

The Trade, In One Paragraph

You contribute low-basis stock to a partnership and receive an interest in a diversified pool of stocks. IRC 721(a) treats the contribution as a **swap** rather than a sale, so nothing is recognized on day one, and your basis carries over **untouched**. Concentration risk drops immediately. The tax does not disappear; it queues. What you pay for is a seven-year commitment, a 20% sleeve of illiquid assets chosen by the sponsor, and a fee load well above an index alternative. Whether the trade pays depends almost entirely on one question: **Will this position ever be sold in your lifetime?**

The Mechanics

Step 1) Contribute

Shares go in, an LP interest comes out. No recognition under 721(a). Original basis and holding period carry over to the partnership interest.

Step 2) Pool

Your position joins hundreds of contributed names. You hold a pro-rata claim on the whole pool from day one, not a claim on your old stock.

Step 3) Season

721(b) denies deferral to an "investment company," defined as 80%+ securities. So 20% sits in qualifying illiquid assets, typically levered real estate.

Step 4) Redeem In Kind

At year seven you can take a diversified basket out under 731. Still no sale. Your original basis splits across every position you receive.

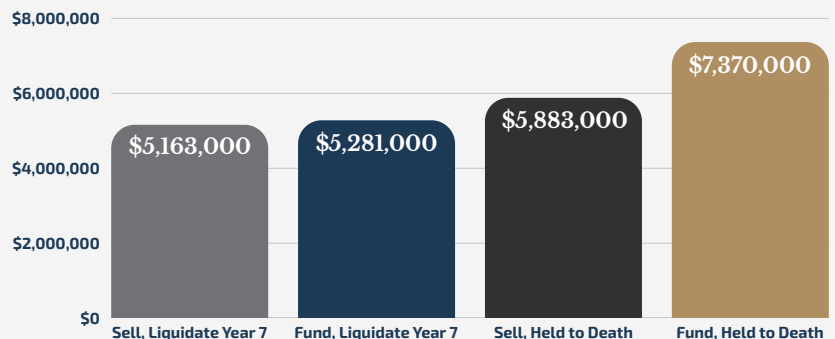
The seven-year clock is statutory, not a sponsor policy. The mixing-bowl rules of IRC 704(c)(1)(B) and 737 can drag the deferred gain back into income if property moves out inside that window. Redeem early and you generally receive your contributed stock back, or the lesser of its value and your NAV share. The deferral survives; the diversification does not.

The Math (High-Tax State Example)

\$5,000,000 Position, \$1,000,000 Basis

Measure	Sell	Exchange Fund
Potential Tax due *	\$1,312,000	\$0
Capital still invested	\$3,688,000	\$5,000,000
Value at year 7 (pre-tax)	\$5,883,000	\$7,370,000
Net if liquidated, year 7	\$5,163,000	\$5,281,000
Net if held to death	\$5,883,000	\$7,370,000

* Assumptions: \$4,000,000 embedded gain. A Massachusetts resident above the surtax threshold, so a sale runs 32.8% (20% federal LTCG + 3.8% NIIT + 5% MA + 4% MA surtax). Both paths compound at 7% gross. The reinvested proceeds carry 0.1% for an index ETF; the fund carries 1.3% all-in. Hypothetical, illustrative of stated assumptions only, not tied to any specific fund and not a projection of results. The 7% rate is arbitrary and applied identically to both paths; it illustrates the interaction of tax and fees, not expected returns. At death, the step-up applies to both paths; the fund path simply has more value to step up. Income tax only; federal and state estate tax are ignored.



Deferral only becomes elimination at the step-up. Everything else is a fee race.

Rates shown are Massachusetts. Federal is 23.8% everywhere; state stacking changes the margin, not the mechanics.



The Part Most Summaries Skip: Liquidate at year seven, and the fund clears an outright sale by roughly \$118,000, about 2%. The fee drag over seven years nearly eliminates the entire advantage gained from compounding pre-tax dollars. If the asset is held until death, IRC 1014 (step-up in basis) increases the heirs' basis, eliminating the gain instead of merely postponing it. Underwrite this as an estate strategy that happens to diversify, not the reverse.

Eligibility And Acceptance (2026)

Gate	Standard In Force
Investor Status	Reg D private placements. Floor is an Accredited Investor under Rule 501: \$1,000,000 net worth excluding primary residence; \$200,000 / \$300,000 income in each of the two prior years, with a reasonable expectation of the same in the current year; or an active Series 7, 65, or 82. Most established sponsors run 3(c)(7) vehicles and require Qualified Purchaser status, \$5,000,000 in investments. The INVEST Act (H.R. 3383, which passed the House 302-123 on December 11, 2025, and was referred to Senate Banking on December 15, 2025) would direct the SEC to modernize the definition. It is not law; Rule 501 is unchanged.
Subscription Size	\$500,000 to \$1,000,000 at traditional sponsors. Newer accredited-investor share classes start near \$100,000 . Multiple positions can be combined to clear the minimum.
Contributed Stock	Marginable public common, generally mid-cap and up. Restricted or control shares, thinly traded names, MLPs, and exchange-traded REITs are typically declined. Sponsors cap each name to hold the pool's profile, so the oversubscribed mega-caps can sit on a waitlist for months. Capacity, not eligibility, is often the binding constraint.
Duration & Reporting	Seven years to an in-kind redemption, plus any contractual lock-up that the sponsor layers on. Schedule K-1 annually, frequently on extension. Fund-level dividends, real estate income, and interest expense flow through whether or not cash is distributed. Ask the sponsor whether a Section 754 election is in place. It determines how cleanly the step-up reaches the heirs, and it must be in place before death.

What You Get

- **Deferral on the full position:** In the page 1 example, \$1,312,000 stays invested rather than being paid out in tax.
- **Day-one diversification:** Single-name risk transfers without a disposition.
- **Step-up at death:** The exit that converts deferral into permanent elimination.
- **No capital gains distributions:** Turnover inside the pool is low by design.
- **Optionality:** Years of runway to gift, donate, or stage recognition into low-income years.

What It Costs

- **Seven years, illiquid:** The lock-up does not renegotiate when circumstances do.
- **The 20% sleeve:** Required, sponsor-selected, and typically financed. Funds often use leverage at the fund level to acquire the qualifying assets.
- **Fee load:** Typically 1% or more, plus placement and fund-level expenses. 1.3% all-in is assumed on page 1.
- **No portfolio control:** The sponsor sets the pool and the redemption basket.
- **Basis fragmentation:** One lot becomes dozens of carryover-basis positions to track forever.
- **Policy risk:** Exchange funds appear on published loophole-closing revenue lists. Proposals so far have been prospective, but seven years outlasts a Congress.

Price These Against It First

Alternative	Treatment Of The Gain
Sell and diversify	Recognize now at up to 23.8% federal plus state. Full liquidity, full control, no counterparty.
Direct indexing	Harvested losses absorb the gain over several years. No lock-up, no illiquid sleeve.
Section 351 ETF contribution	Nonrecognition on contribution, but the 25/50 diversification test binds at the outset.
CRT or DAF	The trust or fund sells with no tax. Deduction now, income stream or charitable remainder. The only option here that removes the gain permanently without waiting for death.

Underwriting Screen: Three conditions have to hold together... **a materially appreciated position, no call on the capital for seven years**, and a **genuine intent to hold through death**. Two out of three usually points somewhere else on the table above. We review all of them side by side, with your actual basis and your actual state exposure, before anything gets recommended.

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If you have any questions, schedule a 15-Minute Discovery Call!

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