Guide for Founders, Employees & Early Investors in Private Company Stock

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Part I: Qualified Small Business Stock

What is Qualified Small Business Stock?

QSBS refers to equity issued by U.S. C-corporations that satisfies specific conditions outlined in Internal Revenue Code Section 1202. Eligibility is limited to certain industry sectors, including technology, manufacturing, and retail operations. Companies in financial services, hospitality, and professional services generally do not qualify.

This provision primarily benefits those willing to accept early-stage investment risk. This group includes company founders, initial employees who receive equity compensation, and angel investors. When properly structured, QSBS can deliver substantial federal tax exclusions on capital gains, potentially shielding millions of dollars from taxation when you sell. Because eligibility depends on both the corporation's characteristics and how stock is issued and maintained, early planning becomes critical when structuring equity grants or organizing investment rounds.

Decisions about timing and entity structure when launching a startup or making early investments can create tax differences worth millions. QSBS, equity issued by qualifying C-corporations, offers substantial federal capital gains tax exclusions. The One Big Beautiful Bill Act (OBBBA) significantly enhanced these benefits, making QSBS more attractive for early investors in qualifying U.S. companies. While it encourages entrepreneurship and sustained investment, maximizing its value requires careful planning, detailed record-keeping, and strict IRS compliance.

How to Qualify for QSBS

Capturing QSBS tax benefits requires both the corporation and the equity to meet IRS standards. These requirements, which include mandatory holding periods and limits on excludable gains, changed substantially under the OBBBA. New rules took effect for stock acquired on or after July 4, 2025. Understanding these IRS standards is essential because they directly impact whether founders or investors can claim the exclusion.

Core Requirements (Apply to All QSBS)

Regardless of when you acquired the stock, these conditions must be met:

- Your corporation must be organized as a U.S. C-corporation.
- You must acquire the equity through original issuance (purchases on secondary markets don't qualify).
- At least 80% of corporate assets must be actively used in conducting a qualified trade or business.
- Certain industries are excluded, including finance, law, consulting, hospitality, and other businesses that depend heavily on individual skill or reputation.

If Stock Was Acquired Before July 4, 2025:

- **Holding Period**: You must hold the stock for at least five years
- **Exclusion Amount**: Up to 100% of capital gains may be excluded
- **Gain Cap**: The greater of $10 million or ten times your initial investment

- **Gross Asset Test:** The corporation's gross assets could not exceed $50 million at the time of issuance

If Stock Is Acquired on or After July 4, 2025:

- **Holding Period:** A tiered system now applies
  - Holding for three years yields a 50% exclusion
  - Holding for four years yields a 75% exclusion
  - Holding for five years yields a 100% exclusion (matching prior law)
- **Exclusion Amount:** Up to 100% of capital gains may be excluded (consistent with pre-July 4 rules)
- **Gain Cap:** Increased to $15 million (with inflation indexing starting in 2027) or ten times your initial investment, whichever is greater
- **Gross Asset Test:** The corporation's gross assets cannot exceed $75 million at the time of issuance

Under the expanded regulations, founders benefit from prioritizing QSBS eligibility when structuring their corporation and planning initial fundraising. The previous regulations continue to apply for stock obtained before July 4, 2025. Founders, employees, and investors with pre-July 4 QSBS must still meet the original requirements to claim the federal capital gains exclusion. Additionally, simple agreements for future equity (SAFEs) and convertible notes may not qualify depending on when and how they convert into QSBS. Confirming QSBS eligibility is essential by verifying that the corporation qualified at issuance and that your holding period tracking remains accurate.

The primary benefit of QSBS is the ability to potentially exclude up to 100% of federal capital gains tax when you sell qualifying stock. For stock obtained on or after July 4, 2025, this exclusion applies to the greater of:

- Up to $15 million in gains (for stock obtained on or after July 4, 2025)
- Ten times your initial stock purchase price

Example: A founder invests $500,000 to purchase QSBS shares, holds them for five years, then sells for $8 million. Up to $7.5 million in gains (the greater of the $15 million cap or 10× basis) could potentially receive federal tax exclusion. This generates tax savings exceeding $1.5 million, based on applicable capital gains rates.

This level of tax protection can be transformational for founders. It allows them to reinvest proceeds in new ventures, direct funds toward philanthropic causes, or implement family wealth strategies.

How to Acquire QSBS

Founders and early-stage team members typically obtain QSBS during startup incorporation. To qualify for tax benefits, equity grants or purchases require proper structuring and timely exercise. Founders should:

- **Incorporate as a C-corporation**: QSBS applies exclusively to C-corps. Most startups choose Delaware C-corps because of their favorable legal framework.

- **Issue stock promptly:** Founders benefit from issuing stock as early as possible, ideally at minimal valuation, to maximize potential gains.
- **Use proper documentation:** This includes board resolutions authorizing stock issuance, executed stock purchase agreements, stock certificates, cap tables, and proof of payment.
- **Track holding periods:** Carefully document the minimum five-year holding requirement by maintaining records of all vesting or transfer events.
- **Maintain corporate and financial records:** Demonstrate that the corporation's asset levels and business activities remained below the $75 million threshold at issuance (for stock obtained on or after July 4, 2025).

Angel investors and venture capitalists acquire QSBS by investing in priced equity rounds, provided the issuing corporation qualifies.

How to Sell and Use the QSBS Exemption

When the time comes to sell, proper documentation remains essential. While the IRS doesn't require special filings when acquiring QSBS, you must report gains from sales using Form 8949 and Schedule D of your federal tax return.

To preserve the exemption:

- Maintain detailed records documenting acquisition timing and method. The stock must satisfy QSBS requirements both at sale.
- If you plan to defer gains, evaluate using the Section 1045 rollover, which permits you to reinvest proceeds into another QSBS-qualifying company within 60 days.
- Work closely with your financial, legal, and tax advisors on documentation, elections, and strategic planning, especially if rolling over proceeds or managing trust and estate matters.

What Else to Know About QSBS

Additional regulations and planning strategies can significantly affect your potential tax savings. Understanding these factors early provides valuable advantages, from state law treatment of QSBS to sophisticated planning techniques:

- **Limitations:** The federal QSBS exemption applies per issuer, per taxpayer. Married couples who acquire stock separately can each claim their individual exclusion, potentially doubling the benefit. Under recent law changes, the exclusion cap increased to up to $15 million (with inflation indexing).
- **Federal Advantage:** Many states, including New York and California, don't follow federal QSBS regulations. State tax treatment varies and requires separate review with local tax advisers to understand additional filing requirements or limitations.
- **Sophisticated Strategies Exist:** "Trust stacking" allows QSBS owners to gift shares into one or multiple trusts for different beneficiaries, potentially multiplying federal tax advantages. These strategies involve complexity and require development alongside experienced advisors.

Make QSBS Work for You

QSBS can be transformational, but only with proper groundwork. This goes beyond simply saving on taxes. It involves building your business with a clear vision for the future.

Key Takeaways

- QSBS regulations permit federal capital gains exclusions ranging from 50% to 100%, depending on how long you hold the stock. The maximum benefit applies to gains of up to $15 million or ten times your initial investment (whichever is greater) for stock acquired on or after July 4, 2025.
- To qualify, you must receive shares directly from a C-corporation whose gross assets don't exceed $75 million at the time of issuance. You'll need to maintain ownership for at least three to five years based on the exclusion tier you're targeting.
- Founders, initial team members, and angel investors should implement strategic planning early, track acquisition dates meticulously, and maintain comprehensive documentation to maximize tax benefits under current QSBS regulations.

Part II: 83(b) Election and Early Exercise

What is an 83(b) election?

The 83(b) election is a tax code provision that allows you to choose to pay taxes on startup equity when granted (typically when worth very little) instead of when it vests. Filing an 83(b) locks in that minimal value for tax purposes. Later, if you sell shares after meeting holding requirements, profits may qualify for long-term capital gains treatment, which typically carries lower tax rates than ordinary income. In essence, filing an 83(b) election freezes the taxable value at the grant date.

What is early exercise?

Early exercise permits you to exercise stock options, typically incentive stock options (ISOs), before they vest. Not every company allows this, though it's becoming more common among startups seeking to offer tax-advantaged compensation.

How it works:

- You pay the strike price to acquire the shares, even though they vest over time
- The shares remain subject to the vesting schedule, so leaving the company early could result in losing the shares
- If you file an 83(b) election within 30 days of early exercise, the IRS treats the shares as if you received them immediately rather than when they vest

This timing is important. Filing the 83(b) starts the clock on long-term capital gains treatment. Without the election, you could face owing higher taxes in the future if you exercise your shares and the stock value has appreciated.

Example: An employee receives a grant of 50,000 shares. At grant time, shares are worth only $0.20 each, meaning they can purchase all shares for $10,000. Several years later, the corporation's value climbed to $15 per share, making the shares worth $750,000.

With the 83(b)

The employee chooses to exercise early and files an 83(b) election within 30 days. They pay $10,000 to purchase all 50,000 shares. Since the fair market value of the shares equals the price paid, no taxable income needs to be reported. The IRS considers the employee to have received the shares immediately, and the clock for long-term capital gains begins.

Without the 83(b)

Consider what happens if they didn't file the election. If their shares are exercised and sold several years later, and the corporation's value has climbed to $15 per share, they will owe taxes on $740,000, calculated either as AMT or ordinary income, rather than receiving the favorable tax treatment from long-term capital gains.

When and How to File an 83(b) Election

Timing is critical. The IRS requires that you file an 83(b) election within 30 days of the stock purchase or grant date. No extensions exist. Missing the deadline eliminates the tax benefit.

The filing process:

- Complete IRS Form 83(b)
- Mail it to the IRS within 30 days (use certified mail to obtain proof of submission)
- Keep a copy for your records
- Provide a copy to your employer and consider attaching it to your annual tax return

It's important to recognize that the IRS doesn't send receipt confirmation. Tracking and documenting the filing remains your responsibility.

Downsides and Risks to Consider

While the tax advantages of early exercise and 83(b) are compelling, the strategy carries some risks:

- **Upfront Cost:** You'll need to pay to exercise the shares and potentially pay taxes before knowing whether the corporation will succeed.
- **Forfeiture Risk:** If you leave the company early, you might lose unvested shares without recovering taxes already paid.
- **Stock Devaluation:** If the corporation's value drops after filing, you've paid tax and exercise costs based on a higher valuation.
- **No Reversals:** The 83(b) election is irrevocable. Once filed, you cannot reverse your decision.
- **Alternative Minimum Tax:** For incentive stock options (ISOs), you might trigger alternative minimum tax (AMT) depending on the spread between strike price and fair market value. Consult a tax advisor to evaluate the risk.
- **Liquidity Risk:** Early exercised shares cannot be sold until a liquidity event occurs, such as a tender offer, secondary sale, or IPO, which may be years away.

Making the 83(b) Election Work for You

For founders and early employees, filing an 83(b) election can substantially reduce taxes, though it requires swift action, careful documentation, and clear understanding of your corporation's equity structure.

When executed effectively, this strategy can help transform startup equity into genuine wealth without the tax shock that can accompany success. Seek professional guidance to tailor the approach to your situation.

Planning with Confidence

Understanding equity compensation strategies like early exercise and the 83(b) election is essential for startup success. At PUREfi Wealth, we work closely with founders and early employees to help them navigate these decisions, align their financial plans, and prepare for liquidity events.

Key Takeaways

- Filing an 83(b) election permits you to purchase options and pay taxes when stock is granted rather than when it vests, potentially reducing your tax bill on a future stock sale. Early exercise allows employees to purchase options before they vest, starting the capital gains clock sooner.

- You must file a Section 83(b) election within 30 days of receiving a restricted stock grant or, if you early exercise options and receive shares, within 30 days of exercising those options.

Founders and early startup team members often receive substantial equity grants in exchange for their contributions to building a company. While these grants can be highly profitable, they carry complex tax implications that may surprise you without proper preparation.

Part III: ISOs vs. NSOs

Stock Option Foundational Knowledge

Stock options give recipients the right to purchase company shares at a predetermined price (the exercised price) sometime in the future (vesting date). Recipients don't own shares until options vest and are exercised.

Stock options are typically structured around a vesting schedule, such as four years with a one-year cliff. In this case, no options vest until the employee has been at the corporation for a year, after which 25% vests. The rest vests monthly, quarterly, or annually over the next three years.

It's not just employees who can receive options. Advisers and founders can too. Startups rely on options to attract and motivate talent as well as preserve cash. Founders often receive their individual grants, particularly in early stages.

ISO vs. NSO: Key Differences

There are two main types of stock options: ISOs and NSOs. Though the names might sound similar, there are sharp differences in how they're taxed and who qualifies.

- **Incentive Stock Options (ISOs)** can only be issued to employees, not board members, contractors, or advisers. When structured and exercised correctly, ISOs receive favorable tax treatment: no regular income tax at exercise and potentially only long-term capital gains tax at sale.
- **Non-Qualified Stock Options (NSOs)** can be issued to anyone, though that flexibility comes at a cost. NSOs are taxed as regular income at exercise time on the difference between the strike price and fair market value (FMV) of the stock.

Tax Implications of ISOs

ISOs offer significant tax benefits, though only if you satisfy specific holding requirements. To receive long-term capital gains treatment, you must hold shares for at least two years after the grant date and one year after exercising them before selling.

There's also a catch: the alternative minimum tax (AMT). The "spread" between the strike price and FMV at exercise counts as income for AMT purposes. This can trigger unexpected taxes, particularly if exercised close to a liquidity event.

Example: Say you're an employee granted 75,000 ISOs at $2 and exercised when the FMV hit $8. That's a $450,000 spread, potentially subject to AMT, even if you haven't sold shares.

Founders and early employees should carefully track vesting, monitor FMV, and assess their AMT exposure, particularly before a significant exit or IPO. Working with a tax adviser is crucial.

Tax Implications of NSOs

NSOs are taxed as ordinary income upon exercise. You pay taxes on the difference between the strike price and FMV, and then again as capital gains when you sell if held beyond one year from exercise.

Example: A developer receives 75,000 NSOs with a strike price of $2 per share.

Two years later, the FMV at exercise is $8. The spread per share creates taxable ordinary income. You'll need to manage this tax bill through current savings or by selling shares back to the corporation. Any shares you keep and hold for at least one year can then be sold with standard long-term capital gains treatment.

Reducing the Tax Burden Through Early Exercise

Early exercise means purchasing shares when the FMV is at or close to the strike price, which minimizes the taxable spread. If you exercise early and file an 83(b) election within 30 days, you lock in that lower value and start the capital gains clock immediately. When the corporation grows and the share price rises, most of your future gain gets taxed at the lower capital gains rate instead of the higher income tax rate.

Option Planning for Founders

As a founder, you're likely wearing two hats when it comes to stock options: granting them and receiving them.

When issuing options:

- Use ISOs for employees to offer better tax treatment.
- Rely on NSOs for advisers, contractors, or grants exceeding ISO limits.

When receiving options:

- **Track your timelines:** Most options expire ten years after they're granted or 90 days after leaving the corporation.
- **Act early if you can:** If the stock's value is minimal, consider early exercise and filing an 83(b) election to lock in lower taxes.
- **Watch your timing:** Exercising options in a year when your income is low may minimize tax impact.
- **Look into Qualified Small Business Stock (QSBS):** If your corporation qualifies and you exercise options into stock meeting QSBS criteria, you may be eligible to exclude up to $15 million in gains (or 10x your investment, whichever is greater) from federal capital gains taxes for stock obtained on or after July 4, 2025. The holding period begins when you exercise the options and acquire shares, not when options are granted, so early exercise can be beneficial.

Key Takeaways

- ISOs offer tax advantages though come with strict eligibility and holding requirements.
- NSOs are more flexible though can trigger higher taxes.
- Founders and early employees should understand vesting, early exercise options such as an 83(b) election, and expiration timelines.
- Tax planning and expert guidance are crucial when exercising stock options.

Equity compensation is a central part of startup culture, it's a way to attract and retain talent, as well as the main incentive when cash is tight. Understanding the technical and tax nuances of stock options is essential. Whether you're granting options to employees or receiving them yourself, getting it wrong can mean missed opportunities or unexpected tax bills.

Part IV: Understanding Restricted Stock Units (RSUs)

What are Restricted Stock Units (RSUs)?

Restricted Stock Units (RSUs) are a form of equity compensation where employees receive shares of stock after meeting specific vesting conditions, typically based on time or performance milestones. Unlike stock options, RSUs don't require any upfront purchase. You receive actual shares once they vest.

RSUs have become increasingly popular at later-stage startups and public companies because of the potential value they offer, whereas options can end up underwater if the stock price falls below the strike price.

Tax Implications of RSUs

RSUs are taxed as ordinary income at vesting, not at grant. The taxable amount is the fair market value (FMV) of the shares on the vesting date. Your employer will withhold taxes automatically, often by selling a portion of your vested shares to cover the tax liability.

This is a crucial difference from stock options: you don't control the timing of the tax event. When RSUs vest, you owe taxes.

Example: You're granted 10,000 RSUs that vest over four years (2,500 per year). In year one, 2,500 RSUs vest at $40 per share. That's $100,000 in taxable ordinary income, even though you haven't sold a single share. Your employer typically withholds 22-37% for federal taxes, plus state taxes, often by automatically selling shares on your behalf. It’s important to know what percentage your employer withholds, and if that is enough to cover your income tax liability.

If you hold the vested shares and sell them later, any additional gain or loss is treated as a capital gain or loss. Hold for more than one year after vesting to qualify for long-term capital gains rates on that additional appreciation.

RSUs at Private Companies

RSUs at private companies work differently. Since there's no public market, you typically can't sell shares immediately after vesting. Many private companies use "double-trigger" RSUs, which require both a time-based vesting schedule and a liquidity event (like an IPO or acquisition) before shares actually settle.

With double-trigger RSUs, you don't owe taxes until both conditions are met. This protects you from owing taxes on illiquid shares you can't sell. However, when both triggers do occur, you could face a significant tax bill all at once if multiple years of RSUs vest simultaneously at a liquidity event.

Managing RSU Tax Liability

Since you can't avoid the tax hit at vesting, planning becomes essential:

- **Set aside cash:** If your employer's withholding isn't enough to cover your full tax liability (which is common, since they may withhold at a flat 22% rate while your marginal rate might be higher), save additional funds to cover the shortfall at tax time.

- **Consider selling at vest:** Many employees sell shares immediately upon vesting to cover taxes and diversify their holdings, particularly if they're already heavily concentrated in company stock.
- **Plan for double-trigger events:** If you hold double-trigger RSUs at a private company, prepare for a potentially large tax bill when a liquidity event occurs. You may need to sell a substantial portion just to cover taxes.

RSUs vs. Stock Options

RSUs may provide more certainty. As long as the stock has value, you receive something. They're generally better for risk-averse employees or those joining later-stage companies with potentially higher and more stable valuations.

Stock options may provide more upside potential. If you join early when the strike price is low and the company grows significantly, options can deliver much larger gains than an equivalent RSU grant. However, options require capital to exercise and carry the risk of expiring worthless.

For founders and early employees, options (especially with early exercise and 83(b) elections) may make more sense. For employees joining established startups or public companies, RSUs may offer more predictable value and less complexity.

Key Takeaways

- **RSUs don't require purchase:** Unlike stock options, you receive actual shares at vesting without paying a strike price.
- **Taxes hit at vesting:** RSUs are taxed as ordinary income when they vest, based on the fair market value at that time. Your employer typically withholds taxes by selling a portion of your shares.
- **Private company RSUs often use double-trigger vesting:** You need both time-based vesting and a liquidity event (IPO or acquisition) before shares settle and taxes are due.

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Part V: Participating in a Tender Offer

What is a tender offer?

A tender offer is a company facilitated program where the company or an outside investor purchases shares from existing shareholders at a specified price. Prices typically sit 10% to 30% below the most recent valuation to account for illiquidity and risk.

Tender offers typically occur when:

- Companies want to provide liquidity to early employees and investors while remaining private
- Existing investors want to increase their ownership stake
- New investors seek to acquire meaningful positions before future liquidity events
- Companies are restructuring their capital

How Tender Offers Work

The company announces the tender offer, specifying the price per share, total shares being purchased and eligibility requirements. Not all shareholders may qualify, as companies often prioritize former employees, early investors, or specific employee groups. Shareholders typically have several weeks to evaluate the offer price, their personal financial situation, tax implications and the company's long-term outlook.

If the offer is oversubscribed, shares may be purchased pro rata, meaning you might sell less than you offered. Once the tender closes, participating shareholders receive payment within a few weeks. Decisions are final and cannot be reversed, making careful evaluation essential.

Tax Considerations

Capital Gains Treatment:

- Shares held over one year: Long term capital gains rates (0% to 20%)
- Shares held under one year: Short term capital gains, taxed as ordinary income (up to 37%+)

QSBS Eligibility:

- For shares obtained on or after July 4, 2025, potential exclusions of as much as $15 million in gains or 10× investment (whichever is greater)
- Tiered exclusions: 50% after 3 years, 75% after 4 years, 100% after holding period
- Selling before meeting full holding requirements may permanently forfeit maximum exclusion on those shares
- Each share sold has its own holding period calculation

Other Tax Factors:

- AMT considerations for ISO exercises
- State taxes may not conform to federal QSBS treatment (particularly California and New York)
- Coordinating with overall tax strategy is essential

Should you participate?

Deciding whether to participate requires balancing immediate financial needs against long term wealth building potential. Tender offers can provide capital for important goals like purchasing a home, paying off debt, building an emergency fund or diversifying concentrated holdings. If your wealth is heavily concentrated in company stock, selling a portion can meaningfully reduce risk.

Consider the company's trajectory carefully. Is it on a clear path to IPO or acquisition within 12 to 24 months? Is the business growing consistently or facing headwinds? A tender offer today might provide 60% of what shares could be worth in an IPO two years from now, or it might prove to be an attractive exit if growth stalls. Run scenarios with your tax adviser, as sometimes waiting one more year for QSBS qualification saves hundreds of thousands of dollars in taxes, while at other times immediate liquidity makes sense despite tax costs.

Many shareholders choose to sell 20% to 40% of their holdings to achieve diversification and liquidity while maintaining upside exposure. This balanced approach provides both security and growth potential without forcing an all or nothing decision.

Common Restrictions

- **Minimum holding periods:** Shares may need to be held 1 to 2 years before eligibility
- **Vesting requirements:** Unvested shares typically cannot be sold
- **Employee restrictions:** Current employees may face different rules than former employees
- **Pro rata limitations:** Oversubscribed offers may result in selling fewer shares than you offered
- **Right of first refusal:** Companies may match offers and purchase shares directly

Process Requirements

To participate effectively:

- Review all offer documents thoroughly and note deadlines
- Verify share ownership records are accurate
- Consult legal and financial advisers for significant transactions
- Submit materials early as tender offers operate on strict timelines
- Maintain copies of all documents for tax reporting

Alternatives to Tender Offers

If a tender offer isn't available or optimal:

- **Secondary market sales:** Platforms facilitate transactions between shareholders and qualified buyers (requires company approval).
- **Exercise and hold:** Start holding period clocks for future liquidity.
- **Collateralized loans:** Some institutions offer loans against private shares (carries specific risks).
- **Wait for traditional exit:** Sometimes patience provides better after-tax proceeds.

Making Tender Offers Work for Your Wealth Plan

Tender offers shouldn't be viewed in isolation.

The decision to participate should integrate with your comprehensive wealth strategy, considering your overall financial picture, tax situation, risk tolerance and long-term goals. Work with your advisers to model different scenarios and optimize your after-tax wealth.

Key Takeaways

- Tender offers provide early liquidity for private company shareholders before an IPO or acquisition.
- Tax implications, particularly QSBS eligibility and holding periods, significantly impact net proceeds.
- Strategic participation requires balancing immediate needs against long term wealth potential.

For founders, early employees, and investors in high growth private companies, tender offers have emerged as an increasingly common solution for accessing liquidity before a traditional exit. These structured programs allow shareholders to sell a portion of their holdings while the company remains private.

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Part VI: Gifting Equity to Family

Advantages of Gifting Equity Early

Early-stage shares often have modest valuations yet hold substantial upside potential. That makes gifting equity to children or other family members a powerful strategy for founders and early employees seeking to preserve wealth, reduce tax exposure, and plan for the future.

You've worked hard building or joining a successful business. Now you want to share the rewards with loved ones. One approach involves gifting equity by transferring private company shares to children or other family members. When implemented effectively, these gifts can reduce estate tax exposure and pass future appreciation to the beneficiary.

Some advantages to gifting early-stage shares:

- Reduce future estate tax exposure by moving appreciating assets out of your estate
- Transfer wealth tax-efficiently to heirs or loved ones
- Gift nominal amounts today when value is minimal, limiting the impact on your lifetime gifting exemption
- Potential to qualify for qualified small business stock (QSBS) treatment

Whether you're designing a long-term estate plan or preparing for a near-term liquidity event, gifting private company equity requires thoughtful strategy. The following sections cover key considerations for when to gift, how to structure the transfer, how to navigate valuations, and what tax and legal risks to watch for.

Timing Considerations: Act Early to Maximize Outcomes

Timing can determine the success of your equity gifting strategy.

Consider the difference between gifting shares before versus after a major event like an IPO. A pre-IPO gift locks in the lower value for tax purposes, so future appreciation benefits the recipient, not your estate. A post-IPO gift may still be meaningful, though it comes with higher gift tax cost.

The IRS taxes gifts based on fair market value (FMV) at the time of the gift, not future value. That means it's often best to gift shares before they appreciate significantly, such as before a Series B funding round, IPO, or acquisition.

To establish fair market value, use a qualified 409A valuation from a third-party firm. It's recommended to obtain a qualified appraisal specifically for gift tax purposes. If the IRS believes you under-reported share value, you could owe additional taxes and penalties. A formal appraisal helps document value and reduce the risk of challenge or dispute.

You can also leverage the annual gift tax exclusion, currently set at $19,000 per recipient in 2025. That means you can gift $19,000 in equity to each child, sibling, or other recipient each year without using your lifetime exemption or triggering gift tax. Consider spreading gifts across multiple years or recipients to maximize impact.

Even when staying under the annual limit, file IRS Form 709 to start the statute of limitations and document the gift.

Gifting to Children: Utilizing the Right Trust Structure

Founders and early employees should consider utilizing trust structures to maintain control and plan for the future:

- **Irrevocable Trusts:** Can be used to make outright gifts of shares while removing them from your taxable estate. You can appoint a trustee to manage the assets, establish rules around when and how the beneficiary receives them, and potentially shield the assets from creditors or poor financial decisions.
- **Intentionally Defective Grantor Trust (IDGT):** Allows shares to grow outside your estate while you continue paying income taxes. This effectively "supercharges" the gift by allowing the trust to grow tax-free to the recipient.
- **Grantor Retained Annuity Trust (GRAT)**: Useful for transferring assets expected to appreciate, such as pre-IPO shares, with minimal gift tax consequences.
- **Spousal Lifetime Access Trust (SLAT)**: Married couples can reduce their future estate tax liability by including the spouse as the current beneficiary through a grantor trust.

These structures also help delay access to wealth until children are ready, avoiding sudden windfalls that can create more harm than good.

A Deep Dive into Grantor Retained Annuity Trusts (GRATs)

Few assets have the potential for explosive growth like early-stage startup shares. That's why GRATs are so compelling for founders and early employees holding private company stock.

A GRAT is a type of irrevocable trust that permits you (the "grantor") to transfer assets, including startup shares, while retaining the right to receive fixed payments over a set number of years. The payments are calculated according to a formula set by the IRS and don't change during the GRAT term. At the term's end, whatever remains in the trust passes to heirs or other beneficiaries, often free of gift tax.

The IRS assumes assets inside a GRAT grow at a specific interest rate set by the tax code, Section 7520. If the actual return exceeds this "hurdle rate," the excess value passes to beneficiaries without gift taxes.

To minimize gift tax, GRATs are often structured as "zeroed out," meaning annuity payments are calculated to equal the initial contribution value. That locks in the early, minimal valuation of the startup before a major funding round or IPO and enables you to pass growth to heirs without using any of the lifetime gift tax exemption.

GRATs for Private Company Equity Holders

Structured correctly, GRATs lock in minimal valuations and pass the upside to family members or trusts with little to no gift tax. Using a GRAT, you might transfer startup shares worth $2 million into a trust. If the corporation's value grows to $15 million during the GRAT term, most of that $13 million appreciation could pass to your children, tax-free.

Although assets leave the estate, you can retain economic benefit during the GRAT term, which can range from two to ten years. You continue receiving annuity payments during that time. The key involves funding the GRAT before a known valuation spike or liquidity event and timing that makes this tool powerful yet challenging.

How GRATs Fit into a Broader Estate Plan

Used strategically, GRATs help protect wealth across generations and build a durable legacy, though a GRAT shouldn't be a standalone tactic. It works best as part of a broader wealth transfer strategy that includes irrevocable trusts, valuation discounts, and Qualified Small Business Stock (QSBS) planning.

Since GRATs rely on precise valuations, working with a team that understands startup equity, particularly restricted or illiquid shares, is essential. GRATs can be layered across years (so-called "rolling GRATs") to continue capturing appreciation as a startup matures.

Risk Considerations

You should carefully evaluate several key risks that could impact GRAT effectiveness and significantly affect the anticipated tax and estate planning benefits if not properly managed:

- **Mortality Risk**: If the grantor dies during the GRAT term, assets may revert to their estate, undermining the tax benefit.
- **Loss of Control**: Once assets are transferred into a GRAT, they are legally owned by the trust during the term. You might have some administrative control if serving as a trustee of the trust, though you cannot reclaim the trust principal aside from annuity payments. At the term's end, any remaining assets pass to beneficiaries.
- **Cost and Complexity**: GRATs can be expensive to establish and manage. The valuation and legal fees can be significant, particularly with illiquid or hard-to-value private company stock.
- **Timing**: A GRAT that starts too late, such as after a funding event or IPO, may offer lesser benefit.

Best Practices for Considering a GRAT

If you're exploring a GRAT, approach the strategy with careful planning and expert guidance to maximize its benefits. These best practices are particularly important in the context of fast-growing, privately held companies:

- **Act Early:** The optimal time to use a GRAT is before a valuation spike, not after.
- **Structure Smartly:** Short-term GRATs of two to three years reduce mortality risk and make it easier to pivot as the corporation grows.
- **Coordinate Across Strategies:** GRATs should align with your vesting schedules, QSBS qualification, and other trust planning tools like IDGTs or Dynasty Trusts.
- **Use the Right Experts:** Engage attorneys and valuation professionals who specialize in high growth, privately held companies.

Tax and Compliance Considerations

Beyond timing and structure, you'll want to keep tax law and compliance front of mind.
If your shares qualify as qualified small business stock (QSBS), gifting can significantly enhance the tax benefit. Each recipient may claim their individual QSBS exclusion of up to $15 million or 10x the stock's basis, whichever is greater, for stock obtained on or after July 4, 2025.

However, the holding period resets at the time of the gift, and recipients must satisfy the three to five-year holding requirement themselves to benefit from the exclusion. Timing and documentation are key.

Don't forget legal and governance issues. Private companies often have restrictions on share transfers. Review your shareholder agreements, notify your board, and consult legal counsel before moving forward.

Key Takeaways

- Gifting private company equity early in a corporation's life cycle can significantly reduce estate tax exposure when designed properly.
- Trust structures like IDGTs, GRATs, and SLATs provide flexibility and control when gifting to children and family members.
- Obtaining accurate valuations and adhering to IRS compliance are essential to avoid potential future tax liabilities.

Part VII: Gifting Equity to Charity

Advantages of Gifting Private Company Stock to Charity

Giving back is often a priority for founders, early employees, and investors who have built wealth through private company equity. Charitable gifting of stock can be a powerful way to support causes you care about while realizing substantial tax benefits.

When you donate appreciated private company stock directly to a qualified charity, you typically receive two key tax benefits:

- Avoid capital gains tax on the appreciation. If you sold the shares first and then donated the cash, you'd owe capital gains tax on the gain. Donating stock directly eliminates that tax.
- Claim an income tax deduction for the fair market value of the shares at the time of donation, subject to certain limitations based on your adjusted gross income.

These benefits make donating appreciated stock far more tax-efficient than donating cash, particularly if you're holding shares that have increased significantly in value since you acquired them.

Unlike gifting to family, charitable contributions can eliminate capital gains taxes on appreciated shares and provide immediate income tax deductions. Whether you're looking for a straightforward giving vehicle or a multi-generational philanthropic legacy, there are structures designed to match your goals.

Timing Considerations: Before or After Liquidity

The timing of charitable gifts matters, particularly around liquidity events.

Donating shares before an IPO or acquisition locks in the current (typically lower) valuation for deduction purposes but avoids capital gains tax on future appreciation. Donating after a liquidity event may provide a larger deduction but could trigger capital gains if you've already sold shares.

For private company stock, obtaining a qualified appraisal is essential to support your charitable deduction, particularly for donations exceeding $5,000. Work with valuation experts familiar with illiquid, restricted shares to ensure IRS compliance.

Donor-Advised Funds (DAFs)

A Donor-Advised Fund (DAF) is one of the most popular and accessible charitable giving vehicles, particularly for individuals who want simplicity and flexibility.

How DAFs Work

You contribute cash, securities, or other assets (including private company stock) to a DAF sponsored by a public charity. You receive an immediate tax deduction for the contribution. The assets are invested and grow tax-free. Over time, you recommend grants from the fund to qualified charities of your choice.

Benefits of DAFs:

- **Immediate tax deduction** when you contribute, even if you don't distribute the funds to charities immediately
- **No ongoing administrative burden** compared to running a private foundation. The DAF sponsor handles compliance, tax filings, and due diligence on recipient charities.
- **Flexibility** to recommend grants over time as your philanthropic priorities evolve
- **Lower cost and complexity** than establishing a private foundation. Many DAF sponsors accept initial contributions as low as $5,000 to $25,000.

DAFs work particularly well for founders and employees who receive RSUs or exercise options and want to offset the resulting tax liability with charitable contributions. They're also ideal if you're not yet sure which specific charities you want to support but want to lock in a tax deduction now.

Limitations of DAFs

While DAFs offer simplicity, they come with some restrictions. You cannot use DAF assets to fulfill legally binding pledges, buy tickets to charity events, or gain direct control over investments. Contributions are irrevocable, and while you can recommend grants, the DAF sponsor has final approval.

For individuals seeking more control, a private foundation may be more appropriate.

Charitable Remainder Trusts (CRTs)

A Charitable Remainder Trust (CRT) allows you to donate appreciated private company stock while retaining an income stream for yourself or other beneficiaries for a specified period or for life. At the end of the trust term, the remaining assets pass to charity.

How CRTs Work

You transfer appreciated stock into an irrevocable CRT. The trust sells the stock without paying capital gains tax. You (or other beneficiaries) receive income payments from the trust, either as a fixed amount (Charitable Remainder Annuity Trust, or CRAT) or as a percentage of the trust's value (Charitable Remainder Unitrust, or CRUT). When the trust term ends, the remaining assets go to the designated charity or charities.

Benefits of CRTs:

- Avoid capital gains tax on the sale of appreciated stock
- Receive an immediate income tax deduction based on the present value of the charitable remainder
- Generate income for yourself or beneficiaries over time
- Diversify holdings from concentrated private company stock without triggering immediate capital gains

CRTs work particularly well for individuals approaching retirement who want to convert illiquid startup equity into a diversified income stream while supporting charitable causes.

Charitable Lead Trusts (CLTs)

A Charitable Lead Trust (CLT) works in reverse of a CRT. Instead of providing income to you first and the remainder to charity, a CLT provides income to charity for a set period, with the remaining assets ultimately passing to your heirs.

How CLTs Work

You transfer appreciated private company stock into an irrevocable CLT. The trust makes annual payments to one or more charities for a specified term (often 10 to 20 years). At the end of the trust term, the remaining assets pass to your designated beneficiaries, typically family members.

Benefits of CLTs:

- Reduce gift and estate taxes by transferring appreciating assets to heirs at a reduced tax cost
- Support charitable causes during the trust term
- Pass significant wealth to heirs if the trust assets appreciate faster than the IRS assumed rate of return

CLTs are particularly attractive for founders and early employees holding fast-growing private company stock. If the stock appreciates significantly during the trust term, your heirs receive the excess appreciation with minimal gift or estate tax consequences.

CLTs require careful planning and are best suited for individuals with substantial charitable intent and long-term wealth transfer goals.

Private Family Foundations

For individuals and families with significant wealth and a desire for direct control over their philanthropy, a private family foundation offers the most comprehensive solution.

What is a Private Family Foundation?

A private family foundation is a nonprofit organization, typically established as a 501(c)(3), that receives most of its funding from a single individual, family, or corporation. Unlike public charities, private foundations are subject to stricter IRS rules but offer greater control over grant-making and investments.

Benefits of Private Foundations:

- Full control over which charities receive funding and how much they receive
- Multi-generational engagement by involving children and grandchildren in grant-making decisions and board service
- Public recognition for your family's philanthropy
- Flexibility to fund a wide range of charitable activities

Key Requirements and Considerations

Private foundations are subject to additional IRS rules and restrictions:

- **Minimum annual distribution:** Foundations must distribute at least 5% of their net investment assets each year to qualified charities.

- **Excise tax on investment income**: Foundations pay a 1.39% tax on net investment income.
- **Strict prohibitions**: Foundations cannot engage in self-dealing, hold excess business holdings, make jeopardizing investments, or make taxable expenditures.
- **Annual tax filings**: Foundations must file Form 990-PF annually, which becomes public record.
- **Costs**: Establishing and maintaining a foundation involves legal, accounting, and administrative costs. While there's no official minimum, an endowment of at least $1 million is often recommended for sustainability.

How to Establish a Private Foundation

Forming a family foundation involves several key steps:

1. **Define your vision and purpose**: Clarify your philanthropic goals and values. What causes are you passionate about? What impact do you hope to achieve?
2. **Establish legal structure and governance**: Choose a legal structure (typically a 501(c)(3)), form a board of directors or trustees, and draft bylaws and governing documents.
3. **Obtain necessary registrations**: Apply for an Employer Identification Number (EIN) and file Form 1023 with the IRS for tax-exempt status.
4. **Fund your foundation**: Transfer cash, appreciated securities (including private company stock), real estate, or other assets.
5. **Implement operations and procedures**: Establish a grant-making process, develop record-keeping systems, and adhere to annual reporting requirements.

Private Foundations vs. Donor-Advised Funds

For individuals with smaller budgets or those seeking a simpler approach, DAFs may be more suitable. DAFs require minimal setup costs, no ongoing administrative burden, and no minimum annual distribution requirements. However, they offer less control and no ability to employ family members or build a public philanthropic identity.

Private foundations are best suited for families with at least $1 million in assets to donate, a desire for direct control, and an interest in multi-generational philanthropic engagement.

Donating Private Company Stock to Foundations and DAFs

Both private foundations and DAFs can accept donations of private company stock, though the process requires careful coordination.

Private company stock is considered "closely held," which means:

- You'll need a qualified appraisal to support your charitable deduction.
- The foundation or DAF sponsor must be willing to accept illiquid, restricted shares.
- The recipient may face challenges selling the shares, particularly if the company has transfer restrictions or no active market.

Work with your legal and tax advisers to ensure the stock transfer complies with shareholder agreements and securities laws. Some DAF sponsors specialize in accepting complex assets like private company stock, while others may decline such contributions.

Integrating Charitable Giving with QSBS Planning

If your private company stock qualifies for QSBS treatment, charitable giving can help you maximize the exclusion.

QSBS allows you to exclude up to $15 million in gains (or 10x your basis, whichever is greater) from federal capital gains taxes for stock obtained on or after July 4, 2025, assuming you meet the holding period and other requirements.

By donating QSBS-eligible shares to charity, you can:

- Claim a charitable deduction for the full fair market value
- Preserve your QSBS exclusion for other shares you sell
- Support causes you care about while optimizing your overall tax strategy

Coordinate with tax advisers to ensure your charitable giving strategy aligns with your QSBS planning and overall wealth management goals.

Support and Solutions from Your Team of Advisers

Equity is among the most valuable assets founders, employees, and early investors own. Gifting shares to family or charity can be a powerful way to share success, plan for the future, manage taxes, and create lasting impact.

The right team (your attorney, tax adviser, and wealth adviser) can help you navigate each step, from valuation and entity formation to compliance and grant-making strategy.
At PUREfi Wealth, we work closely with founders, employees, and early investors to tailor estate, gifting, and charitable strategies that match your goals, values, and company stage.

Key Takeaways

- Donating appreciated private company stock to charity can provide significant tax deductions while avoiding capital gains taxes.
- Donor-Advised Funds (DAFs) offer a simple, flexible approach to charitable giving for those with smaller gifting budgets.
- Charitable trusts and family foundations provide sophisticated strategies for larger estates and multi-generational philanthropy.

Part VIII: Working with PUREfi Wealth

Navigating the complexities of private company equity, from QSBS qualification to 83(b) elections, estate planning strategies and stock option decisions, requires specialized expertise and proactive planning. The difference between maximizing your wealth and leaving money on the table often comes down to timing, documentation and strategic execution.

At PUREfi Wealth, we specialize in working with founders, early employees and investors as they build, grow and ultimately monetize their equity positions.

Our team understands the unique challenges of private company stock and can help you:

- Optimize your equity compensation strategy from day one
- Structure grants and exercises to maximize tax efficiency
- Implement sophisticated estate planning techniques like GRATs and trust stacking
- Navigate liquidity events with confidence
- Coordinate seamlessly with your legal and tax advisors

Whether you're just incorporating, preparing for your next funding round, or approaching a liquidity event, we're here to help you make informed decisions that protect and grow your wealth for generations to come.

Ready to optimize your equity strategy? Contact PUREfi Wealth today.

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About PUREfi Wealth

Headquartered in Boston, PUREfi Wealth is an independent wealth advisory boutique. The firm is deeply committed to providing comprehensive, multi-generational advice, wealth planning, and investment management to individuals, families, and their associated entities, and operating under a fiercely independent and objective fiduciary standard through a state-of-the-art open architecture investment and technology platform.

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