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Strategic Tax Planning for High-Net-Worth Individuals

Paper II: Navigating Mega-Cap Tech Exits & Tax Arbitrage

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1. Pre-Liquidity Friction & The Cash Deficit Model

The June 12, 2026 debut of SpaceX (NASDAQ: SPCX) at US\$135 per share unlocked a US\$1.7 trillion market capitalization, establishing a historic liquidity milestone for early equity holders. However, converting concentrated equity into liquid capital introduces significant friction. For stakeholders domiciled in California, navigating this transition without robust structural planning results in immediate, severe capital erosion.

This risk is driven by the California fiscal regime's strict non-conformity with federal capital gains tax treatments. Unlike the federal framework, which incentivizes long-term investments with preferential rates of 0%, 15%, or 20%, California taxes all realized capital gains as ordinary income. Under this structure, gains are subject to the state's highest income tiers, topping out at a 13.3% marginal rate (inclusive of the 1% Mental Health Services Tax).

1.1 The Fiscal Drag Profile (2026 Baseline)

Taxation Layer	Peak Marginal Rate	Trigger Mechanisms
Top Federal Income Bracket	37%	RSU vesting events, NSO exercises, short-term dispositions
Federal Long-Term Capital Gains	20%	Equity positions maintained for 12+ months
Net Investment Income Tax (NIIT)	4%	Passive investment income exceeding statutory thresholds (US\$250K Married Filed Jointly)
California State Surcharge	13%	Universal application across all income classes; no capital gains preference
Estimated Aggregate Liability (Ordinary)	~54.1%	Applicable to high-bracket executives triggering RSUs or options
Estimated Aggregate Liability (Long Term Capital Gain)	~37.1%	Applicable to long-term shareholders retaining California residency

1.2 Option Mechanics & The Phantom Income Trap

Standard corporate withholding consistently fails to cover the true tax liability for California residents. This discrepancy creates a severe cash-flow deficit prior to the expiration of the lockup period.

A. Restricted Stock Units (RSUs): The Structural Deficit

RSU tax liabilities are triggered strictly upon vesting, independent of market liquidity or trading blackouts. Since corporate withholding defaults to standard federal rates (22% to 37%), California executives facing a ~54% actual tax rate are immediately exposed to a severe cash-flow deficit.

- Baseline Assumptions: 1,500 RSUs vest post-IPO at an estimated 409A valuation of US\$260/share. Gross Taxable Income is US\$390K. Standard Corporate Withholding (22%) is US\$85.8K. Actual Blended Liability (~52.5%) is US\$204.75K (calculated as 390K x 52.5%).
- The Liquidity Deficit: The executive is left with a US\$118.95K unfunded tax liability requiring out-of-pocket estimated tax payments, while the shares themselves remain legally locked from sale due to the share lockup.

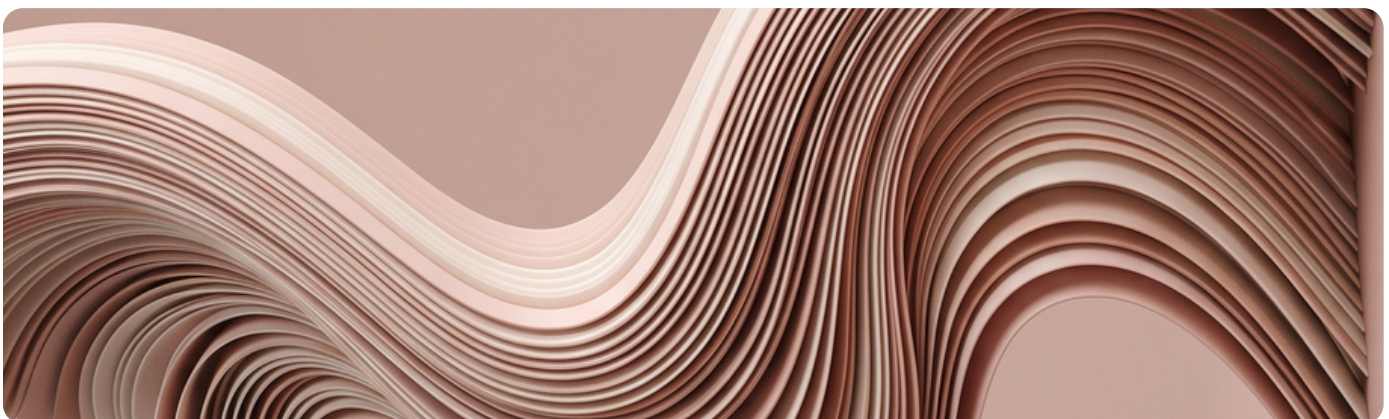
B. Incentive Stock Options (ISOs): The AMT & State Conflict

Federally, exercising an ISO defers ordinary income tax, treating the embedded gain strictly as an Alternative Minimum Tax (AMT) preference item. However, California's tax code explicitly ignores this deferral, classifying the entire exercise spread as ordinary income subject to the 13.3% top rate.

- Baseline Assumptions: Exercising a block of 25,000 ISOs (Strike: US\$35, FMV: US\$115) yields a Gross Spread Value of US\$2M.
- Tax Impact: California exacts an immediate ordinary income tax of ~US\$266K (13.3%), while the spread generates a parallel federal AMT liability approaching US\$560K.
- Strategic Advisory: In cases of severe downward price volatility during the lockup, executing a disqualifying disposition (selling immediately) converts the gain to ordinary income federally but flushes the AMT penalty, often yielding a safer overall tax position.

C. Non-Qualified Stock Options (NSOs): High-Friction Liquidity

Exercising NSOs triggers immediate ordinary income recognition at both federal and state levels based on the spread, demanding massive upfront cash reserves before execution.



2. The 4 Wealth Architecture & Arbitrage Strategies

Passive liquidation results in severe capital erosion. Establishing structural architecture prior to lockup expiration is essential for wealth preservation.

Strategy 1: Charitable Remainder Unitrusts (CRUTs) & Annuity Smoothing

- **The Architecture:** Concentrated equity is transferred into a tax-exempt trust (IRC §664), which liquidates the shares without immediate capital gains. The proceeds are reinvested to generate a fixed annual income for the grantor, with the remainder eventually passing to charity.
- **The Strategic Application:** The grantor bypasses the immediate ~37.1% combined tax liability, defers taxes across the annuity term, and secures a substantial upfront charitable deduction.
- **UHNW CASE STUDY: CRUT DEPLOYMENT**
 - Baseline Assumption: 50,000 shares funded into a 15-year, 7% CRUT (Market Value: US\$6.75M; Basis: US\$200K).
 - Capital Preserved: Circumvents an immediate ~US\$2.5M combined tax liability.
 - Deduction Yield: Generates a ~US\$1.8M upfront charitable income tax deduction and ~US\$472K in first-year liquidity.

Strategy 2: Qualified Opportunity Funds (QOFs) & Geographic Arbitrage

- **The Architecture:** Under IRC §1400Z-2, taxpayers can defer federal capital gains by reinvesting sale proceeds into a Qualified Opportunity Fund (QOF) within 180 days. This postpones the initial federal liability until December 31, 2026.
- **The Strategic Application:** The primary advantage is long-term tax-free growth - assets held in the QOF for over 10 years receive a permanent federal tax exemption on all subsequent capital appreciation.
- **UHNW CASE STUDY: QOF DEPLOYMENT**
 - Baseline Assumption: US\$8M capital gain immediately rolled into a QOF.
 - 2026 Friction: Federal tax is successfully deferred to 2026; however, California's non-conformity mandates an immediate state tax payment of US\$1.06M (13.3%).
 - 2037 Arbitrage: After 10 years, the QOF asset grows to US\$18M. The US\$10M net appreciation is completely exempt from federal taxation, securing a permanent ~US\$2.38M tax shield.



Strategy 3: Charitable Arbitrage & The AGI Shield (DAF vs. Private Foundation)

- **The Structural Friction:** Vesting RSUs or PSUs triggers immediate ordinary income, pushing the executive's AGI into the highest marginal brackets (an estimated 52%–55% blended rate). Because standard corporate withholding defaults to 22%–37%, this creates a substantial tax shortfall and cash deficit.
- **The Strategic Application:** The Dual Tax Shield: Deploying Qualified Charitable Vehicles (QCVs)—such as Donor Advised Funds (DAFs) or Private Foundations (PFs)—redirects tax liabilities into a family legacy. Contributing appreciated equity provides a dual shield: an immediate AGI reduction via a Fair Market Value (FMV) deduction, and a permanent exemption from capital gains and estate taxes.
- **The Architecture Decision:**
 - DAF (Tax First): Optimal for maximizing the upfront tax deduction with minimal administrative complexity.
 - Private Foundation (Control First): Essential for families requiring perpetual control over investments and grantmaking, allowing for permissible family compensation despite higher compliance costs.
 - Strategic Directive: For detailed financial modeling and IRC §4941 compliance frameworks, see our brief: "Strategic Tax Planning for High-Net-Worth Individuals - Paper I: Maximizing Equity Liquidity"

Strategy 4: Algorithmic Liquidation (10b5-1 Blueprints)

- **The Architecture:** Insiders must utilize SEC Rule 10b5-1 trading plans, which enforce a mandatory 90-day cooling-off period to establish a robust affirmative defense against market manipulation claims.
- **The Strategic Application:** While spreading liquidations across multiple years does not lower California's 13.3% top rate, it critically expands the family's AGI absorption capacity. This multi-year income splitting allows wealth holders to maximize charitable deduction ceilings and safely navigate AMT phase-outs.





3. Domicile Defense & State-Level QSBS Disconnect

Federal IRC §1202 (QSBS) provides a massive capital gains exclusion for early-stage investors, but California explicitly decouples from this provision, offering zero QSBS tax benefits (re-confirmed by SB 711).

- **The California Tax Exposure:** A resident qualifying for a full federal exemption on a US\$15 million gain pays US\$0 federally, but immediately owes US\$1.995 million (13.3%) to California. The state taxes are based strictly on residency at the exact time of sale.
- **Relocation & FTB Audit Defense:** While relocating to a zero-tax state prior to liquidity is a common defense, the Franchise Tax Board (FTB) aggressively audits domicile changes within 2–3 years of a liquidity event. Retaining a California home, family presence, or professional licenses can trigger audits with up to an 8-year lookback period.

4. The Algorithmic Execution Blueprint

Execution must be perfectly synchronized with modern multi-tier staggered release windows:

- **T-Minus 0 (Pre-Liquidity Architecture):** Aggregate equity lots, calculate cost bases, and project exact RSU cash-flow deficits. Document QSBS/California non-conformity statuses before public trading opens.
- **T+30 to 90 (The Lockup Incubation):** Fund CRUTs and DAF/Foundation vehicles prior to public earnings releases. Initiate 10b5-1 trading programs to trigger the 90-day SEC cooling-off period.
- **T+90 to 180 (First Tranche Execution):** Liquidate unlocked equity via 10b5-1 routing and match sales with DAF transfers to absorb AGI spikes. Settle Q3 estimated taxes by September 15, 2026, to prevent under-withholding penalties.
- **T+180 to 365 (Full Release & Year-End):** Manage the 180-day lockup expiration on retained shares. Finalize trust hurdle testing, execute federal Form 709 gift tax filings, and settle Q4 taxes by January 15, 2027

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