BURNEY WEALTH MANAGEMENT

Understanding 351 ETF Exchanges

A Tax-Efficient Strategy for Converting Appreciated Positions

What is a 351 exchange?

A 351 exchange is a tax-efficient transaction that can allow investors to transfer a diversified portfolio of qualifying securities to a newly formed ETF in exchange for ETF shares without triggering an immediate taxable event.

This process, governed by Section 351 of the Internal Revenue Code, can enable investors to:

- Convert highly appreciated securities into a diversified ETF
- Maintain their original cost basis and holding period
- Defer capital gains taxes until they sell the ETF shares
- Access professional portfolio management within an ETF structure

Key Benefits of 351 Exchanges

Tax Deferral

- No immediate capital gains taxes on the conversion
- Preserve existing cost basis and holding periods
- Pay taxes only when you sell ETF shares

Portfolio Simplification

- Consolidate multiple holdings into a single, diversified ETF
- Potentially reduce concentration risk in individual securities
- Maintain equity market exposure with professional management

Enhanced Liquidity

- Convert appreciated positions into tradeable ETF shares
- Benefit from daily liquidity and transparency
- Access to institutional-quality investment management

Ongoing Tax Efficiency

- ETF structure provides better tax efficiency compared to mutual funds & SMAs
- In-kind redemption process & custom baskets minimize taxable distributions
- Strategy rebalancing without triggering personal tax consequences

Eligibility Requirements

Portfolio Diversification Standards

- To qualify for a 351 exchange, your portfolio must meet specific diversification requirements:
- No single holding can exceed 25% of your total portfolio value
- Top 5 holdings combined cannot exceed 50% of your portfolio value
- Minimum 25 positions typically required for adequate diversification
- Exchange-traded securities only (US stocks, ETFs, ADRs)

ETF “Look-Through” Rule

If your portfolio includes ETFs, the diversification test applies to the underlying holdings of those ETFs, not the ETF itself. This often makes diversification easier since most ETFs are already well-diversified.

Asset Types

Eligible:

- Individual stocks and equities
- Exchange-traded funds (ETFs)
- American Depositary Receipts (ADRs)

Not Eligible:

- Mutual funds
- Cash or cash equivalents
- Cryptocurrency
- Private investments

How the 351 Exchange Process Works

1

PORTFOLIO REVIEW
(6-8 weeks before launch)

- Submit portfolio holdings for eligibility analysis
- Independent review confirms diversification requirements
- Receive approval for participation

2

DOCUMENTATION
(3-4 weeks before launch)

- Complete required legal documentation
- Authorize custodian transfers
- Submit detailed tax lot information

3

ASSET TRANSFER
(1-2 weeks before launch)

- A trading freeze is implemented on contributed securities
- Securities are transferred to the ETF custodian
- Final diversification verification conducted

4

ETF LAUNCH & SHARE DISTRIBUTION

- ETF begins trading on the launch date
- ETF shares are distributed back to participant accounts
- Cost basis information transferred to maintain tax lots

Tax Implications

At Conversion

- No immediate tax consequences for qualifying transfers
- Original cost basis carries forward to ETF shares
- Holding periods preserved for tax purposes

Post-Conversion

- Capital gains taxes are deferred until ETF shares are sold
- Benefit from ETF's inherent tax efficiency
- Receive the same tax treatment as any other ETF investment

Important Considerations

- This is tax deferral, not elimination - you will pay capital gains when you sell ETF shares
- Consult your tax advisor and financial advisor before participating in any 351 exchange
- State tax implications may vary by jurisdiction

Key Dates & Timeline Overview

6-8 Weeks Before Launch

- Submit an indication of interest
- Portfolio eligibility review
- Initial documentation begins

3-4 Weeks Before Launch

- Complete all required documentation
- Submit final tax lot details
- Receive confirmation of participation

1-2 Weeks Before Launch

- Implement a trading freeze on contributed securities
- Final diversification testing
- Coordinate with custodians

Launch Week

- Securities are transferred to the ETF
- ETF begins trading
- Shares are distributed to participants
- Cost basis information is updated

Frequently Asked Questions

Q: Is there a minimum investment amount?

A: Minimum contribution requirements vary by ETF launch. Contact us for specific details on upcoming opportunities.

Q: What happens to my dividend income?

A: You'll receive dividends from the ETF based on your proportional ownership, similar to the dividends you received from your original holdings.

Q: Can I participate if I have a retirement account?

A: 351 exchanges are primarily designed for taxable accounts. Retirement accounts generally don't benefit from the tax deferral advantages.

Q: How long is the process?

A: The typical timeline is 6-8 weeks from initial interest to ETF launch, with most documentation completed 2-3 weeks before launch.

Q: Are there any fees?

A: Unlike traditional exchange funds, 351 ETF conversions typically don't charge upfront fees. You'll pay the ETF's ongoing expense ratio like any other ETF investor.

Next Steps

Stay Informed

351 exchange opportunities are limited-time events that occur during ETF launches. These opportunities are not available on an ongoing basis.

Portfolio Assessment

If you have a concentrated or highly appreciated portfolio, consider having it evaluated for 351 exchange eligibility before the next opportunity arises.

Professional Guidance

Consult with your financial advisor and tax professional to determine if a 351 exchange aligns with your investment objectives and tax situation.

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