2025 companies may hold “Legacy Stock” while newer investors hold “OBBBA Stock,” creating different liquidity timelines and tax outcomes for the same cap table.
- **Risk Mitigation:** Trusts must be sufficiently distinct in terms of beneficiaries and terms to avoid IRS aggregation under Section 643(f).



Connect with us to learn more

www.naviterwealth.com
team@naviterwealth.com
501.333.9800



Naviter Wealth, LLC (“Naviter”) is a Registered Investment Advisor (“RIA”). Naviter provides investment advisory and related services for clients nationally. Naviter will maintain all applicable registration and licenses as required by the various states in which Naviter conducts business, as applicable. Naviter renders individualized responses to persons in a particular state only after complying with all regulatory requirements, or pursuant to an applicable state exemption or exclusion.

Information provided in this material is for informational and/or educational purposes only and is not, in any way, to be considered investment advice nor a recommendation of any investment, legal, tax, or financial product. Information regarding investment services is provided solely to gain an understanding of our investment philosophy, our strategies and to be able to contact us for further information. Advice may be provided by Naviter’s advisory personnel only after an advisory agreement has been executed and Naviter has received all requested background and account information. Consult with a qualified professional before making any legal, tax, investment, or financial decision. Different types of investments involve varying degrees of risk. Therefore, it should not be assumed that future performance of any specific investment or investment strategy will be profitable. Asset allocation may be used in an effort to manage risk and enhance returns. It does not, however, guarantee a profit or protect against loss. Performance of the asset allocation strategies depends on the underlying investments.

For additional information, please visit our website at <https://naviterwealth.com/>

[Click Here for Naviter Wealth Disclaimers](#)