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October 19, 2026

By Electronic Delivery

Internal Revenue Service
CC:PA:01:PR (Notice 2026-62)
Room 5503

Re: Notice 2026-62

Ladies and Gentlemen:

We are writing on behalf of our client, Cache Advisors LLC ("Cache"), to provide comments with respect to the type of transaction discussed in Section 2.03 of Notice 2026-62 -- "Transfers to partnerships in connection with a § 351 conversion transaction". The Notice seeks to describe novel strategies that produce tax results that may be inconsistent with the purpose and proper application of the relevant federal tax rules. The Notice also distinguishes these novel strategies from conventional, long-established tax planning consistent with the intent of Congress. As requested in the Notice, we wish to describe transactions currently being conducted that may appear similar to the transactions described in Section 2.03, but which differ in several material respects, and which are consistent with longstanding partnership tax-planning methods.

The transactions described in Section 2.03 of the Notice, involving a partnership exchange fund, have the following features:

- (1) As part of a plan, individuals contribute appreciated securities (typically stock of a single issuer or a small number of issuers) to a partnership exchange fund. Although the contributions result in greater diversification by means of the partnership's broader investment holdings, these contributions are not taxable because at least 20 percent of the value of the partnership's assets consists of property that is not stocks or securities within the meaning of section 351(e)(1)(B). As a result, the partnership is not treated as an investment company and section 721(b) does not apply.
- (2) As a result of the contributions described in item (1), the partnership owns a portfolio of securities that is diversified for purposes of section 351(e).
- (3) As part of the same plan, the partnership exchange fund transfers securities to an ETF in a § 351 conversion transaction, as described in section 2.02 of the Notice.
- (4) By means of this ETF contribution, as part of the same plan, investors in the partnership exchange fund effectively exchange their securities for an indirect interest in an ETF "with a materially different portfolio of securities."

The discussion in the Notice concludes that, in these transactions, sections 351, 721 and 852(b)(6) are being applied to a series of planned transactions to achieve a result that these provisions were not intended to produce.

Since the 1980s, partnership exchange funds have engaged in transactions having the following features, which should be compared with the features described above:

- (1) Individuals contribute appreciated securities (typically consisting of stock of a single issuer or a small number of issuers) to a partnership exchange fund. Although the contributions result in greater diversification by means of the partnership's broader investment holdings, these contributions are not taxable because at least 20 percent of the value of the partnership's assets consists of property that is not stocks or securities within the meaning of section 351(e)(1)(B). As a result, the partnership is not treated as an investment company and section 721(b) does not apply.
- (2) As a result of the contributions described in item (1), the partnership owns a portfolio of securities that is diversified for purposes of section 351(e), which means it is also a diversified portfolio for purposes of section 721(b):
- (3) As part of a plan, the partnership exchange fund transfers all of its portfolio to a master fund partnership, in which multiple exchange funds participate, in a transaction intended to qualify for nonrecognition under section 721(a).
- (4) By means of this contribution, investors in the partnership exchange fund effectively exchange their securities for an indirect interest in a master fund with a materially more diversified portfolio.

Some of these traditional exchange funds took further steps to increase diversification. One exchange fund sponsor established a structure comprised of (i) exchange fund partnerships, which accepted contributions of concentrated equity positions and held real estate comprising at least 20 percent of their assets; (ii) an intermediate master partnership, to which the exchange funds contributed all of their securities holdings (comprising diversified portfolios of securities); and (iii) a diversified, open-end management investment company registered under the Investment Company Act of 1940, as amended, and classified as a partnership for federal income tax purposes, to which the intermediate master partnership contributed the securities it received from the exchange funds.

Although the registered fund in this structure was a partnership, rather than a corporation, the contributions made by the exchange funds to the intermediate fund, and by the intermediate fund to the registered fund, needed to consist of diversified portfolios in order for the contributions to be nontaxable, just as is the case when exchange funds contribute securities to a new ETF. An advantage provided by the earlier structure was that, because the registered fund was classified as a partnership, the exchange funds and intermediate fund could make multiple in-kind contributions to the registered fund, rather than being limited to a one-time contribution as is the case in making a contribution to a new ETF. The intermediate fund and exchange funds could also withdraw the contributed securities from the registered fund, in a nontaxable fashion, in order to meet redemption requests. An ETF shareholder does not have a comparable withdrawal right.

The sponsor of this earlier structure formed more than a dozen different exchange funds, each of which contributed all of its securities to the intermediate partnership, which in turn contributed all of its securities to the registered fund. By investing in the registered fund through the intermediate fund, the exchange funds could participate in a substantially larger and more diversified investment portfolio than if they held their contributed securities directly. Mutual funds managed by the same sponsor also invested cash in the registered fund. This resulted in even more diversification. The registered fund was able to actively manage the part of its portfolio contributed by the mutual funds, adding an investment management feature unavailable to the exchange funds themselves. This structure was available to its sponsor's exchange funds because the sponsor was a very large investment manager with extensive registered fund offerings and the resources needed to support such a structure.

The partnership exchange funds that have made in-kind contributions to ETFs are managed by an independent adviser that is not a sponsor of registered funds. The exchange funds' use of contributions to ETFs to help build a benchmark portfolio is modeled on the traditional master fund structure. The opportunity to make contributions to new ETFs of unrelated sponsors is a practical alternative used to achieve investment goals similar to those sought in the traditional structure, without the need for the exchange funds to set up their own registered funds.

One notable difference between the current exchange funds' contributions to ETFs and the classic master fund structure described above is that each exchange fund in the traditional structure contributed all of its securities to the registered fund, while the current exchange funds only contribute portions of their portfolios to ETFs, as the ETFs only serve as a complement to the exchange funds' investment objectives. After they have participated in contributions to ETFs, these exchange funds continue to receive contributions from investors and continue to hold investments directly in furtherance of their investment objectives.

Partnership exchange funds use ETFs as an investment management tool; the exchange funds are not formed as simple conduits to bundle securities in order to participate in ETF contributions. Investment in ETFs provides a more predictable path for tracking an exchange fund's investment benchmark. The portion of the exchange fund's assets contributed to an ETF in any transaction varies based on (i) the time when the opportunity to participate in a contribution becomes available in the exchange fund's life cycle, (ii) the composition of the exchange fund's existing portfolio as compared to its benchmark at the time of the contribution, (iii) the investment thesis of the ETF, and (iv) the expected continuing contributions to the exchange fund by investors.

Exchange funds also continue to manage the composition of their portfolios by rejecting securities offered by investors when proposed contributions would be inconsistent with the exchange fund's benchmark or would increase tracking error in the exchange fund's portfolio.

The Role Played by Section 852(b)(6)

The discussion in Section 2.03 of the Notice says that section 852(b)(6) plays a significant role in the partnership exchange fund's purposes in making a contribution to an ETF, as if the contribution were part of a transaction of the type described in recently issued Revenue Ruling 2026-20. As described above, contributions to ETFs are a means for an exchange fund

to achieve better benchmark tracking, as well as additional diversification similar to what is achieved in the traditional exchange fund structures described above.

Revenue Ruling 2026-20 describes a transaction in which an investor exchanges one portfolio of securities for a materially different portfolio, utilizing sections 351 and 852(b)(6) to avoid tax. By contrast, when an exchange fund chooses to make a contribution to an ETF, it chooses the ETF based upon the ETF's investment thesis and the role the ETF will play in helping the exchange fund track its benchmark, and it contributes assets to the ETF consistent with the ETF's investment thesis.

Although the contribution to an ETF may increase the exchange fund's diversification, it does not result in the exchange fund acquiring an interest in a "materially different portfolio of securities" in the manner described in Revenue Ruling 2026-20. Also, an exchange fund is only one contributor among many in making contributions in seeding an ETF. It receives confirmation from the ETF sponsor that the exchange fund's contribution meets the criteria established by the ETF sponsor, but it does not engage in planning with respect to how the ETF sponsor will later manage the ETF. The exchange fund achieves its goals of greater diversification and better benchmark tracking as a result of the contributions made by the other participants in the seeding transaction. The ETF's use of in-kind distributions to authorized participants is not needed for purposes of achieving these goals.

Diversification as a Business Purpose

The Notice criticizes the transactions it describes as not being "the result of conventional, long-established tax planning that is consistent with the intent of Congress." This statement should not extend to traditional partnership exchange fund transactions.

Preventing diversification without recognition of gain by contributing securities to an investment partnership was a goal sought by Congress when it enacted section 721(b) in 1976.¹ At that time, Congress chose to set the boundaries for partnerships by incorporating the standards for corporations under section 351, for which regulations already existed.² Under these rules, diversification was not permitted unless the contribution was made to an entity that did not meet the definition of an investment company, because not more than 80 percent of the partnership's assets consisted of stock and securities. The regulations under section 351 were later amended to add a second exception allowing contributions to be made to an investment company by multiple parties, each contributing a non-identical portfolio of stock and securities meeting a required diversification standard, making it clear that "combinations of already diversified portfolios are not inconsistent with the purposes of section 351(e)."³ The roadmap

¹ See Staff of the Joint Comm. on Taxation, "General Explanation of the Tax Reform Act of 1976," JCS-33-76, at 655-659 (1976).

² Ibid., at 657. "A partnership will be treated as an 'investment company,' for purposes of this provision, if it satisfies the definition of an investment company under the present rules relating to corporate exchange funds (sec. 351). The latter rules are set forth in detail under section 351....The diversification rules of the section 351 regulations are also intended to be incorporated under section 721 as an integral part of the definition of an investment company."

³ Treas. Reg. § 1.351-1(c)(1)(i), (c)(6); T.D. 8663, 61 Fed. Reg. 19544 (May 2, 1996); 60 Fed. Reg. 40794, 40795 (Aug. 10, 1995).

was clearly laid out. Achieving additional diversification without gain recognition is permissible, and consistent with the intent of Congress, provided a contribution meets these rules.

Congress revisited these rules in 1997 when it amended section 351(e) to broaden the meaning of “stock and securities” for purposes of determining whether a fund was an investment company for these purposes.⁴ Congress otherwise retained the existing regulatory framework that set forth the requirements for determining when a fund was an investment company and when a contribution resulted in impermissible diversification, including the diversified portfolio rule adopted in 1996.⁵ Partnership exchange funds abide by those continuing rules, and they further their business purpose by engaging in transactions to provide investment diversification that the rules, consistent with Congressional intent, expressly permit.

Requests for Consideration

We respectfully request that Treasury and the IRS confirm that any guidance issued in response to the Notice will not apply to a partnership exchange fund's contribution of a diversified portfolio to a newly established ETF when (i) the contributed assets are consistent with the ETF's investment thesis, (ii) the exchange fund is not formed or used as a conduit for the ETF contribution, (iii) the exchange fund does not participate in or have an agreement, arrangement or understanding regarding a related redemption of the contributed assets, (iv) the exchange fund is not affiliated with the ETF's sponsor or adviser, and (v) the contribution is undertaken for bona fide investment-management purposes, including benchmark tracking and portfolio diversification. These facts distinguish both traditional exchange fund investments and the current practice of exchange fund contributions to ETFs from the planned conversion transactions described in sections 2.02(2) and 2.03 of the Notice and in Revenue Ruling 2026-20.

If Treasury and the IRS determine that guidance is necessary, the guidance should target the coordination or prearrangement that causes the contributing investor or partnership effectively to exchange contributed securities for a materially different portfolio. The guidance should not treat diversification itself, or compliance with the objective standards of sections 351(e) and 721(b), as evidence of abuse.

Any guidance addressing the transactions described in the Notice should apply prospectively. Notice 2026-62 acknowledges both that such guidance could apply prospectively or retroactively and that Treasury and the IRS intend to “respect market expectations with respect to conventional, long-established tax planning that is consistent with the intent of Congress.”⁶ Partnership exchange funds have relied for decades on the statutory and regulatory framework governing contributions of diversified portfolios in structuring and operating ongoing investment arrangements that differ materially from the planned conversion transactions identified in the Notice. That longstanding and reasonable reliance creates precisely the market expectations the Notice states should be respected and therefore strongly

⁴ Pub. L. 105-34, Sec. 1002(a), Aug. 5, 1997, 111 Stat 788 (1997).

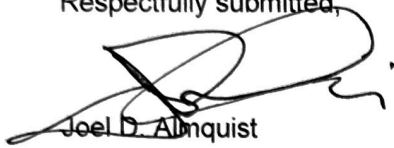
⁵ See Staff of the Joint Comm. on Taxation, “General Explanation of Tax Legislation Enacted in 1997,” JCS-23-97 at 182-185 (1997).

⁶ Notice 2026-62, § 1.

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supports prospective application of any new guidance that could affect traditional exchange fund transactions.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Joel D. Almqvist", written over a horizontal line.

cc: Cache Advisors LLC