Forbes

Robert W. Wood
THE TAX LAWYER

TAXES 6/14/2016

LinkedIn Cash From Microsoft Means Big Taxes For Founders/Employees, Unless...

LinkedIn shareholders can start counting their heady cash payday from Microsoft's $26.2 billion cash buyout, its biggest to date. It is a rich deal even for more modest shareholders. For the biggest, it is, well, astounding. Recent filings suggest that co-founder and chairman Reid Hoffman may own about 11% of LinkedIn. At $196 a share, he could collect up to $2.8 billion.

That is before taxes, of course. And his total taxes could be about $1 billion. In fact, just Reid Hoffman's California tax bill could be massive, exceeding $300 million. For federal tax purposes, at least he would pay capital gain tax rather than ordinary income. Some founders and other employees have trouble with the capital gain rules. That is, some founders received optioned or restricted stock, and must navigate those rules.

LinkedIn CEO Jeff Weiner, Microsoft CEO Satya Nadella and LinkedIn's co-founder and chairman Reid Hoffman (Photo via Microsoft)

Many will have made section 83(b) elections to lock in capital gain on sale. In fact, most founders find a way to claim capital gain treatment on a big payday. At federal tax rates, ordinary income is taxed up to 39.6%. Long term capital gain is taxed up to 20%, although in most cases, one must add 3.8%. This Obamacare investment income tax thus brings the federal total to 23.8%.

Some founders (and other employees) who are selling out companies smaller than LinkedIn may qualify for Qualified Small Business Stock (QSBS) treatment. For the small companies that qualify—generally up to $50 million in assets—shareholders who have held their stock for 5 years may be able to exclude their gain from federal tax. The shareholder limit is usually $10 million, for still: $10 million tax free would be nice.

If you sell QSBS but have not held it for 5 years, there is *another* QSBS benefit. You can *defer* the gain by rolling it over into a *new* investment in QSBS. Of course, much of the most effective planning that goes on for big transactions should happen long before the sale. Family partnerships, foundations, charitable remainder trusts and other techniques can sometimes reduce the blow and achieve other goals.

State taxes can also play a big part. Some states conform to the capital v. ordinary distinction and afford a tax rate preference. Some states—including California—do not. In fact, California's top 13.3% rate applies to both ordinary income and capital gain. It is one reason some people try to avoid California taxes by moving before a major income event. They might be selling a company or settling a lawsuit. Done carefully, and with the right kind of income, it can cut the sting of California's high 13.3% state tax.

Yet even *moving* to avoid California taxes can be tough. California can tax the income of its residents, regardless of where realized. California can also tax California source income, even to non-residents. Stock is an intangible, meaning that it is generally taxed where the shareholder lives. A shareholder who lives in a no-tax state such as Nevada, Texas, Washington or Florida should not face state tax, except on income sourced to another state.

Of course, California and other high tax states may contest whether a move was really effective, or may dispute the *date* when it was effective. You can end up in a messy tax fight. Yet you can still be vastly better off if you have good facts and there are large dollars at stake. This is so even when you factor in lawyer's fees, perhaps even an eventual settlement with the state.

And although states like California have been pushing the envelope for many years, some taxpayers are pushing back. An emerging answer for the adventurous is a Nevada or Delaware Incomplete Gift Non-Grantor Trusts. A

‘NING’ is a Nevada Incomplete Gift Non-Grantor Trust. A ‘DING’ is its Delaware sibling. There is even a ‘WING,’ from Wyoming. The donor makes an incomplete gift—with strings attached—to the trust, and the trust has an independent trustee.

The idea is to keep the grantor involved but not technically as the owner. New York State has changed the law to make the grantor taxable no matter what. California’s Franchise Tax Board says it is studying the issue. Some marketers of NING and DING trusts offer it as an alternative or adjunct to a physical move.

The idea is for the income and gain in the NING or DING trust not to be taxed until it is distributed. At that point, the distributees will hopefully no longer be in California. The chosen trustee must not be a resident of California, and there are other technical rules. And since these trusts may be contested by California, they are not for the faint of heart.

For alerts to future tax articles, email me at Wood@WoodLLP.com. This discussion is not legal advice.