



BERNSTEIN

## Threading the Needle

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Key Considerations When  
Donating Business Interests  
to Charity



Owners and founders of privately held businesses face unique challenges and needs as they navigate a potential exit. Their goals may include retirement or a new passion project, as well as maximizing profits and minimizing taxes. For those who are inclined to give back, business exit planning using charitable strategies may fulfill another dream: donating to a favorite charity or to a community that helped spur on success.

With a significant liquidity event, engaging in charitable giving in the year of sale can help reduce the income tax liability emanating from the transaction. When structured correctly, the business owner receives an income tax charitable deduction for the fair market value of the business interest contributed while avoiding income tax on the subsequent recognition event.

To do so, owners must execute a charitable planning strategy well in advance of signing a binding sale agreement. The process of donating closely held business interests can be incredibly nuanced and complex. And current and pending tax legislation adds yet another layer of intricacy that business owners must surmount.

The benefits of charitable giving depend on the business owner's personal situation and long-term financial goals. In what follows, we cover both the challenges and opportunities when engaging in pre-transaction charitable strategies.



There are many owners who will pursue a strategy for income tax purposes, but these are complicated planning strategies and if you don't pay attention, you can find yourself in a long-lasting charitable plan when you don't have a lot of charitable intent. Once the charitable intent is solidified, then we design a plan to seed their charitable endeavors. If the business owner wants to engage in pre-transaction planning, I recommend starting the dialogue six months prior to a sale.

—Los Angeles  
Trust & Estate Attorney

To deepen our insights, we spoke with several entrepreneurs and their professional advisors who have undertaken pre-transaction planning and successfully donated gifts of business interests to charity. Their experiences and best practices are shared in the pages that ensue.

## Identifying Your Values and Objectives

Undoubtedly, selling a business can be overwhelming. It may mean relinquishing control after spending many years building and growing a company. The complexities may seem daunting, both emotionally and on paper. As the owner embarks on this life-changing wealth-creation event, financial planning around lifestyle spending and legacy remains an important piece of the puzzle.

Identifying values, and prioritizing goals and objectives, are critical first steps. In addition to charitable gifts, the business owner may want to make gifts to descendants and retain access to sale proceeds for their own noncharitable uses, while reserving an appropriate amount for taxes. Defining and communicating desired outcomes many months in advance of the sale is crucial. These conversations can be emotional and complicated, and business owners often benefit from engaging skilled advisors who can help them articulate aspirations and concerns while suggesting strategies and investment approaches designed to meet stated objectives.

Assuming charitable intent exists, the next step is to ascertain the owner's giving capacity. At Bernstein, we use a framework to ensure owners sustain what we call "core capital": the amount of money needed today to secure living expenses for the rest of their lives. We employ our Wealth Forecasting System<sup>SM</sup> to estimate core capital conservatively, assuming individuals may live beyond their actuarial life expectancies, that high inflation might drive up spending needs, and that deep bear markets may depress portfolio values from time to time. Additional assets, if any, are "surplus capital" that can be spent on larger discretionary purchases or given to family or charity. Prior to establishing any wealth transfer strategy, we quantify core and surplus capital to ensure the strategy does not divert assets that are required to meet lifetime spending needs, pay income taxes, or satisfy other personal goals.



It's a really intense experience...I have an accounting and finance background so I knew a lot of these deals are very numbers intensive and the due diligence process was a really stressful time, but I felt like we had put together such a good team to support us that it really helped navigate answers to all the various questions that we had...

—Entrepreneur (high-end apparel firm)

One thing I frequently see is the valuation can sometimes be an afterthought. Planning can be done a lot more efficiently with a good appraiser. I recommend engaging with a valuation firm earlier rather than later in the planning process. There could be a discount on the income tax charitable deduction for the lack of marketability and control, which can be useful to know ahead of the date of the donation.

—Seattle Trust & Estate Attorney

It wasn't all just getting the deal done. There is also a lot of planning around the next steps, and what happens after the deal is done. That was an important part to look beyond—just getting to the finish line. It helped set me up for a smoother transition away from the daily career part of things to the next phase of my life.

—Entrepreneur; Founder (web development company)

## Key Considerations

When transferring closely held business interests to charity in advance of an anticipated transaction, several key factors must be considered.

**Timing:** The timing of the gift is vital. Suppose the sale transaction is expected to close in a few weeks. In that case, the IRS may permit the income tax charitable deduction but may not allow the owner to avoid recognition of capital gain from the pending sale. In general, an owner should donate shares before signing a legally binding sale agreement, and there should be a possibility at the time of the gift that a deal might not occur. On the other hand, an owner shouldn't donate shares years in advance, unless she wants the charitable organization to have a continuing stake in the company. Bottom line: timing is essential for this strategy to work.

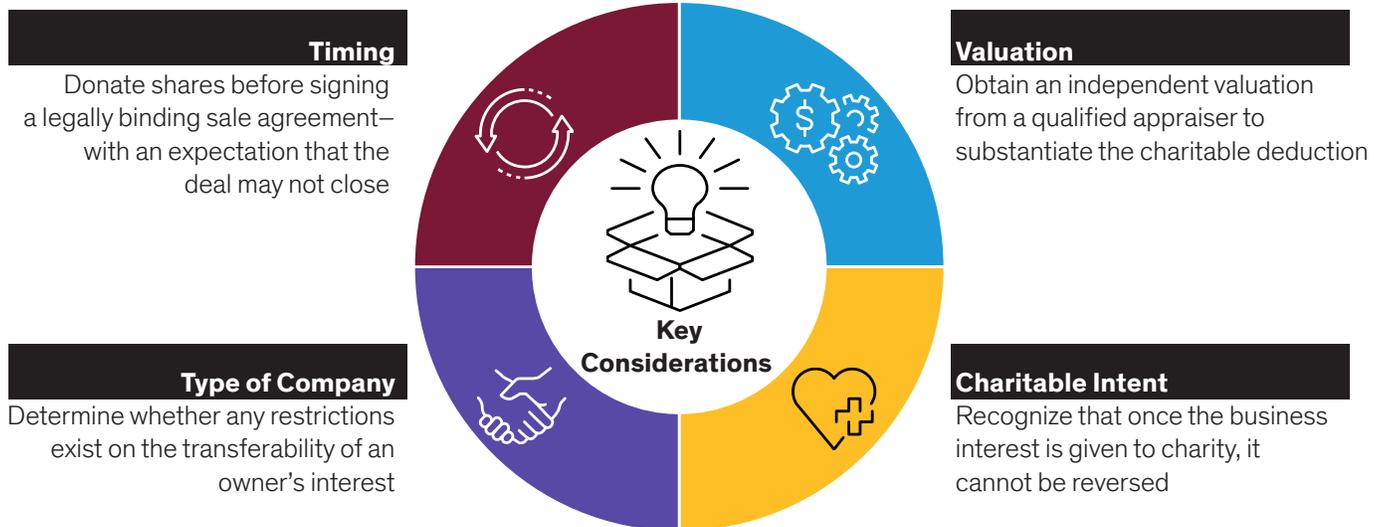
**Valuation:** Giving shares of a private company to charity will require a qualified appraisal by an independent valuation firm to substantiate the amount of charitable deduction that the business owner can

claim. If the appraisal is not obtained within a window between 60 days before the date of donation and the date on which the business owner's income tax return is due for the year in which the gift is made, the charitable deduction may be disallowed.

**Type of Company:** Do the governing documents of the company (i.e., articles, bylaws, operating agreement, and the like) permit transfers of ownership interests to charity? Those documents should be reviewed to determine whether any restrictions exist on the transferability of an owner's interest. If so, approval may be required from all or a majority of the other owners, the board of directors, the general partner, the manager, or other stakeholders, as the case may be.

**Charitable Intent:** A charitable gift is irrevocable, meaning that once the business interest is given to charity, it cannot be reversed—the interest is no longer in the business owner's control. The business owner must feel a strong charitable inclination before even contemplating a substantial gift.

## DISPLAY 1: FOUR KEY FACTORS STRONGLY INFLUENCE THE POTENTIAL FOR SUCCESS



For illustrative purposes, Bernstein does not provide legal or tax advice. Consult with competent professionals in these areas before making any decisions.

## The Tax Labyrinth of Charitable Giving

Tax laws limit the deductibility of certain charitable contributions. Those limitations are exacerbated when the assets transferred to charity consist of closely held business interests, and especially when they are transferred to charity just before a sale. The potential economic benefits of a pre-transaction gift to charity are substantial: complete avoidance of income taxation upon sale of the transferred interest, and a fair market value income tax charitable deduction that may be applied against the donor's other income, including capital gain recognized in the business sale. Timing of the gift is crucial. But threading that needle making the gift late enough that the stock has accrued substantial value, but not so late that the business sale is a foregone conclusion—is not always easy.

### Know the Guardrails

As a general rule, a donor contributing long-term capital gain property,<sup>1</sup> including a closely held business interest, may deduct its fair market value from adjusted gross income if made to or for the benefit of a publicly supported charity—such as a church, hospital, museum, educational institution, community foundation, or donor-advised fund (DAF)—or a private foundation that is not merely a passive grant-making foundation. On the other hand, when giving such property to a private foundation that merely makes grants to other charitable organizations, the deduction would be limited to the donor's adjusted income tax basis, which often is zero (or nearly so). Thus, most business owners who want to benefit from a substantial deduction will seek to transfer their interests to a public, rather than a private, charity.

A donor's deduction is not unlimited; it is subject to income-based parameters. In general, the deduction for contributing property other than cash to a public charity is limited to 30% of the donor's adjusted gross income (AGI) for the year. Any unused portion of the deduction may be carried forward up to five years, subject to the same 30% limitation in each succeeding year. Some business owners may have much less AGI after selling the business, and thus may be well advised to restrict their contribution to 30% of the donor's anticipated AGI in the year of sale.

### Find the Right Window

What is the “fair market value” of a closely held business interest when donated to charity in advance of a transaction? For tax deduction purposes, the test is the amount that a hypothetical willing buyer would pay a hypothetical willing seller for the interest, with both parties having full knowledge of all relevant circumstances. On the eve of the business sale, that value may be very close or equal to the sale price. But well in advance of a sale—when the transaction potentially may not close—fair market value may be substantially below the ultimate sale price.

Timing the gift is crucial, as is coordination with any noncharitable transfers to family members that the business owner may be contemplating. Some business owners start with noncharitable transfers, well in advance of the business sale, when the value of the transferred interests for gift tax purposes may still be quite low. They hold off charitable transfers until later, when the value of the transferred interests for income tax deduction purposes may rise considerably higher. Treasury regulations require a qualified appraisal of fair market value for any charitable contribution of a closely held business interest that exceeds \$5,000.



The closer you get to the transaction you're potentially running up against an anticipatory assignment of income risk. You need to ask, 'Does it just make sense to wait until after the transaction and donate cash proceeds?' This is why starting pre-transaction planning months in advance is necessary. And, when you get to less than three months before a deal, it could be challenging to get a strategy like a private foundation up and running in time. Getting a timely valuation is also key—valuation firms are backed up and having this value is important for running calculations for planning purposes.

—Strategic Philanthropic Advisor

<sup>1</sup> Long-term capital gain property means a capital asset that the donor has held for at least one year.

Timing affects not only value for charitable deduction purposes, but also whether the interest transferred to charity will or will not be subject to income tax upon sale. If a charitable contribution occurs near the transaction's closing, the government—under the so-called “step-transaction doctrine”—may be permitted to treat the sale as if it occurred before the charitable contribution.

In general, the step-transaction doctrine applies when the transaction is so certain to close, the donor's business interest effectively has been converted into a right to receive cash. At that point, the donor's gift to charity is deemed an “assignment of income” to a tax-exempt organization. In such a case, the donor would recognize taxable income in the sale as if she had never transferred the business interest to charity, but she would still get an income tax charitable deduction (presumably for the full sale price) for charity's share of the proceeds.

When transferring an interest in a business that is structured as a pass-through entity—such as an S corporation or an entity taxed as a partnership—donors must consider the potential impact of unrelated business taxable income (UBTI), which entails most income derived from an active trade or business, or from debt-financed property. If a charity owns an interest in a pass-through entity that has UBTI, that income will be taxable to the charity at the otherwise applicable income tax rate for a noncharitable corporation or trust, depending upon how the charity is structured. UBTI may be a significant issue, especially when a considerable period will elapse between the gift of the closely held business interest and the sale of the company.

### **A Tax Landscape in Flux**

Business owners currently benefit from the deductibility of contributions of cash, publicly traded securities, and closely held business interests to charity. However, at the time of this writing, Congress is considering legislation as part of the Build Back Better Act that could further change the dynamics of pre-transaction charitable planning.

- This legislation may include income tax rate increases that could make charitable contributions more valuable from a tax-saving perspective. Therefore, the economic benefit of a pre-transaction charitable contribution would be greater because more of the deduction could be applied against income that is likely to be taxed at a higher rate. Congress is still debating the final bill. The net effect of any near-term changes will depend on the details of the law.
- Furthermore, bipartisan legislation—called the Accelerating Charitable Efforts (ACE) Act—would deny an immediate charitable deduction for a contribution to a DAF that does not require the distribution of all its assets within 15 years, and no deduction would be permitted for a contribution of nonpublicly traded assets, like closely held business interests, until those assets are sold.

Given the complexity of these current and pending rules, business owners must consult with qualified tax advisors before engaging in any pre-transaction charitable planning strategies, some of which are highlighted below. An experienced team of experts, including trusted accountants, attorneys, and financial advisors, should first aim to understand the business owner's holistic situation, values, and goals, and then ensure that the gift is structured properly to preserve the desired income tax benefits and to fulfill the business owner's charitable intent.



I think that people don't always give themselves enough time to do this pre-transaction planning ahead of a liquidity event. The closer you get to the liquidity event, the fewer options are available to you, as you need to plan thoughtfully to ensure all parties involved have time to do due diligence, etc. Sometimes, the time you have available is the factor that will drive the charitable strategy. The sooner you can get ahead of it, the larger suite of options and strategies that may be available to you.

—Seattle Trust & Estate attorney

## Choosing a Pre-Transaction Charitable Giving Strategy

Business owners who wish to move forward with donating business interests have many charitable strategies from which to choose, though some are more advantageous than others (**Display 2**).

**Direct gift to public charity:** The simplest charitable strategy is a direct gift to one or more public charities. A gift of a closely held business interest to a public charity will generally qualify for an income tax charitable deduction in an amount equal to the fair market value of the transferred interest at the time of the gift. Up to 30% of the donor's AGI will be deductible in the year of the contribution; any excess may be carried forward up to five years. If the charitable contribution is made well in advance of the sale of the business, there may be an additional benefit: avoidance of capital gain tax on the portion of the owner's interest that is transferred to charity. In most cases, when the business is structured as a pass-through entity—an S corporation or an entity that is taxed as a partnership—UBTI that is generated in the period between the gift and the sale should be avoided, if possible. Some public charities will not accept gifts of closely held business interests; others have a rigorous due diligence process that must be completed prior to acceptance of such a gift. Typically, a qualified appraisal of the fair market value of the donated business interest as of the date of the gift will also be required. Plenty of advance planning is needed to maximize the charitable planning opportunity, even for a “simple,” direct gift.

**Gift to a DAF:** Some business owners may want income tax relief in the year of the transaction but have yet to solidify which charities should receive their largesse. For owners facing this dilemma, a DAF can be an excellent alternative. A DAF is a public charity established by a sponsor, such as a community foundation or investment manager. Many DAFs readily accept gifts of closely held business interests. Like a gift to any other public charity, the owner will generally receive a fair market value deduction, subject to the 30% of AGI limitation each year. Under the rules of most DAFs, the owner may direct the investment of sale proceeds, as well as recommend distribution of assets to specified, publicly supported charities over a period of many years. However, the proposed ACE Act, if adopted, would require distribution of the entire fund within 15 years and postpone the business owner's charitable deduction until the year when the business is sold. Many philanthropically motivated business owners find DAFs to be superior to “direct” gifts due to the added convenience and control that the fund structure affords.

**Private operating foundation:** For a business owner who craves personal involvement—rather than passive grant-making—a private operating foundation may fit the bill. Though not supported with public funds, a private operating foundation is treated like a public charity for purposes of (i) obtaining a fair market value deduction (rather than a deduction limited to basis) for the business owner's contribution,

## DISPLAY 2: ADVANCE PLANNING IS NEEDED—EVEN FOR “SIMPLE” GIFTS

	Cash	Appreciated Traded Securities	Private Securities
Overview	Simplest for donors to give and for not-for-profit to receive	Simple; can avoid embedded capital gain by giving to not-for-profit	A little more complex; require qualified appraisals; may not be suitable for some strategies
Deductions	Yes	Generally based on fair market value of gift, if held for one year	Generally based on fair market value of gift, if held for one year
Public Charity	60% of adjusted gross income (AGI)	30% of AGI	30% of AGI
Private Operating Foundation	60% of AGI	30% of AGI	30% of AGI
Private Non-Operating Foundation	30% of AGI	20% of AGI	20% of AGI; lesser of fair market or cost basis
Valuation Required ?	No	Generally, no	Yes, if deducted above \$5,000
Exceptions	N/A	Will not realize a capital loss if you give securities with an embedded loss	Private business; may be subject to bargain-sale rules depending on capital structure; deductions for S-corp stock and LP and LLC interests are complex

**Bernstein does not provide legal or tax advice. Consult with competent professionals in these areas before making any decisions.**

Source: Bernstein

and (ii) currently allowing the business owner to deduct up to 30% of her AGI (rather than just 20% for the more common passive grant-making private foundation). A private operating foundation requires a significant, ongoing commitment to charitable activity on the part of the business owner and her family, and thus should not be undertaken lightly. In addition, significant reporting requirements, self-dealing penalties, and other restrictions add levels of bureaucracy that may prove suboptimal. Qualified legal and tax advice is needed for any pre-transaction gift of a business interest; this is especially true in the case of a gift to a private operating foundation.

**Private nonoperating foundation:** A gift of business interests to a private “nonoperating” foundation is generally inadvisable, for several reasons. First, when the recipient of the gift is a nonoperating foundation, the donor’s income tax charitable deduction is limited to her basis in the business interest, which in many cases will be zero, or nearly so. Second, private foundations are subject to significant reporting requirements and other restrictions that many find intrusive and undesirable. Business owners who like the additional control—and perhaps panache—of a private nonoperating foundation should consider funding with the cash proceeds from the business sale or appreciated publicly traded stock after the transaction (but in the same taxable year). While the donor will not avoid capital gain tax on any portion of the business interest that is sold, she will get a full fair market value income tax deduction for her contribution, which could offset at least some of the capital gain recognized in the sale.

**Charitable remainder trust:** What about a business owner who has modest charitable intent, but wants to defer the recognition of at least some of the capital gain income that would otherwise be recognized in the transaction? In this case, a charitable remainder unitrust (CRUT) could serve as an intriguing “partial” solution. To implement this strategy, the business owner would contribute a portion of her interest to a CRUT well in advance of the sale. The CRUT would then hold the transferred interest until the transaction is finalized. At that time, the trustee would invest the cash proceeds and “book” the capital gain; as a charitable entity, a charitable remainder trust pays no income tax. Beginning after the sale and through the owner’s lifetime, the CRUT would pay her a specified percentage of the trust assets, revalued each year. Each payment would “carry out” a portion of the previously deferred capital gain tax liability to the owner on a Schedule K-1. In most cases, the economic benefit of deferring the capital gain tax hit over one’s lifetime will greatly exceed the incidental benefit payable to charity upon the owner’s death. But as with most pre-transaction charitable strategies, there are potential downsides. With any charitable remainder trust, a portion of the cash proceeds of sale would be effectively locked-up for the owner’s lifetime. Further, the strategy does not work if the business is structured as an S corporation, and for a business that is taxed as a partnership, the UBTI rules would apply during the period between the gift and the sale. Finally, deferring taxation into the future may result in the owner

paying tax on the previously deferred gain at higher marginal federal and state rates. All these trade-offs must be assessed by the owner’s tax and investment advisory team well before consummating any transaction.

**Charitable lead trust:** The flip side of a charitable remainder trust is a charitable lead annuity trust (CLAT). Here, property is contributed, and payouts are made annually to charity, usually for a fixed term of years. If the assets in the trust outperform a specified rate of return based on current US Treasury yields—just 1% per year for a trust established as of this writing<sup>2</sup>—any assets remaining in the CLAT at the end of the annuity term will pass free of any gift or estate tax to or in trust for the descendants (usually children) of the business owner. This strategy holds particular appeal when the fair market value of assets contributed to the trust—like closely held business interests—and the annuity payments to charity that are calculated based on that value, are low. A future sale of the business at a much higher price would result in a windfall to the CLAT, which would largely inure to the owner’s descendants at the end of the annuity term. With that said, the owner would face a Hobson’s choice when the CLAT is funded: Either take a relatively small upfront charitable income tax deduction and bear the full brunt of income taxes attributable to the CLAT’s interest in the business when the company is sold, or forego any personal deduction and allow the CLAT to take deductions annually instead. Notably, the latter is likely to result in substantial tax liability to the CLAT in the year of the sale. In most cases, it would be better to either (i) benefit children by using a grantor retained annuity trust (GRAT) or similar strategy, and donate to charity separately using one of the other strategies discussed previously in this section; or (ii) fund a CLAT with cash proceeds after, but in the same taxable year, as the business sale. Importantly, a charitable lead trust is a complex planning strategy that requires the owner to engage highly qualified tax and investment advisors.



There are added layers of complexity to run a private foundation. There are costs and time commitments involved, versus more flexible charitable vehicles, such as a donor-advised fund.

—Los Angeles Trust & Estate Attorney

### CASE STUDY: Meet the Jacksons

Jorge and Sherice Jackson, a 40-year-old couple, co-founded a privately held software company. They had three young children and wanted to concentrate on family, so when the Jacksons were approached by a strategic buyer, it felt like the right time to sell. Their current assets totaled \$1.6 million and they expected to receive \$75 million pretax for their ownership stake—a figure they couldn't pass up. After years of building their company, the couple was ready to commit to other priorities, such as building a philanthropic strategy, and taking a break to determine what the next phase of their lives would look like. Jorge and Sherice wanted to ensure that the proceeds of sale would allow them to maintain spending of \$300,000 per year. Their other immediate goals included funding Section 529 college savings plans, supporting charitable causes they cared about, and providing a financial head start for their children. We started by quantifying their core capital, which showed they needed to reserve nearly \$16 million to meet their lifestyle goals. They had ample surplus capital of \$33 million after-tax to commit to philanthropy and trusts for their children. But their long-term capital gain tax liability was estimated to be \$27 million, and they wanted to focus on how to mitigate the taxes owed (**Display 3**).

In helping the Jacksons think through various income tax mitigation strategies, we first considered the timing of the potential business sale. As they were still in negotiations and had yet to sign a binding sale agreement, Jorge and Sherice decided to make a large pre-transaction gift of company shares to a DAF. A DAF allows donors to contribute assets to a tax-free investment account, from which they can direct gifts to the charities of their

choice. The contribution to the fund provides the donor with a charitable income tax deduction in the year that it's made. If the Jacksons had instead chosen to make the gift with cash post-transaction, they would not have been able to avoid the large capital gain tax liability.

We determined that they would receive an upfront income tax charitable deduction of nearly \$6 million (approximately 30% of their AGI). Additionally, they would avoid paying capital gain tax on approximately \$27.58 million of sale proceeds that would reside in the DAF rather than on their personal balance sheet. They were delighted by this double-barreled benefit.

As the Jacksons committed significant funds to philanthropy, they could begin to accomplish their goal of creating positive change via causes that are most dear to them. As their children grow older, they want to use the DAF to teach values and to help influence their community and the world.

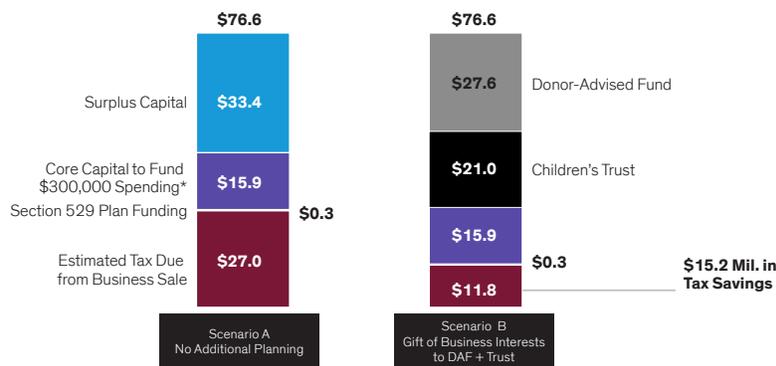
Together with their advisor, they implemented a plan to allocate \$75 million of pre-transaction sale proceeds as follows:

- \$27.58 million to a DAF
- \$27.58 million in trust for the children
- \$19.84 million retained in their personal portfolio

This plan helped the Jacksons reduce their income tax liability by more than \$15 million (**Display 3**). By planning early, they were able to take advantage of pre-transaction charitable and noncharitable gifts, while retaining adequate proceeds to pay all taxes and secure their lifestyle. and secure their lifestyle plan.

### DISPLAY 3: PRE-TRANSACTION PLANNING HELPS MITIGATE INCOME TAXES

\$ Millions



\*Represents the core capital required with a 50% level of confidence (years 1–14) and then calculated at a 90% level of confidence beginning in year 15. This is based on a sustainable spending rate of \$300,000, after taxes and inflation. Assets are allocated 50% equities and 50% fixed income in the accumulation phase (years 1–14) and 30% equities and 70% fixed income in retirement (beginning in year 15). Data as of December 31, 2020.

Based on AB's estimates of the range of returns for the applicable capital markets over the periods analyzed. Data do not represent past performance and are not a promise of actual future results or range of future results. See Notes on Wealth Forecasting in the appendix for further details. See additional disclosures on next page. **Source: AB**



Some questions I typically ask business owner clients include, ‘Do you need income following the business transition, and if so, how soon? Are you interested in engaging in philanthropy immediately upon retirement/ business succession, or are you more interested in knowing your philanthropic legacy is solidified and in place for future generations of family to direct?’ The answers help guide us to the right solution.

—Strategic Philanthropic Advisor

## It’s About Time

Many business owners feel enduring gratitude to the communities that have supported them along the way. And these strong community ties often foster a desire to give back. Donating an interest in a closely held business prior to an exit can serve as a “win-win” approach. It strengthens the charity’s ability to make an impact while securing significant tax savings for the business owner. But such a strategy involves many intricacies. Ultimately, charitable planning for a philanthropically inclined family with a closely held business requires careful timing and expert, personalized advice to ensure the plan’s success.

Additional disclosure pertaining to Display 3: \*Includes \$1.6 million of current liquid assets, plus pretax sale proceeds of \$75 million. Scenario A assumes pretax proceeds of \$75 million are subject to a blended federal and state long-term capital gains tax rate of 36.02%. Scenario B assumes pretax proceeds of \$19.8 million are subject to a blended federal and state long-term capital gains tax rate of 36.02% with a charitable income tax deduction of \$5.95 million (30% of adjusted gross income), children’s trust proceeds of \$27.58 million are subject to a federal capital gains tax rate of 23.8%, and Donor-Advised Fund proceeds are nontaxable.

## NOTES ON WEALTH FORECASTING SYSTEM

### 1. Purpose and Description of Wealth Forecasting System

AB’s Wealth Forecasting Analysis is designed to assist investors in making their long-term investment decisions as to their allocation of investments among categories of financial assets. Our planning tool consists of a four-step process: (1) Client-Profile Input: the client’s asset allocation, income, expenses, cash withdrawals, tax rate, risk-tolerance level, goals and other factors; (2) Client Scenarios: in effect, questions the client would like our guidance on, which may touch on issues such as when to retire, what his/her cash-flow stream is likely to be, whether his/her portfolio can beat inflation long-term, and how different asset allocations might impact his/her long-term security; (3) The Capital-Markets Engine: our proprietary model that uses our research and historical data to create a vast range of hypothetical market returns, which takes into account the linkages within and among the capital markets, as well as their unpredictability; and finally (4) A Probability Distribution of Outcomes: based on the assets invested pursuant to the stated asset allocation, 90% of the estimated ranges of probable returns and asset values the client could experience are represented within the range established by the 5th and 95th percentiles on “box-and-whiskers” graphs. However, outcomes outside this range are expected to occur 10% of the time; thus, the range does not guarantee results or establish the boundaries for all outcomes. Estimated market returns on bonds are derived taking into account yield and other criteria. An important assumption is that stocks will, over time, outperform long bonds by a reasonable amount, although this is in no way a certainty. Moreover, actual future results may not meet AB’s estimates of the range of market returns, as these results are subject to a variety of economic, market and other variables. Accordingly, the analysis should not be construed as a promise of actual future results, the actual range of future results or the actual probability that these results will be realized. The information provided here is not intended for public use or distribution beyond our private meeting. Of course, no investment strategy or allocation can eliminate risk or guarantee returns.

### 2. Retirement Vehicles

Each retirement plan is modeled as one of the following vehicles: Traditional IRA, 401(k), 403(b), Keogh, or Roth IRA/401(k). One of the significant differences among these vehicle types is the date at which mandatory distributions commence. For traditional IRA vehicles, mandatory distributions are assumed to commence during the year in which the investor reaches the age of 70.5. For 401(k), 403(b), and Keogh vehicles, mandatory distributions are assumed to commence at the later of (i) the year in which the investor reaches the age of 70.5 or (ii) the year in which the investor retires. In the case of a married couple, these dates are based on the date of birth of the older spouse. The minimum mandatory withdrawal is estimated using the Minimum Distribution Incidental Benefit tables as published on [www.irs.gov](http://www.irs.gov). For Roth IRA/401(k) vehicles, there are no mandatory distributions. Distributions from Roth IRA/401(k) that exceed principal will be taxed and/or penalized if the distributed assets are less than five years old and the contributor is less than 59.5 years old. All Roth 401(k) plans will be rolled into a Roth IRA plan when the investor turns 59.5 years old to avoid Minimum Distribution requirements.

### 3. Rebalancing

Another important planning assumption is how the asset allocation varies over time. We attempt to model how the portfolio would actually be managed. Cash flows and cash generated from portfolio turnover are used to maintain the selected asset allocation between cash, bonds, stocks, REITs and hedge funds over the period of the analysis. Where this is not sufficient, an optimization program is run to trade off the mismatch between the actual allocation and targets against the cost of trading to rebalance. In general, the portfolio allocation will be maintained reasonably close to its target. In addition, in later years, there may be contention between the total relationship's allocation and those of the separate portfolios. For example, suppose an investor (in the top marginal federal tax bracket) begins with an asset mix consisting entirely of municipal bonds in his/her personal portfolio and entirely of stocks in his/her retirement portfolio. If personal assets are spent, the mix between stocks and bonds will be pulled away from targets. We put primary weight on maintaining the overall allocation near target, which may result in an allocation to taxable bonds in the retirement portfolio as the personal assets decrease in value relative to the retirement portfolio's value.

### 4. Expenses and Spending Plans (Withdrawals)

All results are generally shown after applicable taxes and after anticipated withdrawals and/or additions, unless otherwise noted. Liquidations may result in realized gains or losses, which will have capital-gains tax implications.

### 5. Modeled Asset Classes

The following assets or indexes were used in this analysis to represent the various model classes:

Asset Class	Modeled as:	Annual Turnover Rate
Municipal Cash	Municipal money-market securities	100%
Cash Equivalents	3-month Treasury bills	100%
Intermediate-Term Diversified Municipals	AA-rated diversified municipal bonds of 7-year maturity	30%
Intermediate-Term Taxables	Taxable bonds with maturity of 7 years	30%
US Diversified	S&P 500 Index	15%
US Value	S&P/Barra Value Index	15%
US Growth	S&P/Barra Growth Index	15%
US Low Vol Equity	MSCI US Minimum Volatility Index	15%
Developed International	MSCI EAFE Unhedged	15%
Emerging Markets	MSCI Emerging Markets Index	20%
US SMID	Russell 2500	15%
High-Risk Intl	Country Fund	15%
Global Intermediate Taxable Bonds Hedged	7-year 50% Sovereign and 50% Investment Grade Corporate Debt of Developed Countries	30%

### 6. Volatility

Volatility is a measure of dispersion of expected returns around the average. The greater the volatility, the more likely it is that returns in any one period will be substantially above or below the expected result. The volatility for each asset class used in this analysis is listed on the Capital-Market Projections page at the end of these Notes. In general, two-thirds of the returns will be within one standard deviation. For example, assuming that stocks are expected to return 8.0% on a compounded basis and the volatility of returns on stocks is 17.0%, in any one year it is likely that two-thirds of the projected returns will be between (8.9)% and 28.8%. With intermediate government bonds, if the expected compound return is assumed to be 5.0% and the volatility is assumed to be 6.0%, two-thirds of the outcomes will typically be between (1.1)% and 11.5%. AB's forecast of volatility is based on historical data and incorporates AB's judgment that the volatility of fixed-income assets is different for different time periods.

### 7. Technical Assumptions

AB's Wealth Forecasting System is based on a number of technical assumptions regarding the future behavior of financial markets. AB's Capital Markets Engine is the module responsible for creating simulations of returns in the capital markets. These simulations are based on inputs that summarize the current condition of the capital markets as of December 31, 2020. Therefore, the first 12-month period of simulated returns represents the period from December 31, 2020, through December 31, 2021, and not necessarily the calendar year of 2020. A description of these technical assumptions is available on request.

### 8. Tax Implication

Before making any asset allocation decisions, an investor should review with his/her tax advisor the tax liabilities incurred by the different investment alternatives presented herein including any capital gains that would be incurred as a result of liquidating all or part of his/her portfolio, retirement-plan distributions, investments in municipal or taxable bonds, etc. AB does not provide tax, legal, or accounting advice. In considering this material, you should discuss your individual circumstances with professionals in those areas before making any decisions.

### 9. Tax Rates

The federal income tax rate represents AB's estimate of either the top marginal tax bracket or an "average" rate calculated based upon the marginal rate schedule. The federal capital gains tax rate is represented by the lesser of the top marginal income tax bracket or the current cap on capital gains for an individual or corporation, as applicable. Federal tax rates are blended with applicable state tax rates by including, among other things, federal deductions for state income and capital gains taxes. The state income tax rate represents AB's estimate of the "average" rate calculated based upon the applicable state's marginal tax schedule. Where an applicable state tax code permits the exclusion of a portion of capital gain income from gross income for purposes of calculating state income tax such exclusions have been included in the calculation.

#### **10. Intentionally Defective Grantor Trusts (IDGTs)**

The Intentionally Defective Grantor Trust (IDGT) is modeled as an irrevocable trust whose assets are treated as the grantor's for income tax purposes, but not for gift or estate tax purposes. Some income and transfer-tax consequences associated with transfers to and the operation of an IDGT remain uncertain, and the strategy may be subject to challenge by the IRS. Hence, this technique requires substantial guidance from tax and legal advisors. The grantor may give assets to the trust, which will require using gift tax exemptions or exclusions, or paying gift taxes. The IDGT is modeled with one or more current beneficiaries, and one or more remainder beneficiaries. Distributions to the current beneficiaries are not required, but the system permits the user to structure annual distributions in a number of different ways, including 1) an amount or a percentage of fiduciary accounting income (FAI) (which may be defined to include some or all realized capital gains); 2) FAI plus some principal, expressed either as a percentage of trust assets or as a dollar amount; 3) An annuity, or fixed-dollar amount, which may be increased annually by inflation, or by a fixed percentage; 4) A unitrust, or annual payment of a percentage of trust assets, based on the trust's value at the beginning of the year, or average over multiple years; or 5) any combination of the above four payout methods. Because the IDGT is modeled as a grantor trust, the system calculates all taxes on income and realized capital gains that occur in the IDGT portfolio each year, based on the grantor's tax rates and other income, and pays them from the grantor's personal portfolio. The IDGT may continue for the duration of the analysis, or the trust assets may be distributed in cash or in kind at a specific point in time or periodically to (1) a non-modeled recipient, (2) a taxable trust, or (3) a taxable portfolio for someone other than the grantor. If applicable, an installment sale to an IDGT may be modeled as a user-entered initial "seed" gift followed by a sale of additional assets to the trust. The system will use one of two methods to repay the value of the sale assets plus interest (less any user-specified discount to the grantor): 1) user-defined payback schedule, or 2) annual interest-only payments at the applicable federal rate (AFR) appropriate for the month of sale and the term of the installment note, with a balloon payment of principal plus any unpaid interest at the end of the specified term.

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