THREE PRIVATE DEAL LOOPHOLES:

HOW TO MAKE MILLIONS AND PAY ZERO TAXES

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DAY ONE
INVESTOR

Three Private Deal Loopholes

How to Make Millions and Pay Zero Taxes

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Buried within the 317-page Taxpayer Relief Act of 1997 is arguably the most valuable retirement hack available to U.S.-based investors.

Section 408A established an entirely new form of retirement account known as a Roth IRA. The design enabled Americans to put a relatively small amount of after-tax dollars into the account every year.

But what made the Roth IRA so significant is that all future gains from investments in a Roth IRA account would be tax-free, as long as no distributions were made before the age of 59 and a half.

The Roth IRA had some constraints, however. Annual after-tax contributions can be made to a Roth IRA as long as annual earned income is below a certain level. Other than that, the capital within a Roth IRA can be invested into anything, and all future capital gains will be tax-free upon retirement.

When the Roth IRA was envisioned, the thinking was that retirement savers could put in a modest amount every year until their earned income threshold was exceeded. Once that happened, they would be free to invest in assets like stocks and bonds and be rewarded when retirement came.

But many sophisticated investors realized early on that such a long-term retirement vehicle would be a perfect place to hold private investments that start small and become large over a period measured in years.

They realized that using a Roth IRA to make small investments in private deals was a path towards incredible tax-free capital gains.

Tech entrepreneur turned venture capitalist Peter Thiel was one of those people.

In 1999, Theil was chairman and CEO of a very young financial technology startup – PayPal.

And as with most startups, annual salaries tend to be on the low side while stock options and/or stock grants make up most of future earnings. That year, Thiel – now a billionaire – only made $73,263 and could contribute just $2,000 to his Roth IRA.

It wasn't the amount he set aside for his Roth IRA that mattered. It's what he did with it.

Thiel paid $0.001 per share for 1.7 million shares in PayPal. That stake cost him just $1,700 from his Roth IRA, leaving him another $300 to invest elsewhere. He was able to do that because he was a founder of the company.

And what happened since then is remarkable.

COMPOUNDING IN A ROTH IRA

In 2002, eBay acquired PayPal for $1.5 billion. Thiel then sold his PayPal shares in this Roth IRA, which had ballooned to a value of $28.5 million by the end of 2002.

And with the windfall from PayPal in his Roth IRA, he was free to invest in new private investments. In 2003, Thiel founded Palantir (PLTR) and used some of the capital in his Roth IRA to buy shares. And then in 2004, Thiel invested $500,000 from his Roth IRA into Facebook.

I know, it's incredible.

And in 2005, he founded his now iconic venture capital firm, Founders Fund, which meant he had access to even more incredible deals.

By 2019, his Roth IRA had grown to more than $5 billion.

And all he ever contributed to his Roth was the original $2,000.

But Thiel wasn't the only one. He wasn't a unicorn.

- Ted Weschler, a deputy of Warren Buffett, had amassed a Roth IRA of $264.4 million by 2018
- Randall Smith, a hedge fund manager, had amassed $252.6 million
- Buffett himself had $20 million in his Roth by 2018
- Another hedge fund manager, Robert Mercer, had grown his Roth to $31.5 million.

Thousands, in fact, had grown their Roth IRA with similar effects. And they all had one thing in common...

They invested in private securities with their Roth IRA. And here is the best part. None of us need to be a hedge fund manager or start our own company to take advantage of a Roth IRA. We can all benefit from this kind of retirement account.

What most investors who are familiar with both the Roth IRA and private securities do is open a self-directed Roth IRA account. This is the key to enabling investors to have control over how their Roth IRA funds are allocated.

Most Roth IRA custodians at large financial services firms like Fidelity, Schwab, TD Ameritrade, and others tend to limit investors to investing in a number of mutual or index funds. There's nothing wrong with that, but there simply won't be the kind of growth potential that comes from exposure to private investments that I shared in my *Day One Manifesto*.

And for those who don't yet have a Roth IRA and exceed the annual earned income threshold, there is still a way to implement this retirement strategy.

Other forms of retirement accounts like 401Ks and Traditional IRAs can be converted to a Roth IRA. These are taxable events, but they only happen once. And after that, all capital gains are tax-free.

There are two key strategies for those who choose to use a Roth IRA for private investments:

- For those with enough capital in their Roth IRA to make a number of investments into early-stage private securities, it is important to build a portfolio of companies over time.

At a minimum, 30-50 high-potential, early-stage private companies will help reduce the risk and ensure that you have exposure to the outliers that have successful exits.

It's important to never go all in on just one or two early-stage private deals with a Roth IRA. If they fail, there will no longer be any capital left in the Roth IRA, and all tax benefits will be lost.

- For those with less capital to invest or who would prefer to reduce risk, a smarter strategy is to invest in a smaller number of private securities that are much later stage.

  So rather than investing at the Pre-Seed or Seed rounds, investing in successful private companies at a Series C, D, or E round where most of the risk has been eliminated but there is still great growth potential is a very smart approach. There won't be as much upside, but the upside will still be far greater than a mutual or index fund.

With crowdfunding regulations and the Roth IRA, any American can take advantage of these retirement and investment strategies. And the sooner we do so, the better, as great investments compound over time.

It's also worth mentioning that several other countries have similar mechanisms as the Roth IRA for retirement savings and investments. These are always worth taking advantage of.

And there is another "secret" to incredible returns that only a small number of sophisticated investors know about, and it is buried well within another 6,688-page document from the Internal Revenue Service (IRS).

SECTION 1202 – THE SECRET TO TAX-FREE CAPITAL GAINS

Title 26, also known as the Internal Revenue Code, is part of the United States Code covering taxation. And the federal agency that implements the code is, of course, the IRS.

Contained within Title 26 is Section 1202 – arguably the greatest single tax incentive that almost no one has heard about.

Section 1202 provides for up to a 100% exclusion of capital gains taxes under specific circumstances for investments made in qualified small business stocks (QSBS).

That's not a mistake, investments made in early-stage qualified small business companies if held for a certain period of time result in 100% tax-free gains.

I know that it's hard to believe, but as a result of the Small Business Jobs Act of 2010, Section 1202 was amended to allow for the exclusion of 100% of capital gains for qualified small business companies.

Prior to that amendment, the exemption level was 75%, and before that it was 50%.

What was unique about this amendment is that the 100% capital gains exemption kicked in for investments held for five years or more. And this five-year holding period requirement resulting in tax-free capital gains became permanent in 2015.

The reason the date is important is that investments under the amendments back in 2015 or later have only just recently started to become realized – five-plus years later. This is why so few understand the power of Section 1202, very few have only started to receive the benefits of these tax-free capital gains in recent years.

Here's how this works for investors. In general, investors can use this exclusion as long as:

- The stock has been held for at least five years
- The stock was issued by a domestic C corporation with a maximum of $50 million of gross assets when the stock was issued
- The company that issued the stock used at least 80% of its assets for its business
- The stock was issued after August 10, 1993
- The investor is a non-corporate taxpayer (thus an individual investor or investment entity)

So, basically, as long as the investment is made by an investor into an early-stage company that has $50 million in assets or less and the stock is held for five years, the capital gains on a winner are 100% tax-free. Incredible.

And there is only one "limit" to be aware of. The tax-free exclusion applies to gains up to $10 million, or 10 times the basis of our original investment, whichever is greater. That's not unreasonable at all.

What it means for most investors is that the first $10 million of profits are 100% tax-free, and then after that, any capital gains will be based on the prevailing long-term capital gains tax. Fantastic!

I know that this seems too good to be true, but there is a reason that these amendments to Section 1202 were made back in 2015. The U.S. government needed to stimulate investment in small businesses around the country.

Small businesses are the engine of growth for economic development, innovation, and future economic health. But investing in early-stage companies carries the highest risk, which meant there needed to be an incentive for investors to take the risk and deploy capital into promising early-stage companies. And that incentive is Section 1202.

As far as I'm concerned, the 100% tax-free exclusion of Section 1202 is the best-kept secret in the world of investing. But there is one more section of the Internal Revenue Code (IRC) that is just as compelling... Section 1045.

DON'T FORGET TO ROLLOVER

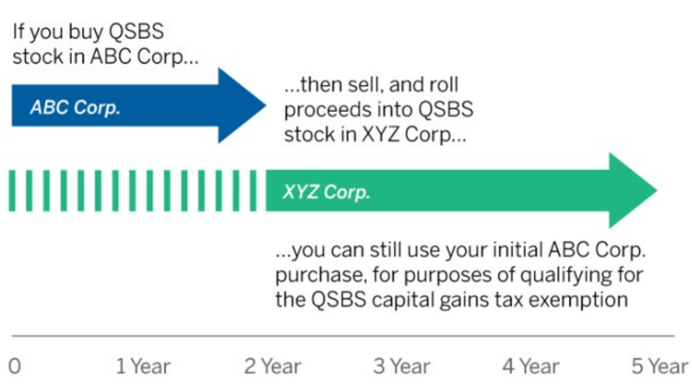
Section 1045 addresses a situation that actually happens often. What are the tax implications if an early-stage private investment in a small business goes public or is acquired in less than five years? This is what Section 1045 is all about.

Section 1045 enables a "1045 rollover." Basically, any capital gains realized from a QSBS in less than five years can be rolled over into another QSBS tax-free.

To be clear, as long as an investor takes the gains from their private investment and rolls them into another early-stage private investment, no capital gains taxes need to be paid.

Even better, the clock on the five-year 100% capital gains exclusion keeps ticking. It doesn't reset to zero when you take profits off the original investment and reallocate into a new small business.

The 1045 Rollover



The above image provides an example of what this looks like. If an investor earns capital gains off of a private investment after two years and redeploys that capital into another small business, then three years later, the five-year mark has been reached, and any future gains will be 100% tax-free.

Section 1045 is really a smart provision. It further incentivizes those who make shorter-term gains to reinvest in new businesses and economic growth. This is a great compliment to Section 1202 and equally as valuable for investors looking to generate incredible wealth over longer periods of time.

THE *DAY ONE* RETIREMENT MINDSET

Investing in private securities using tax-advantageous techniques like the ones I shared above is complimentary to more traditional income-generating investments like tax-free municipal bonds, corporate bonds, dividends from stable large-cap stocks, real estate, or agricultural land.

This is often referred to as the barbell strategy of investing. On one end of the spectrum are low-risk, income-producing investments… and on the other end are high-risk, high-growth investments.

This strategy enables investors to gain exposure to the kind of high growth and returns that can only come from getting in early, when companies are small and private and valuations are low… enabling us to compound our wealth that much more.

And it provides the security of income needed for daily life.

Some find it useful to think of investments in private securities as an evergreen fund. Once individual companies start to exit and return profits, those funds can be recycled – sometimes tax-free as we saw above – into new private investments in order to maximize investment returns for retirement.

Not only is this a great way to set ourselves up for a comfortable retirement, but it's also an incredible way to create generational wealth.

To contact Customer Service, call toll-free Domestic/International: (833) 601-0061, Mon–Fri, 9 a.m.–5 p.m. ET.

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