QUESTAR CAPITAL PARTNERS

Tax-Aware Long-Short Strategies (TALS)

Powerful tax mitigation for ESOP sellers and S-corporation shareholders — because what you keep matters more than what you sell for.

By Chris Stadler, MBA, CEPA®
VP, ESOP & Transaction Advisory | Questar Capital Partners
questarcap.com | esopexpert.com

Introduction

For many successful entrepreneurs, the real challenge is not creating wealth. It is preserving it after a liquidity event.

Whether you're considering an ESOP transaction, transitioning ownership to management, recapitalizing your business, or simply diversifying concentrated wealth, taxes often become the single largest obstacle standing between gross proceeds and net wealth. While much attention has been given to traditional tax planning techniques, a new generation of investment solutions is emerging that focuses on after-tax outcomes rather than simply pre-tax returns.

One of the most compelling developments in this area is the growth of Tax-Aware Long-Short Strategies (TALS), a sophisticated investment approach designed to help investors generate meaningful tax assets while maintaining market exposure and pursuing attractive risk-adjusted returns. Research and industry analysis suggest these strategies may produce significantly more tax-loss generation than traditional tax-loss harvesting approaches by combining active investment management with deliberate gain-deferral and loss realization.[1]

For business owners navigating an ESOP transaction — particularly S-corporation shareholders who historically have not been eligible for a full Section 1042 rollover — TALS may provide a highly valuable component of a comprehensive tax mitigation strategy.

What's Inside

01 The Problem: Wealth Creation Is Often Followed by Wealth Erosion
02 What Is a Tax-Aware Long-Short Strategy?
03 The ESOP Connection
04 Why TALS May Be Especially Valuable for S-Corporation Owners
05 Tax Alpha: The Often-Overlooked Return Driver
06 Integrating TALS into ESOP and Exit Planning
07 The Bottom Line

[1] AQR, *Beyond Direct Indexing: Dynamic Direct Long-Short Investing*, The Journal of Beta Investment Strategies (Fall 2023); Lincoln Fleming and Taotao Cai, *The Time Value of Capital Losses*, The Tax Adviser (Oct. 2024). Findings are based on historical simulations and backtests of hypothetical portfolios, are not indicative of future results, and actual tax outcomes will vary by investor and market conditions.

01

The Problem: Wealth Creation Is Often Followed by Wealth Erosion

Business owners spend decades building enterprise value. Then a major liquidity event occurs:

- Sale to an ESOP
- Partial recapitalization
- Management buyout
- Strategic sale
- Private equity transaction

Unfortunately, capital gains taxes frequently create a significant drag on the value realized from these transactions.

For owners of qualifying C-corporations who sell stock to an ESOP, Section 1042 may provide the opportunity to defer capital gains taxes by reinvesting proceeds into Qualified Replacement Property (QRP). However, the traditional 1042 benefit generally applies only to qualifying C-corporation stock sold to an ESOP meeting specific ownership requirements.

Historically, S-corporation shareholders have not enjoyed the same broad access to Section 1042 planning opportunities, creating a substantial planning gap for many middle-market business owners pursuing employee ownership transactions.

> *"How can I reduce the tax burden associated with my liquidity event while remaining invested for future growth?"*

02

What Is a Tax-Aware Long-Short Strategy?

At its core, a Tax-Aware Long-Short Strategy combines two objectives: pursuing investment returns through long and short market exposures, and actively managing taxable gains and losses to improve after-tax outcomes.

Unlike traditional tax-loss harvesting, which relies largely on market declines to create harvestable losses, TALS strategies are intentionally constructed to create a continuous opportunity for tax management through both the long and short sides of the portfolio.

The strategy may:

- Harvest realized losses more consistently.
- Defer taxable gains where possible.
- Create tax assets that can offset gains from other investments.
- Improve overall after-tax wealth accumulation.

> *In many cases, the tax savings themselves can become a meaningful contributor to total return.*

03

The ESOP Connection

At Questar Capital Partners, we frequently work with owners evaluating employee ownership transactions and long-term succession planning. ESOPs continue to be an attractive option for owners looking to transition ownership of their business. They can:

- Preserve independence.
- Reward employees.
- Create succession continuity.
- Provide liquidity to shareholders.
- Generate significant corporate tax benefits.

For C-corporation owners, Section 1042 often becomes one of the most attractive aspects of an ESOP transaction because it may allow capital gains tax deferral when proceeds are reinvested into Qualified Replacement Property.

However, many businesses operating in America today are organized as S-corporations. For these owners, the planning conversation becomes more complicated because the traditional 1042 pathway has generally not been available to the same extent. As a result, founders often find themselves searching for alternative tax mitigation strategies that can complement their overall exit planning.

04

Why TALS May Be Especially Valuable for S-Corporation Owners

When an S-corporation owner sells shares through an ESOP transaction or other liquidity event, several challenges often emerge simultaneously.

Large capital gains

Years of business appreciation frequently produce substantial embedded gains.

Concentrated wealth

Many founders have the majority of their net worth tied to the company.

Need for diversification

Post-transaction wealth generally requires broader investment exposure.

Tax burden

Without significant offsetting deductions or losses, tax liabilities can be considerable.

> *Rather than viewing taxes as an unavoidable outcome, TALS turns tax management into an intentional component of portfolio design.*

05

Tax Alpha: The Often-Overlooked Return Driver

Most investors focus exclusively on pre-tax returns. However, sophisticated investors increasingly recognize that what matters most is the amount of wealth retained after taxes.

Consider two portfolios:

- **Portfolio A** earns 10% annually but creates substantial taxable gains.
- **Portfolio B** earns 9% annually but generates meaningful tax benefits and gain deferral.

The second portfolio may ultimately leave the investor with more spendable wealth. This concept is known as tax alpha.

Research in the tax-aware investing space suggests that tax-aware long-short strategies can create substantial after-tax benefits through a combination of realized losses and deferred gains that may materially improve investor outcomes.[2] For high-income business owners facing large liquidity events, this distinction can become critically important.

THE TAKEAWAY

A lower headline return can produce a higher net outcome. Pre-tax performance is only half of the equation.

[2] AQR, *Loss Harvesting or Gain Deferral? A Surprising Source of Tax Benefits of Tax-Aware Long-Short Strategies*, The Journal of Wealth Management (working paper dated April 30, 2024); AQR, *Beyond Direct Indexing: Dynamic Direct Long-Short Investing*, The Journal of Beta Investment Strategies (Fall 2023). Findings are based on historical simulations of hypothetical portfolios, are not indicative of future results, and actual tax outcomes will vary by investor and market conditions.

06

Integrating TALS into ESOP and Exit Planning

The most effective tax planning rarely relies on a single technique. Instead, successful founders typically coordinate:

- ESOP structures
- Estate planning
- Trust design
- Charitable planning
- Asset protection
- Qualified Replacement Property strategies where applicable
- Tax-aware investment management

Tax-Aware Long-Short Strategies can fit naturally into this broader framework. For owners who cannot fully utilize Section 1042 planning, TALS may provide an alternative mechanism to help manage taxes over time while maintaining exposure to investment opportunities across public markets.

The objective is simple: preserve more of what you've spent a lifetime building.

07

The Bottom Line

Business succession and liquidity planning are not merely transaction decisions. They are wealth preservation decisions.

As tax rates, regulatory complexity, and business valuations continue to evolve, affluent investors need solutions that address both sides of the equation: investment performance and tax efficiency.

Tax-Aware Long-Short Strategies represent an innovative development in modern portfolio management because they seek to improve after-tax outcomes rather than focusing solely on headline returns. For ESOP sellers, founders approaching a liquidity event, and particularly S-corporation owners who may not have access to traditional Section 1042 rollover planning, TALS can become an important tool in the broader conversation around tax mitigation and wealth preservation.

At Questar Capital Partners, we believe the best exit strategies are those that align transaction structure, investment strategy, and tax planning into a cohesive long-term wealth plan.

> *Because the true measure of success is not what you sell your business for. It's what you keep.*

Your Next Step

Schedule a Confidential Conversation With Chris

If you are approaching a liquidity event — or already through one and wondering how much of it you'll keep — a 30-minute conversation can help you understand where tax-aware investing fits alongside your ESOP structure, your estate plan, and your broader wealth strategy.

No pressure. No obligation. Just an honest look at the after-tax picture most owners never get shown.

Chris Stadler, MBA, CEPA®

VP, ESOP & Transaction Advisory | Questar Capital Partners

(850) 655-6500

questarcap.com | esopexpert.com

115 W. Century Rd., Suite 180, Paramus, NJ 07652

Securities offered through Sanctuary Securities, Inc., Member FINRA, SIPC. Advisory services offered through Sanctuary Advisors, LLC, an SEC Registered Investment Advisor. Questar Capital Partners is a DBA of Sanctuary Securities, Inc. and Sanctuary Advisors, LLC. This article is provided for educational purposes only and does not constitute tax, legal, or investment advice. Consult with qualified professionals regarding your specific circumstances before making decisions about business succession or tax planning strategies. Investing involves risk, including the possible loss of principal. Long-short strategies involve additional risks, including the use of leverage and short selling, and are not suitable for all investors.