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Rollover Equity and Wealth Planning Considerations

Business owners in the run-up to a liquidity event are well advised to learn about the practices and approaches common in transactions. Among the most important is rollover equity—i.e., when a seller agrees to reinvest sale proceeds in the newly formed company.

In fact, financial sponsors are increasingly seeking such arrangements, meaning there is a good chance rollover equity will play a critical part in what could be a once-in-a-lifetime capital infusion for founder-led midmarket companies. The following article outlines relevant wealth planning considerations drawing on William Blair's extensive experience working with rollover equity.

Why Rollover Equity Use Is Growing

While rollover equity might be increasingly common, business owners unaccustomed to the transaction process are often surprised when potential buyers suggest it. But the strategy has benefits for both parties—it can bridge valuation gaps, provide tax advantages to sellers, and perhaps most significantly, preserve valuable institutional knowledge and expertise by maintaining a connection with former owners.

57% of deals in 2023 included rollover equity, up from 46% in 2020.[1]

Especially common in transactions involving founder-owned businesses, as sponsors want to see founders maintain skin in the game.

20%-30% is the typical rollover percentage for middle-market transactions.[2]

Different size deals have different size rollovers; the larger the business, typically, the smaller the rollover.

Key Rollover Equity Details

- Many transactions involving rollover equity include vesting schedules, the vast majority of which include provisions—i.e., how much of the new company is owned by the former owner—based on a combination of time and performance.
- Most rollover equity agreements come with non-compete, non-solicit, and non-hire agreements.
- Put rights, the ability for rollover participants to sell equity to the sponsor, while very rare, do occur. These provisions allow a seller to obtain liquidity at certain milestones of time or performance.

Wealth Planning Considerations

- With the increased federal lifetime estate and gift tax exemptions under 2017's Tax Cuts and Jobs Act set to be halved in 2026, gifting rolled equity into a trust might be an attractive option.
- Rollover is typically treated as a nontaxable event, deferring the income tax on gain attributed to that portion of the transaction.
- If Section 1202 applies to the transaction, gains can be deferred on equity that is rolled, and participants can also continue their qualified small business stock (QSBS) hold periods.

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1 Source: Goodwin Procter, "*Use of Equity Rollovers Continues to Rise Amid Market Uncertainty*," February 26, 2024.

2 Source: William Blair estimates.