

Managing Concentrated Stock Positions

We frequently have the privilege of partnering with clients who have built their wealth from a concentrated ownership position in their employer's stock or other investment. For many, the dynamics associated with concentrated positions are complicated by both financial and emotional factors since the asset that created their wealth now represents the greatest risk to it. As with most aspects of financial planning, there is no single solution for managing concentrated positions that fits all circumstances. Rather, through an in-depth, holistic discovery process, it is important to identify a client's short- and long-term goals, risk tolerance, income and spending trends, tax situation, philanthropic desires, liquidity needs, etc., and then advise them on the most appropriate solution for their situation. In this edition of MAInsights, we will provide a brief synopsis of the primary solutions available to manage the risk associated with concentrated stock positions and then offer our initial thoughts on opportunity zones – the most recent entrant into the world of tax sheltered investments.

Primary Solutions

While there are a number of potential solutions for mitigating the investment and tax risk associated with concentrated positions, we would group them into the following four broad strategies: to sell, to hedge, to diversify and to donate. In the following table, we outline the implementation strategies within each category and the investor goals they are designed to achieve. In each case, there are pros and cons that must be weighed to deliver the optimal solution for the client.

Strategy	Implementation*	Goal	Pros	Cons
Sell	Sell all now	Eliminate stock-specific risk	Simple; immediate risk reduction	Large potential tax liability
	Sell over time	Reduce stock-specific risk	Simple; ability to optimize tax lots if possible	Maintain concentrated risk exposure
Hedge	Buy puts	Maintain upside potential; insure against downside risk	Allows client to maintain exposure without all the risk	Can be a costly strategy over the long run
	Collar strategy (buy puts; sell calls)	Insure against downside risk at limited/no cost	Hedging strategy with little to no cost	Limited upside potential
Diversify	Contribute to exchange fund or qualified opportunity fund	Eliminate stock-specific risk and defer taxes	Diversification; tax deferral	Liquidity constraints; additional fees
Donate	Contribute to charity	Fulfill charitable desires	Eliminates capital gains tax	Assets leave personal estate

*Option trading may entail significant risk and is not appropriate for all investors. Diversification does not ensure profit or protect against a loss in declining market. This should not be considered a recommendation to buy or sell any security.

An Introduction to Opportunity Zones

The newest entrant into the solution set above is the Qualified Opportunity Fund, which was introduced as part of the 2017 tax reform legislation to encourage private investment in economically challenged areas (“Opportunity Zones”) across the United States. For investors who allocate to a Qualified Opportunity Fund, there are three potential tax benefits available:

1. Deferral of a realized capital gain
2. Step-up in tax basis of 10-15% if Opportunity Zone investment is held for 5-7 years
3. Permanent exclusion of capital gain on Opportunity Zone investment if held for 10 years

A wide range of investments can be made in a Qualified Opportunity Fund including real estate and operating companies – to date, we have seen most Opportunity Funds focus on real estate development. A successful

investment in an Opportunity Zone requires an attractive underlying investment opportunity coupled with compliance to a complex set of rules and regulations. Given the unique tax and investment implications of this new structure, we are approaching it with an elevated level of scrutiny and recommend that clients work closely with their wealth manager and tax adviser before pursuing an Opportunity Zone investment. More information on Opportunity Zones including frequently asked questions can be found on the IRS website at <https://www.irs.gov>.

Concluding Thoughts

Helping clients navigate the myriad of potential solutions to a concentrated stock position is just one example of the holistic guidance we strive to deliver. Partnering with our clients to mitigate their unique risks and optimize their financial future is a responsibility we value a great deal and we appreciate the confidence you have placed in us as your trusted advisor. If you have any questions or would like to discuss any changes in your financial situation, please do not hesitate to reach out to us.

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