RESEARCH REPORT

Section 351 and ETF Formation

What Fund Directors Need to Know

Notes and analysis from the MFDF webinar with Karen Aspinall and Raymond Holst of Practus LLP, recorded September 9, 2026

Prepared by Matt Bucklin, Founder and CEO, ExchangiFi
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About this report

The Mutual Fund Directors Forum (MFDF) recorded a webinar on September 9, 2026 titled "Section 351 and ETF Formation, What Fund Directors Need to Know." The panelists were Karen Aspinall and Raymond Holst of Practus LLP. Karen is a partner and chair of the firm's financial services practice. Her work centers on SEC and fund regulatory compliance. Ray is a tax attorney who focuses on the taxation of financial products. An MFDF host moderated the program and ran the Q&A.

This report pulls from three places. The first is the webinar summary and my own notes. The second is my follow-up research on the tax and securities rules the panel raised. The third is primary source material, including the SEC's July 27, 2026 settled order against Simplify Asset Management. Where a point comes from outside the webinar, I label it as additional context. That matters for attribution when this becomes public content.

One note on the source summary. The automated meeting summary attributes nearly every substantive point to "Thomas," the MFDF host. That is a transcription artifact. The substance came from Karen and Ray. The summary also lists the firm as "Practice LLP." The correct name is Practus LLP.

Executive summary

Section 351 is a general rule for forming corporations. It is not an ETF rule. It lets a taxpayer contribute property to a corporation in exchange for stock without recognizing gain at that time. An ETF organized as a regulated investment company (RIC) is a corporation for tax purposes. So an investor can contribute an appreciated portfolio to a new ETF, receive ETF shares of equal value, and carry the original cost basis and holding period into those shares. The gain is deferred. It is not eliminated.

Every 351 ETF transaction has to clear two separate rulebooks. The tax rules include the 80% control test, the investment company and diversification rules in Section 351(e), and the RIC qualification tests the new fund has to meet. The securities rules include the affiliated transaction prohibitions in Section 17 of the Investment Company Act of 1940, the fund of funds limits in Section 12(d)(1), the basket policies required by the ETF rule, valuation, and exchange listing.

The panel's message to directors was practical. Read and understand the tax opinion. Take the first transaction slowly. Confirm the adviser has written policies for evaluating contributed securities. Make sure those securities fit the fund's strategy. Vet the experience of every service provider in the chain. After launch, expect the adviser to document the business reason for any sale or in-kind delivery of contributed securities, especially in the first year.

Ray made a point that stuck with me. In substance, he described a 351 transaction as one big information-sharing exercise. Contributors, advisers, custodians, tax counsel, fund administrators, and the board all need the same accurate data at the same time. Whoever coordinates that information well will complete the most transactions with the fewest problems.

The SEC's settled order against Simplify Asset Management shows what happens when the securities side gets missed. A trust that owned roughly 25% of the adviser contributed about $107 million of securities across two in-kind subscriptions into the Simplify Propel Opportunities ETF (SURI). The SEC found the trust was a second-tier affiliate of the fund. It found Simplify caused a Section 17(a)(1) violation.

Treasury and the IRS have not issued rules that address Section 351 seeding combined with Section 852(b)(6) in-kind redemptions. Officials have said they are looking at it. Until guidance arrives, careful process and complete documentation are the best protection available to every party.

1. Why 351 ETFs are growing

The tax efficiency gap between SMAs and ETFs

A separately managed account (SMA) holds securities directly in the client's name. When the manager rebalances, sells trigger realized gains. Over time that creates tax drag. Many long-held SMAs end up with large unrealized gains that make the manager reluctant to trade.

An ETF works differently. It can meet redemptions by delivering securities in kind to an authorized participant (AP). Under Section 852(b)(6) of the Internal Revenue Code, a RIC does not recognize gain when it distributes appreciated property to meet a shareholder redemption. That lets the fund move low-basis positions out of the portfolio without realizing gain inside the fund.

The panel used a simple example. A security has a fair market value of $100 and a cost basis of $50. The ETF can deliver that security to an AP in a redemption and bring in new securities through creations. The fund does not recognize the $50 built-in gain. The shareholder still carries that gain in the basis of their ETF shares. They defer it until they sell the shares.

Additional context. After a 351 contribution, the same economic gain is embedded twice. The fund holds the contributed securities at the contributor's old basis. The contributor holds ETF shares at that same old basis. Section 852(b)(6) addresses the fund-level gain. The shareholder-level gain stays with the shareholder until sale.

Why managers and investors use it

The panel was clear that there should be real business reasons for a 351 transaction beyond tax. That point matters for both the IRS and the SEC.

On the manager side, the reasons include economies of scale and simpler operations. Running one fund is easier than running hundreds of individual accounts. Consolidation can support lower management fees over time. Seeding also gives a new fund meaningful assets on day one, which helps it reach viable scale.

On the investor side, the reasons include holding one exchange-listed position instead of many line items, simpler reporting, daily liquidity, and the ability to pledge or margin a single position more easily.

The panel noted that 351 transactions have become much more common over the past five years.

2. Where Section 351(e) comes from

Section 351(e)(1) has been in the Code for a long time. Congress added it in the Foreign Investors Tax Act of 1966. The target was the "swap fund." In the 1960s, promoters pooled concentrated stock positions from many investors into a new corporation. Each investor walked away with a share of a diversified pool without paying tax. Congress shut that down. A transfer to an investment company is taxable if it results in diversification of the transferor's interests.

The Taxpayer Relief Act of 1997 broadened the rule. It expanded the list of assets that count toward investment company status to include items like cash, foreign currency, precious metals, options, futures, and interests in RICs and REITs.

The logic behind the rule is what makes 351 ETF seeding possible. The rule targets tax-deferred diversification. An investor whose portfolio is already diversified before the contribution is not using the ETF to diversify. So the contribution can qualify.

3. How a 351 seeding transaction works

The flow of securities

In a typical transaction, securities move from the contributor's custodian, often the SMA custodian, to the ETF's custodian. In exchange, the contributor receives ETF shares of equal value. Legal ownership of the securities moves to the fund. The contributor now owns a proportional interest in the fund.

The control test

Section 351 requires the transferors, as a group, to be in control of the corporation immediately after the exchange. Control means at least 80% of the total combined voting power and at least 80% of the shares of each other class of stock. The panel described this as the contributing group owning at least 80% of the ETF's shares at the outset. This is why 351 seeding happens at launch, when the contributors are essentially all of the shareholders.

The investment company rule and the 25/50 diversification test

A new ETF will almost always be an investment company under Section 351(e). The Treasury regulations generally treat a corporation as an investment company if more than 80% of the value of its assets, excluding cash and nonconvertible debt, is held for investment in readily marketable stocks, securities, and similar assets.

That means the contribution only qualifies if it does not result in diversification. The regulations provide that no diversification results if each transferor's contributed assets are already diversified. The test borrows the 25/50 standard from Section 368(a)(2)(F). A portfolio is diversified if no more than 25% of its value is in any one issuer and no more than 50% of its value is in five or fewer issuers. Cash and government securities get special treatment in the calculation.

The panel stressed a point that often gets missed. **The test applies contributor by contributor.** A pool of contributors that looks diversified in the aggregate does not help an individual contributor whose own portfolio fails.

The panel also described two technical wrinkles. First, practitioners look through certain pass-through holdings to their underlying positions when running the test. Second, accounts held through grantor trusts, such as a revocable living trust, are combined with the grantor's other contributed accounts for testing, because the grantor is treated as the owner.

With many contributors, the analysis multiplies quickly. The panel emphasized the role of service providers and tax counsel in running and documenting it.

The tax opinion

Tax counsel typically issues an opinion that the transaction should qualify under Section 351. Karen and Ray said they will provide draft opinions to boards on request, especially for a fund's first 351 transaction. Directors should read the opinion and understand the assumptions it relies on. Those assumptions often include representations about the contributors, the portfolios, and the adviser's intent for the contributed securities.

4. Cost basis and holding period

What data has to move

A 351 transaction is a data migration as much as a securities transfer. For each contributor, the SMA custodian has to deliver CUSIPs, share counts, tax lots, acquisition dates, and cost basis to the ETF's custodian and transfer agent. That record follows the contributor for as long as they hold the ETF shares.

Carryover basis and tacked holding period

The contributor's basis in the ETF shares equals their basis in the securities they contributed. Their holding period in the contributed capital assets carries over to the shares. The fund takes the same carryover basis in the securities it receives.

Two ways to allocate basis across shares

The panel described two methods.

Tracing. Specific tax lots map to specific ETF shares. A share traced to a lot bought in 2012 carries that lot's basis and holding period.

Average cost. All of the contributor's basis is added together and divided equally across the ETF shares received.

The panel noted that the custodian's systems generally determine which method applies in practice. Either way, the built-in gain from the contributed securities stays with the ETF shares. The contributor does not recognize gain on the contribution itself.

Additional context. The allocation method can change the tax result on a later partial sale of shares. Contributors should confirm the method with the custodian and their tax advisor before they contribute.

An error in lot data at the time of migration carries into future Form 1099-B reporting for years.

5. What can be contributed

The tax view and the securities view are different

From a pure Section 351 perspective, almost any property can be contributed. The limits come from two other places. The first is the receiving fund's need to keep its RIC status. The second is securities law, which governs what a registered fund can hold and how it can acquire it. The panel noted that some assets, such as shares of gold ETFs and some crypto investments, may not work because they generate income that does not qualify for a RIC.

RIC status and the 90% gross income test

Most ETFs elect to be treated as RICs under Subchapter M. A RIC acts as a pass-through. The fund pays no corporate tax on income it distributes to shareholders.

To keep that status, the fund has to pass the 90% gross income test every year. At least 90% of its gross income has to come from qualifying sources. Qualifying income includes dividends, interest, payments with respect to securities loans, gains from selling stock, securities, or foreign currencies, and certain other income from the business of investing in those assets.

What counts as bad income

"Bad income" is the industry term for gross income that does not qualify. No more than 10% of a RIC's gross income can be bad income. Two common sources stand out.

Physical commodities. Gold, silver, oil, and agricultural products are not securities. Gains from trading them directly are bad income. A share of a gold ETF organized as a grantor trust looks like a security. For tax purposes the holder is treated as owning the underlying gold. So gains on those shares are generally bad income for a RIC.

Spot digital assets. The IRS treats digital assets like bitcoin as property. They are generally not securities for purposes of the RIC income test. Gains from holding them directly are bad income.

What happens if a fund fails

A fund that fails the income test can lose RIC status. It would then be taxed as a regular C corporation. The fund pays corporate tax on its earnings, and shareholders pay tax again on distributions and sales. That double tax destroys the efficiency the structure is built for.

Additional context. The Code now includes cure provisions that can let a fund keep RIC status after certain failures by paying a tax, if the failure had reasonable cause. A cure is a backstop. It is not a plan.

The RIC asset diversification test

Additional context. RICs also have to pass a quarterly asset diversification test. At the close of each quarter, at least 50% of the fund's assets must be in cash, government securities, other RICs, and other securities limited per issuer to 5% of the fund's assets and 10% of the issuer's voting securities. No more than 25% of the fund's assets can be in any one issuer, other than government securities and other RICs. A seed portfolio built from concentrated positions needs to be checked against this test as well as the 25/50 contributor test.

How commodity and crypto products work around the rules

Fund sponsors use three structures to offer commodity and crypto exposure.

Offshore subsidiaries. Many broad commodity ETFs hold commodity exposure through a wholly owned subsidiary, often in the Cayman Islands. The subsidiary's income flows into the fund under the controlled foreign corporation rules, and Treasury regulations generally treat those inclusions as qualifying income. Funds typically cap the subsidiary at 25% of total assets to stay within the RIC asset diversification test.

Grantor trusts. Single-asset products, such as physical gold trusts and spot bitcoin ETFs, skip RIC status entirely. They are grantor trusts. Investors are treated as owning the underlying asset directly. These products generally are not registered under the 1940 Act. Because a grantor trust is not a corporation, the 351 corporate seeding model does not map onto them.

Limited partnerships. Funds that trade commodity futures, such as the United States Oil Fund, are often organized as partnerships. They pass tax items directly to investors on Schedule K-1.

Securities law limits on what a fund can accept

Additional context. A registered fund can only acquire securities consistent with its stated investment objective, policies, and restrictions. If the fund's name suggests a focus, the Names Rule generally requires an 80% investment policy tied to that focus. The liquidity rule caps illiquid investments at 15% of net assets for open-end funds, which matters if a contributor holds restricted or thinly traded positions. The board and the adviser should screen for all of this before the securities arrive, not after.

6. Strategy alignment, holding intent, and business purpose

Contributed securities should fit the fund

The panel gave an intentionally absurd example. A large cap US equity ETF should not receive Brazilian bonds in a seeding transaction. A mismatch like that raises questions from the SEC about whether the fund is following its strategy. It also raises questions from the IRS about whether the fund is a real investment vehicle or a tax conduit.

No pre-planned dispositions

Contributed securities should be positions the fund could hold, or plans to hold, for the long term. Nothing should be contributed with a pre-planned exit from the fund immediately after launch.

Additional context. Current 351 ETF prospectuses reflect this risk. The Harris Oakmark ETF Trust prospectus, for example, warns that the IRS could apply the step transaction doctrine to combine a 351 seed contribution with later Section 852(b)(6) redemptions. If that happened, the IRS could recharacterize the contribution as a taxable sale at fair market value.

How much alignment is enough

There is no bright line. The panel said managers take different views on what percentage of contributed securities needs to align with the fund's target portfolio. Around 80% alignment is a commonly referenced level. Some managers are comfortable accepting up to roughly 20% of contributed positions that do not match the model, with a plan to transition those positions through ordinary course portfolio management.

After launch, the adviser is a fiduciary to the fund

Once the ETF launches, the adviser owes fiduciary duties to the fund and all of its shareholders. Trades have to be made for investment and business reasons based on market conditions. That duty can cut both ways. An adviser should not dump contributed securities on a preset schedule. It also should not hold a position that no longer fits the strategy just to protect the tax treatment of the seed.

There is no rule on how long contributed securities have to stay in the fund. The panel's guidance was to run in-kind creations and redemptions with a genuine market purpose, especially in the first year after the 351 transaction. Directors should expect the adviser to document the legitimate business purpose for any rebalancing or disposal of contributed securities shortly after launch.

7. Securities law considerations

7.1 Section 17 and affiliated transactions

Section 17(a) of the 1940 Act prohibits an affiliated person of a registered fund, or an affiliated person of that affiliated person, from knowingly selling securities or other property to the fund as principal. The same restriction applies to buying from the fund. An in-kind 351 contribution is a transfer of securities to the fund in exchange for fund shares. If the contributor is a first-tier or second-tier affiliate, the contribution can be a prohibited transaction unless an exemption applies.

Who counts as an affiliated person. Under Section 2(a)(3), affiliated persons of another person include anyone owning, controlling, or holding with power to vote 5% or more of that person's outstanding voting securities. They also include officers, directors, partners, and employees, and anyone controlling, controlled by, or under common control with that person. The fund's investment adviser is an affiliated person of the fund by definition.

Practical examples. A few scenarios should get a hard look in any 351 launch. The first is a contributor that owns 5% or more of the adviser, the sub-adviser, or the distributor. The second is a principal, officer, or employee of the adviser contributing a personal portfolio. The third is a contributor whose trustees or representatives also serve as portfolio managers of the fund.

Why common exemptions may not fit. Rule 17a-7 permits certain cross trades between affiliated funds and accounts, but it generally requires cash consideration and securities with readily available market quotations. An in-kind contribution for fund shares does not fit that framework. Section 17(b) allows the SEC to grant an exemptive order for a specific transaction, but a fund has to apply for it.

7.2 Case study. Simplify Asset Management and the SURI ETF

On July 27, 2026, the SEC issued a settled cease-and-desist order against Simplify Asset Management (Investment Company Act Release No. 36269). The Section 17 portion is the clearest public example of how a 351-style seed transaction can go wrong on the securities side.

Date	What happened
October 1, 2021	Trust A held an approximately 25% fully diluted equity interest in Simplify through preferred shares. Those shares gave Trust A the right to select two of the four directors on Simplify's board, which made them voting securities.
October 10, 2022	The SURI board approved the formation of SURI. A portfolio manager at the sub-adviser, Person C, presented to the board and was slated to manage SURI. Person C was also a trustee of Trust A.
January 30, 2023	Simplify sent the board a memo stating Trust A would seed SURI with approximately $71.5 million of securities in what the memo called a "tax-free exchange." Simplify told the board Trust A was not an affiliate. It did not share the basis for that conclusion.
February 7, 2023	The seed transaction closed and SURI launched the same day.
June 20 and 21, 2023	The board approved and Simplify executed a second in-kind subscription by Trust A of approximately $35.7 million. The basket was not pro rata. It included new securities and different weightings. The memo did not address affiliation or the tax benefits to Trust A. Trust A held 97.6% of SURI's shares as of June 20.
Both transactions	No application for exemptive relief under Section 17(b) was filed.
March 31, 2026	Trust A still owned approximately 90.3% of SURI's outstanding shares.
July 27, 2026	The SEC entered the settled order. It found Trust A was an affiliated person of Simplify and therefore a second-tier affiliate of SURI. It found Simplify caused Trust A's Section 17(a)(1) violations.

What else was in the order. The $400,000 civil penalty covered more than the Section 17 issue. The order also found that Simplify caused a leverage breach under Rule 18f-4 and late Form N-RN filings at a different ETF, missing Section 19(a) notices on return of capital distributions across seven ETFs, and Rule 38a-1 compliance program failures. Simplify settled without admitting or denying the findings.

The custom basket finding. This detail matters for any 351 launch. The SEC found SURI's Rule 6c-11 policies did not address custom baskets containing securities the fund did not already hold until June 2026. SURI documented the June 2023 basket as a "rebalance" basket. The policies also lacked any process for deviations from basket parameters.

Takeaways for 351 transactions.

The adviser should trace the ownership of every contributing entity before accepting a seed portfolio. That review should cover the adviser, any sub-adviser, and the distributor. Board appointment rights and other voting features count, not just common equity.

The board should see the analysis behind any conclusion that a contributor is not an affiliate. A bare conclusion is not enough.

Overlapping roles deserve scrutiny. In SURI, a trustee of the contributing trust was also a portfolio manager of the fund.

Basket records should describe what actually happened. A seed or follow-on contribution basket should be documented as a custom basket under written procedures, not labeled as something else.

If a contributor is an affiliate, the path forward is exemptive relief or a different structure. It is not a reclassification.

A settled order is not binding precedent on anyone else. The order says so directly. It is still a clear signal of how the SEC staff views these transactions.

7.3 Rule 6c-11 and custom baskets

Rule 6c-11, the ETF rule, provides exemptive relief that lets ETFs operate. It includes relief from Section 17(a) for in-kind creations and redemptions with persons who are affiliated with the fund solely because they own 5% or more of the ETF's shares. That relief is built for ordinary creation and redemption activity. It does not cover a contributor who is an affiliate for other reasons, such as owning part of the adviser.

The rule also requires every ETF to adopt written policies governing basket construction and acceptance. For custom baskets, the policies must set detailed parameters that are in the best interests of the fund and its shareholders, including a process for revisions and deviations. A 351 seed basket processed as a creation is typically a custom basket. Directors should confirm the fund's policies cover it before the first transaction.

7.4 Section 12(d)(1) and the fund of funds limits

Section 12(d)(1)(A) generally prohibits a fund from acquiring more than 3% of the outstanding voting stock of another registered fund. Section 12(d)(1)(B) generally prohibits a registered open-end fund, including an ETF, from selling its shares to another investment company if the buyer would then own more than 3%.

When this comes up in a 351 launch. Most 351 contributors are individuals, trusts, and families contributing SMA portfolios. They are not investment companies, so 12(d)(1) usually does not apply. It can apply if a contributor is a registered fund, or a pooled vehicle that relies on Section 3(c)(1) or 3(c)(7). Private funds relying on those exclusions are treated as investment companies for purposes of these limits. Some family investment vehicles and pooled structures fall into that group.

Exemptions. Rule 12d1-4 allows registered funds and business development companies to exceed the 3% limit subject to conditions. Those conditions include limits on control of the acquired fund, voting requirements, and in some cases a fund of funds investment agreement. Private funds cannot rely on

Rule 12d1-4. A private fund contributor that would own more than 3% of the new ETF needs a different solution. Counsel should confirm the analysis for any contributor that is a pooled vehicle.

7.5 Section 12(b) of the Securities Exchange Act of 1934

Section 351 handles the tax treatment. It does nothing for listing. For ETF shares to trade on a national securities exchange like NYSE Arca or Nasdaq, the shares have to be registered under Section 12(b) of the Exchange Act. Without that registration, the shares issued in the seeding transaction cannot be listed or traded on the exchange.

7.6 Valuation and the compliance program

The panel emphasized proper valuation procedures and compliance with fund policies as part of the transaction's legitimacy.

Additional context. Contributed securities have to be valued under the fund's valuation policies, and Rule 2a-5 frames the board's oversight of fair value determinations. Most contributed equities have readily available market quotations, but restricted or thinly traded positions need more attention. Rule 38a-1 requires the fund to adopt written compliance policies reasonably designed to prevent securities law violations, with board approval and a chief compliance officer. The Simplify order cited Rule 38a-1 failures alongside the Section 17 finding. A 351 program belongs inside that compliance framework.

8. IRS reporting and the significant transferor rule

The panel noted that most shareholders will not see a 351 transaction on their tax returns unless they receive 5% or more of the ETF's shares.

The 5% threshold

Treasury Regulation §1.351-3 defines a significant transferor. For a publicly traded corporation, it is a transferor who owns at least 5% of the outstanding stock, by vote or value, immediately after the exchange. For a corporation that is not publicly traded, the threshold is 1%. Because a new ETF launches with a limited shareholder base, large seed contributors can cross 5%.

Above the threshold

A significant transferor has to attach a statement to their federal income tax return for the year of the exchange. The statement is titled "STATEMENT PURSUANT TO §1.351-3(a) BY [name and taxpayer identification number], A SIGNIFICANT TRANSFEROR." It lists the transferee corporation's name and employer identification number, the date of the transfer, and the aggregate fair market value and basis of the property transferred, determined immediately before the exchange. The IRS uses it to track large tax-deferred transfers into corporate structures.

Additional context. The receiving corporation has a parallel obligation. A corporation that receives property from a significant transferor in a 351 exchange must also file a statement with its return under §1.351-3(b). For a 351 ETF, that means the fund's tax reporting process needs to identify its significant transferors. That is a board-level oversight item.

Below the threshold

A contributor who owns less than 5% afterward does not file the §1.351-3 statement. There is no special disclosure attached to the return. The carryover basis and holding period attach to the new ETF shares and sit in the custodian's records. Nothing is reported until the shares are sold, when the broker issues Form 1099-B.

Additional context. Every taxpayer still has a general obligation to keep records that support basis. Contributors below the threshold should keep their own record of the contributed lots, values, and basis, and confirm how the custodian will report basis on future 1099-Bs.

9. The board's role

Directors do not run a 351 transaction. They oversee it. The panel framed oversight around a few questions. Is the process sound? Are the right people involved? Is the documentation good enough to defend the transaction to the IRS and the SEC later?

The panel's guidance for directors, plus the additional context in this report, fits into the oversight map below.

Oversight area	What directors should understand	What to ask the adviser for
Tax qualification	The control test, the contributor-level 25/50 diversification test, and the RIC income and asset tests	The tax opinion, a draft before the first transaction, and a summary of contributor diversification results
Contributed securities	Fit with the fund's objective, the Names Rule, liquidity limits, and valuation	The adviser's written evaluation policy, an alignment analysis against the target portfolio, the full securities list, and the valuation method
Affiliation	Section 17(a) first-tier and second-tier affiliate risk	Affiliation questionnaires from contributors, an ownership review of the adviser, sub-adviser, and distributor, and the reasoning behind any non-affiliate conclusion
Contributor type	Section 12(d)(1) limits if a contributor is a fund or 3(c)(1) or 3(c)(7) vehicle	Confirmation of each contributing entity's status and the exemption relied on
Basket process	Rule 6c-11 custom basket policies	Written custom basket procedures that cover seed baskets and deviations, and accurate basket records
Service providers	Experience with 351 transactions at the custodian, administrator, transfer agent, and tax counsel	Track record, prior 351 volume, and the data handoff process between custodians
Post-launch trading	Fiduciary duty, holding intent, and no pre-planned dispositions	A log of dispositions and in-kind deliveries of contributed securities with the documented business purpose, especially in year one

Oversight area	What directors should understand	What to ask the adviser for
Disclosure	Section 351 and 852(b)(6) risk factors	Prospectus and SAI disclosure describing the seeding and its tax risks
Tax reporting	The significant transferor rule	Identification of 5% transferors and the fund's §1.351-3(b) statement

The panel's closing guidance for a board doing this for the first time was simple. See the tax opinion. Understand it. Take it slowly.

10. Regulatory backdrop and open questions

No rules yet on 351 plus 852(b)(6)

There are no specific Treasury regulations addressing a Section 351 seeding followed by Section 852(b)(6) in-kind redemptions. The panel said Treasury has indicated it would provide guidance. Nobody knows when, or whether, it will arrive.

What officials have said

Additional context. At a Wall Street Tax Association meeting on July 21, 2026, IRS and Treasury officials discussed ETFs and tax-aware strategies. According to a K&L Gates summary of that meeting, officials declined to bless any particular transaction. They did acknowledge the importance of Section 852(b)(6) to ordinary ETF operations and the viability of 351 contributions where the contributed assets fit the ETF's investment profile and dispositions happen in the ordinary course. They also asked the industry for more detailed information about these transactions.

That framing lines up closely with the panel's guidance. Fit with the strategy and ordinary course trading are the two things that keep coming up.

Disclosure is catching up

Additional context. Fund prospectuses now carry specific 351 risk language. AllianceBernstein's AB Active ETFs prospectus notes that Treasury and the IRS have publicly said they are reviewing how Sections 351 and 852(b)(6) apply to certain ETF transactions. The Harris Oakmark ETF Trust prospectus flags step transaction risk.

Open questions

Several practical questions remain without clear answers. How long should contributed securities stay in the fund? What level of alignment with the target portfolio is enough? How should basis be allocated across shares? How will the IRS view follow-on contributions after launch? Each manager and each law firm is making its own judgment calls today. That is exactly why documentation matters.

11. What this means for ExchangiFi

Internal section. Not for public content.

The webinar confirmed our thesis

My main takeaway is that ExchangiFi is solving the most frustrating part of the exchange for every party. That is information gathering and record keeping for compliance.

Ray's point about the transaction being an information-sharing exercise is the clearest description of our value I have heard from an outside expert. The party that coordinates the information across contributors, advisers, custodians, counsel, and the board is the party that makes these deals work.

The compliance file is the gap

Most advisors have an internal compliance process. They need to document the full 351 process and justify why specific securities were contributed and exchanged for the ETF. Practus advises clients to do exactly that. Right now that documentation lives in emails, spreadsheets, and PDFs.

I think we can do more to support this through the portal. The pieces we already touch map directly to what the panel said boards and compliance teams need.

On the advisor side, a downloadable 351 compliance file per household could include the diversification test results, the affinity or alignment analysis, a field for the advisor's written rationale, contributor attestations, a snapshot of the tax lot data at submission, and a timestamped approval trail. Attestations could cover affiliation with the adviser, sub-adviser, or distributor, whether the contributing entity is a fund or a 3(c)(1) or 3(c)(7) vehicle, and whether the contributor expects to own 5% or more of the ETF.

On the sponsor side, the same data rolls up into a board-ready packet. That could include the contributor roster, an attestation summary, an alignment summary, custom basket documentation, and a list of expected significant transferors. A post-launch log of dispositions of contributed securities with documented business purpose could come later as a Sponsor Premium feature.

Where this fits in pricing

This looks like a strong fit for the Advisor Pro license. Removing compliance friction is a concrete reason for an individual advisor to pay. The free tier keeps the analysis. Advisor Pro adds the branded compliance file. Enterprise could add a firm-level view for the CCO. The sponsor board packet fits Sponsor Premium alongside the contribution tracking dashboard.

The affinity score

The panel confirmed there is no industry standard for alignment. Around 80% is commonly referenced and managers take different views. That supports our plan to set ExchangiFi's own affinity score thresholds with an expert tax attorney. Karen and Ray would be natural people to pressure-test it.

Guardrails

ExchangiFi collects and organizes information. It does not determine affiliation, tax qualification, or suitability. Attestations are the contributor's own representations for review by the fund's counsel and the advisor's compliance team. Product and marketing language should say the portal helps parties document and coordinate. It should not say the portal ensures compliance.

Follow-ups

Confirm the exact wording of Ray's information-sharing comment before quoting him publicly. Ask Practus whether they would review a draft compliance file template. Consider MFDF and fund directors as a new audience for content, since boards now carry oversight of every 351 launch.

12. Content angles for the article, LinkedIn post, and email

Article. Frame it around the board. Section 351 ETFs have gone mainstream, and fund directors now own the oversight. Walk through the two rulebooks, the Simplify lesson, and what directors should ask for. Close on the information-sharing point.

LinkedIn post. Lead with Ray's information-sharing idea, confirmed wording first. Pair it with one concrete lesson from the Simplify order. The tax side of a 351 can be perfect and the transaction can still fail on the securities side. Link to the article in the first comment.

Email. Short intro on the MFDF program, then the main points as bullets. Good candidates are the two rulebooks, contributor-level diversification, strategy fit and no pre-planned exits, documented business purpose after launch, the Section 17 affiliate check, the significant transferor rule, and the lack of Treasury guidance.

13. Corrections and items to verify before publishing

Item	Issue	Recommended fix
Speaker attribution	The meeting summary attributes nearly all content to "Thomas," the MFDF host	Attribute substance to Karen Aspinall and Ray Holst or to "the panel"
Firm name	Summary says "Practice LLP"	Use Practus LLP
"Tax-free"	Summary and some notes use "tax-free"	Use "tax-deferred." The gain carries into the ETF shares
Ray's quote	My notes paraphrase it	Confirm wording with Ray before using quotation marks
Simplify ownership	Pasted summary says Trust A owned 25% of the "voting preferred shares"	The order says an approximately 25% fully diluted equity interest held through preferred shares that carried the right to select two of four directors

Item	Issue	Recommended fix
Simplify penalty	Pasted summary ties the $400,000 penalty to the affiliate transactions alone	The penalty covered Section 17, Rule 18f-4, Section 19(a), and Rule 38a-1 findings together
Simplify precedent	Pasted summary calls the case a clear precedent	It is a settled order, entered without admitting or denying, and not binding on others. Call it a signal or a case study
Simplify dates	Pasted summary says "early 2023" and "months later"	February 7, 2023 and June 21, 2023. Order dated July 27, 2026
Section 12(d)(1)	Notes say hedge fund seed investors can rely on Rule 12d1-4	Private funds cannot rely on Rule 12d1-4. Registered fund acquirers face conditions including a control limit
Crypto classification	Notes say the SEC classified crypto as property or commodities	Say the IRS treats digital assets as property and they are generally not securities for the RIC income test
Offshore subsidiaries	Notes describe subsidiary income as a "dividend"	Income is generally included under the controlled foreign corporation rules and treated as qualifying income under Treasury regulations. Subsidiaries are typically capped at 25% of assets
Loss of RIC status	Notes describe loss of status as automatic	Cure provisions exist for certain failures with reasonable cause
Significant transferor	Notes cover only the contributor	Add the 1% threshold for non-publicly traded corporations and the receiving corporation's §1.351-3(b) statement
351(e) history	1966 and 1997 dates	Accurate per my research. Confirm against a primary source if the article cites specific statutory sections

Sources

Webinar. MFDF, "Section 351 and ETF Formation, What Fund Directors Need to Know," with Karen Aspinall and Raymond Holst of Practus LLP, recorded September 9, 2026. Meeting summary and Matt Bucklin's notes.

SEC order. In the Matter of Simplify Asset Management, Inc., Investment Company Act Release No. 36269, File No. 3-22662, July 27, 2026. https://www.sec.gov/files/litigation/admin/2026/ic-36269.pdf

Treasury and IRS remarks. K&L Gates, "IRS and Treasury Discuss Current Issues With ETFs and Tax Aware Strategies," July 22, 2026. https://www.klgates.com/thought-leadership/IRS-and-Treasury-Discuss-Current-Issues-With-ETFs-and-Tax-Aware-Strategies-7-22-2026

Prospectus disclosures. AB Active ETFs, Inc., Form 485BPOS, 2026. https://www.sec.gov/Archives/edgar/data/0001496608/000091957426004699/d161945d485bpos.htm and Harris Oakmark ETF Trust, Form 497, 2026. https://www.sec.gov/Archives/edgar/data/0002035827/000110465926077625/tm2618404d1_497.htm

Speaker background. Practus LLP attorney profile for Karen Aspinall. https://practus.com/attorney/karen-aspinall/

Statutes and rules referenced. Internal Revenue Code Sections 351, 358, 368(a)(2)(F), 368(c), 851(b), and 852(b)(6). Treasury Regulations §1.351-1 and §1.351-3. Investment Company Act of 1940 Sections 2(a)(3), 12(d)(1), 17(a), and 17(b), and Rules 2a-5, 6c-11, 12d1-4, 17a-7, 22e-4, 35d-1, and 38a-1. Securities Exchange Act of 1934 Section 12(b).