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Internal Revenue Service
CC:PA:01:PR (Notice 2026-62)
Room 5503
P.O. Box 7604
Ben Franklin Station
Washington, D.C. 20044

Re: Notice 2026-62, Guidance and Other Actions Being Considered Regarding Certain Potentially Abusive Investment Fund Strategies Involving Financial Products (Section 2.02, Transfers to Controlled Corporations in Transactions Intended to Qualify Under § 351)

Dear Sir or Madam:

Exchangifi LLC (“Exchangifi”) welcomes the opportunity to comment on Notice 2026-62 (the “Notice”),¹ which the Treasury Department and the Internal Revenue Service (the “IRS”) issued together with Rev. Rul. 2026-20 (the “Ruling”).² Our comments address only section 2.02 of the Notice, which concerns transfers of securities to newly formed exchange-traded funds (“ETFs”) in transactions intended to qualify under § 351.³

In our experience, § 351 ETF launches are generally seeding transactions of the kind the Notice states it does not address.⁴ For the investors who contribute, a § 351 exchange is a responsible portfolio management tool, not a strategy pursued solely for tax reasons. Our main observations are summarized below and discussed in Part II.

1. For most investors, the realistic alternative to a § 351 exchange is continued holding, not a taxable sale. Measured against that baseline, the exchange is most likely revenue-neutral.

¹ Notice 2026-62, *Guidance and Other Actions Being Considered Regarding Certain Potentially Abusive Investment Fund Strategies Involving Financial Products* (Sept. 28, 2026), <https://www.irs.gov/pub/irs-drop/n-26-62.pdf>.

² Rev. Rul. 2026-20 (Sept. 28, 2026), <https://www.irs.gov/pub/irs-drop/rr-26-20.pdf>.

³ Unless otherwise noted, section references are to the Internal Revenue Code of 1986, as amended, and the Treasury regulations issued under it.

⁴ Notice § 2.02(2) (stating that the Notice “does not address, and expresses no view regarding,” a § 351 transaction used to seed a newly established ETF with assets that are consistent with the ETF’s investment thesis and that are intended and expected to be retained by the ETF).

2. Investors use § 351 exchanges to consolidate fragmented and high-fee accounts and to put a coherent strategy and professional management in place. In theory, moving locked-in positions into professionally managed funds may also make markets more efficient.
3. These investors are typically not ultra-wealthy. The wealthiest investors have access to several other tax deferral strategies, which are generally limited to accredited investors or qualified purchasers and often carry high fees.
4. An investor who exchanges a diversified portfolio for shares of a diversified ETF has essentially the same market risk and expected return before and after the exchange.
5. In our experience, fund sponsors approach seeding conservatively. They screen contributions and decline portfolios assembled only to pass the diversification tests, as well as securities that do not fit the fund's mandate and that the fund would not intend to hold.
6. Any change in investment strategy is not, by itself, a problem. No one can reliably predict which investment style, factor, sector, geography, or theme will deliver a better risk-adjusted return, or time a switch between them. Section 1031 already lets real estate investors change property type and geography, so long as they stay in the same asset class.
7. Most ETFs seeded through § 351 exchanges gather new assets after launch, and few have closed. Continued inflows show that sponsors launch these funds as ongoing businesses, not only for the tax treatment at launch. That sustainability benefits end investors and supports competition among ETF issuers.

In Part III, we recommend that the Treasury Department and the IRS rely on targeted information reporting rather than identifying § 351 ETF seeding as a listed transaction or transaction of interest.

I. ABOUT EXCHANGIFI AND THE BASIS FOR OUR COMMENTS

ExchangiFi is an independent financial technology company. It operates an online bulletin board on which ETF sponsors post information about funds that plan to accept contributions of securities, before launch, in exchanges intended to qualify under § 351.⁵

Over the past year, we have spoken with several hundred financial advisors, who together serve thousands of clients, about § 351 exchanges. We also maintain a fund-level database of ETFs seeded through § 351 exchanges since 2019, compiled from registration statements filed with the

⁵ Cf. Regulation of Exchanges and Alternative Trading Systems, Exchange Act Release No. 40760, 63 Fed. Reg. 70844, 70850-51 & n.47 (Dec. 22, 1998) (explaining that systems that merely provide information about trading interest, without facilities for execution, are not exchanges under Rule 3b-16, 17 C.F.R. § 240.3b-16, and citing staff no-action letters describing bulletin board systems).

Securities and Exchange Commission (the “SEC”) and other public data.⁶ Our observations draw on both sources.⁷

II. RESPONSES TO QUESTIONS 1 AND 2 OF SECTION 4.01

Question 1. *Is the description of the subject transactions accurate? Are there additional facts or considerations of which the Treasury Department and the IRS should be aware in determining the appropriate federal income tax treatment of the subject transactions?*

The Notice describes one pattern. In our experience, that pattern does not describe the typical § 351 ETF launch. We offer the following additional facts and observations.

A. For most investors, the realistic alternative is continued holding, not a taxable sale.

Our conversations with advisors follow a consistent pattern. The advisor recommends that the client consolidate high-fee accounts or organize the portfolio around a clear strategy. The client declines because a sale would trigger capital gains tax. The client keeps the securities. No advisor has told us of a client who had decided to sell and pay the tax but then chose a § 351 exchange instead. The usual alternative is to hold the securities indefinitely, often until death, when the heirs take a basis equal to the securities’ fair market value under § 1014(a). The Congressional Research Service has observed that the treatment of gains at death “is viewed as a major reason for the lock-in effect,” the tendency to hold assets to avoid capital gains tax.⁸

B. The exchange is most likely revenue-neutral.

A § 351 exchange defers tax. It does not eliminate it. The investor takes a substituted basis in the ETF shares under § 358(a)(1) and recognizes the deferred gain on any later sale of those shares. Measured against the realistic baseline of holding until death, the exchange is most likely revenue-neutral.

C. Section 351 exchanges are a responsible portfolio management tool.

A majority of the portfolios we see are already broadly diversified, but they are fragmented. A typical household we see holds many positions across several accounts, some of them high-fee accounts, accumulated over years without a coherent strategy or professional management. Many of these investors are approaching retirement and want to simplify. A § 351 exchange lets them move holdings that fit a fund’s strategy into a single ETF that offers professional management, daily liquidity, daily disclosure of its holdings, the protections of the Investment Company Act of 1940, and often lower costs. In theory, this may also make markets more efficient. Stock sales are sensitive to capital gains tax rates, and the resulting lock-in effect can affect stock prices.⁹ Once in

⁶ Exchangifi, *Section 351 ETF Seeding and Organic AUM Growth Report* (Sept. 2026), summarized in *The 351 ETF Launchpad: How Tax-Deferred Seeding Is Changing Active ETF Launches* (Oct. 7, 2026), <https://exchangifi.com/351-etf-launchpad-tax-deferred-seeding/> (the “Exchangifi Report”).

⁷ This letter reflects Exchangifi’s experience and views. It is not tax, legal, or investment advice.

⁸ Jane G. Gravelle, Cong. Research Serv., IF11812, *Tax Treatment of Capital Gains at Death* (updated June 4, 2021).

⁹ Martin Feldstein, Joel Slemrod & Shlomo Yitzhaki, *The Effects of Taxation on the Selling of Corporate Stock and the Realization of Capital Gains*, 94 Q.J. Econ. 777 (1980) (finding that corporate stock sales are quite sensitive to

a professionally managed fund, locked-in positions can be rebalanced according to the fund's disclosed strategy, and changes in market or business conditions.

D. Section 351 exchanges reach investors who lack the tools available to the ultra-wealthy.

Shares issued in a § 351 seeding are offered under an effective registration statement and trade on an exchange from launch. The securities laws do not limit participation to accredited investors or qualified purchasers.¹⁰ The wealthiest investors have other tools that are generally limited to those categories of investors and often carry high fees. Tax-aware long/short strategies are generally offered only to accredited investors or qualified purchasers, and typically charge higher fees than ETFs. Private exchange funds are generally limited to qualified purchasers and also tend to carry higher fees. Private placement life insurance typically requires large premiums. Complex trust structures often require substantial legal fees to establish and maintain. A § 351 exchange into a registered ETF gives investors without access to these tools a path to professional, diversified management.

E. Most § 351 ETFs gather new assets, and few have closed. That reflects a business purpose and benefits end investors.

Our September 2026 study of 101 ETFs seeded through § 351 exchanges found that 70 percent have gathered organic net inflows since launch. New money accounted for \$6.3 billion, or 47 percent, of the cohort's \$13.5 billion in asset growth.¹¹ Investors who buy shares after launch receive no § 351 benefit, so these inflows reflect demand for the strategies themselves and show that sponsors run these funds as ongoing businesses. Of the 136 ETFs seeded through § 351 exchanges since 2019, two have closed or merged, a cumulative rate of about 1.5 percent.¹² By comparison, Morningstar reports that 146 actively managed ETFs closed in 2025 alone, and that only six of those funds had more than \$50 million in assets at the start of that year. Morningstar has estimated an active ETF's breakeven at about \$33 million in assets.¹³ The median seed in our study was \$118 million.¹⁴

Fewer closures are better for end investors. A fund liquidation forces shareholders out of a strategy they chose and creates a taxable event they did not plan for.¹⁵ More issuers launching funds that last also gives investors more choice. The three largest ETF providers held 70.6 percent

tax rates). Zhonglan Dai, Edward Maydew, Douglas A. Shackelford & Harold H. Zhang, *Capital Gains Taxes and Asset Prices: Capitalization or Lock-in?*, 63 J. Fin. 709 (2008) (finding a dominant lock-in effect on stock prices in the week after the 1997 capital gains rate reduction took effect).

¹⁰ See 17 C.F.R. § 230.501(a) (accredited investor) and Investment Company Act of 1940 § 2(a)(51), 15 U.S.C. § 80a-2(a)(51) (qualified purchaser).

¹¹ Exchangifi Report.

¹² Exchangifi Report.

¹³ Morningstar Manager Research, *Active ETF Launches and Closures: 2025 in Review* (Feb. 13, 2026), <https://www.morningstar.com/business/insights/blog/active-etf-launches-and-liquidations-2025>.

¹⁴ Exchangifi Report.

¹⁵ See § 331(a).

of U.S. ETF assets as of July 2026.¹⁶ Section 351 seeding allows independent managers and advisory firms to launch funds at a sustainable size that can compete in this market.

Question 2. *Are there transactions that appear to be similar to the subject transactions but have different facts or different economics that warrant different federal income tax treatment than the subject transactions? If so, what are the crucial differences between those transactions and the subject transactions?*

Yes. In our experience, seeding transactions are generally done conservatively, in anticipation of guidance like the Ruling. A seeding transaction shares the form of the § 351 conversion transaction described in the Notice, but its facts and circumstances differ in three ways.

Fit with the fund's strategy. In a seeding transaction, the contributed securities fit the fund's disclosed strategy, and sponsors review contributions with that in mind. We have seen sponsors decline portfolios that were "stuffed," meaning the investor had borrowed to buy additional positions so the portfolio would pass the diversification test. We have also seen sponsors decline securities that do not fit the fund's mandate and that the fund would not intend to hold, and portfolios in which a single position was too large, even though the security fit the fund's strategy.

No planned redemption of contributed securities. In a seeding transaction, the fund intends to retain the contributed securities, subject to ordinary portfolio management. It does not plan to issue shares to an authorized participant and redeem them with the contributed securities.

Same market risk and expected return. Diversification removes most stock-specific risk with a moderate number of holdings, leaving mainly market risk.¹⁷ Investors are compensated for market risk, not stock-specific risk, so a diversified portfolio's expected return is driven by its market exposure.¹⁸ Before costs, actively managed portfolios as a group earn the market return.¹⁹ The portfolios we see must meet the diversification tests of Treas. Reg. § 1.351-1(c)(6) and typically hold far more positions than those tests require. Their risk and expected return are driven mainly by market exposure and are generally close to the market's, as are those of the diversified ETF the investor receives. The Treasury Department reached a consistent conclusion in 1996, when it adopted the diversified-portfolio rule on the basis that "transfers of diversified portfolios

¹⁶ Shanny Basar, *Vanguard Nears BlackRock for Top Spot in U.S. ETF Assets*, Markets Media (Sept. 3, 2026) (citing ETFGI data as of the end of July 2026).

¹⁷ See Harry Markowitz, *Portfolio Selection*, 7 J. Fin. 77 (1952). John L. Evans & Stephen H. Archer, *Diversification and the Reduction of Dispersion: An Empirical Analysis*, 23 J. Fin. 761 (1968) (finding little added benefit beyond about ten stocks). Meir Statman, *How Many Stocks Make a Diversified Portfolio?*, 22 J. Fin. & Quantitative Analysis 353 (1987) (concluding that a well-diversified portfolio requires at least 30 to 40 stocks). John Y. Campbell, Martin Lettau, Burton G. Malkiel & Yexiao Xu, *Have Individual Stocks Become More Volatile? An Empirical Exploration of Idiosyncratic Risk*, 56 J. Fin. 1 (2001) (finding that about 20 stocks in earlier decades, and almost 50 stocks in 1986 to 1997, were needed to bring a portfolio's standard deviation within about five percentage points of that of an equally weighted index of all stocks).

¹⁸ William F. Sharpe, *Capital Asset Prices: A Theory of Market Equilibrium under Conditions of Risk*, 19 J. Fin. 425 (1964). John Lintner, *The Valuation of Risk Assets and the Selection of Risky Investments in Stock Portfolios and Capital Budgets*, 47 Rev. Econ. & Stat. 13 (1965).

¹⁹ William F. Sharpe, *The Arithmetic of Active Management*, 47 Fin. Analysts J. 7 (1991). See also Eugene F. Fama & Kenneth R. French, *Luck versus Skill in the Cross-Section of Mutual Fund Returns*, 65 J. Fin. 1915 (2010) (finding that the aggregate portfolio of actively managed U.S. equity mutual funds "is close to the market portfolio").

are not inconsistent with the Congressional purpose of section 351(e)(1).”²⁰ The investor has not “cashed in,” in the words of *Portland Oil Co. v. Commissioner*, which the Ruling quotes.²¹

We also offer two broader considerations for the Treasury Department as it decides how strict any further guidance should be.

A change in investment strategy is not, by itself, a problem. Section 1031 already accepts this for real property. It defers tax on the gain when real property held for investment or for use in a trade or business is exchanged for other such real property.²² “Like kind” refers “to the nature or character of the property and not to its grade or quality.”²³ An investor may exchange an office building in one state for land in another, changing both property type and geography within the United States, and the deferred gain carries over in the investor’s basis.²⁴ The key requirement is that the investor stay in real property, the same asset class. The investor’s money is “still tied up in the same kind of property,” in the words of the 1934 House report on the rule.²⁵ An investor who exchanges a diversified stock portfolio for shares of a diversified equity ETF likewise stays in the same asset class, with a substituted basis that preserves the deferred gain. In most seedings we see, the investor also ends with market exposure similar to that of the portfolio contributed, because sponsors have approached seeding conservatively.

Finance theory gives no reason to treat a change in strategy as an advantage. Long-run returns compensate investors for bearing market risk. Roger Ibbotson’s work documents equity risk premiums, and shows that a typical fund’s asset allocation policy explains about 90 percent of the variability of its returns over time.²⁶ Within an asset class, no one can reliably predict which investment style, factor, sector, geography, or theme will deliver a better risk-adjusted return, because market prices generally reflect available information.²⁷ No one can reliably time the market either. William Sharpe estimated that a market timer moving between stocks and cash must be right about seven times out of ten to make timing worthwhile, and investors in U.S. funds earned

²⁰ T.D. 8663, Transfers to Investment Companies (1996), preamble (describing the basis for the proposed regulations, CO-19-95, 60 Fed. Reg. 40794 (Aug. 10, 1995)), <https://www.irs.gov/pub/irs-regis/td8663.txt>.

²¹ Ruling, Law and Analysis (quoting *Portland Oil Co. v. Commissioner*, 109 F.2d 479, 488 (1st Cir. 1940)).

²² § 1031(a)(1).

²³ Treas. Reg. § 1.1031(a)-1(b), (c) (providing that whether real estate is improved or unimproved is not material, and treating city real estate and a ranch or farm as like kind).

²⁴ § 1031(d).

²⁵ H.R. Rep. No. 73-704 (1934), *reprinted in* 1939-1 C.B. (Part 2) 554, 564.

²⁶ Roger G. Ibbotson & Rex A. Sinquefeld, *Stocks, Bonds, Bills, and Inflation: Year-by-Year Historical Returns (1926-1974)*, 49 J. Bus. 11 (1976). Roger G. Ibbotson & Peng Chen, *Long-Run Stock Returns: Participating in the Real Economy*, 59 Fin. Analysts J. 88 (2003) (estimating a long-term equity risk premium over government bonds of about 6 percentage points arithmetically and 4 percentage points geometrically). Roger G. Ibbotson & Paul D. Kaplan, *Does Asset Allocation Policy Explain 40, 90, or 100 Percent of Performance?*, 56 Fin. Analysts J. 26 (2000) (finding that about 90 percent of the variability of a typical fund’s returns over time is explained by its asset allocation policy).

²⁷ Eugene F. Fama, *Efficient Capital Markets: A Review of Theory and Empirical Work*, 25 J. Fin. 383 (1970). Burton G. Malkiel, *The Efficient Market Hypothesis and Its Critics*, 17 J. Econ. Persp. 59 (2003).

about 1.2 percentage points per year less than the funds they owned over the decade ended in 2024, a gap Morningstar attributes to the timing of purchases and sales.²⁸

Professional managers have not shown a consistent ability to beat the market. About 90 percent of actively managed large-cap U.S. equity funds trailed the S&P 500 over the 15 years ended in 2025, and only 4.5 percent of large-cap funds that ranked in the top half in 2021 stayed in the top half through 2025, less than the 6.25 percent expected from chance alone.²⁹ Investors still spend substantial sums trying.³⁰ An investor who moves from U.S. to international stocks may see international stocks lag for years. An investor who moves from growth to value may see growth outperform for years more. Ending with a different diversified strategy is neither a gain nor a loss that the investor can expect in advance. In our experience, what investors gain from a § 351 exchange comes mainly from moving into an ETF, with professional management, consolidated accounts, daily liquidity, and often lower costs, not from a change in strategy. For these reasons, a change in strategy, even a material one, should not by itself be treated as evidence of a plan to avoid tax.

III. RECOMMENDATION (QUESTION 3 OF SECTION 4.01)

***Question 3.** What future guidance would commenters suggest to address the concerns discussed in this notice and not addressed by Rev. Rul. 2026-20? What is the appropriate scope of such guidance so that it does not adversely affect well-established market practice that is consistent with the intent of Congress?*

Rely on targeted information reporting rather than reportable-transaction identification.

Identifying § 351 ETF seeding as a listed transaction or transaction of interest under Treas. Reg. § 1.6011-4 would impose disclosure, list-maintenance, and penalty regimes on a broad group of investors, advisors, and service providers.³¹ It would also reach transactions the Notice states it does not address and signal that ordinary seeding is suspect.

Current rules require § 351 statements only for a “significant transferor,” meaning a transferor that owns, immediately after the exchange, at least five percent (by vote or value) of the transferee’s stock if the stock is publicly traded, or at least one percent if it is not.³² Many

²⁸ William F. Sharpe, *Likely Gains from Market Timing*, 31 Fin. Analysts J. 60 (1975). Morningstar, *Mind the Gap 2025* (finding that investors earned about 7.0 percent per year versus 8.2 percent for the funds they owned over the 10 years ended December 31, 2024), as reported in *Morningstar: Investors Miss Out on 15% of Fund Total Returns*, WealthManagement.com (Aug. 13, 2025), <https://www.wealthmanagement.com/investing-strategies/morningstar-investors-miss-out-on-15-of-fund-total-returns>.

²⁹ S&P Dow Jones Indices, *SPIVA U.S. Scorecard Year-End 2025* (reporting that 89.93 percent of all large-cap funds underperformed the S&P 500 over 15 years, and 92.89 percent over 20 years), <https://www.spglobal.com/spdji/en/spiva/article/spiva-us>. S&P Dow Jones Indices, *U.S. Persistence Scorecard Year-End 2025* (May 7, 2026), <https://www.spglobal.com/spdji/en/spiva/article/us-persistence-scorecard/>.

³⁰ Kenneth R. French, *Presidential Address: The Cost of Active Investing*, 63 J. Fin. 1537 (2008) (estimating that investors spent 0.67 percent of the aggregate value of the U.S. stock market each year from 1980 to 2006 searching for superior returns).

³¹ See §§ 6011, 6111, 6112, 6707A, 6708. Treas. Reg. § 1.6011-4(b)(2), (b)(6).

³² Treas. Reg. § 1.351-3(a), (d).

contributors to an ETF seeding hold less than either percentage. We recommend that guidance do the following.

- (a) Require the transferee fund to file a statement for each § 351 seeding that lists every transferor and the securities each transferred, and to furnish each transferor a statement of its own contribution.
- (b) Require each transferor to file the statement described in Treas. Reg. § 1.351-3(a) without regard to the ownership thresholds.

This approach parallels the reporting framework for like-kind exchanges, in which the real estate reporting person files Form 1099-S and the taxpayer reports the exchange on Form 8824.³³ It would give the IRS a complete record of each seeding and its contributors. The IRS could compare that record with the fund's later holdings, which most ETFs disclose daily on their websites and which funds report to the SEC on Form N-PORT.³⁴ If the Treasury Department and the IRS nonetheless consider identifying any § 351 transaction as reportable, the identification should be limited to the conversion transaction the Ruling describes and made through notice-and-comment rulemaking.³⁵

IV. CONCLUSION

Section 351 ETF seeding is a responsible portfolio management tool for a broad range of investors. It lets investors who would otherwise hold their securities indefinitely consolidate accounts and gain professional management with essentially the same market risk and expected return, and in theory it may also make markets more efficient. It defers tax rather than eliminating it and is most likely revenue-neutral against the realistic alternative. A change in strategy within the same asset class gives the investor no risk-adjusted advantage that can be predicted or timed, a principle § 1031 already reflects for real property. Sponsors approach seeding conservatively, most of the resulting funds attract new money after launch, and few have closed. These facts reflect a business purpose beyond tax, support competition among ETF issuers, and benefit end investors. We understand the concern that a contribution followed by a planned redemption of the contributed securities can produce a result § 351 was not designed to produce. We respectfully recommend that the Treasury Department and the IRS rely on targeted information reporting rather than reportable-transaction identification.

³³ See § 6045(e). IRS, Instructions for Form 8824, Like-Kind Exchanges.

³⁴ See 17 C.F.R. § 270.6c-11(c)(1)(i) (daily website disclosure of portfolio holdings). 17 C.F.R. § 270.30b1-9 (monthly reports on Form N-PORT).

³⁵ See *Mann Construction, Inc. v. United States*, 27 F.4th 1138 (6th Cir. 2022) (setting aside a listed-transaction notice issued without notice-and-comment procedures under the Administrative Procedure Act).

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Thank you for the opportunity to comment. Given the short comment period, we did not have time to analyze every portfolio we have seen. We would be happy to provide additional aggregate, anonymized data if it would be helpful, to take part in any outreach the Treasury Department or the IRS undertakes, or to answer questions about these comments. I can be reached at matt@exchangifi.com or (561) 206-2416.

Sincerely,

Matthew Bucklin

Matthew Bucklin
Founder and Chief Executive Officer
Exchangifi LLC