

Transaction Tax Bridge Strategy



The sale of a business often generates a significant tax liability. Rather than holding cash or liquidating appreciated investment assets to cover this payment—a move that can trigger additional capital gains taxes and interrupt long-term portfolio growth—Ultra-High Net Worth (UHNW) families should consider a Securities-Based Line of Credit (SBLOC) secured by their investment portfolio. This strategy can provide immediate, flexible, and potentially tax-advantaged capital.

The Strategic Drivers of the SBLOC Advantage

This strategy is made possible by a combination of favorable market and tax conditions that create a significant wealth advantage:

High Investment Return:

The committed portfolio must generate a superior net-of-tax expected return for this strategy to be profitable. This return is the primary engine that justifies the leverage.

Low True Cost of Debt:

The after-tax cost of capital for the SBLOC must be sufficiently below the expected net-of-tax returns for the strategy to function properly. This favorable spread ensures borrowing is wealth-accretive.

Tax-Deductibility Shield:

The interest paid on the SBLOC can be made tax-deductible by strategically allocating the loan proceeds to purchasing or carrying taxable investment property. This tax shield is the essential mechanism that converts a standard loan into a low-cost, effective financial tool.

Unencumbered Collateral:

Your existing, highly liquid portfolio serves as secure collateral, allowing the lender to offer interest-only terms and low rates, providing maximum flexibility in repaying the principal.

Targeting Meaningful Return and Managing Volatility

For the SBLOC strategy to be accretive, the net-of-tax portfolio return must consistently exceed the after-tax cost of capital. Even a small difference, such as 1%, is easily erased by market friction or minor tax changes. While high returns are desirable, low volatility is essential to ensure the longevity of the SBLOC strategy. High volatility directly increases the risk of a maintenance call from the lender.

Calculating the True Cost of Capital

The true cost of capital is the actual, after-tax expense of the SBLOC. Because the interest expense may be tax-deductible, the true cost is significantly lower than the stated interest rate.

The calculation for the After-Tax Cost of Debt is:

After-Tax Cost of Capital = Stated Interest Rate x (1 - Marginal Income Tax Rate)

Example Scenario

Factor	Value
Stated SBLOC Interest Rate	6.00%
Combined Marginal Tax Rate	40.00%
After-Tax Cost of Capital	$6.00\% \times (1 - 0.40)$
True Cost of Capital	3.60%

In this scenario, the ability to deduct the interest expense effectively reduces the borrowing cost by 2.40% (the 6.00% rate multiplied by the 40% tax shield). The true cost of capital (3.60%) can then be compared to the expected after-tax return of the assets that are being invested and used for collateral. If the portfolio's expected return is greater than the true cost of the SBLOC, the strategy is mathematically accretive to wealth creation.

The Power of Tax Deductions

A crucial element of this strategy is the potential for the interest paid on the SBLOC to be tax-deductible. The key is the use of proceeds.

Investment Interest Expense (Form 4952)

When the borrowed funds are used to acquire or carry taxable investment property—which, for UHNW families, often includes investments in private equity, private credit, and other private assets—the interest paid on the SBLOC may qualify as investment interest expense. This deduction is calculated using IRS Form 4952.

The Benefit:

Investment interest expense is generally deductible up to the amount of your net investment income (NII) for the year.

A Key Strategy:

By strategically using the SBLOC to acquire income-generating private assets, you may be able to offset a significant portion of the borrowing cost. Any interest expense that exceeds your current year’s net investment income can be carried forward indefinitely to offset NII in future years.

Important Note: To maximize this benefit, the proceeds of the SBLOC must be properly traced and allocated to the purchase of taxable investments. Using the funds for personal expenses would generally make the interest non-deductible.

Typical Advance Rates

The advance rate determines the maximum credit line you can secure against your pledged assets. Advance rates are set by the lender and are largely determined by the type of assets owned in the portfolio. The following ranges are common for UHNW lending programs:

Asset Category	Typical Advance Rate	Rationale/Conditions
U.S. Government Securities & Cash Equivalents (U.S. Treasuries, Cash, CDs)	90% - 95%	The highest rate is due to minimal credit risk and the highest liquidity. Cash is often given a 95% rate.
Traditional Equity (Stocks, ETFs, Mutual Funds)	Up to 70%	This range applies to diversified, non-leveraged equity positions with share prices above a minimum threshold (e.g., >\$3).
Fixed Income (Non-Government) (Corporate & Municipal Bonds)	70% - 85%	Rates vary based on credit rating (investment grade preferred), maturity, and market liquidity. High-quality corporate bonds often receive higher advance rates.
Concentrated / Low-Priced Stocks (e.g., <\$3 per share or high single-name concentration)	50% or 0%	Heavy discounts are applied to single positions that represent a large portion of the portfolio, or to volatile, low-priced securities.
Private Assets	0%	Often ineligible due to lack of market pricing and long lock-up periods.

Asset Allocation: The Nexus of Risk, Return, and Tax

Thoughtful asset allocation is the single mechanism that brings all facets of the SBLOC strategy together, simultaneously driving a meaningful return and maintaining low volatility. The asset allocation must also satisfy two additional critical, competing objectives:

Collateral Management:

The portfolio must be structured to favor assets that have higher advance rates. This is essential to ensure the desired loan amounts can be achieved, as well as create a sufficient cushion against market fluctuations and mitigate the risk of a maintenance call.

Tax Efficiency:

The SBLOC funds must be channeled into investments classified as taxable investment property to ensure the interest remains tax-deductible, thereby preserving the low cost of capital.

The Trade-Off: Since the best tax-qualifying assets often have a 0% advance rate, the asset allocation strategy is built on separation of function: using high-advance-rate public assets as collateral while deploying the borrowed funds directly into the 4952-compliant growth assets.

Scenario Comparisons

Key Assumptions for 20-Year Projection

Parameter	Value	Notes
Business Sale Proceeds	\$40,000,000	The full amount received.
Tax Bill / Debt Balance	\$9,520,000	23.8% of sale proceeds.
Expected Annual Portfolio Return	8.00% (Net-of-Tax)	Assumed long-term growth rate.
Combined Marginal Tax Rate	40.00%	Used for calculating the tax shield.
SBLOC Stated Interest Rate	6.00%	Illustrative borrowing rate.
After-Tax Cost of Capital	3.60%	$6.00\% \times (1 - 0.40)$. This is the deductible rate.

1

Scenario 1: Direct Liquidation

The tax is paid immediately by selling \$9.52 million of the \$40 million proceeds.

- Initial Invested Principal: \$30,480,000 (\$40M - \$9.52M)
- Loan Value: \$0

2

Scenario 2: SBLOC (Interest Paid Annually)

The full \$40 million is invested. The annual after-tax interest of \$342,720 is paid from the portfolio's cash flow/value.

- Initial Invested Principal: \$40,000,000
- Loan Value: \$9,520,000 (Static)
- LTV: Declines as the portfolio grows

3

Scenario 3: SBLOC (Interest Rolled into Loan)

The full \$40 million is invested. The annual after-tax interest is added to the loan principal, causing the debt to compound.

- Initial Invested Principal: \$40,000,000
- Loan Value: Compounds annually at 3.6%
- LTV: Drops more slowly than Scenario 2 due to growing debt

20-Year Net Portfolio Value Comparison

Year	Scenario 1: Direct Liquidation Net Value	Scenario 2: SBLOC (Interest Paid from Portfolio) Net Value	Scenario 3: SBLOC (Interest Rolled into Loan) Net Value
0	\$30,480,000	\$30,480,000	\$30,480,000
1	\$32,918,400	\$33,337,280	\$33,337,280
2	\$35,551,872	\$36,423,142	\$36,438,222
3	\$38,396,022	\$39,755,874	\$39,802,862
4	\$41,467,704	\$43,355,224	\$43,452,858
5	\$44,785,120	\$47,242,522	\$47,411,622
6	\$48,367,929	\$51,440,803	\$51,704,457
7	\$52,237,364	\$55,974,948	\$56,358,717
8	\$56,416,353	\$60,871,823	\$61,403,961
9	\$60,929,661	\$66,160,449	\$66,872,141
10	\$65,804,034	\$71,872,165	\$72,797,786
11	\$71,068,357	\$78,040,818	\$79,218,215
12	\$76,753,825	\$84,702,964	\$86,173,755
13	\$82,894,131	\$91,898,081	\$93,707,990
14	\$89,525,662	\$99,668,807	\$101,868,015
15	\$96,687,715	\$108,061,192	\$110,704,724
16	\$104,422,732	\$117,124,967	\$120,273,112
17	\$112,776,550	\$126,913,845	\$130,632,603
18	\$121,798,674	\$137,485,832	\$141,847,409
19	\$131,542,568	\$148,903,579	\$153,986,910
20	\$142,065,974	\$161,234,745	\$167,126,072

Key Takeaways on Net Equity Growth

1

Leverage Advantage (S2 & S3): By keeping the full \$40 million invested and covering the tax bill with a loan, Scenarios 2 and 3 generate \$19M to \$25M more in net wealth than Scenario 1 over 20 years. This confirms the benefit of arbitrage.

2

Scenario 3 is Superior Net Value: Allowing the loan to compound at 3.60% results in \$5.9 million more net wealth than paying the interest from the portfolio (Scenario 2). This is because leaving the full portfolio untouched to compound at the high 8.00% rate outweighs the increasing cost of the 3.60% debt.

3

Scenario 1 remains the lowest net value, as taking \$9.52M out of the market immediately sacrifices the most growth.

This SBLOC strategy is a sophisticated wealth management tool. It requires careful coordination between your investment advisor, lender, and tax professionals to ensure proper structuring and adherence to all tax laws, particularly the rules regarding tracing loan proceeds and calculating the deductible investment interest expense under Form 4952. While the benefits of using debt may be significant, using leverage increases the risk of the portfolio.



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