

CALLAN

FAMILY OFFICE

It Is Different This Time
The Tax Strategy Is Not New.
Starting With the Exit Is.

4Q26 Tax Letter



4Q26 Tax Letter

In the spring and summer of 1979, America had an energy problem. Gasoline shortages had returned, dependence on imported oil had become a national concern, and President Jimmy Carter urged Americans to conserve. Energy had become one of the defining domestic issues of his presidency.

A little more than a year later, Joseph Newman, a self-taught inventor from Mississippi, proposed a considerably more convenient answer. On August 18, 1980, Newman filed a patent application for a machine he claimed could produce more usable energy than it consumed. If he was right, conservation suddenly looked far less important.

The machine itself was difficult to ignore. It relied on enormous magnets wrapped with extraordinary amounts of copper wire; one version reportedly contained 55 miles of it. When Newman later delivered a working model to the National Bureau of Standards for testing, he arrived with 116 nine-volt batteries to power it.



Joseph Newman and his machine

More intriguing than the machine's appearance were its measurements. One physicist reported that an eight-foot fluorescent tube connected to the motor coil illuminated while the measured battery input appeared to be only a fraction of a watt. Newman and his supporters argued that conventional measurements were missing important sources of energy.

Those results made the claim considerably harder to dismiss. If several watts were truly coming out while less than one watt was going in, Newman appeared to have accomplished the impossible. The real question, however, was whether both the inputs and outputs were being measured correctly.

The Patent and Trademark Office remained skeptical, and years of litigation eventually led to independent federal testing. The National Bureau of Standards conducted 77 separate tests under varying operating conditions and found no instance in which output exceeded input. After correcting for measurement offsets, every result remained below 100 percent efficiency. The remarkable performance depended less on the machine itself than on what was being measured and what was not.

There is something wonderfully instructive about a machine containing miles of copper wire, enormous magnets, and more than a hundred nine-volt batteries ultimately confronting such a simple question: does the entire system work? It is not enough to identify an impressive result in one part of the machine. You must also account for everything that went in and everything that happened elsewhere in the system.

Modern tax-efficient investing presents much the same challenge. The technology may be newer, but the underlying question is unchanged: Are we measuring the entire system or only the part producing the most impressive number?

The Newest Version of an Old Idea

Tax-aware long-short strategies, commonly referred to as TALS, have become increasingly prominent in tax-focused investing. The basic objective is appealing: maintain meaningful equity exposure while systematically realizing capital losses that can be used against gains elsewhere in an investor's portfolio.

Technology makes this possible at a scale that would have been difficult to imagine with traditional year-end tax-loss harvesting. A manager can continuously monitor thousands of positions, identify loss opportunities, balance long and short exposures and make portfolio adjustments throughout the year. Long-short structures can also continue generating potential harvesting opportunities after a traditional long-only portfolio has become increasingly populated with appreciated positions.

For an investor confronting a large taxable gain, the result can be compelling. A business owner sells a company and realizes a \$25 million capital gain, while a tax-aware investment strategy generates \$25 million of usable capital losses. On the tax return for that year, the result appears remarkably clean: \$25 million of gain meets \$25 million of loss.

The most impressive number may appear there, but it should not be where the analysis ends. The more important questions are what had to happen elsewhere in the portfolio to produce that result, what the investor will own afterward, and what alternatives will eventually be available to address it. Answering those questions requires more than understanding the investment strategy or the tax rules in isolation because the two are now working together.

The Loss Still Has to Be a Loss

There is an important threshold question before reaching any discussion of the exit. A good back-end plan cannot repair a loss that should not have been recognized on the front end. The legitimacy of the loss and the quality of the eventual exit are separate questions, and both must survive scrutiny.

Taxpayers have intentionally harvested legitimate investment losses for generations. The fact that an investor considers the tax consequences of selling an investment does not transform a genuine economic loss into an artificial one. Tax-aware investing is not inherently suspect simply because tax consequences influence portfolio decisions.

The difficulty begins when the tax loss recognized by the investor no longer corresponds with the economic loss actually borne. The Internal Revenue Code already contains overlapping rules addressing versions of that problem. Wash-sale rules can disallow certain losses when substantially identical securities are reacquired within the prescribed period. Straddle rules can defer losses associated with offsetting positions, while constructive-sale rules address the opposite problem by limiting the ability to eliminate meaningful economic exposure to appreciated property while postponing the corresponding gain.

Modern tax-aware portfolios are not automatically equivalent to the transactions those rules were designed to address. They may involve genuine diversification, real long and short exposures, actual market risk, and thousands of bona fide purchases and sales. Those facts matter enormously, but sophisticated portfolio technology does not by itself answer the tax question.

This is the first measurement. Before asking how much tax a strategy appears to save, determine whether the losses creating that result are supported by the actual economics and applicable tax rules. Once that question has been answered, the analysis can turn to the rest of the machine.

What Exactly Are We Measuring?

Suppose the \$25 million loss is entirely legitimate. The investor owned the positions, experienced the market movements, closed or sold investments at losses, and complied with the tax rules governing recognition. There is no sleight of hand in the loss itself, but the immediate tax result can still tell us surprisingly little about the ultimate economics.

A tax-aware long-short portfolio can systematically realize losses while deferring gains. In practice, that can mean liquidating loss positions while avoiding or delaying the liquidation of positions carrying gains. Over time, the investor may therefore recognize substantial losses today while substantial unrealized gains accumulate elsewhere in the portfolio. The current gain may have been offset, but the corresponding tax exposure may have changed its location and timing rather than disappeared.

None of this means the strategy failed. Deferring tax liability can have substantial economic value because capital that otherwise would have been paid in tax remains invested. If that capital compounds for ten, fifteen or twenty years, the value of the deferral can be significant.

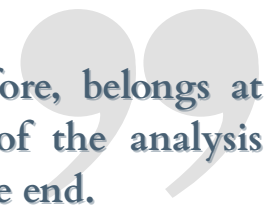
The problem arises when a strategy that produces deferral is measured as though it produced permanent elimination. Looking only at the \$25 million loss is a little like looking at one wire coming out of Newman's machine and declaring victory. Before reaching a conclusion, we need to understand what happened everywhere else in the system and what eventually must happen to the gain that remains.

The \$25 Million Loss Has Another Side

If the strategy works exactly as intended, several years later the portfolio may contain significant unrealized appreciation. The investor then faces a different question: what happens when leverage is reduced, short positions are closed, appreciated assets are sold, or the investor simply wants the capital back?

The answer can fundamentally change the value of the original loss. An investor who must liquidate everything two years later may have achieved little more than a relatively short deferral. Another investor who can maintain the strategy for 20 years, selectively recognize gains, coordinate them with other losses and ultimately integrate the portfolio into broader tax planning may achieve a dramatically different result.

The tax returns in the first year can look identical even though the lifetime after-tax economics are completely different. The exit, therefore, belongs at the beginning of the analysis rather than at the end. The correct question is not merely, “How much loss can this strategy generate?” It is also, “If it generates exactly the loss we want, what can we ultimately do with what remains?”



The exit, therefore, belongs at the beginning of the analysis rather than at the end.

Those questions are where professional judgment begins to matter. The best exit is rarely determined by a single tax rule or investment consideration. It depends on how the portfolio, tax consequences, liquidity needs, holding period, and the investor’s broader planning objectives fit together.

Time Creates Choices. Expertise Determines Which Ones Work.

Deferral creates time, and time can create additional planning choices. Simply having more time, however, does not determine the best exit. The difficult part is understanding which alternatives are actually available to a particular investor, how they interact with the investment structure and tax rules, and when decisions must be made to preserve them.

An investor may be able to reduce appreciated positions gradually rather than through a single taxable unwind. Gains may be coordinated with future investment losses or other available tax attributes. The strategy itself may continue operating as a long-term investment and tax-management platform rather than being dismantled simply because the original gain has already been offset.

For some investors, charitable planning may become part of the eventual exit. Appreciated assets or interests may fit within an existing philanthropic strategy, potentially changing how and when embedded gain is ultimately recognized while advancing a charitable objective. The important point is not that charitable planning somehow cures the embedded gain, but that an appreciated position can have a very different planning profile when its ultimate destination was considered before the position had to be sold.

Estate and wealth transfer planning can create another set of choices. Interests may be incorporated into trusts or other long-term family planning while future appreciation occurs in a different ownership structure. Depending on the investor’s circumstances and the assets involved, basis rules at death may also become relevant to the ultimate disposition of appreciated property.

State income-tax planning can matter as well, particularly over a long holding period. An investor’s domicile may change years after the original transaction, and future gain from non-source investment assets may eventually be recognized while the investor resides in a jurisdiction with a different income-tax regime. The possibility of a future domicile change should not drive an investment decision by itself, but it illustrates why the tax consequences of an exit cannot always be predicted by looking only at the taxpayer’s circumstances in the year the loss is generated.

4Q26 Tax Letter

The partnership or investment structure may provide still other paths. Positions can sometimes be reduced over time, leverage adjusted, liquidity introduced, and distributions coordinated with the investor's basis and the composition of the underlying assets. The alternatives will depend heavily on the structure, which is precisely why they should be understood before the investor enters it.

These choices are not interchangeable, and some disappear once an investment decision or disposition has already been made. Charitable planning may require action before a contemplated sale. Wealth-transfer planning may raise different questions involving basis, valuation, ownership and control. Partnership-based exits can depend on liabilities, basis and the composition of underlying assets. Even the order in which decisions are made can preserve one path while eliminating another.

Evaluating these strategies requires an understanding of both the tax law and the investment itself. Tax counsel needs to understand enough about the portfolio to know what is occurring economically, while the investment advisor needs to recognize when a portfolio decision can create or eliminate an important tax-planning alternative. The objective is not to catalogue every theoretical exit. It is to identify the realistic ones early enough to preserve those that fit the investor.

Start with the Exit

This changes the way a loss strategy should be evaluated before it is implemented. A projection showing that a strategy can generate losses equal to 20, 30 or 40 percent of the capital invested may be interesting, but the largest projected loss is not necessarily the best result. Every additional dollar of current loss may produce additional embedded appreciation or other economic consequences elsewhere in the structure.

The analysis therefore should not begin by asking how much loss the strategy can generate. It should begin with a more difficult question: if the strategy works exactly as expected, which exit paths will realistically be available? Answering that question requires looking at investment and tax consequences together rather than treating one as the concern of the investment advisor and the other as a problem for the tax advisor to solve years later.

Investment horizon and liquidity matter because some alternatives require years rather than months. Portfolio construction and leverage matter because the investor may not be able to maintain the strategy indefinitely. Basis and partnership tax rules matter because economically similar exits can produce very different tax consequences. Charitable, estate and family objectives matter because positions that appear problematic in isolation may fit naturally into planning the investor already intends to undertake.

The amount of loss that can be generated and the amount that should be generated are therefore not necessarily the same number. Determining the difference requires judgment about both the benefit created today and the position the investor is likely to face tomorrow.

Starting with the exit does not mean predicting the future perfectly. It means understanding which alternatives require time, which depend on the structure selected at inception and which can disappear once a sale, distribution or other transaction is already underway. Those constraints can influence how much capital goes into the strategy and how aggressively losses should be generated in the first place.

What Is Actually Different This Time

Tax-aware long-short investing may represent a meaningful advancement in investment technology. Modern portfolio construction, large-scale computing, and continuous tax management can produce investment and tax results that would have been much more difficult to achieve even a decade ago.

Technology, however, does not repeal the rules governing tax losses, and sophistication does not transform deferral into elimination. Those parts are not different this time. What can be different is the way the strategy is designed, advised, and ultimately exited.

Starting with the exit does not mean predicting the future perfectly. It means understanding which alternatives require time, which depend on the structure selected at inception and which can disappear once a sale, distribution or other transaction is already underway.

Instead of starting with a projected loss and discovering the exit years later, start with the exit and work backward. Determine what is likely to remain if the strategy succeeds, identify the realistic paths for addressing that exposure and then decide how much front-end loss actually makes sense. The process requires advisors who understand enough about both the tax law and the investment structure to see how decisions on one side change the choices available on the other.

It also provides a better way to measure success. The relevant number is not simply the loss reported on the first tax return. It is the after-tax economic result across the entire life of the strategy, including what the loss deferred, how long the deferral lasted, what the retained capital earned, what it cost to maintain the strategy and how much of the embedded exposure was ultimately recognized, eliminated or incorporated into other planning.

Joseph Newman's machine ultimately faced the same discipline. After all the copper wire, magnets, batteries, demonstrations and competing explanations, federal engineers measured what went into the system and what came out. The machine had to be evaluated as a whole, and sophisticated tax planning deserves the same measurement.

Innovation is not simply generating the loss; it is understanding what the loss leaves behind, knowing which paths remain available from there and designing the strategy today so the right paths remain open tomorrow. That is how this time can actually be different.

4Q26 Tax Letter

For more information visit us at:
www.callanfo.com

Jeffrey Getty is Chief Tax Strategist at Callan Family Office. He is a published author of two books, several national publications and TEDx speaker. He is a licensed attorney, holds an MS (Tax) and was elected a Fellow by the American College of Trust & Estate Counsel (ACTEC) in recognition of his contributions in the field of trusts and estate law.

©2026 Callan Family Office. All rights reserved.

Callan Family Office (CFO) is the exclusive trademark licensee of Callan LLC. Callan LLC provides products and services to CFO. Clients of CFO are not clients of Callan LLC, and the parties are not affiliated. CALLAN, CFO and the other Callan trademarks and service marks are registered and/or unregistered trademarks of Callan LLC and may not be used without its permission. INVESTMENT ADVISORY SERVICES AND PRODUCTS PROVIDED TO CLIENTS OF CFO ARE PROVIDED SOLELY BY CFO AND NOT BY OR ON BEHALF OF CALLAN LLC. REPRESENTATIVES OF CFO ARE EMPLOYEES AND AGENTS OF CFO AND NOT EMPLOYEES OR AGENTS OF CALLAN LLC. CFO does not provide tax or legal advice. You should contact your tax advisor, accountant and/or attorney before making any decisions with tax or legal implications. All information is provided solely for convenience purposes and all users thereof should be guided accordingly.

CFO is an SEC registered investment adviser. Registration as an investment adviser does not imply a certain level of skill or training. The publication of this content should not be construed by anyone as a solicitation or attempt to effect transactions in securities, or the rendering of personalized investment advice. A copy of CFO's current written disclosure statement as set forth on Form ADV, discussing CFO's business operations, services, and fees is available at www.adviserinfo.sec.gov.

CALLAN
FAMILY OFFICE

Info@CallanFO.com

CallanFamilyOffice.com