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Strategic Tax Planning for High-Net-Worth Individuals

Paper I: Maximizing Equity Liquidity

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1 Executive Summary

The core financial challenge for high-net-worth individuals and entrepreneurs following a significant Restricted Stock Units/Performance Stock Units (RSU/PSU) liquidity event is an unexpectedly large tax bill due to insufficient withholding.

When restricted stock or performance shares vest, the company's automatic tax withholding (typically around 22–37%) rarely covers the client's true liability at the top marginal rates, resulting in a significant tax bill.

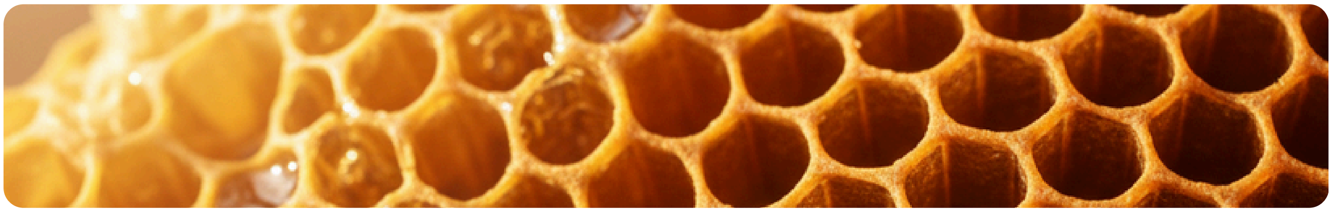
Source of the AGI (Adjusted Gross Income) Escalation

This memo addresses an illustrative scenario in which the client's financial position is dominated by a single vesting cycle of equity awards (RSU/PSU), resulting in the recognition of approximately US$5 million in ordinary income.

- **The Mechanism:** Unlike capital gains, the entire Fair Market Value (FMV) of the stock received from vesting RSUs/PSUs (minus any cost basis, which is often nil) is immediately recognized as ordinary employment income.
- **The Problem:** This income recognition immediately escalates the client's AGI — essentially total income minus certain above-the-line deductions — to US$5 million, subjecting them to the maximum federal and state marginal tax brackets. The resulting tax crisis is driven by the severe discrepancy between statutory withholding rates and the actual liability: the blended marginal tax rate is estimated to be 52% to 55%.

The strategic imperative is to leverage qualified charitable vehicles (QCVs)—Donor Advised Funds (DAF), or Private Foundations (PF)—to create a critical dual tax shield:

- **Income Tax Mitigation:** Immediate reduction in AGI via a charitable deduction for the FMV of contributed assets.
- **Capital Gains Avoidance:** Permanent exemption of the asset's unrealized appreciation from Federal and State capital gains taxation.



QCVs: Why Wealth Transfer & Estate Tax Elimination

Beyond immediate income tax benefits, QCVs serve as a powerful long-term estate planning tool. Once capital is contributed to a DAF or PF, that wealth, and all future growth, is permanently removed from the donor's taxable estate. This exclusion is critical for efficient multi-generational wealth transfer, as the asset's appreciation will bypass potential future estate taxes entirely.

Simply put, this strategy is not merely about "avoiding tax;" rather, it is about legally redirecting money that would otherwise be remitted involuntarily to the IRS into a family-controlled charitable vehicle that reflects your values and legacy.

Below is an illustrative example of tax savings on US$1,000,000 FMV long-term appreciated stock with a US$250,000 cost basis (or US$750,000 unrealized gain) by using DAF or PF:

Benefit Source	Calculation Basis	Estimated Savings
Ordinary Income Tax Offset	$1,000,000 FMV Deduction * 52% Marginal Rate	$520,000
Capital Gains Tax Avoided	$750,000 Unrealized Gain * 33% Blended Rate	$247,500
Total Immediate Tax Savings		$767,500

Specifically,

- **52% Ordinary Income Rate Breakdown:** Includes 37.0% Federal Top Marginal Rate, 3.8% Net Investment Income Tax (NIIT), 0.9% Additional Medicare Tax, and ~10.3% State Marginal Tax.
- **33% Capital Gains Rate Breakdown:** Includes 20.0% Federal Long-Term Capital Gains Rate, 3.8% NIIT, and ~9.2% State Marginal Tax.

2 Strategic Analysis of DAF vs. PF

When faced with a seven-figure tax bill, the complexity of a QCV is justified by the client's ability to retain perpetual family influence and fiduciary control over the US$767,500 in redirected capital.

A. Doctrine of Irrevocability: Fiduciary Control vs. Ownership

To claim a deduction, the donation must be irrevocable. The key difference between a DAF and a PF is how much control the donor retains:

Feature	Donor Advised Fund (DAF)	Private Foundation (PF)
Legal Title/Ownership	Owned by the Sponsoring Public Charity.	Owned by the separate Private Foundation entity.
Donor/Family Access	Strictly Prohibited.	Strictly Prohibited (Subject to IRC §4941 Self-Dealing rules).
Investment Authority	Advisory. Donor recommends from a pre-approved menu.	Fiduciary Control. Donor-appointed Board directly controls investment strategy (subject to IRC §4944 prudent care).
Grant Authority	Advisory. Sponsor retains final legal approval.	Executive Control. The donor/family Board executes all grants.
Mandatory Annual Payout	None.	Required 5% Annual Payout.

B. Control, Deduction, and Suitability

Feature	DAF (Tax First)	PF (Control First)
Tax Deduction	Higher: Deduction is generally based on the full FMV of appreciated securities.	Lower: Deduction for certain non-publicly traded assets is generally limited to the asset's cost basis.
Suitability	Optimal for maximizing the initial deduction, securing simple succession, and minimizing administrative complexity.	Mandatory for clients prioritizing perpetual, executive control over the investment strategy and grant mission.

C. Costs of Formation and Professional Requirements

Feature	Donor Advised Fund (DAF)	Private Foundation (PF)
Start-Up Cost	Minimal to None. Requires an initial minimum contribution (e.g., $5,000-$25,000).	Substantial. Legal and accounting fees often range from $5,000–$15,000 for formation.
Professional Help	A tax advisor is necessary for modeling and contribution strategy.	Mandatory involvement of tax professionals due to the creation of a separate legal entity and ongoing complex compliance.

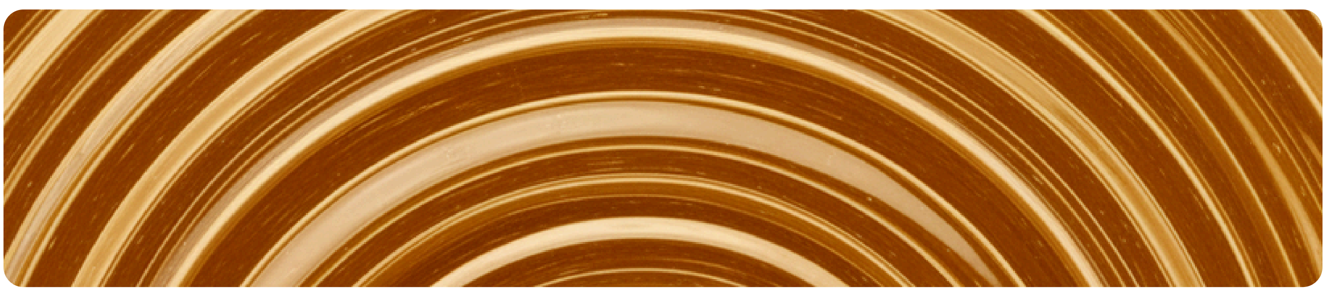
3 Permissible Benefits and Governance

Private Foundations, in particular, offer certain non-financial benefits that cement family involvement. These benefits must be meticulously structured to avoid illegal self-dealing (IRC §4941).

A. Legally Permissible Donations and the Incidental Benefit Rule

Both a PF and a DAF cannot be used to relieve a personal financial obligation (e.g., paying a child's tuition).

- **Permissible Action:** A grant to a private school's general development fund, endowment, or capital campaign is PERMISSIBLE.
- **Rationale:** The school retains full control over the donated funds, and the grant benefits the entire student body. The donor's child receives only an incidental benefit.
- **Benefit to Donor:** The client receives the full tax deduction, and the family secures naming rights and a lasting legacy at the institution.



B. Direct Personal Benefits (Meticulously Structured)

PFs can provide limited, legitimate personal benefits to "Disqualified Persons" (DPs) — such as the donor, family members, or managers — as long as they are reasonable, necessary, and in service of the foundation's mission.

- **Reasonable Salary:** The PF can employ DPs (e.g., donor's child as Executive Director) provided the payment is for personal services that are reasonable and necessary for the PF's exempt purpose, and the compensation is not excessive.
- **Expense Reimbursement:** The PF can reimburse DPs for reasonable and necessary expenses (e.g., travel to a board meeting) incurred on behalf of the foundation.
- **Crucial Distinction:** If the primary purpose of the compensation or expense is to benefit the DP, it becomes illegal self-dealing (IRC §4941).

4 Multi-Generational Legacy and Compliance

Feature	DAF Succession (Simplicity)	PF Succession and Governance (Control)
Mechanism	Naming Successor Advisors in the fund agreement. They assume an advisory grant-making role.	Formal appointment of subsequent generations to the governing Board of Directors/Trustees via Bylaws, transferring financial and mission stewardship.
Transfer	Simple: Continues until the capital is depleted or the sponsor's permitted number of successive generations is reached.	Perpetual: Achieves perpetual family involvement but mandates rigorous adherence to complex compliance.

Key Private Foundation (PF) Compliance Rules:

- **Self-Dealing (IRC §4941):** Prohibits nearly all financial transactions between the foundation and DPs, even if the transaction is fair. Penalties begin at 10% of the amount involved.
- **Excess Business Holdings (IRC §4943):** Prohibits the PF (together with DPs) from owning more than 20% of a business enterprise to prevent control.
- **Jeopardizing Investments (IRC §4944):** Prohibits investments that jeopardize the foundation's ability to carry out its exempt purpose (e.g., margin trading). Penalties begin at 10% of the amount involved.

5 Conclusion

The decision to choose a charitable vehicle must align the client's immediate tax objective with their long-term philanthropic goals. The financial model clearly demonstrates that utilizing either a DAF or a PF provides a superior outcome, redirecting a substantial involuntary tax liability into a controlled charitable legacy.

- If the priority is maximizing the upfront tax deduction and minimizing administrative burden, the DAF (Tax First) is the optimal choice.
- If the priority is perpetual family control over asset management and grant execution, the Private Foundation (Control First) is mandatory.

Regardless of the choice, due diligence with specialized tax counsel is required to ensure compliant structuring, particularly concerning self-dealing and the transfer of appreciated assets. If you have any questions or would like to explore this topic further, please email tax@unityinvestments.com.

$$A = P\left(1 + \frac{r}{n}\right)^{nt}$$

This is Life, Compounded.