Allspring

Much ADO About Taxes:

10 Techniques for Diversifying a Concentrated Position in a Tax-Efficient Manner

HOLLY SWAN

+ Head of Wealth Solutions

As you know, concentrated stock positions can create unwanted risk in your clients' portfolios. While a combination of factors—including emotional biases and fear of built-in capital gain consequences—can make investors less willing to diversify, you may be able to move the conversation forward by educating them about tax-efficient strategies for diversification. Remember that while each of these strategies is valuable on its own, they can be particularly powerful when combined.

Think of tax-management diversification strategies as being in one of these three buckets: **A**void, **D**efer, and **O**ffset.

Avoid:

01 Hold: Assets that pass through a taxable estate will receive a step-up in cost basis, thus avoiding capital gains. For diversification purposes, this strategy can be combined with other strategies, like exchange funds.

02 Gift: Investors may choose to gift highly appreciated assets to lower earners who are therefore unlikely to pay capital gains tax. Note that because assets typically retain the donor's carryover basis and because capital gains tax rates are lower than the federal estate and gift tax rates, this strategy may make financial sense only in limited cases.

03 Borrow: In lieu of selling, clients may be able to borrow against their portfolio. This can provide liquidity without triggering taxes. Be aware that limits may be placed on how the borrowed funds can be used and that borrowing against a portfolio introduces the risk of a margin call.

04 Options: A collar strategy may be used to buy a protective put option and sell a covered call, thus limiting downside risk while also capping the upside in a cost-effective manner. The sale of the call can help finance the purchase of some, or all, of the put.

05 QSBS: The qualified small business stock (QSBS) exclusion, as set forth in Section 1202 of the Internal Revenue Code (IRC), is a tax benefit that applies to some early-stage investors and employees. When shareholders sell qualified stock, the QSBS exclusion can allow them to exclude up to the greater of $10 million or 10x their basis worth of capital gains.

Defer:

06 Systematic diversification: Investors can sell portions of a concentrated position over time to spread out the capital gains consequences and manage the tax burden more effectively. Public company executives may take this approach through a 10b5-1 plan in order to avoid violating insider trading rules.

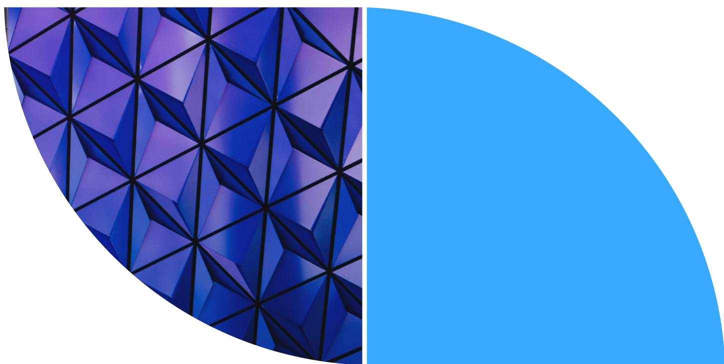
07 Tax-loss harvesting: Because capital gains can be offset with capital losses, investors may choose to use a systematic tax-loss harvesting approach to harvest losses over time and use those losses to offset gains from the sale of the concentrated position.

08 Exchange fund: Subject to the provisions of Section 721 of the IRC, an exchange fund allows qualified investors to pool their concentrated stock with other investors, reducing individual stock risk and gaining diversification without selling the stock.

09 Opportunity Zones: Opportunity Zones were created to encourage investment in undercapitalized communities. Using these investments may allow investors to defer realizing capital gains and, in some cases, avoid future gain-recognition events.

Offset:

10 Charitable giving: Donating appreciated stock to charity allows an investor to avoid capital gains taxes while receiving a tax deduction for the fair market value of the stock, subject to certain income limitations. Investors who prefer not to fully part with their economic interest in the appreciated security can consider split-interest giving, like a charitable remainder trust (CRT). A CRT allows an investor to contribute stock, avoid immediate capital gains taxes, receive a partial tax deduction, and retain income from the trust, with the remainder going to charity.



Educating your clients on the many options for tax-efficient diversification can be a powerful step in helping them become comfortable with moving away from a concentrated position that may be adding unnecessary risk to their portfolios.

For further information

We're committed to thoughtful investing, purposeful planning, and the desire to deliver outcomes that expand above and beyond financial gains. Visit our website at www.allspringglobal.com.

Contact details

- For retail clients, contact your financial advisor.
- To reach our intermediary sales professionals, contact your dedicated regional director, or call us at **+1-866-701-2575**.
- To reach our institutional investment professionals, contact your existing client relations director, or email us at **AllspringInstitutional@allspringglobal.com**.
- To reach our retirement professionals, contact your dedicated defined contribution investment only specialist, or call us at **+1-800-368-1370**.
- To discuss sustainable investing solutions, contact **Henrietta Pacquement**, head of Sustainability, and **Jamie Newton**, deputy head of Sustainability, at **henrietta.pacquement@allspringglobal.com** and **jamie.newton@allspringglobal.com**.

Allspring Global Investments does not provide accounting, legal, or tax advice or investment recommendations. Any tax or legal information in this brochure is merely a summary of our understanding and interpretations of some of the current income tax regulations and is not exhaustive. Investors should consult their tax advisor or legal counsel for advice and information concerning their particular situation.

Diversification does not ensure or guarantee better performance and cannot eliminate the risk of investment losses.

This material is provided for informational purposes only.

THIS DOCUMENT AND THE INFORMATION WITHIN DO NOT CONSTITUTE AN OFFER OR SOLICITATION IN ANY JURISDICTION WHERE OR TO ANY PERSON TO WHOM IT WOULD BE UNAUTHORIZED OR UNLAWFUL TO DO SO.

Allspring Global Investments (Allspring) is the trade name for the asset management companies of Allspring Global Investments Holdings, LLC (Allspring Holdings), a holding company indirectly owned by certain private funds of GTCR LLC and Reverence Capital Partners, L.P. Unless otherwise stated, Allspring is the source of all data (which is current or as of the date stated); content is provided for informational purposes only with no representation regarding its adequacy, accuracy, or completeness and should not be relied upon; views, opinions, assumptions, or estimates are not necessarily that of Allspring Holdings, Allspring, or their affiliates and are subject to change without notice; and this communication does not contain investment advice, an investment recommendation, or investment research, as defined under local regulation of the respective jurisdiction.

FOR INVESTMENT PROFESSIONAL USE ONLY – NOT FOR USE WITH THE RETAIL PUBLIC

© 2024 Allspring Global Investments Holdings, LLC. All rights reserved.

ALL-10182024-rq6wpznu