TAX AWARE

The Tax Benefits of Separating Alpha from Beta

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Separating active returns (i.e., alpha) from market exposure (i.e., beta) has recently received significant attention in the investment community. Whereas most of the focus has been on pre-tax returns, we show that the separation of a portfolio into an active long-short portfolio and a passive index portfolio can have significant tax benefits. The turnover of a traditional active strategy causes capital gain realizations on both the active and the market components of the strategy returns. In contrast, the turnover of a strategy that separates alpha from beta is aimed at the active exposures and enables the deferral of capital gain realizations on the passive market exposure.