

How to Reduce Risk & Taxes on Your Stock Options and Concentrated Stock



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Summary

- Owning concentrated stock positions are usually riskier than owning a diversified basket of stocks.
- There are ways to reduce concentrated equity risk while remaining invested.

Stock Options & Concentrated Stock Positions

If you are in a high-level position at a company, chances are you have stock options. Companies typically grant stock options to employees as part of their compensation package. For some people, equity compensation can be a significant amount. These concentrated positions, referred to as “having all your eggs in one basket”, can be associated with higher-than-average risk. In other words, owning just one stock as opposed to a larger, more diversified amount of different stocks can be a riskier bet. In fact, according to Goldman Sachs, individual stock volatility has fluctuated to more than 4x the volatility of the Russell 3000 index. To add, 99% of the Russell 3000 stocks had a lifetime realized volatility greater than the index’s volatility. Lastly, 31% of the median

stocks in the Russell 3000 index had a 31% chance of losing more than 30% of its value in one year versus a 5% chance for the Russell 3000 index itself¹. When you break down the numbers it’s easy to see why some people prefer to reduce their concentrated risks in order to minimize volatile swings and protect their money. There are countless examples of companies that went public, for instance, whose employees became very wealthy through concentrated equity, at least on paper, only to succumb to greed and ride their company stock price down into the ground: worthless. Don’t be another example of what not to do. There are ways to reduce your concentrated equity risk while staying invested.



Summary

- Taxation of concentrated equity positions can be significant.
- How to potentially reduce your concentrated equity risk and tax bill.

The other main concern people have with concentrated equity positions is taxes. If you are someone who does not like to pay taxes, you are not alone. And if you are someone who does not want to pay more taxes than you legally have to, join the club. Oftentimes people who have large individual equity positions do not sell their stock because they are afraid of paying a massive tax bill. As a result, they may be jeopardizing their entire investment and financial plan because of potential tax liabilities. The good news is that there are ways to potentially reduce taxes on your concentrated equity positions.

How To Reduce Risk & Taxes on Your Concentrated Equity Positions

There is a section in the internal revenue code that allows people to swap concentrated equity shares for shares of ownership in a diversified entity without triggering a large capital gains tax. This strategy dates back to the 1960's, however, many people are either unaware that it exists or lack the understanding of how it works to actually take advantage of the opportunity².

How It Works

There are companies out there that will take individual stocks from investors and in return give them back a diversified basket of stocks (a "fund") usually designed to track a broader index. The fund is usually structured as a limited partnership. So, individuals swap their concentrated stock for shares of the fund. By doing this they have effectively reduced their risk and reduced the potential tax liability on their concentrated equity positions. The obvious question then is, why doesn't everybody do this? There are two reasons. One, not every company's stock qualifies for a swap. And two, there are very few companies in the business of facilitating these types swaps.

Do You Want To Potentially Reduce Risks & Taxes On Your Stock Options?

If you have concentrated equity positions or stock options and you want to potentially reduce your risks and have the ability to reduce your tax bill as well, let's set up a time to discuss.



References & Disclosure

1. Goldman Sachs Asset Management Exchange Place: All Cap LP, 12.31.21.
2. The Tax Benefits of Exchange Funds, 6.17.19.

<https://www.barrons.com/articles/the-tax-benefits-of-exchange-funds-51560794410>.

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Paul Litchfield Biography

Summary

- Paul has over a decade of experience working with clients across the United States. His unique skill set allows him to add value in areas most advisors cannot.

Why Paul?

- 24/7 White Glove Service
- Direct access. You don't get passed off.
- Youthful – Most advisors are in their 60's, thinking about their own retirement, not yours.
- Prevents you from experiencing problems in the first place, instead of after they occur.

Paul Litchfield is a fiduciary Wealth Advisor and Financial Planner. A fiduciary is a person who holds a legal or ethical relationship of trust with one or more other parties. Typically, a fiduciary prudently takes care of money or other assets for another person. Paul puts clients' interests first and is passionate about helping his clients meet all their financial needs through comprehensive planning. Paul was named a 2020 Five Star Wealth Manager* and was also named to the 2020 Top 100 People in Finance Magazine*.

Paul teamed up with Claro Advisors in 2018 to provide his clients with a deep bench of resources. Prior to joining Claro, Paul managed successful investment practices as a Vice President at another boutique investment firm and Morgan Stanley. Before transitioning to investment management, he worked for a public accounting firm in Boston as a CPA. Paul serves on the Board of Directors for The Massachusetts Society for the Prevention of Cruelty to Children and The Miss Massachusetts Organization, a subsidiary of the Miss America Organization. He is the founder of AdVenture International, a 501(c)(3) non-profit that he created after spending a summer teaching math and English in Africa.

Paul received a Bachelor's degree in both accounting and finance from The University of Massachusetts at Lowell and graduated Summa Cum Laude as a Commonwealth Honors Scholar. He holds a Master of Business Administration from The University of Massachusetts at Lowell with high honors. Paul also served on the advisory board at the University of Massachusetts Lowell.

Paul enjoys spending time with his family and supports the following causes: our service men and women, education, and helping mentor future generations. Paul is also a private pilot and enjoys flying airplanes in his spare time.

