RESEARCH MEMO

Concentrated Positions

The decision is determined by what happens to the shares, not by what the client says they want

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November 2026

Framework memo, and the entry point for a set of companion pieces treating each tool in detail. Illustrative throughout; no client facts are described. Nothing here is tax or legal advice.

1 · SUMMARY OF CONCLUSIONS

A concentrated position is usually approached as a menu problem: here are the available tools, which one fits. That framing produces long conversations and slow decisions, because the tools are described by what they do rather than by the situation they solve.

The menu is shorter than it looks. Three questions eliminate most of it before any tool is evaluated, and several of the remaining options are mutually exclusive in ways that are rarely stated. A client who enters an exchange fund cannot gift those shares, write calls against them, or sell them on their own schedule for seven years. A client who gifts the lowest-basis lots has given away precisely the shares that benefit most from a step-up. Choosing one tool closes others, and the closing is frequently irreversible.

> Organize the decision around what eventually happens to the shares, not around what the client says they want. Objectives are descriptions of a disposition the client has not yet specified. Once the disposition is named, most of the menu resolves itself.

Findings

1 · Three questions do most of the work. Terminal disposition, embedded gain, and the availability of outside capital. A fourth, whether the shares are restricted, overrides all three when it applies and is the most commonly overlooked. (§2)

2 · Hold to death is the disposition with the most planning, not the least. The step-up eliminates the entire embedded gain, which makes every share sold during life a forfeited benefit. The work is deciding which shares are spent and which are held, and funding spending from elsewhere wherever possible. Treating this as the passive option is the most common error in the category. (§3.2)

3 · Charitable intent and step-up planning compete for the same shares. Both want the lowest-basis lots. A gifting program and a hold-to-death plan running simultaneously without coordination will each assume it has first claim on the same position. (§4)

4 · Several tools are mutually exclusive, and the exclusions are not symmetric. Shares committed to an exchange fund leave the client's control entirely. Shares pledged as collateral generally cannot be transferred. A collar written too tightly can trigger constructive sale treatment and realize the gain the structure was built to defer. (§4)

5 · Where basis is high, the sophisticated tools are not merely unnecessary, they are worse. Every structure in this memo costs time, money, and certainty. When the tax liability on an outright sale is small, selling is faster, cheaper, and fully known in advance. Recognizing when the machinery is not warranted is part of the analysis, not a shortcut around it. (§5)

Three standing rules

1. **Establish the disposition before evaluating any tool.** A recommendation made without it is a guess dressed as analysis.
2. **Check restriction status first.** Insider windows, lockups, and existing trading plans override every other consideration and are cheap to confirm.
3. **Price the certainty, not just the outcome.** Good and timely beats perfect and late. A structure that takes nine months to implement and leaves residual uncertainty can be worse than a sale executed next week at a known cost.

What would change these conclusions

- **Legislative change to the basis step-up.** A large share of this framework rests on it. Its removal would collapse the hold-to-death disposition and push nearly every case toward staged sale or charitable disposition.
- **Qualified small business stock.** If the position qualifies under §1202, the exclusion available on sale can exceed anything else discussed here, and the analysis should begin there instead. Eligibility is a legal determination, not an investment one.
- **An estate above the exclusion amount.** Hold-to-death stops being a clean answer when estate tax applies to the retained value, and the planning shifts toward transfer techniques outside the scope of this memo.

2 · THE DIAGNOSTIC

2.0 The override: is the position restricted?

Before anything else, establish whether the client can transact at all. Insider status, blackout windows, lockup agreements, existing Rule 10b5-1 plans, registration requirements on restricted stock, and employer holding policies each constrain what is possible and when.

This is not a tax question and it is cheap to answer, which is why it should come first. A recommendation built over several weeks and then blocked by a trading window is a recommendation that was never available. Where a 10b5-1 plan already exists, the schedule it establishes is generally the plan, and the remaining work is building around it rather than replacing it.

2.1 What eventually happens to the shares?

Three answers, and they are genuinely different problems.

Sold during life. The most planning, because every dollar of the decision is live: how much, over what period, funded how, offset by what. The embedded gain will be recognized, so the question is timing and sequencing rather than avoidance.

Held to death. The gain is eliminated by the basis adjustment at death. Every share sold during life forfeits that benefit on those shares specifically, which makes liquidity planning the central problem rather than a side issue.

Given away. The gain is never recognized by anyone, and the client receives a deduction at fair market value. This is the cleanest outcome available and it is constrained mainly by how much the client actually intends to give.

Most clients are a blend, and the blend is the answer rather than a complication. A position partly spent, partly held, and partly given is three dispositions running against one asset, and the shares should be assigned to each deliberately rather than drawn from pro rata.

2.2 How much embedded gain is there?

This determines whether there is a problem worth solving with anything beyond a sale. Everything in this memo exists to manage a tax cost, so the size of that cost sets the budget for complexity.

A position at or near cost basis presents a concentration problem but not a tax problem, and §5 treats that case directly. A position at 10% basis presents both, and the tax cost of correcting the concentration is the binding constraint on how fast it can be corrected.

Worth measuring as a share of market value rather than of basis. The decision variable is dollars of market value moved, and the gain share of market value is what determines the tax per dollar transacted.

2.3 Is there outside capital, and is more coming?

Several tools require funding the position itself cannot provide. A direct indexing sleeve built around a concentrated holding needs cash to buy the complement. A charitable program sized against a pledge needs a source for any shortfall. A staged sale produces proceeds, but those proceeds are the thing being diversified, not a separate source.

The forward-looking half matters more than the current balance. A client still earning, still receiving equity grants, or expecting a liquidity event can dilute a concentrated position with new money rather than selling it, which is the only approach that reduces concentration at zero tax cost. A client whose earning years have ended has no such option and faces a harder problem with fewer tools.

The distinction is frequently missed because the position looks identical in both cases. It is the cash flow around it that differs, and the cash flow determines whether time is an ally or a constraint.

3 · THE DISPOSITIONS

3.1 Sold during life

The default assumption in most advice, and the one with the most moving parts. The tools that serve it:

Staged sales against a gain budget. The unglamorous answer and frequently the correct one. Set an annual realized-gain target consistent with the client's bracket and surcharge thresholds, and sell into it. Predictable, requires no counterparty, costs nothing to implement, and can be stopped at any time. Developed separately.

Transition into a direct index or SMA. The position is contributed or held alongside a managed sleeve that is built to be complementary, and the sleeve harvests losses that offset the gains realized on the way out. Powerful and slower than it appears, and it carries a funding problem treated in the companion memo: the sleeve needs cash the concentrated position cannot supply without being sold.

Exchange funds. The client contributes shares to a partnership in exchange for units representing a diversified pool, with no gain recognized on contribution. The constraints are substantial: a seven-year holding period, a requirement that the fund hold a meaningful allocation to illiquid assets in order to avoid investment company treatment, carryover basis rather than a fresh start, and the complete loss of control over the specific shares. Developed separately.

Option overlays during the unwind. Collars and written calls can manage risk or generate income while a staged sale runs. They do not solve the concentration and they introduce assignment risk that can disrupt the schedule. Treated in the companion memo on overlays, and in the covered call memo for the mechanics of the premium itself.

Loss harvesting elsewhere. The rest of the portfolio is a source of offsets. A client unwinding a concentrated position should have every other taxable account running an active harvesting program, because those losses are worth more here than they are anywhere else.

3.2 Held to death

Often described as the do-nothing option. It is not.

The basis adjustment at death eliminates the embedded gain entirely, and no other disposition does this. That makes the retained shares extraordinarily valuable in tax terms, and it makes every share sold during life a specific, measurable forfeiture.

So the planning question is not whether to hold. It is which shares are held and which are spent, and the answer should be deliberate. Where the client needs liquidity, the order of preference is roughly:

1. Spend from other assets first, particularly cash and high-basis holdings, preserving the concentrated position intact.
2. Borrow against the position where the rate is tolerable and the client's balance sheet supports it. Securities-based lending preserves both the position and the step-up, at the cost of margin risk and an interest expense that is only sometimes deductible.
3. Sell the highest-basis lots, which forfeit the least.
4. Sell lowest-basis lots only when the first three are exhausted.

Two risks attach to this disposition and both deserve to be stated to the client plainly. The client bears single-name risk for the remainder of their life, which may be decades, and the step-up is a legislative benefit rather than a contractual one. A plan whose entire value rests on a provision of the code should be reviewed when that provision is under discussion.

Hedging without selling is therefore the natural complement, and the collar is the usual instrument. The constraint is §1259, discussed in §4.

3.3 Given away

Where charitable intent exists, the concentrated position is close to the ideal funding asset, and the reasoning runs opposite to the intuition elsewhere in this memo. The characteristic that makes the position a problem, a large embedded gain, is exactly what makes it efficient to give.

A gift of long-term appreciated securities to a public charity or donor advised fund produces a deduction at fair market value while the gain is never recognized by anyone. The client disposes of the concentration, captures a deduction, and pays no tax on the appreciation. No other disposition achieves all three.

The constraints are the 30% of adjusted gross income limit applicable to appreciated property, with a five-year carryforward, and the simple fact that the client has to actually want to give the money away. Charitable gifting is not a tax strategy for someone who is not charitable; it converts a tax liability into a smaller tax liability plus a transfer, and the transfer is the larger number.

Where the client wants both an income stream and a diversified outcome, a charitable remainder trust achieves it, at the cost of irrevocability and administrative complexity. Developed separately, along with the lot-selection questions treated in the existing gifting memo.

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4 · WHAT IS MUTUALLY EXCLUSIVE

The reason to establish disposition first is that several of these tools consume the shares, and a client who commits before the disposition is settled may find the preferred route closed.

Exchange fund units are not the shares. Contribution is irrevocable for the holding period. Those shares cannot be gifted, cannot be written against, cannot be sold on the client's schedule, and cannot be used as collateral. Basis carries over, so the gain is deferred rather than eliminated. The units do receive a step-up at death, which preserves that disposition, but every other option closes on contribution.

Gifting and step-up compete for the same lots. Both strategies want the lowest-basis shares: gifting because the avoided gain is largest, step-up because the eliminated gain is largest. A client running an annual gifting program funded from the concentrated position is steadily giving away the shares a hold-to-death plan depends on. Where both dispositions apply, the allocation between them should be set explicitly and reviewed, not left to whichever program happens to transact first.

A collar written too tightly is a sale. Under IRC §1259, a position that substantially eliminates both risk of loss and opportunity for gain can be treated as a constructive sale, realizing the gain immediately. The entire purpose of a collar in this context is to hedge without triggering recognition, so the structure has to retain meaningful exposure in both directions. This is a legal determination and it is the single technical point in this memo most likely to be gotten wrong by someone working from first principles.

Pledged shares are encumbered. Shares serving as collateral on a securities-based loan generally cannot be transferred, which forecloses gifting and complicates a staged sale. The borrowing route and the giving route do not run simultaneously against the same shares.

Written calls can override the schedule. A staged sale assumes the client controls the timing. An assigned call does not ask. Where an overlay runs alongside a planned unwind, the strikes should be set at prices the client would be content to sell at, so assignment accelerates the plan rather than disrupting it.

5 · WHEN THE MACHINERY IS NOT WARRANTED

Every structure described above costs something. Exchange funds carry fees and a seven-year lock. Direct indexing carries a management fee and tracking error. Collars cost premium or upside or both. All of them take time to evaluate, implement, and monitor, and each introduces some residual uncertainty about the final outcome.

Against that, an outright sale has a cost that is known exactly, today, and takes a week.

So the threshold question, once diversification is established as the goal, is whether the tax saving available from a structure exceeds its all-in cost and justifies its delay. That comparison moves in one direction as basis rises: the saving available shrinks with the embedded gain, while the fee, the lock-up, and the implementation effort do not. At some level of basis the structure costs more than the liability it is managing, and the only way to know where that line sits for a given client is to price both sides rather than assume the structure wins.

> An executive I worked with put it as good and timely beats perfect and late. A client moved out of a concentrated position next week at a known cost is in a better place than a client still evaluating an optimal structure nine months later, with the risk borne in full throughout and the problem itself no longer the one that was analyzed.

The delay is not neutral, which is the part most easily missed. The position does not wait. If it appreciates during the analysis, the embedded gain is larger and every structure under consideration is now solving a bigger problem at higher cost. If it declines, the client has absorbed the concentration risk the engagement existed to remove, and the saving the structure was meant to deliver may be smaller than the loss already taken. Both outcomes argue for acting on a good answer rather than waiting for the best one.

This is not an argument against the structures. It is an argument for sizing the analysis to the problem. The diagnostic in §2 exists partly to establish how much complexity the situation can justify, and a short answer arrived at quickly is a legitimate output of it.

Two related cases where the same logic applies. A position that is concentrated in percentage terms but small in absolute terms rarely justifies a bespoke structure. And a client who is genuinely comfortable with the risk, understands it, and has the balance sheet to absorb it has made a decision rather than a mistake. The role is to ensure the decision is informed, not to correct it.

6 · HOW THE COMPANION MEMOS FIT

This memo is the entry point. Each tool is treated in its own piece, and each assumes the diagnostic above has already been run.

- **Staged sales and the gain budget** — sizing annual realization against bracket and surcharge thresholds, and sequencing lots within it.

- **Transitioning into a direct index or SMA** — the complement portfolio, the funding problem, and what the sleeve can and cannot offset.
- **Exchange funds** — structure, the illiquid asset requirement, carryover basis, and the cases where the seven-year lock is and is not acceptable.
- **Option overlays on a concentrated position** — collars, written calls, the constructive sale constraint, and coverage ratio as the first design decision.
- **Charitable disposition of a concentrated position** — outright gifts, donor advised funds, and charitable remainder trusts, extending the lot-selection framework in the existing gifting memo.
- **Holding to death** — the liquidity sequence, borrowing against the position, and the legislative risk the disposition carries.

Framework memo prepared for illustrative purposes. Not tax or legal advice. Constructive sale treatment, qualified small business stock eligibility, trust structures, and restricted stock requirements are legal determinations and should be confirmed with qualified counsel.