07/23/2025 10:00:11 [BN] Bloomberg News

Millionaires Get Billionaire Tax Trick in $446 Million ETF (1)

By Justina Lee

(Bloomberg) -- As wealth advisers across Wall Street embrace a hot new method to help their rich clients sidestep capital gains taxes, a pioneer of the strategy is already taking it to the next level.

Wes Gray, an ex-Marine with a PhD in finance who's making a name for himself with his increasingly creative use of exchange-traded funds, is launching the Alpha Architect US Equity ETF (ticker AAUS) on Wednesday with $446 million. It's one of a growing breed of products he's helped popularize known as 351 conversions, which are seeded with appreciated assets before the ETF structure is used to wash out capital gains.

But Gray and his firm Alpha Architect LLC have added a new twist with AAUS: The investors seeding it include a so-called swap fund. Also confusingly known as an exchange fund, it's a structure often used by the ultra wealthy to diversify stock holdings tax-free by pooling them together in a partnership.

Wes Gray

The combination is set to benefit both products. An investor can't contribute directly to a 351 conversion if their portfolio is too concentrated, but they can enter a swap fund. Meanwhile swap funds face an abundance of similar holdings — think high-flying tech stocks — and by swapping some holdings for shares in the ETF, they can effectively end up with a diversified portfolio. (The objective of AAUS is simply to offer exposure to large US stocks.)

What's more, a swap fund can't wash out capital gains — but an ETF can.

"There are all these inefficiencies that people creep themselves into, but then they can't do anything because they're locked in tax," said Gray, CEO of Alpha Architect. "They're like, 'man, I would love to just go be in a Vanguard fund, but

I don’t want to pay a lot of taxes.’”

To critics, AAUS will be yet another demonstration of the extent to which ETFs are exploited to circumvent a system meant to tax investments when they are sold. With the S&P 500 tripling in a decade and stock–picking falling out of fashion, so–called tax efficiency has become the latest frontier for financial advisers keen to prove their worth to clients.

Strategies for minimizing tax liabilities have become increasingly sophisticated and widespread, while countless mutual funds, hedge funds and private portfolios have been converted into ETFs for tax benefits.

Billionaire ‘Tricks’

AAUS is getting roughly $140 million of its seed capital from Cache, a swap–fund startup founded by a former Uber Technologies Inc. engineer. Usually arranged by a big bank like Goldman Sachs Group Inc. or Morgan Stanley, swap funds take various individuals’ stock holdings in exchange for a share in the resulting combined portfolio.

Seeding the ETF will help solve a major challenge faced by swap funds, according to Cache founder Srikanth Narayan. It’s easy to find tech employees with appreciated Nvidia Corp. or Apple Inc. stock, but far harder to locate holders of, say, Johnson & Johnson to contribute. That means shareholders in some of the big tech names have been rejected from such partnerships for years. Cache will be able to accept them and use some of the shares to seed the ETF.

“What we’re able to do is take some of the incoming contributions and essentially use it as a way to rebalance the portfolio toward the benchmark,” said Narayan. “Folks with high appreciation – the Nvdias or Apples – those are the ones that are seeking diversification usually because they see this massive gain and they want to protect it.”

Swap funds have a complex structure designed specifically to squeeze into the nooks and crannies of tax law. To avoid being declared an investment firm, they have to hold at least 20% of illiquid assets, typically real estate. To keep the tax benefits, investors cannot cash out for seven years, after which they can withdraw their share of a fund’s securities tax–free.

These restrictions will still apply, and when the investor eventually sells the AAUS shares the capital gains will be calculated based on the cost, or basis, of the shares they contributed originally. But in the meantime, they diversify their portfolio while keeping more cash invested.

Read more on the boom in tax–efficient investment strategies:

- Capital Gains Vanish Into ‘Black Holes’ in Latest ETF Tax Trick
- Wall Street Builds S&P 500 ‘No Dividend’ Fund in New Tax Dodge
- Quant Giant AQR Cuts Income Tax Bills for Wealthy Clients
- Wall Street Takes Tax–Loss Harvesting to a Powerful New Level

Meanwhile, precisely to prevent investors from using them to diversify portfolios tax–free, a rule was added to 351 conversions that means each contributor’s portfolio cannot be too concentrated to start with. But now someone with a big Nvidia bet, for instance, can seed AAUS through Cache rather than directly.

Because ETFs can only be seeded once, Gray plans to corral a new herd of tax–sensitive investors for another version of AAUS later this year. In keeping with another increasingly popular tax strategy, AAUS will also sometimes sell shares before they pay a dividend in order to avoid taxable payouts.

Like other syndicated 351 conversions, AAUS launched with a hodgepodge of securities that will need to be rebalanced over time. Many of its largest holdings are also major members of the S&P 500, but it also includes an array of ETFs from the likes of Vanguard Group, BlackRock Inc. and more, Bloomberg data show.

Gray sees himself as a Jack Bogle of sorts, democratizing tax strategies that used to be the preserve of the ultra–rich for the merely wealthy. Cache will charge an all–in fee of 40 to 95 basis points (including the ETF’s cost) depending on the amount invested while AAUS’s own fee is 15 basis points. The hefty paperwork still means each contributor typically brought in at least $1 million to AAUS, which sourced its seed capital from around 140 investors including Cache, Gray says.

"Do you not think the billionaires have all the tricks already and will always have the tricks? Of course they will," Gray said on the Meb Faber Show podcast last week. "All we're trying to do is: how do we democratize access with affordability, try to get complexity way down and try to make this transparent to people? Everyone should be able to use all the tricks that the billionaires use."

(Adds AAUS objective in fourth paragraph and holdings details in third-to-last paragraph.)

To contact the reporter on this story:
Justina Lee in London at jlee1489@bloomberg.net

To contact the editors responsible for this story:
Sid Verma at sverma100@bloomberg.net
Sam Potter