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Combining VPFs and Tax-Aware Strategies to Diversify Low-Basis Stock

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We illustrate how combining VPFs (variable prepaid forwards) with tax-aware strategies can help diversify low-basis stock and thereby improve after-tax wealth accumulation. We find that direct-indexing strategies have limited ability to offset VPF settlement gains. Thus, in the context of a VPF transaction, direct indexing adds value only when managed at a very low cost.

Tax-aware long-short factor strategies offer two advantages over direct indexing. First, they can outperform a passive index before tax. Second, they realize significantly higher net losses than direct-indexing strategies, allowing the investor to offset a larger fraction of the VPF settlement gain.

As a result, long-run after-tax wealth outcomes are significantly better when a VPF is combined with tax-aware long-short factor strategies rather than with other alternatives, such as a direct-indexing strategy or a market index fund.

See the full library of our tax-aware research here.

See our short Tax Matters blog posts on key tax-aware issues here.

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