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PORTFOLIO MANAGEMENT | WHITE PAPER

TAX-AWARE LONG-SHORT INVESTING

AQR's Tax-Aware Delphi Plus Strategy and Flex Long-Short Strategies:
structures, tax characteristics, and the 2026 regulatory landscape.

21 OCTOBER 2026 | WHITE PAPER

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ABOUT THIS PAPER

SOURCE BASIS AND SCOPE

This white paper examines the tax characteristics of two AQR tax-aware long-short offerings — the AQR TA Delphi Plus Fund, a commingled fund that takes the position that it is a trader fund, and the AQR Flex separately managed account strategies — together with the 2026 legislative, regulatory, and custodial developments that shape their use. It relies only on public sources: AQR’s published research and Tax Matters commentary, SEC filings, IRS and legislative materials, and press and practitioner commentary. It is written for investors, family offices, and advisers weighing these strategies against large capital gains or high ordinary income.

SOURCES DRAWN ON

AQR PUBLISHED RESEARCH

Peer-reviewed and working papers by AQR’s tax-aware research group — Sialm and Sosner (2018), Liberman et al. (2020, 2023), Krasner and Sosner (2024), Liberman, Sosner, and Freitas (2026), and Krasner et al. (2026) — together with the AQR Tax Matters series.

REGULATORY AND PUBLIC FILINGS

SEC Form D and Form ADV filings for the AQR TA Delphi Plus Fund, AQR Flex 1 Series LLC, and AQR Flex Management, LLC; IRS Notice 2026-62 and Rev. Rul. 2026-20; Rev. Proc. 2025-32; and the One Big Beautiful Bill Act.

PRESS AND PRACTITIONER COMMENTARY

Bloomberg News, Institutional Investor, InvestmentNews, Hedgeweek, and client alerts from Ropes & Gray, Withum, Baker Tilly, and Willkie Farr & Gallagher.

WHAT IS NOT INCLUDED

No AQR offering documents, due diligence questionnaires, or investor presentations are cited, and no performance of any Robertson client account is shown. Figures are as of the dates stated in the sources cited.

HOW TO READ THE ILLUSTRATIONS

Worked examples use assumed figures to illustrate the mechanics of the tax rules; they are not projections of any fund or account. Research results cited are historical simulations published by AQR and in academic journals and are hypothetical. See Important Disclosures.

For informational and educational purposes only — not individualized investment, legal, or tax advice.

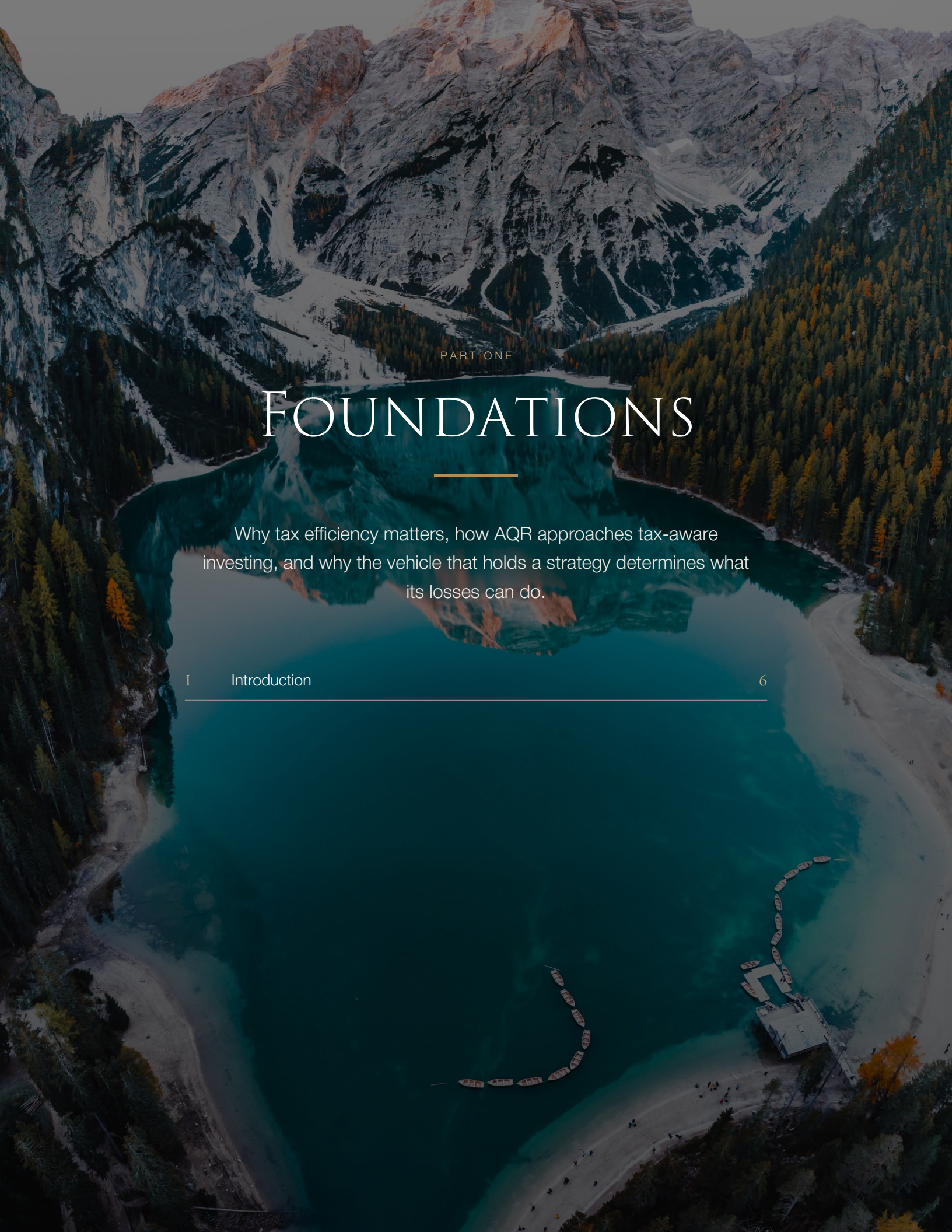
ABSTRACT

The integration of tax-aware investment strategies into portfolio management has moved from a niche practice to a mainstream component of private wealth planning. Industry estimates place inflows into tax-aware long-short strategies above \$150 billion over the past three years (Bloomberg News, 2026). AQR reported approximately \$58.3 billion of client assets as of June 30, 2026 in the tax-aware strategies it is transferring to a newly registered affiliate, AQR Flex Management, LLC, and the AQR TA Delphi Plus Fund had raised \$6.8 billion from more than 4,400 investors by August 2026 (AQR Flex Management, 2026; AQR TA Delphi Plus Fund, 2026). This paper examines the tax characteristics of AQR's Tax-Aware Delphi Plus Strategy and AQR's Flex long-short separately managed account strategies, emphasizing how each seeks to improve after-tax wealth through gain deferral, loss realization, and, in the case of the Delphi Plus fund, trader fund status. The Tax-Aware Delphi Plus Strategy employs a multi-strategy, long-short equity and trend-following approach designed to deliver diversifying returns with lower market beta while allocating ordinary and short-term capital losses to investors (Bloomberg News, 2024). The Flex strategies use a long-short separately managed account structure that pursues pre-tax alpha and systematic net capital loss realization, particularly for investors managing substantial capital gains events, such as business sales (AQR, 2026h).

Research published by AQR and in peer-reviewed journals has clarified how these strategies work. In historical simulations, tax-aware long-short factor strategies implemented with sufficient leverage and tracking error realized cumulative net capital losses exceeding 100% of initially invested capital within the first few years, while outperforming the benchmark before tax net of implementation costs (Lieberman, Krasner, Sosner & Freitas, 2023). Those net losses arise not from an increased realization of losses but from the deferral of gains, especially short-term gains on long positions (Krasner & Sosner, 2024). More recent work shows that pre-tax alpha enhances rather than erodes tax benefits (Lieberman, Sosner & Freitas, 2026) and that investors may be able to withdraw substantial capital from these strategies without liquidating them (Krasner, Lieberman, Sosner & Brenner, 2026).

An essential component of the Delphi Plus Strategy is its trader fund status, which allows the fund's net ordinary losses and deductions to be treated as trade or business items that can offset wages and other ordinary income, subject to the excess business loss limitation of Internal Revenue Code Section 461(l) (Bloomberg News, 2024; Sosner & Steblea-Lora, 2021). The regulatory environment surrounding these strategies changed materially during 2025 and 2026. The One Big Beautiful Bill Act of 2025 made the excess business loss limitation permanent and reset its inflation indexing, lowering the 2026 threshold to \$256,000 (\$512,000 for joint filers). On September 28, 2026, Treasury and the IRS issued Notice 2026-62, which identifies certain multi-position "tax-aware" partnership and separately managed account strategies that pair capital gains with ordinary losses as potential transactions of interest or listed transactions. Through comparative analysis and illustrations of the tax mechanics, the paper highlights the potential advantages of incorporating tax-aware long-short techniques into broader portfolio construction, while emphasizing that the ordinary-loss component of these strategies now carries heightened regulatory risk that investors and advisors must monitor closely.

Information in this paper is as of October 21, 2026. Asset, investor-count, and regulatory figures are as of the dates stated in the sources cited and will change over time.



PART ONE

FOUNDATIONS

Why tax efficiency matters, how AQR approaches tax-aware investing, and why the vehicle that holds a strategy determines what its losses can do.

I Introduction

6

I INTRODUCTION

Tax efficiency has become an essential component of modern investment strategies, particularly for high-net-worth and institutional investors seeking to maximize after-tax returns. The ability to minimize tax liabilities through strategic portfolio management is a critical consideration, as capital gains taxes, ordinary income taxes, and transaction costs can significantly erode wealth accumulation over time. AQR Capital Management has been a pioneer of tax-aware investment strategies, including the Tax-Aware Delphi Plus Strategy and the Flex long-short strategies, both of which are designed to enhance after-tax returns through gain deferral, systematic loss realization, and long-short portfolio construction (AQR, 2026c; AQR, 2026h).

Three recent developments frame this analysis. First, the research base has expanded: AQR has published new work on the role of pre-tax alpha in tax benefits, on tax-efficient withdrawals, and on the differences between tax-aware long-short investing and direct indexing. Second, Congress enacted the One Big Beautiful Bill Act (Pub. L. No. 119-21, 2025) in July 2025, making permanent several provisions of the Tax Cuts and Jobs Act that were scheduled to expire and permanently codifying the excess business loss limitation. Third, the rapid growth of these strategies has drawn the attention of custodians, which have restricted or repriced access (InvestmentNews, 2026), and of Treasury and the IRS, which issued Notice 2026-62 in September 2026. This paper addresses each of these developments.

SECTION 1.1

UNDERSTANDING TAX EFFICIENCY IN INVESTING

The impact of taxation on investment performance is a key consideration for investors looking to maximize after-tax wealth. Traditional investment vehicles, such as mutual funds and exchange-traded funds (ETFs), often generate taxable distributions that reduce an investor's net returns. Portfolio turnover, dividend distributions, and realized capital gains all contribute to tax drag, diminishing overall performance. In contrast, tax-aware investment strategies seek to mitigate these effects by deferring taxable gains where possible and realizing losses that can offset gains elsewhere in an investor's portfolio (Krasner & Sosner, 2024).

Research on tax-aware long-short strategies highlights their potential advantages over long-only loss harvesting. The seminal work on the tax benefits of shorting showed that relaxing the long-only constraint allows an active strategy to realize losses on both sides of the portfolio while deferring gains (Sialm & Sosner, 2018). In hypothetical historical simulations published in *The Journal of Beta Investment Strategies*, the annual net losses realized by direct indexing strategies tapered toward zero within the first few years, so that cumulative net losses plateaued at roughly 30% to 45% of initially invested capital, with wide dispersion of outcomes. Long-short factor strategies implemented with sufficient leverage and tracking error realized cumulative net capital losses of 100% of invested capital within a few years and, at the same time, outperformed the benchmark index before tax (Lieberman, Krasner, Sosner & Freitas, 2023; Lieberman, Sosner & Freitas, 2026). Earlier research showed why: separating a portfolio into an active long-short component and a passive index component allows turnover to be concentrated in the active exposures, enabling deferral of gains on the market exposure (Lieberman, Sialm, Sosner & Wang, 2020). Such tax benefits are particularly relevant for investors with highly appreciated assets or large liquidity events who seek to manage taxable gains

effectively. These are simulated results from published research, not the performance of any Robertson client or AQR product; see the Important Disclosures.

SECTION 1.2

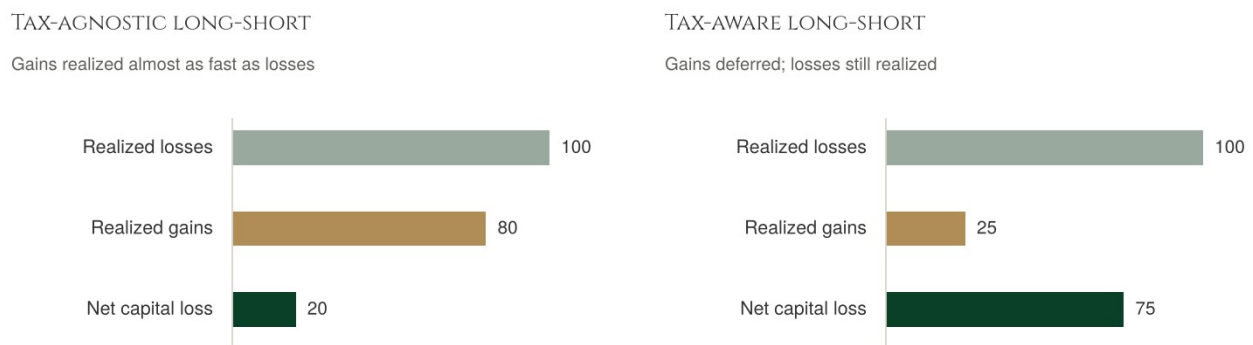
AQR'S APPROACH TO TAX-AWARE INVESTING

AQR's tax-aware investment approach is based on two core principles: gain deferral and loss realization. Gain deferral postpones the realization of capital gains, allowing investment returns to compound on a pre-tax basis and thereby increasing overall portfolio efficiency. Loss realization involves selling securities at a loss, as a byproduct of normal active turnover, to offset capital gains; realized losses that are not used can be carried forward indefinitely to offset future gains (Krasner & Sosner, 2024).

AQR has been explicit that its tax-aware long-short strategies are not “direct indexing on steroids.” The strategies trade to pursue pre-tax alpha, selling positions when AQR's models no longer favor them rather than seeking lookalike substitutes, and the long and short books are intentionally different because they carry opposite exposures to the factors AQR expects to be rewarded. Most of the tax benefit relative to a tax-agnostic counterpart comes from deferring gains, especially short-term gains, not from realizing larger losses; the net effect is roughly the same losses but far fewer gains (AQR, 2026e; AQR, 2026f). Tracking error is intentional and necessary to outperform the benchmark, and a well-designed strategy balances expected returns, risk, costs, and taxes rather than maximizing realized losses (AQR, 2026g). AQR has been equally explicit that alpha is not optional: if a strategy's expected alpha is negative after financing costs, trading costs, and fees, tax benefits alone do not justify a long-short implementation, and investors should evaluate these strategies first as risky active investments (AQR, 2026a; Liberman, Sosner & Freitas, 2026). AQR also notes that, while gain deferral has meaningful value, the eventual “exit tax” on a tax-aware portfolio can be significant, and it encourages investors to evaluate the full lifecycle of the investment, including liquidation (AQR, 2026c).

FIGURE 1

WHERE THE TAX BENEFIT OF A TAX-AWARE LONG-SHORT STRATEGY COMES FROM (CONCEPTUAL)



Index values, conceptual (realized losses = 100). The net loss comes from deferring gains, not from harvesting more losses.

Source: Conceptual illustration based on Krasner & Sosner (2024) and AQR (2026a). Bar heights are not data. Hypothetical; see Important Disclosures.

An additional component of AQR's approach is the ability to tailor strategies to investors with specific tax needs. Investors who have recently sold a business or other highly appreciated assets may benefit from the Flex strategies, which are designed to realize net capital losses that can offset large taxable gains (AQR, 2026h). Investors whose tax burden is dominated by high-rate ordinary income and short-term gains are the intended audience for the Tax-Aware Delphi Plus Strategy, which allocates ordinary and short-term losses through a trader fund vehicle (Bloomberg News, 2024). AQR's research shows that investors with allocations to hedge funds and derivatives are the most likely to have systematic short-term gains and therefore derive the greatest benefit from harvested losses (Sosner, Gromis & Krasner, 2022).

SECTION 1.3

REGULATORY CONSIDERATIONS AND THE ROLE OF TRADER FUND STATUS

A critical factor in tax-efficient investing is the tax classification of the investment vehicle. A fund that engages in substantial, regular, and continuous trading with the intent to profit from short-term price changes may take the position that it is a trader fund. Its expenses, including management fees, are then deductible as trade or business expenses, and its net ordinary losses are business losses that may offset ordinary income, including wages, subject to the excess business loss limitation; capital losses allocated by the fund retain their capital-loss limitations (Sosner & Steblea-Lora, 2021). AQR's tax-aware funds, including the AQR TA Delphi Plus Fund, take this position (Bloomberg News, 2024).

For investors in high-income tax brackets, the ability to deduct ordinary losses can provide immediate tax relief. This is the principal source of the Delphi Plus Strategy's tax benefit, whereas the Flex strategies are designed to realize net capital losses. Trader fund losses are subject to the excess business loss limitation of IRC Section 461(l), which the One Big Beautiful Bill Act made permanent beginning with tax years after December 31, 2025, and which limits the amount of net business losses that can offset wages and other nonbusiness income in a given year to \$256,000 (\$512,000 for joint filers) in 2026 (Rev. Proc. 2025-32; Internal Revenue Service, 2026b).

Beyond trader fund status, AQR's tax-aware strategies operate within the wash sale, straddle, and constructive sale rules, and under the economic substance doctrine. AQR has emphasized that entity wrappers do not neutralize these anti-abuse rules and that strategies should be grounded in a pre-tax investment rationale (AQR, 2026b; AQR, 2026c). In September 2026, Treasury and the IRS identified specific multi-position "tax-aware" strategies that pair capital gains with ordinary losses as areas of concern (Internal Revenue Service, 2026a). Section 6 discusses this guidance in detail.

FIGURE 2

TWO VEHICLES, TWO KINDS OF LOSSES: HOW EACH STRATEGY'S LOSSES FLOW THROUGH THE 2026 TAX RULES

AQR TA DELPHI PLUS FUND	AQR FLEX ACCOUNT
Commingled fund · trader fund position · Schedule K-1	Separately managed account · beta near 1 · Form 1099
Allocates net ordinary losses and short-term capital losses, alongside long-term gains	Realizes net capital losses, short- and long-term, through ordinary portfolio turnover
Ordinary losses offset wages and other ordinary income up to the Section 461(l) threshold: \$256,000 single / \$512,000 joint for 2026	Capital losses offset capital gains dollar for dollar, including the gain on a business sale
Losses above the threshold become a net operating loss carryforward, usable against up to 80% of taxable income in later years	Excess capital losses offset \$3,000 of ordinary income a year; the remainder carries forward indefinitely
BEST SUITED TO High ordinary income or short-term gains	BEST SUITED TO Large realized capital gains

DELPHI PLUS MAY ALLOCATE ORDINARY AND CAPITAL LOSSES; FLEX SEEKS TO GENERATE CAPITAL LOSSES

Source: Author's summary of the vehicle structures and the 2026 tax rules (Sosner & Steblea-Lora, 2021; Bloomberg News, 2024; Rev. Proc. 2025-32).

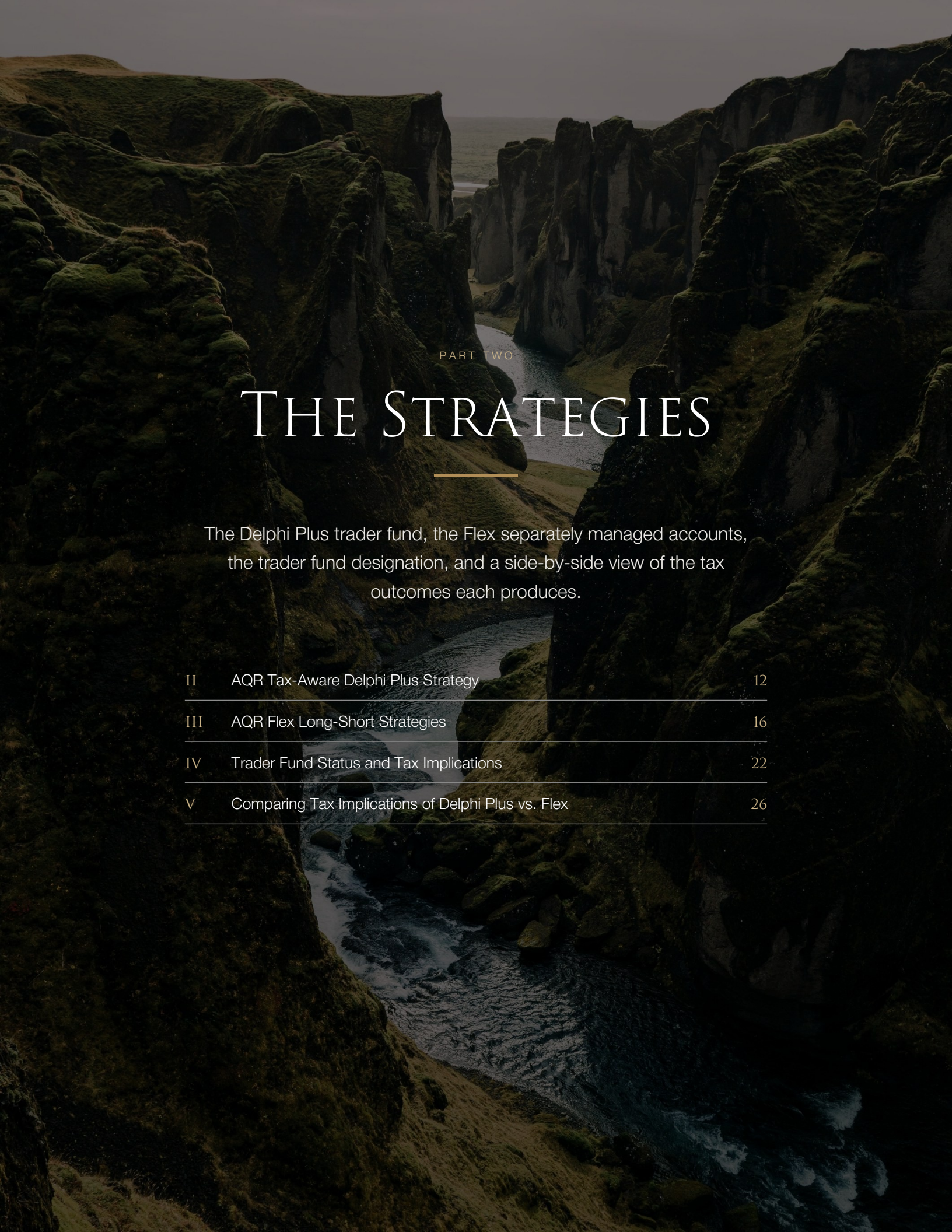
SECTION 1.4

PURPOSE OF THIS PAPER

This paper explores the tax characteristics, regulatory considerations, and strategic applications of AQR's Tax-Aware Delphi Plus and Flex strategies. By integrating peer-reviewed research, AQR's published commentary, public regulatory filings, and press reporting, it provides an evaluation of how these investment solutions may help sophisticated investors improve after-tax wealth. The discussion also examines how the 2025 tax legislation, the 2026 IRS guidance, and changes in custodian policy affect the applicability of trader fund losses and net capital loss realization.

The following sections delve deeper into the mechanics of each strategy, including an analysis of how the Delphi Plus Strategy and the Flex structures seek to enhance after-tax returns. A comparative evaluation of traditional investment approaches versus tax-aware strategies highlights their relative characteristics in different investor situations. Illustrations of the tax mechanics show how these strategies interact with the rules governing capital losses, ordinary losses, and the excess business loss limitation.

Tax-aware long-short strategies turn ordinary portfolio turnover into a source of realized losses; loss character and applicable tax rules determine which income the losses may offset.



PART TWO

THE STRATEGIES

The Delphi Plus trader fund, the Flex separately managed accounts, the trader fund designation, and a side-by-side view of the tax outcomes each produces.

II	AQR Tax-Aware Delphi Plus Strategy	12
III	AQR Flex Long-Short Strategies	16
IV	Trader Fund Status and Tax Implications	22
V	Comparing Tax Implications of Delphi Plus vs. Flex	26

II AQR TAX-AWARE DELPHI PLUS STRATEGY

The AQR Tax-Aware Delphi Plus Strategy (“TA Delphi Plus” or the “Delphi Strategy”), offered through the AQR TA Delphi Plus Fund, LLC, is a diversified, alternative multi-strategy that combines a defensive-focused long-short equity strategy with a trend-following strategy and incorporates AQR’s tax-aware rebalancing. According to Bloomberg’s reporting on the fund’s materials, roughly 70% of the strategy is long-short equity, which favors profitable, low-volatility stocks and shorts the opposite, with the remainder allocated to trend-following across dozens of futures markets (Bloomberg News, 2024). AQR’s published research on a hypothetical tax-aware defensive equity long-short strategy describes the design principles behind this approach: the strategy closely replicates the pre-tax performance of a tax-agnostic counterpart while seeking a meaningful tax benefit, is designed to be attractive in both up and down markets, and may make an investor’s entire portfolio more tax-efficient (Sosner, Pyne, Liberman & Liu, 2020).

The fund’s first sale occurred in December 2020, and it has grown rapidly. Its Form D filings show cumulative subscriptions of \$2.4 billion from 1,472 investors in July 2025, \$4.1 billion from 3,315 investors in January 2026, and \$6.8 billion from 4,462 investors by August 20, 2026, with a \$5 million minimum investment (AQR TA Delphi Plus Fund, 2026). Bloomberg reported the fund’s assets at \$6.6 billion at mid-year 2026 (Bloomberg News, 2026). In May 2026, AQR opened a sibling vehicle, AQR TA Delphi Long Short Equity Fund II, LLC, which had raised \$432 million from 277 investors by September 2026 (AQR TA Delphi Long Short Equity Fund II, 2026). The fund is available only to qualified purchasers, and its fees, terms, and risk factors are set out in its private placement memorandum.

SECTION 2.1

STRUCTURE AND INVESTMENT OBJECTIVES

TA Delphi Plus seeks total returns similar to equity markets over the long term while taking meaningfully less market beta. The long-short component draws on AQR’s research on the low-risk anomaly and quality investing, favoring low-beta, high-quality stocks and shorting their riskier, lower-quality counterparts, and the trend-following allocation positions in assets with positively trending prices and macroeconomic fundamentals, which has historically been complementary to equity exposure (Sosner, Pyne, Liberman & Liu, 2020). AQR also manages a tax-agnostic version of the Delphi long-short equity approach for institutional investors, which shares the core equity models.

One of the primary objectives of the Delphi Strategy is to defer the realization of taxable gains while allocating a favorable mix of tax characters to investors. By maintaining a tax-aware trading framework, the strategy seeks to optimize the timing of gain realization, so that investors can defer taxation and allow returns to compound on a pre-tax basis, while ordinary and short-term losses generated by the strategy’s instruments are passed through to investors in the year they arise (Bloomberg News, 2024).

SECTION 2.2

TAX CHARACTERISTICS OF THE DELPHI PLUS STRATEGY

The Delphi Strategy is structured to generate tax advantages through several key mechanisms, including the allocation of ordinary and short-term capital losses, tax-efficient rebalancing, and gain deferral.

Ordinary and Short-Term Loss Allocation: As a trader fund, the strategy has allocated substantial net ordinary losses and net short-term capital losses to investors, while its realized gains have tended to be long-term. According to Bloomberg's reporting on fund documents, the fund's ordinary-loss allocations have amounted to a substantial fraction of invested capital in recent years, reported at 31% for 2023 and 28% for 2025 (Bloomberg News, 2024; Bloomberg News, 2026). The ordinary losses arise mainly from notional principal contracts (swaps): payments to a counterparty on a losing position create an ordinary loss, while early termination of a contract can produce capital gain or loss (Bloomberg News, 2024). These losses can offset ordinary income and short-term gains from other sources, which are taxed at the highest rates. Allocations vary from year to year and are not guaranteed.

Tax-Efficient Rebalancing: The strategy employs tax-aware rebalancing techniques that seek to minimize the realization of taxable gains while maintaining the desired investment exposure. AQR's tax-aware optimization works to avoid selling gain positions, especially short-term ones, unless the alpha model strongly favors selling (AQR, 2026f).

Gain Deferral: Another key tax feature of the Delphi Strategy is its ability to defer taxable gains through structured portfolio management, allocating gains, losses, income, and deductions in a more beneficial mix for taxable investors than funds that do not take tax consequences into account (Krasner & Sosner, 2024).

AQR has stated long-run objectives for the strategy's pre-tax return and for the annual tax benefit it seeks to generate, and Bloomberg has reported that the strategy has also had negative pre-tax years (Bloomberg News, 2024). Current objectives and performance are available from AQR through a financial advisor; they are objectives, not forecasts or guarantees, and actual results have varied and will vary. See the Important Disclosures.

SECTION 2.3

ORDINARY INCOME TAX CONSIDERATIONS

An important aspect of the Delphi Strategy is its impact on ordinary income taxation. Because the AQR TA Delphi Plus Fund takes the position that it is a trader fund, its management fees, financing costs, and other trade or business expenses are deductible above the line under IRC Section 162(a), and its net ordinary losses are treated as active business losses rather than investment or passive losses, while any capital losses it allocates retain their capital character (Bloomberg News, 2024; Sosner & Steblea-Lora, 2021).

Ordinary Losses and the Excess Business Loss Limitation: Net ordinary losses allocated by the fund can offset wages, retirement income, and portfolio income from other sources, but only up to the excess business loss threshold under IRC Section 461(l); any excess is carried forward as a net operating loss (Sosner & Steblea-Lora, 2021). For 2026 the threshold is \$256,000 (\$512,000 for joint filers), down from \$313,000 (\$626,000) in 2025 because the One Big Beautiful Bill Act reset the inflation base year to 2024 (Rev. Proc. 2025-32). Investors should also be aware of the basis and at-risk rules, which can suspend losses once cumulative allocated losses exceed the investor's tax basis or amount at risk.

Dividend and Interest Considerations: The long-short structure also generates dividend income from long positions and interest expense on leverage and short positions. Qualified dividends may be taxed at preferential rates, while

interest expense allocated to individual investors is generally treated as investment interest, deductible only to the extent of net investment income under IRC Section 163(d). Beginning in 2026, taxpayers in the 37% bracket also face a new limitation that reduces the value of itemized deductions, including investment interest, by 2/37, or about 5.4% (Internal Revenue Service, 2026b). Because the fund uses leverage, investors are allocated partnership liabilities that support their tax basis.

SECTION 2.4

ILLUSTRATION: HOW ORDINARY LOSSES FROM A TRADER FUND INTERACT WITH THE TAX RULES

The following illustration is intended solely to show how the tax rules apply to ordinary losses allocated by a trader fund. It assumes a loss allocation for arithmetic purposes and is not a projection of the Delphi Strategy's results. Consider a high-net-worth investor with substantial ordinary income and short-term capital gains from other investments, the profile for which tax-aware long-short strategies were designed (Sosner, Gromis & Krasner, 2022). Suppose this investor allocates \$10 million to a trader fund and, for purposes of illustration only, is allocated net ordinary losses equal to 30% of capital, an arbitrary round assumption.

The investor would be allocated \$3 million of net ordinary losses. Under the 2026 excess business loss limitation, a married investor filing jointly with no other business income could deduct up to \$512,000 of that loss against salary and other nonbusiness income in the current year, with the remaining \$2.488 million carried forward as a net operating loss to offset up to 80% of taxable income in future years. Any short-term capital losses allocated by the fund would offset short-term gains from other investments. If the allocation were larger, the current-year deduction would be the same \$512,000 and the carryforward larger; the statutory threshold, not the size of the allocation, governs the first-year benefit.

In this illustration, the investor benefits from:

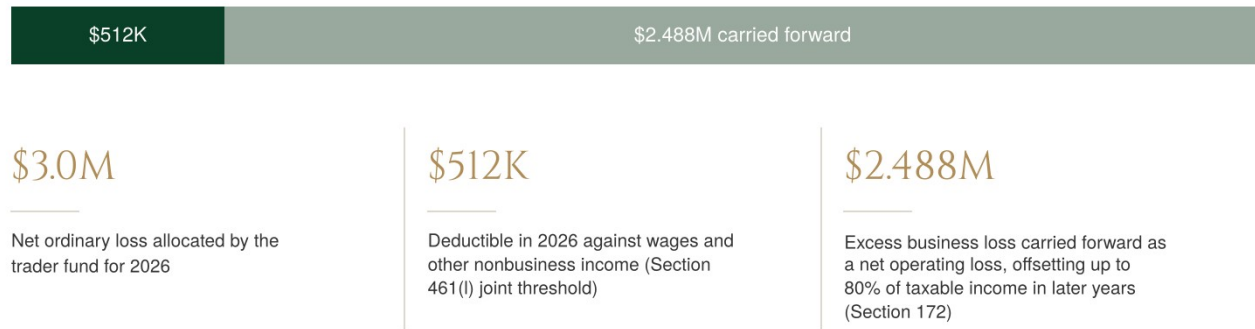
1. **Current-year tax savings** by offsetting ordinary income and short-term capital gains, up to the excess business loss limitation.
2. **Ongoing tax efficiency** through deferred gains and the carryforward of unused ordinary losses.
3. **Long-term wealth accumulation** by compounding returns on a pre-tax basis.

The value of these benefits depends on the investor's income, filing status, state of residence, and the fund's actual allocations, which vary from year to year.

FIGURE 3

HOW THE 2026 EXCESS BUSINESS LOSS LIMITATION SPLITS AN ASSUMED \$3 MILLION ORDINARY LOSS (ILLUSTRATION OF THE RULES; NOT A PROJECTION)

ASSUMED \$3.0 MILLION NET ORDINARY LOSS, MARRIED FILING JOINTLY, 2026



Source: Illustration of the rules using an assumed loss; married filing jointly, no other business income. Threshold per Rev. Proc. 2025-32. Not a projection of any fund's allocations.

SECTION 2.5

CONCLUSION

The AQR Tax-Aware Delphi Plus Strategy is designed for investors seeking to improve after-tax returns through gain deferral, favorable character allocation, and tax-aware portfolio management. Its long-short and trend-following structure is intended to provide a diversifying source of return with lower market beta. The tax features of the Delphi Strategy, particularly its allocation of ordinary and short-term capital losses, may make it suitable for high-net-worth investors with high-rate ordinary income and short-term gains, subject to the eligibility requirements, fees, and risks described in its offering documents.

Those same ordinary-loss characteristics are the reason the strategy now requires closer monitoring. The IRS guidance issued in September 2026, discussed in Section 6, targets multi-position strategies that pair capital gains with ordinary losses, and press reports have linked that guidance to the Delphi Plus fund (Bloomberg News, 2026). The following section explores how AQR's Flex strategies extend tax-aware principles through customized separate account management focused on net capital loss realization.

Delphi Plus takes the trader fund position: its net ordinary losses may offset ordinary income, subject to the excess business loss limitation, while its short-term capital losses retain capital-loss treatment.

III AQR FLEX LONG-SHORT STRATEGIES

AQR Flex, also called Flex SMA, is AQR's suite of tax-aware long-short equity strategies for taxable separately managed accounts. AQR describes Flex as designed to narrow the gap between how investments perform and how wealth grows: unlike conventional approaches such as direct indexing, Flex invests both long and short, which allows AQR to implement its investment views more fully and may lead to more consistent pre-tax and after-tax outcomes (AQR, 2026h). The strategies are driven by AQR's systematic investment process and are offered through financial advisors (AQR, 2026h). On September 30, 2026, AQR's registration of a dedicated adviser, AQR Flex Management, LLC, became effective; AQR disclosed that the tax-aware strategies moving to the new adviser represented approximately \$58.3 billion of client assets as of June 30, 2026 (AQR Flex Management, 2026).

SECTION 3.1

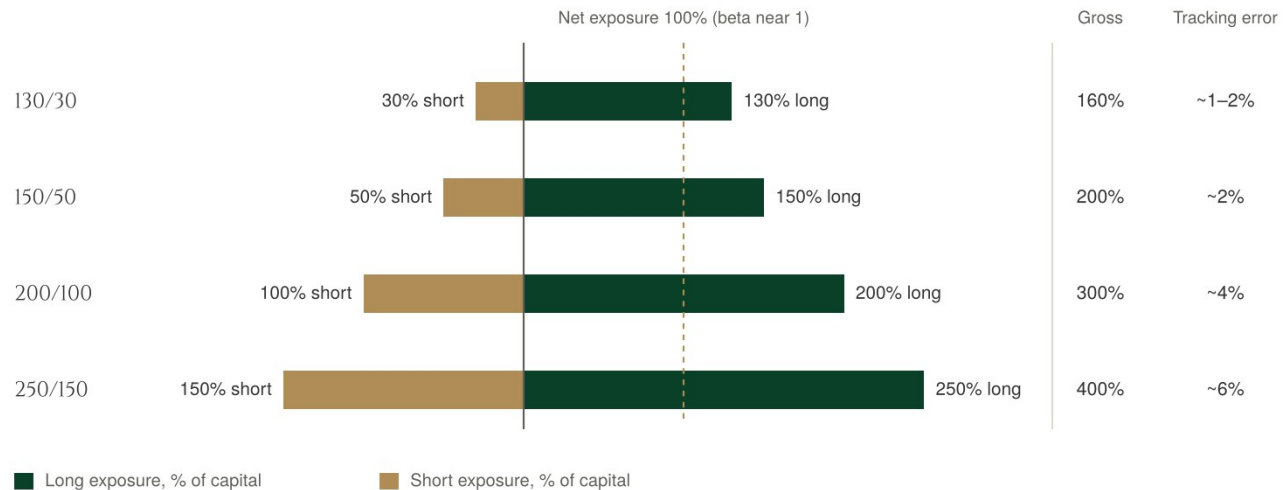
OVERVIEW OF THE FLEX STRUCTURE

Flex strategies integrate tax-aware stock selection with long-short portfolio construction. Unlike direct indexing strategies, which primarily track a benchmark while harvesting losses, Flex actively seeks to generate excess returns while optimizing tax efficiency (AQR, 2026e; AQR, 2026h). The standard implementations maintain a beta of approximately one to the benchmark, meaning they keep full market exposure while adding long and short extensions; AQR also offers lower-beta implementations.

A key feature of the Flex structure is its ability to customize benchmarks and active risk. Implementations are described by their long and short extensions, from 130/30 and 145/45 through 200/100 and higher, with tracking error and expected excess return rising with the size of the extensions (Casey, 2026). AQR's published research on comparable strategies models 150/50, 200/100, and 250/150 implementations at roughly 2%, 4%, and 6% tracking error, respectively, and AQR has stated that a 200/100 portfolio targets about 4.0% annualized tracking error (Liberman, Krasner, Sosner & Freitas, 2023; AQR, 2025). AQR does not publish tier-level return expectations or performance, and it restricts its Flex materials to investment professionals; third-party comparisons report that, under 2026 custodian constraints, new separately managed account clients have generally been limited to the 200/100 implementation, with higher leverage available through AQR's series limited liability company vehicles, which have minimum investments of \$5 million to \$15 million per series (Frec, 2026; AQR Flex 1 Series LLC, 2026). Management fees for Flex accounts are negotiated with the advisor and, according to AQR Flex Management's Form CRS as summarized by a third-party comparison, may range up to 2.50% per year, with typical minimums of \$1 million (NinePointTwo, 2026).

FIGURE 4

FLEX IMPLEMENTATIONS: LARGER LONG AND SHORT EXTENSIONS WITH THE SAME NET MARKET EXPOSURE



Under 2026 custodian constraints new SMA clients have generally been limited to 200/100; higher-leverage tiers are offered through series LLC vehicles.

Source: Tracking-error ranges from AQR published research and commentary (Liberman et al., 2023; AQR, 2025; Casey, 2026). Exposures are each implementation's nominal long/short structure. Under 2026 custodian constraints, new SMA clients have generally been limited to 200/100; higher leverage is available through series LLC vehicles.

SECTION 3.2

TAX CHARACTERISTICS OF FLEX STRATEGIES

Flex strategies are designed to minimize the tax impact of portfolio turnover while realizing net capital losses. The primary tax benefits arise from three key mechanisms: net capital loss realization, tax-aware rebalancing, and gain deferral.

Net Capital Loss Realization: The long-short nature of Flex allows for a greater and more persistent realization of net capital losses than long-only portfolios or direct indexing. In AQR's published hypothetical simulations of comparable model strategies, a 200/100 implementation at 4% tracking error reached cumulative net capital losses of 100% of invested capital in under three years, and a 250/150 implementation at 6% tracking error in under two years, compared with a plateau of roughly 30% for direct indexing (Liberman, Krasner, Sosner & Freitas, 2023). Over longer horizons the gap widens: in AQR's 2026 simulations over 21 fifteen-year periods, with zero net-of-cost alpha, mean cumulative net capital losses after fifteen years were about 45% of initial capital for direct indexing, 158% for a 150/50 strategy, 308% for 200/100, and 455% for 250/150; with an information ratio of 1.0 the long-short figures rose to 168%, 421%, and 830%, while the direct indexing figure fell slightly (Liberman, Sosner & Freitas, 2026). These realized losses can be used to offset both short-term and long-term capital gains, thereby lowering overall tax liability.

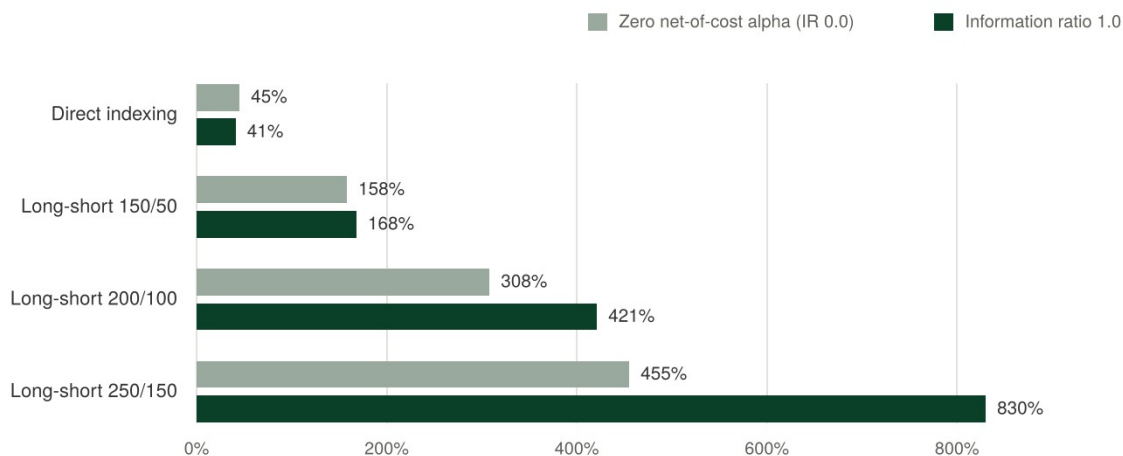
Tax-Aware Rebalancing: AQR employs a tax-aware trading process that prioritizes selling high-basis positions while deferring the realization of taxable gains. This rebalancing process is designed to improve after-tax returns without disrupting investment objectives. AQR's research shows that higher pre-tax alpha enhances these tax benefits: alpha accelerates NAV growth and pushes leverage below target, so the manager adds new long and short positions with

no embedded gains, acting like a recurring capital contribution (Lieberman, Sosner & Freitas, 2026; AQR, 2026a). The same mechanism reduces the cost of eventually unwinding the strategy: in the 2026 simulations, transitioning to a long-only portfolio after ten years cost about 11%, 24%, and 39% of NAV in taxes for the 150/50, 200/100, and 250/150 strategies with zero alpha, and less when alpha was positive (Lieberman, Sosner & Freitas, 2026). Investors should weigh this exit cost, which grows with leverage and holding period, against the benefits of deferral.

FIGURE 5

CUMULATIVE NET CAPITAL LOSSES AFTER 15 YEARS BY STRATEGY AND SKILL LEVEL, FROM AQR'S PUBLISHED HYPOTHETICAL SIMULATIONS

CUMULATIVE NET CAPITAL LOSSES AFTER 15 YEARS, % OF INITIAL CAPITAL



Source: Lieberman, Sosner & Freitas (2026), hypothetical simulations over 21 fifteen-year periods, 1989–2023, Russell 1000 universe, net of transaction and financing costs. Hypothetical results; see Important Disclosures.

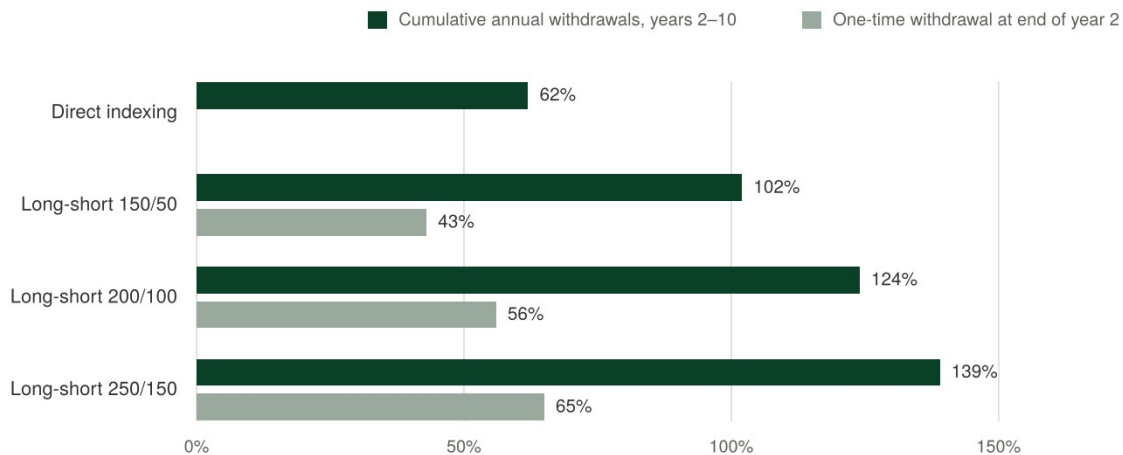
Gain Deferral: The ability to defer the realization of capital gains is a critical advantage of AQR's tax-aware SMA structure. Unlike traditional mutual funds, which frequently distribute taxable gains to investors, Flex provides a high degree of control over taxable events. This allows investors to compound returns on a pre-tax basis, enhancing long-term portfolio growth (Krasner & Sosner, 2024).

Liquidity Without Liquidation: A common concern is that assets in a tax-aware long-short account are “locked up.” AQR's 2026 research shows that substantial capital may be withdrawn while preserving tracking error, leverage, and pre-tax information ratios. In hypothetical simulations over 26 ten-year periods, annual withdrawals sized to avoid net gain realization, beginning in year two, accumulated by year ten to about 102% of initial capital for a 150/50 strategy, 124% for 200/100, and 139% for 250/150, compared with 62% for direct indexing; a one-time withdrawal at the end of year two averaged as much as 43%, 56%, and 65% of initial capital for the three long-short strategies. Fixed annual withdrawals of about 5% of NAV (10% for 250/150) could be sustained without material gain realization, whereas direct indexing had to realize gains even at 5%. Withdrawal capacity increases with tracking error and leverage, an adaptive process manages gain realization better than a fixed schedule, and withdrawing reduces after-tax wealth unless the cash is redeployed at a higher after-tax return (Krasner, Lieberman, Sosner & Brenner, 2026; AQR, 2026d).

FIGURE 6

TAX-EFFICIENT WITHDRAWAL CAPACITY BY STRATEGY, FROM AQR'S PUBLISHED HYPOTHETICAL SIMULATIONS

TAX-EFFICIENT WITHDRAWALS, % OF INITIAL CAPITAL



Source: Krasner, Liberman, Sosner & Brenner (2026), hypothetical simulations over 26 ten-year periods, 1989–2023; withdrawals sized to avoid net gain realization. Hypothetical results; see Important Disclosures.

SECTION 3.3

CAPITAL LOSS TREATMENT AND ORDINARY INCOME

Because Flex accounts are separately managed accounts rather than pooled funds, the losses they generate are capital in character. Understanding how capital losses can be used is therefore central to evaluating the strategy.

Capital Losses and Their Limitations: Under standard tax regulations, capital losses can only offset capital gains dollar-for-dollar, with any excess losses deductible against ordinary income up to \$3,000 per year (\$1,500 for married individuals filing separately). Any remaining losses can be carried forward indefinitely (IRC §§ 1211(b), 1212(b)). While this structure benefits investors with substantial capital gains, it provides limited relief for those seeking to offset high levels of ordinary income.

Loss Character and Trader Status: Flex seeks to generate net capital losses through the turnover of its long and short equity positions. Whether an investor's losses are capital or ordinary, and whether trader status applies, depends on the underlying investments, the nature and level of trading activity, and the applicable tax rules rather than on the account structure alone (Sosner & Steblea-Lora, 2021). Investors seeking ordinary losses should evaluate the Delphi Strategy, discussed in Sections 2 and 4, with their tax advisers.

Capital Losses and a Business Sale: For an investor with a large realized capital gain, such as from a business sale, the \$3,000 limit is rarely binding, because Flex losses offset the gain itself. Losses not used in the year of the sale carry forward indefinitely to offset future capital gains. Capital losses are also excluded from the excess business loss calculation that applies to trader fund losses (Sosner & Steblea-Lora, 2021).

SECTION 3.4

ILLUSTRATION: A BUSINESS SALE AND THE MECHANICS OF NET CAPITAL LOSSES

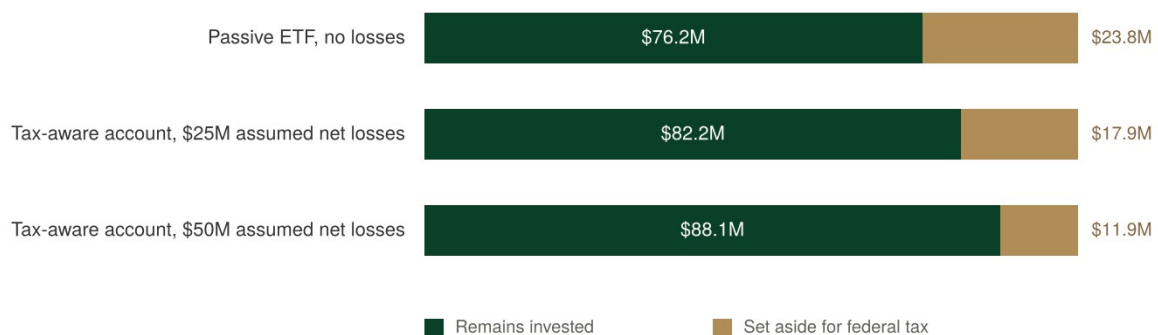
The following illustration shows how net capital losses interact with a large realized gain. It uses assumed loss amounts to demonstrate the tax arithmetic and is not a projection of what any Flex account would realize. Consider an investor who has sold a business for \$100 million with a near-zero cost basis and is deciding between a traditional passive ETF investment and a tax-aware long-short account.

If the investor selects a traditional ETF, the full \$100 million gain is recognized in the year of sale. At the 23.8% top federal rate on long-term gains, about \$24 million is set aside for taxes, and only \$76 million is invested. If the investor instead funds a tax-aware long-short account with the proceeds and the account realizes net capital losses during the year of sale, those losses offset the gain dollar-for-dollar before the \$3,000 limit is reached. For example, if the account realized \$25 million of net capital losses in the first year, the taxable gain would fall to \$75 million and the tax set aside to about \$18 million, allowing roughly \$6 million more to remain invested; if first-year losses were larger, more of the gain would be offset. Net capital losses realized after the sale year may offset later capital gains or be carried forward, subject to applicable rules. AQR's published research indicates that strategies with larger long and short extensions realize net losses more quickly, and that most of the benefit comes from deferring gains rather than from unusual loss realization (Lieberman, Krasner, Sosner & Freitas, 2023; Krasner & Sosner, 2024).

FIGURE 7

BUSINESS SALE ILLUSTRATION: HOW ASSUMED FIRST-YEAR NET CAPITAL LOSSES CHANGE THE TAX SET ASIDE AND THE AMOUNT THAT REMAINS INVESTED

\$100 MILLION OF SALE PROCEEDS, NEAR-ZERO BASIS, FEDERAL TAX AT 23.8%



Source: Illustration of the tax arithmetic using assumed first-year net capital losses on \$100 million of proceeds with near-zero basis; federal tax only, at 23.8%. Not a projection of any strategy's results.

The potential advantages of the tax-aware approach in this situation are:

1. **Tax relief in the year of sale** to the extent net capital losses are realized in that year.
2. **A continuing source of net capital losses** that may offset other gains in later years, subject to the strategy's performance.

3. **More capital remaining invested** because less is set aside for taxes at the outset, which can compound over time.

Investors who later need cash may be able to draw on the account tax-efficiently rather than liquidating it (Krasner, Liberman, Sosner & Brenner, 2026). Investors with concentrated low-basis stock can combine these strategies with variable prepaid forwards or charitable remainder unitrusts to diversify while deferring gains (Liberman & Sosner, 2025; Liberman, Sosner & Maron, 2026). AQR's Nathan Sosner, writing as guest co-editor of a 2026 special issue of *The Journal of Wealth Management* on concentrated wealth, frames the underlying decision as a balance between the volatility drag of a concentrated position and the tax drag of diversifying, argues that technique should follow purpose, and cautions that a “buy, borrow, die” approach to a volatile holding often loses to diversification once the holder's remaining horizon exceeds a few years (Sosner, 2026; AQR, 2026i; AQR, 2026j).

SECTION 3.5

CONCLUSION

AQR's Flex strategies offer a tax-aware investment structure that integrates long-short equity exposure with systematic net capital loss realization. By providing customizable active risk, tax-aware rebalancing, and gain deferral mechanisms, these strategies are designed to improve after-tax outcomes relative to traditional passive investing approaches.

The ability to generate net capital losses makes the Flex framework particularly relevant for investors with significant taxable gains. As the strategies have grown, custodian capacity and financing costs have become practical constraints, discussed in Section 6, and investors should confirm current platform availability and pricing before funding an account. The following section explores trader fund status, which applies to the Delphi Strategy's fund vehicle, and the limitations imposed on loss deductions under current tax law.

Flex accounts realize net capital losses while keeping full equity exposure — the natural complement to a large realized capital gain.

IV TRADER FUND STATUS AND TAX IMPLICATIONS

The classification of an investment fund as a trader fund carries significant tax implications. A trader fund's expenses, including management and performance fees, are deductible as trade or business expenses, and the losses it allocates are business losses that can offset income from other sources, subject to limitations (Sosner & Steblea-Lora, 2021). AQR's tax-aware funds, including the AQR TA Delphi Plus Fund, have taken the position that they are trader funds (Bloomberg News, 2024). The Flex strategies, which are held in investors' own separately managed accounts, do not involve a trader fund; their benefit comes from net capital losses, as discussed in Section 3.

SECTION 4.1

UNDERSTANDING THE TRADER FUND DESIGNATION

Hedge funds are generally either investor funds, which seek to generate portfolio income, or trader funds, which seek to generate trade or business income (Sosner & Steblea-Lora, 2021). Based on case law, a trader must engage in substantial, regular, and continuous trading and intend to profit from short-term price changes rather than from interest, dividends, and long-term appreciation. A fund makes this determination each year, without IRS consent, and states its position on the Schedule K-1 (Sosner & Steblea-Lora, 2021).

Trader fund status should not be confused with a Section 475(f) trader-in-securities election, although a fund must be a trader to make one (Sosner & Steblea-Lora, 2021). The two differ as follows:

1. **Trader fund position** – Does not change the fund's accounting method or the character of its income, gains, and losses: capital gains and losses remain capital, short- or long-term depending on holding period. Its main effects are the deductibility of fund fees and the treatment of the fund's losses as business losses (Sosner & Steblea-Lora, 2021).
2. **Section 475(f) election** – Changes the fund's accounting method so that all gains and losses on covered securities, realized or not, are recognized as ordinary income or loss each year, with an exception for Section 1256 contracts such as regulated futures. The election must be made early in the year and applies to future years (Sosner & Steblea-Lora, 2021).
3. **Wash sales and gain deferral** – Positions subject to a Section 475(f) election are marked to market at year-end, which removes wash sale concerns but also gives up gain deferral. Public reporting describes the TA Delphi Plus Fund as a trader fund whose ordinary losses arise from the instruments it trades, principally swaps, rather than from a mark-to-market election (Bloomberg News, 2024; Celarier, 2026); investors should confirm the fund's elections with AQR and their tax advisers.

For investors, the practical consequence of trader fund status is that a fund's net ordinary losses and deductions may offset ordinary income from other sources, subject to applicable limits, while any capital losses it allocates retain their

capital-loss limitations. However, certain limitations restrict how these losses can be applied, and the character of the losses themselves is now under regulatory review.

FIGURE 8

TRADER FUND POSITION VERSUS A SECTION 475(F) ELECTION

	TRADER FUND POSITION	SECTION 475(F) ELECTION
How it arises	Annual position based on facts and circumstances, under case law	Statutory election made early in the year; applies to future years
Accounting method	Unchanged: gains and losses recognized when realized	Mark-to-market: all covered positions recognized annually, realized or not
Character of gains and losses	Unchanged: capital stays capital, short- or long-term by holding period	Ordinary income or loss on covered securities (Section 1256 contracts excepted)
Main effects	Fund fees deductible; net ordinary losses are business losses subject to Section 461(l); capital losses keep capital-loss limits	Removes wash sale concerns; gives up gain deferral
AQR TA Delphi Plus Fund	Takes the trader fund position	Not reported to use a Section 475(f) election; ordinary losses arise from the instruments traded

Source: Sosner & Steblea-Lora (2021); public reporting (Bloomberg News, 2024; Celarier, 2026). Investors should confirm a fund's elections with the manager and their tax adviser.

SECTION 4.2

HOW AQR STRATEGIES UTILIZE TRADER FUND STATUS

AQR's tax-aware funds, including the AQR TA Delphi Plus Fund, take the position that they are trader funds, so the net ordinary losses they allocate are neither portfolio nor passive losses but active trade or business losses; trader status does not itself change the capital character of any capital losses the fund allocates (Bloomberg News, 2024; Sosner & Steblea-Lora, 2021). The fund's tax-aware process seeks to allocate a more beneficial mix of ordinary and capital items to taxable investors, and in recent years it has allocated substantial net ordinary losses (Bloomberg News, 2024; Bloomberg News, 2026). The Flex accounts are not trader funds.

Because these losses are business losses, they can offset ordinary income from other sources, including wages, without the \$3,000 annual limit that applies to net capital losses (Sosner & Steblea-Lora, 2021). This is particularly beneficial for high-net-worth investors with substantial ordinary taxable income, subject to the limitations described below.

For example, an investor filing jointly with \$2 million in earned income who is allocated \$500,000 of net ordinary losses from the AQR TA Delphi Plus Fund could use those losses to offset ordinary income in 2026, because the loss falls within the \$512,000 excess business loss threshold discussed below (Rev. Proc. 2025-32; Sosner & Steblea-Lora, 2021).

SECTION 4.3

LIMITATIONS ON USING ORDINARY LOSSES

Despite these benefits, trader fund losses are subject to several limitations that affect their deductibility.

Excess Business Loss Limitation (IRC Section 461(l)) – Originally enacted in the Tax Cuts and Jobs Act and modified by the CARES Act, the limitation caps the amount by which a noncorporate taxpayer's aggregate business losses may exceed aggregate business income and gains in a given tax year; wages are not treated as business income for this purpose (Sosner & Steblea-Lora, 2021). The One Big Beautiful Bill Act made the limitation permanent for tax years beginning after December 31, 2025 and reset the inflation base year to 2024, so the threshold fell from \$313,000 (\$626,000 for joint filers) in 2025 to \$256,000 (\$512,000 for joint filers) in 2026 (Rev. Proc. 2025-32; Internal Revenue Service, 2026b). Losses exceeding the threshold are carried forward as net operating losses (NOLs) and applied against taxable income in future years without being retested under Section 461(l).

Net Operating Loss (NOL) Carryforward Rules – Excess ordinary losses that cannot be deducted immediately may be carried forward indefinitely to offset up to 80% of taxable income in future years (IRC § 172). This carryforward provision ensures that losses remain valuable over time but restricts immediate tax relief for high-income investors.

At-Risk and Basis Rules – A partner may not deduct partnership losses in excess of its adjusted tax basis, and the at-risk rules of IRC Section 465 can suspend losses once cumulative net losses exceed the investor's amount at risk, which approximates contributed capital adjusted for prior gains, losses, and redemptions. Suspended losses are freed when additional capital is contributed or when gains are recognized, including on a full redemption.

Trader vs. Investor Classification Risks – The trader position rests on facts and circumstances, and the IRS has challenged trader status on numerous occasions. If a fund were treated as an investor rather than a trader, its management and performance fees would generally not be deductible, and past deductions could be disallowed, with back taxes, interest, and penalties (Sosner & Steblea-Lora, 2021). The permanent disallowance of miscellaneous itemized deductions under the One Big Beautiful Bill Act makes this distinction more consequential, because investor-fund fees can no longer be deducted even in part.

Character Risk Under Notice 2026-62 – In September 2026, Treasury and the IRS identified multi-position strategies in tax-aware partnerships and SMAs that generate capital gains alongside ordinary losses, including mixed-character identified straddles, hindsight Section 988 elections on same-day currency forwards, and selective terminations of notional principal contracts, as strategies that may be designated as transactions of interest or listed transactions, potentially with retroactive effect (Internal Revenue Service, 2026a). Section 6.2 discusses this guidance.

Given these constraints, investors considering trader fund strategies should review the fund's trader position, the sources of its ordinary losses, and their own ability to use the allocated losses with their tax advisers.

SECTION 4.4

ILLUSTRATION: HIGH-INCOME INVESTOR UTILIZING TRADER FUND LOSSES

To illustrate the impact of trader fund classification on an investor's tax burden, consider a high-net-worth individual earning \$2.5 million annually in salary, filing jointly, with no other business income or losses. Assume, for purposes of illustrating the tax rules only, that this investor allocates \$10 million to a trader fund that allocates \$3 million in net ordinary losses for the 2026 tax year. This is an assumption for arithmetic, not a projection for any fund.

If the fund's trader position is respected:

- The \$3 million loss is treated as a trade or business loss, allowing the investor to deduct up to \$512,000 (married filing jointly) against nonbusiness income, such as salary, in 2026.
- The remaining \$2.488 million loss is carried forward as an NOL, reducing taxable income in subsequent years, subject to the 80% limitation.

If the fund were instead treated as an investor fund:

- The fund's management and performance fees would be nondeductible investment expenses, and any net capital losses would remain subject to the \$3,000 annual limit against ordinary income, significantly reducing the tax benefit (Sosner & Steblea-Lora, 2021).

Had the 2025 threshold of \$626,000 still applied, the same investor could have deducted \$114,000 more in the current year; the 2026 reset pushes more of the benefit into future years, which lowers its present value. This illustration highlights how trader fund classification can significantly enhance the tax benefits of loss-generating investment strategies, particularly for high-income individuals seeking immediate tax relief, while also showing how sensitive that benefit is to the statutory threshold (Sosner & Steblea-Lora, 2021).

SECTION 4.5

CONCLUSION

Trader fund status offers substantial tax advantages by making a fund's expenses deductible and its net ordinary losses available to offset ordinary income from other sources. The AQR TA Delphi Plus Fund takes this position, which is the main source of the Delphi Strategy's tax benefit; the Flex strategies rely instead on net capital losses.

However, these benefits are subject to the now-permanent excess business loss limitation, NOL carryforward rules, at-risk rules, and classification risks, and the specific techniques that produce ordinary losses are the subject of pending IRS guidance. Investors should confirm with their tax advisers how much of the allocated losses they can use each year and should ask AQR how the fund's ordinary losses arise and how AQR has assessed Notice 2026-62.

As tax regulations continue to evolve, trader fund strategies can be a valuable tool for investors aiming to reduce taxable income, defer gains, and enhance after-tax returns. The next section compares the tax implications of AQR's Tax-Aware Delphi Plus Strategy and Flex strategies, providing a detailed analysis of their relative advantages and applications in different investor scenarios.

Trader fund status does not itself convert capital losses into ordinary losses.

V COMPARING TAX IMPLICATIONS OF DELPHI PLUS VS. FLEX

AQR’s Tax-Aware Delphi Plus Strategy and Flex strategies share a common objective: optimizing after-tax returns through tax-aware investing. However, while both leverage long-short equity structures and systematic tax-aware trading, they differ in their vehicle, market exposure, the character of the losses they produce, and the regulatory risks they carry. These distinctions have significant implications for investors seeking to manage tax liabilities, particularly those facing substantial capital gains or ordinary income exposure. This section explores the differences between these strategies and evaluates their suitability for various investment scenarios.

SECTION 5.1 SIDE-BY-SIDE TAX ANALYSIS

The key distinction between AQR’s Delphi Plus and Flex strategies lies in their respective portfolio structures and tax mechanisms. While both incorporate long-short positions, the Delphi Strategy is a commingled trader fund that integrates a trend-following component and targets meaningfully lower market beta, whereas the Flex strategies are typically beta-one separately managed accounts that emphasize pre-tax alpha generation alongside net capital loss realization (Bloomberg News, 2024; AQR, 2026h).

One of the most significant tax advantages of these strategies is their ability to generate losses that offset other taxable income. The Flex strategies generate net capital losses that offset capital gains, while the Delphi Strategy, as a trader fund, allocates ordinary and short-term capital losses; its net ordinary losses may also offset wages and other ordinary income, subject to the excess business loss limitation, while its short-term capital losses retain capital-loss treatment (Sosner & Steblea-Lora, 2021).

A comparative analysis of the tax implications of these strategies is outlined below:

TABLE 1
SIDE-BY-SIDE TAX ANALYSIS OF DELPHI PLUS AND FLEX

FEATURE	AQR TA DELPHI PLUS	AQR FLEX (E.G., 200/100)	AQR FLEX (HIGHER-LEVERAGE TIERS)
Vehicle	Commingled fund (LLC); Schedule K-1; \$5M minimum	Separately managed account	Series LLC vehicle (AQR Flex 1 Series LLC); Schedule K-1; \$5M–\$15M minimum per series
Primary Focus	Long-short equity + trend following; lower market beta	Long-short tax-aware equity; beta 1	Long-short tax-aware equity; beta 1

FEATURE	AQR TA DELPHI PLUS	AQR FLEX (E.G., 200/100)	AQR FLEX (HIGHER-LEVERAGE TIERS)
Capital Loss Realization	Moderate (mainly short-term)	High	Very High
Tax Deferral	Strong	Strong	Strong
Trader Fund?	Yes (fund takes trader position)	No	No
Ordinary Loss Generation	Yes (trader fund; see Section 2.2)	No (capital losses only)	No (capital losses only)
Best for Offsetting Capital Gains?	Mainly short-term gains	Yes	Yes
Best for Offsetting Ordinary Income?	Yes, subject to § 461(l) (\$512,000 joint in 2026)	Limited (\$3,000/yr)	Limited (\$3,000/yr)
Exposure to Notice 2026-62	Potentially elevated: ordinary-loss techniques are the subject of the Notice	Low: conventional loss realization; not named in the Notice	Low: conventional loss realization; not named in the Notice
Active Risk	Multi-strategy; not benchmark-relative	~4% tracking error for 200/100 (AQR research)	Higher; ~6% for 250/150 in AQR research
Custodian / Platform Constraints	Fund subscription; not custodian-dependent	Subject to custodian margin, financing and onboarding policies	Generally available through series LLC vehicles rather than SMAs under 2026 custodian constraints
Ideal Use Case	High ordinary income and short-term gains; diversifying exposure	Taxable investors seeking core equity with tax efficiency	Business sale proceeds and investors seeking aggressive capital loss realization

This table illustrates that the Delphi Strategy is best suited to offsetting ordinary income and short-term gains, while the Flex strategies are designed to provide higher levels of net capital loss realization for investors with large capital gains (Lieberman, Krasner, Sosner & Freitas, 2023; Bloomberg News, 2024). It also shows that the two strategies carry different implementation risks: regulatory character risk for Delphi Plus, and platform and financing risk for Flex accounts.

SECTION 5.2

CONSIDERATIONS FOR INVESTORS

The choice between AQR's Delphi Plus and Flex strategies depends on an investor's specific tax situation, risk tolerance, and investment objectives. Each strategy offers unique advantages that cater to different tax scenarios:

For High-Income Investors Seeking Ordinary Loss Offsets: Investors with substantial earned income may benefit from the Delphi Strategy, whose fund takes the position that it is a trader fund, so that its net ordinary losses can offset wages, business income, and other non-investment income (Sosner & Steblea-Lora, 2021). However, due to the excess business loss limitation, investors should assess whether they can utilize the full amount of allocated losses in

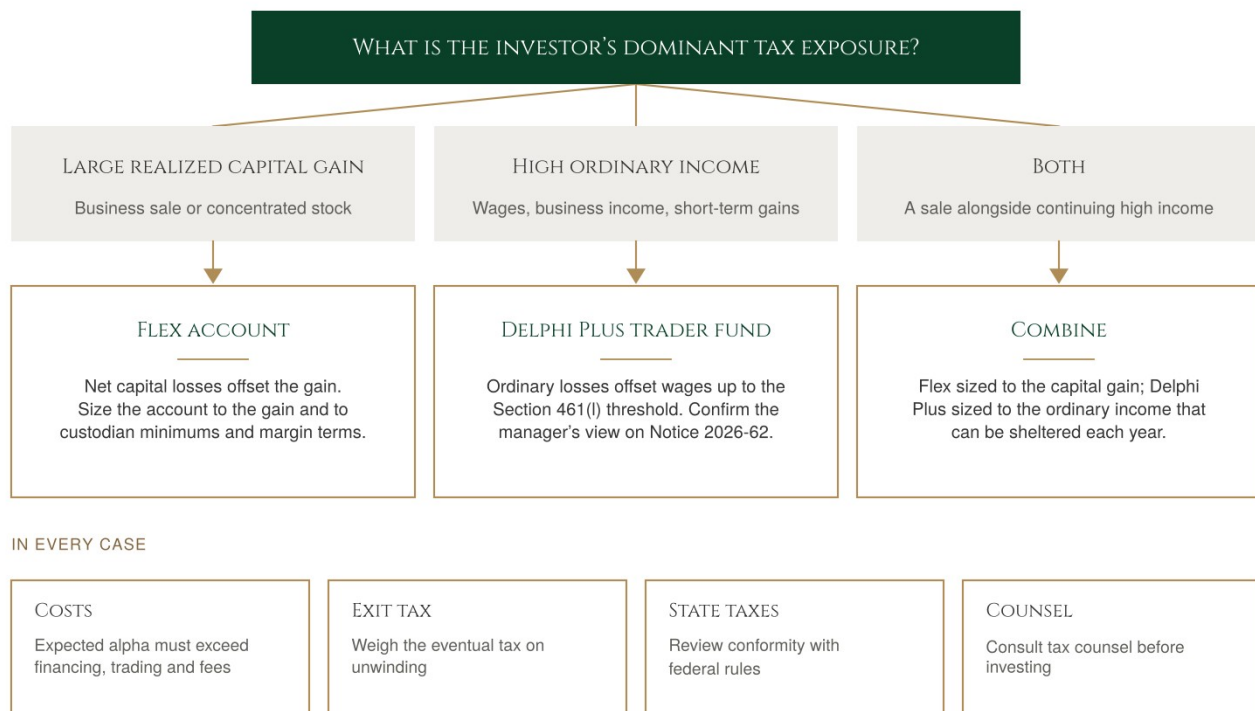
the current tax year or whether they will need to carry forward portions of these losses under NOL rules (Sosner & Steblea-Lora, 2021). These investors should also weigh the regulatory uncertainty created by Notice 2026-62 and consider sizing the allocation accordingly.

For Investors Managing Large Capital Gains Events: Investors who have realized substantial capital gains—such as from the sale of a business, real estate, or equity holdings—may be better served by the Flex strategies, whose net capital losses can offset long-term gains directly, beginning in the year of the sale (Lieberman, Krasner, Sosner & Freitas, 2023). The Delphi Strategy’s losses are mainly ordinary and short-term, so it is a better complement for investors who also have high ordinary income or short-term gains (Bloomberg News, 2024).

For Long-Term Tax-Efficient Portfolio Management: Investors looking for a diversifying, lower-beta allocation may prefer the Delphi Strategy, which combines defensive long-short equity with trend following at lower market beta while deferring gains (Sosner, Pyne, Lieberman & Liu, 2020). Investors seeking a tax-aware core equity allocation with full market exposure may prefer a beta-one Flex account, which AQR’s published research suggests outperformed both direct indexing and a passive index fund on an after-tax basis over long horizons in hypothetical historical simulations, provided the strategy delivers alpha at least sufficient to cover its costs (Lieberman, Krasner, Sosner & Freitas, 2023). The same research shows the other side: with a net-of-cost information ratio of -0.5 , the long-short strategies’ fifteen-year after-tax value per \$100 fell to between \$323 and \$386, below the \$400 of direct indexing, even though their tax benefits were larger (Lieberman, Sosner & Freitas, 2026). Manager selection and cost control therefore matter as much as structure.

FIGURE 9

MATCHING THE STRATEGY TO THE INVESTOR’S DOMINANT TAX EXPOSURE



Source: Author's synthesis of the analysis in Chapters II through V.

For Investors Who May Need Liquidity: Both strategies can accommodate withdrawals, but AQR's research on tax-efficient withdrawals applies most directly to Flex accounts, where partial withdrawals can be sized to the account's capacity to offset withdrawal-related gains with realized losses. In AQR's illustration, a hypothetical \$10 million investment supported cumulative tax-efficient withdrawals of roughly \$10.2 million (150/50), \$12.4 million (200/100), or \$13.9 million (250/150) by year ten while remaining invested, although after-tax wealth was modestly lower than if no withdrawals had been made (Krasner, Liberman, Sosner & Brenner, 2026; AQR, 2026d). Redemptions from the Delphi Plus fund are governed by the fund's governing documents and may trigger gain recognition or free suspended losses; investors should review the fund's offering materials with their tax advisers.

SECTION 5.3

ILLUSTRATION: MATCHING THE STRATEGY TO THE TYPE OF INCOME

To illustrate the application of these strategies, consider an investor who has sold a business for \$50 million with a low cost basis, resulting in a capital gains tax liability of roughly \$12 million at the 23.8% federal rate. The investor is deciding between:

1. Allocating \$10 million into the Delphi Strategy to generate ordinary and short-term capital losses and defer future taxable gains.
2. Allocating \$10 million into a higher-leverage Flex account to realize net capital losses while maintaining equity exposure.

If the investor selects the Delphi Strategy, they will receive mainly ordinary and short-term losses, which are most valuable against ordinary income and short-term gains rather than the long-term gain from the sale. If they choose the Flex account, the investor would realize capital losses, which offset the long-term gain from the sale directly; AQR's published research indicates that larger long and short extensions realize net losses more quickly, although actual results depend on markets and the strategy's performance (Liberman, Krasner, Sosner & Freitas, 2023).

Additionally, because the Delphi Strategy's ordinary losses can offset wages and other ordinary income, an investor filing jointly could deduct up to \$512,000 of net business losses against nonbusiness income in 2026, with any excess carried forward as an NOL (Rev. Proc. 2025-32; Sosner & Steblea-Lora, 2021). An investor with both a large capital gain and high ordinary income may therefore benefit from combining the two strategies, with the Flex sized to the capital gain and the Delphi allocation sized to the ordinary income the investor expects to shelter within the excess business loss threshold over several years.

SECTION 5.4

CONCLUSION

AQR's Delphi Plus and Flex strategies each offer unique advantages for tax-conscious investors. The Delphi Strategy, as a trader fund, allocates ordinary and short-term capital losses while deferring gains, making it well suited for investors with high ordinary income or short-term gains. Conversely, the Flex strategies focus on net capital loss realization, making them better suited for investors facing large capital gains (AQR, 2026h).

Selecting the most appropriate strategy depends on an investor's individual tax profile, income structure, and long-term financial goals. While Delphi Plus provides ordinary loss benefits within a diversifying multi-strategy framework, Flex strategies offer greater capital loss realization through higher tracking error allowances. As tax regulations evolve,

these strategies can be useful tools for investors looking to minimize their tax liabilities and enhance after-tax portfolio growth (Lieberman & Sosner, 2025).

The next section examines the regulatory considerations, tax law changes, and recent market developments that affect the effectiveness of these tax-aware investment strategies.

Match the strategy to the dominant tax exposure: ordinary income points to Delphi Plus, capital gains to Flex, and many investors to both.

PART THREE

REGULATION AND PRACTICE

The One Big Beautiful Bill Act, IRS Notice 2026-62, the anti-abuse doctrines, custodian constraints, and what they mean for investors and advisers.

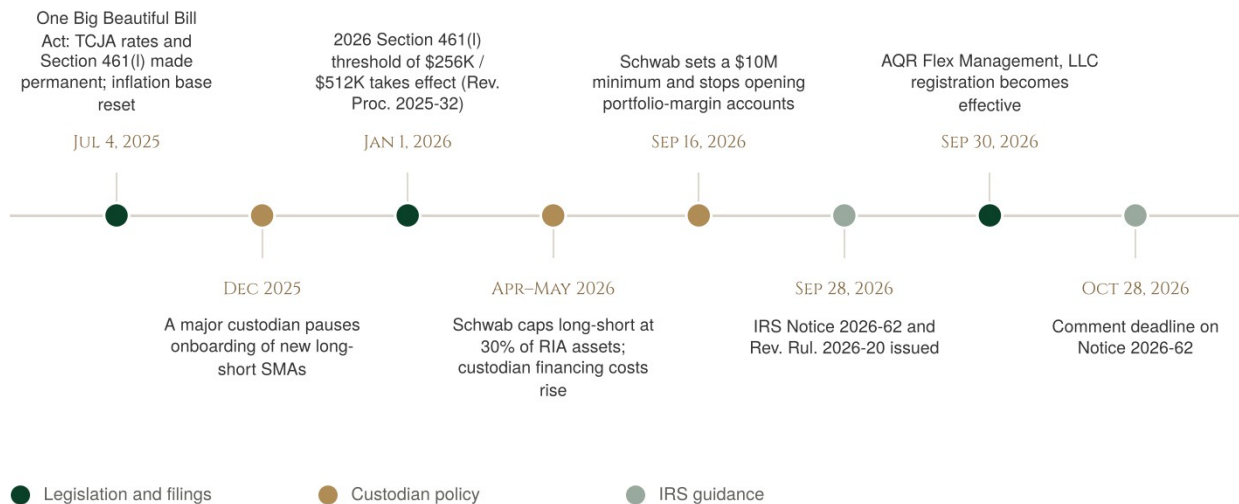
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VI REGULATORY CONSIDERATIONS AND FUTURE OUTLOOK

Tax-aware investment strategies, including AQR's Tax-Aware Delphi Plus Strategy and Flex strategies, operate within a complex and evolving regulatory environment. Federal tax policy, IRS guidance, and custodian policy all affect the effectiveness of tax optimization techniques such as net capital loss realization, trader fund status, and gain deferral. Over the past eighteen months, Congress has enacted major tax legislation, Treasury and the IRS have issued targeted guidance on tax-aware fund strategies, and the largest RIA custodians have restricted access to long-short SMAs (InvestmentNews, 2026). This section reviews each development and its implications for AQR's strategies.

FIGURE 10

THE 2025–2026 LEGISLATIVE, REGULATORY, AND CUSTODIAN TIMELINE FOR TAX-AWARE LONG-SHORT STRATEGIES



Source: Pub. L. No. 119-21 (2025); Rev. Proc. 2025-32; InvestmentNews (2026); Bloomberg News (2026); Internal Revenue Service (2026a); AQR Flex Management (2026).

SECTION 6.1

TAX LAW CHANGES: THE ONE BIG BEAUTIFUL BILL ACT OF 2025

On July 4, 2025, the One Big Beautiful Bill Act (Public Law 119-21) was signed into law. Several of its provisions bear directly on the strategies discussed in this paper (Internal Revenue Service, 2026b; Willkie Farr & Gallagher, 2025):

- Individual tax rates. The Tax Cuts and Jobs Act's reduced brackets, with a top rate of 37%, were made permanent. The 3.8% net investment income tax and the 20% top long-term capital gains rate are unchanged,

so the spread between ordinary and long-term rates that drives the value of character and deferral benefits remains in place.

- Excess business loss limitation. IRC Section 461(l) was made permanent for tax years beginning after December 31, 2025, and its inflation indexing base was reset to 2024. The threshold therefore fell from \$313,000 (\$626,000 for joint filers) in 2025 to \$256,000 (\$512,000 for joint filers) in 2026, and will be indexed from the lower base in future years (Rev. Proc. 2025-32). Disallowed losses continue to carry forward as NOLs and are not retested under Section 461(l) in later years.
- Miscellaneous itemized deductions. The suspension of miscellaneous itemized deductions, including investment expenses, under IRC Section 67(g) was made permanent. Fees of an investor fund are therefore permanently nondeductible, which increases the value of trader fund status for fee deductibility.
- Limitation on itemized deductions. Beginning in 2026, taxpayers in the 37% bracket lose 2/37 (about 5.4%) of the value of their itemized deductions, including investment interest expense, which modestly reduces the after-tax value of interest deductions allocated by leveraged funds.
- Estate and gift tax. The basic exclusion amount rose to \$15 million per individual (\$30 million per married couple) for 2026, indexed thereafter, which increases the importance of lifetime gain deferral and basis step-up planning for the families most likely to use these strategies.

Capital loss rules were not changed: realized capital losses still offset capital gains dollar-for-dollar, with up to \$3,000 per year deductible against ordinary income and unlimited carryforward (IRC §§ 1211(b), 1212(b)). The wash sale rule of IRC Section 1091, the straddle rules of Section 1092, and the Section 475(f) election were also unchanged.

SECTION 6.2

IRS NOTICE 2026-62 AND REVENUE RULING 2026-20

On September 28, 2026, Treasury and the IRS released Revenue Ruling 2026-20 and Notice 2026-62 (Internal Revenue Service, 2026a). The revenue ruling addresses ETF “seeding” transactions in which appreciated securities are contributed to a new ETF under Section 351 and then redeemed in kind, treating the contribution as a taxable exchange; it does not concern the AQR strategies discussed here. The Notice is broader. It describes a series of “novel investment fund strategies” that Treasury and the IRS believe produce tax results inconsistent with the purpose and proper application of the Code, requests public comments by October 28, 2026, and states that future guidance could designate these strategies as transactions of interest or listed transactions, potentially with retroactive effect (Ropes & Gray, 2026; Withum, 2026).

The portion of the Notice relevant to this paper concerns multi-position “tax-aware” strategies in partnerships and separately managed accounts that produce a pattern of capital gains paired with ordinary losses. Three techniques are identified: mixed-character identified straddles under Section 1092(a)(2), in which a Section 988 currency forward or an equity index swap is paired with an offsetting Section 1256 futures contract and the futures leg is closed first so that gains are capital and losses ordinary; hindsight elections under Section 988(a)(1)(B) made after same-day currency forwards are closed, so that capital treatment is elected only for gains; and selective terminations of notional principal contracts, in which appreciated short-term swaps are terminated before a scheduled payment to obtain capital treatment while losing swaps are held to maturity to claim ordinary deductions (Ropes & Gray, 2026; Withum, 2026). The Notice states that it does not suggest every tax-managed strategy is problematic and expressly recognizes

that conventional tax-loss harvesting may reduce federal income tax in a manner consistent with congressional intent (Withum, 2026).

FIGURE 11

IRS NOTICE 2026-62: IDENTIFIED AREAS OF CONCERN AND WHAT THE NOTICE LEAVES ALONE

IDENTIFIED AS AREAS OF CONCERN	NOT TREATED AS A CONCERN
■ Multi-position “tax-aware” strategies in partnerships and SMAs that pair capital gains with ordinary losses Mixed-character identified straddles under Section 1092(a)(2): a currency forward or index swap paired with Section 1256 futures Hindsight Section 988(a)(1)(B) elections on same-day currency forwards, claiming capital treatment for gains only Selective termination of notional principal contracts: capital gain on winners, ordinary loss on losers Possible designation as listed transactions or transactions of interest, potentially retroactive	■ Conventional tax-loss harvesting, which the Notice says may reduce tax consistent with congressional intent The “tax-aware” label by itself Ordinary ETF creations and redemptions, and bona fide ETF seeding

IMPLICATION FOR THE TWO AQR STRATEGIES

FLEX ACCOUNTS Capital losses from equity turnover; not named in the Notice, so exposure appears low	DELPHI PLUS Ordinary losses from swaps are the kind of technique the Notice describes; obtain AQR’s written assessment
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Source: Summarized from Notice 2026-62 and Rev. Rul. 2026-20 (September 28, 2026) as described by Ropes & Gray (2026) and Withum (2026). Comments were due October 28, 2026.

The implications for the two AQR strategies differ. The Flex strategies realize net capital losses on equity positions through ordinary active turnover; they are not named in the Notice, and AQR’s own research shows that their benefit arises mainly from deferring gains rather than from unusual loss realization (Krasner & Sosner, 2024). Their exposure appears low, although commentators have noted that the IRS could extend similar arguments to long-short strategies in the future (Baker Tilly, 2026). The Delphi Plus Strategy, by contrast, derives its principal tax benefit from allocating ordinary losses alongside long-term gains, and press reports have described the fund as using swap agreements to generate those ordinary losses and have linked the Notice directly to the strategy (Celarier, 2026; Hedgeweek, 2026). AQR has stated that it modifies its strategies to comply with applicable regulations and guidance but, to Robertson’s knowledge as of October 21, 2026, had not published a response to the Notice (Hedgeweek, 2026). Whether the fund’s techniques fall within the specific patterns the Notice describes cannot be determined from publicly available materials. Investors and their advisors should obtain AQR’s written assessment of the Notice, including any changes to the fund’s trading or elections, before making new or additional allocations to the fund.

SECTION 6.3

ANTI-ABUSE RULES AND ECONOMIC SUBSTANCE

AQR's own commentary anticipates the direction of the Notice. In June 2026, AQR explained that U.S. tax law looks through legal wrappers to economic substance: the wash sale rules of Section 1091, the straddle rules of Section 1092, and the constructive sale rules of Section 1259 apply to SMAs as if the investor traded directly, look through funds-of-one and related persons, and in the case of straddles reach positions held through flow-through entities. AQR advised that entity structures should be evaluated for administrative and liability benefits rather than as a way to avoid anti-abuse rules, and that structures whose main appeal is a tax result unsupported by their economics should be avoided (AQR, 2026b). In August 2026, AQR welcomed growing scrutiny of the industry and stated that credible strategies should be grounded in time-tested investment models, prioritize expected pre-tax profits, reflect economic substance, and operate in line with relevant guidance and regulations (AQR, 2026c).

For investors, the practical test is whether a strategy has a pre-tax investment rationale that would justify holding it even without tax benefits. AQR has stated that it offers the same strategies to tax-exempt institutions and to taxable clients (AQR, 2026c). The economic substance doctrine, codified in IRC Section 7701(o), nonetheless remains the IRS's most flexible tool, and the 2026 Notice signals a willingness to use it against specific techniques within otherwise legitimate strategies.

SECTION 6.4

CUSTODIAN AND PLATFORM DEVELOPMENTS

Rapid growth has strained the custodians that provide margin and securities lending for long-short SMAs. During 2026, major RIA custodians paused new onboarding into long-short SMAs, raised financing costs, or restricted the share of advisor assets that may be placed in these accounts (InvestmentNews, 2026). Charles Schwab capped the share of an RIA's custodied assets that may be placed in long-short accounts at 30%, and effective September 16, 2026 raised the minimum for tax-aware long-short SMAs to \$10 million and stopped accepting new clients or capital into portfolio margin accounts, citing the pace of growth and balance-sheet considerations (InvestmentNews, 2026). AQR's series LLC vehicles offer a route to higher-leverage implementations outside the SMA margin framework (AQR Flex 1 Series LLC, 2026).

These developments matter because Flex accounts depend on a custodian's willingness to provide margin, securities lending, and competitive financing. Financing cost is the largest implementation expense of a long-short SMA; AQR estimates all-in financing of about 80 basis points annualized for a 200/100 portfolio at competitive spreads, and notes that Regulation T margin would cap leverage at two times, so institutional portfolio margin, with requirements as low as 15%, is needed for higher tracking-error implementations (AQR, 2025). AQR's 2026 research illustrates how quickly costs accumulate: under illustrative assumptions of 80 basis points of financing per dollar of one-sided extension, 10 basis points per dollar traded, and a 1% fee per dollar of extension, total annual costs were about 1.26%, 2.34%, and 3.42% of NAV for 150/50, 200/100, and 250/150 strategies, equivalent to roughly 0.6 of information ratio at each leverage level, which the strategy's gross alpha must exceed (Lieberman, Sosner & Freitas, 2026). A doubling of financing spreads or a loss of portfolio margin access would materially reduce a strategy's expected net excess return. Accordingly, advisors, including Robertson, size new Flex accounts to current custodian minimums and margin constraints, such as Schwab's \$10 million minimum and Regulation T limits, which favor the lower tracking-error implementations, or develop alternative custodian relationships to provide client access to higher-leverage implementations where appropriate. Before funding any new Flex account, advisors should confirm current

onboarding status, financing spreads, and margin terms with the custodian and AQR. The Delphi Plus fund, as a commingled vehicle that arranges its own financing, is not affected by RIA custodian policy.

SECTION 6.5

EXPECTED FUTURE DEVELOPMENTS IN TAX-AWARE INVESTING

The regulatory landscape governing tax-aware investing is subject to continuous change. The most immediate uncertainty is the guidance that will follow Notice 2026-62. If Treasury designates the identified techniques as listed transactions or transactions of interest, participants and material advisors would face disclosure obligations on Forms 8886 and 8918 and significant penalties for noncompliance, and the designation could reach transactions already completed (Withum, 2026). Funds that use the identified techniques would be expected to restructure, which could reduce the ordinary-loss component of their tax benefit. Investors in such funds should expect correspondence from the manager and should plan for the possibility that future allocations contain fewer ordinary losses.

A second area of focus is the IRS's scrutiny of trader status itself. The trader position rests on case law rather than statute, and the permanent disallowance of investor-fund expenses increases both the incentive for managers to take the position and the incentive for the IRS to challenge it (Sosner & Steblea-Lora, 2021). Future rulings could impose stricter criteria for trader qualification.

A third area is the broader policy debate. With the TCJA rates now permanent, near-term changes to capital gains rates appear less likely than they did in 2025, which reduces one source of uncertainty for gain deferral strategies. At the same time, the strategies' growth, with AQR alone reporting about \$58 billion in the strategies as of June 30, 2026 and industry inflows estimated at more than \$150 billion over three years, has attracted critics who argue that leveraged loss realization combined with basis step-up at death allows gains to escape taxation entirely (Celarier, 2026). Proposals to limit step-up, to tax unrealized gains of the wealthiest households, or to restrict loss realization strategies could resurface in future legislation.

A final consideration is the potential impact of state-level tax policies. While federal regulations govern capital gains and loss deductions, some states impose additional taxes on capital gains, do not conform to federal NOL or excess business loss rules, or disallow certain loss carryforward provisions. Texas imposes no individual income tax, so for Texas residents the federal analysis is generally sufficient, but clients resident in other states should assess their state-specific tax implications.

SECTION 6.6

CONCLUSION

The regulatory environment for tax-aware investment strategies has become more defined and, in one respect, more demanding. The One Big Beautiful Bill Act removed the uncertainty of the TCJA sunset and made the excess business loss limitation permanent, while lowering its threshold. IRS Notice 2026-62 drew a line between conventional loss realization, which the IRS continues to accept, and multi-position techniques that manufacture ordinary losses, which it intends to restrict. Custodian policy has added a practical constraint on the implementation of long-short SMAs.

Looking ahead, the Flex strategies appear well positioned under the current guidance, subject to platform access and financing costs. The Delphi Plus Strategy continues to offer a distinctive benefit for investors with high ordinary income, but the durability of that benefit now depends on how AQR responds to the Notice and on the guidance that

follows. The possibility of increased IRS scrutiny underscores the importance of proactive tax planning, careful sizing, and ongoing communication with the manager when implementing tax-aware investment strategies.

In the following section, the paper summarizes key takeaways and provides final considerations for investors seeking to optimize their after-tax wealth through AQR's tax-aware investment strategies.

The rules are moving — the 2025 Act, Notice 2026-62, and custodian policy each change the calculus and each deserves a place in the planning conversation.

VII CONCLUSION & FINAL CONSIDERATIONS

The evolving landscape of tax-aware investment strategies underscores the critical role of tax optimization in portfolio management, particularly for high-net-worth and institutional investors. AQR's Tax-Aware Delphi Plus Strategy and Flex strategies offer distinct yet complementary approaches to minimizing tax liabilities, deferring gains, and realizing losses. By integrating long-short equity structures, systematic trading, and tax-aware rebalancing, these strategies are designed to provide advantages over traditional long-only portfolios and passive indexing approaches (Liberman, Krasner, Sosner & Freitas, 2023). This section summarizes the key findings from the analysis and offers final considerations for investors seeking to enhance their after-tax returns through tax-aware investing.

SECTION 7.1

SUMMARY OF TAX IMPLICATIONS AND BENEFITS

The AQR Tax-Aware Delphi Plus Strategy and Flex strategies share a common objective of optimizing after-tax wealth, but they differ in their structural design and application. The Delphi Strategy integrates long-short equity with trend-following exposure in a commingled trader fund, offering ordinary and short-term loss allocation and gain deferral, making it a strategy for investors looking to diversify equity exposure while sheltering high-rate income (Bloomberg News, 2024).

Conversely, the Flex strategies provide a more aggressive approach to net capital loss realization, incorporating higher tracking error allowances and a customizable long-short framework. These strategies are particularly relevant for investors seeking to offset capital gains from liquidity events, such as business sales or large equity dispositions (AQR, 2026h). The Delphi Strategy, by contrast, is the vehicle for investors seeking losses that can offset wages, business income, and other ordinary income, because its fund takes the position that it is a trader fund (Bloomberg News, 2024).

Regulatory considerations play a crucial role in shaping the applicability and effectiveness of these tax-aware strategies. The now-permanent excess business loss limitation under IRC Section 461(l), with its lower 2026 threshold, and the NOL carryforward rules restrict the immediate usability of large ordinary losses, and Notice 2026-62 places the techniques that generate those losses under review. These constraints emphasize the importance of strategic tax planning to ensure compliance while maximizing allowable deductions.

SECTION 7.2

FINAL THOUGHTS ON INVESTOR SUITABILITY FOR DELPHI PLUS VS. FLEX

Selecting the most appropriate tax-aware strategy depends on an investor's specific financial profile, income structure, and long-term objectives. Investors with high ordinary income or short-term gains, who also value reduced

market exposure and trend-following diversification, may find the Delphi Strategy to be the better fit, provided they are comfortable with the regulatory uncertainty surrounding its ordinary-loss techniques. On the other hand, business owners and investors facing substantial capital gains may benefit more from Flex, provided custodian access and financing terms remain attractive.

Additionally, investors must consider state-specific tax laws, as certain states impose additional restrictions on capital loss utilization and loss carryforward provisions. A tailored tax strategy that integrates Delphi Plus and Flex strategies can provide a well-balanced tax-efficient investment solution, helping to improve outcomes under current and evolving tax laws.

SECTION 7.3

ACTIONABLE INITIATIVES FOR INVESTORS AND ADVISORS

Given the complexities of tax-aware investing, investors and their advisors should take the following steps to maximize tax efficiency while maintaining compliance with IRS regulations:

1. **Assess Current Tax Exposure and Investment Goals** – Investors should evaluate their capital gains exposure, ordinary income tax burden, expected use of losses within the 2026 excess business loss threshold, and long-term financial objectives before selecting a tax-aware investment strategy.
2. **Obtain the Manager's Assessment of Notice 2026-62** – Before new or additional allocations to any trader fund that allocates ordinary losses, including the TA Delphi Plus Fund, advisors should ask the manager in writing how the fund's ordinary losses arise, whether any of the techniques identified in the Notice are used, and what changes have been made or are planned (Internal Revenue Service, 2026a).
3. **Confirm Custodian Access and Financing Terms** – Advisors should size new Flex accounts to current custodian minimums and margin constraints, or develop alternative custodian relationships to provide client access to higher-leverage implementations, and should confirm onboarding status, financing spreads, and portfolio margin availability with the custodian and AQR before funding (InvestmentNews, 2026).
4. **Leverage Gain Deferral and Loss Realization** – Whether using Delphi Plus or Flex strategies, investors should take advantage of structured gain deferral and loss realization to minimize taxable gains while maintaining market exposure, and should evaluate the full lifecycle of the investment, including liquidation or withdrawal taxes (Krasner & Sosner, 2024; AQR, 2026c).
5. **Monitor Regulatory Changes and IRS Guidance** – Tax laws are continuously evolving, particularly regarding the guidance that will follow Notice 2026-62, trader fund classification, and state conformity. Investors should work closely with tax professionals to stay informed and adjust strategies as needed.
6. **Implement a Multi-Strategy Approach** – A combination of Delphi Plus and Flex strategies may offer the most comprehensive tax efficiency, with the Flex sized to realized capital gains and the Delphi allocation sized to the ordinary income the investor can shelter each year, creating a sustainable after-tax wealth strategy.

SECTION 7.4

CONCLUSION

As tax regulations continue to evolve, AQR's tax-aware investment strategies remain a relevant tool for high-net-worth and institutional investors. The Tax-Aware Delphi Plus Strategy provides a systematic, tax-efficient investment framework with trader fund benefits, while the Flex strategies offer higher tracking error flexibility and more aggressive net capital loss realization. Recent research has strengthened the case for tax-aware long-short investing, showing that its benefits come primarily from gain deferral, that pre-tax alpha enhances rather than erodes those benefits, and that investors may be able to access liquidity without liquidation. The same research is clear that the case rests on alpha: without expected returns sufficient to cover financing, trading, and fees, the tax benefits do not justify the leverage, and the eventual exit tax grows with leverage and holding period.

By integrating advanced tax-aware investment principles, regulatory compliance, and strategic planning, investors may be able to enhance their after-tax portfolio performance. Whether seeking long-term tax deferral, capital loss offsets, or ordinary loss benefits, AQR's Delphi Plus and Flex strategies offer a scalable and customizable approach to tax-efficient investing. As tax laws shift and regulatory scrutiny increases, proactive tax planning, careful due diligence, and strategic investment selection will remain key to optimizing long-term wealth accumulation while minimizing tax liabilities (Krasner & Sosner, 2024).

After-tax wealth is the outcome that matters; the strategies are tools whose value depends on the investor's income, gains, horizon, and tolerance for regulatory change.



SUPPORTING MATERIAL

APPENDICES

A glossary of tax terms, the Internal Revenue Code provisions behind the analysis, illustrative tax calculations using assumed figures, and the key risk disclosures drawn from AQR's public materials.

VIII	Glossary of Tax Terms	42
IX	IRS Tax Code Provisions Relevant to AQR Strategies	43
X	Illustrative Tax Calculations	44
XI	Key Risk Disclosures from AQR's Public Materials	46

VIII GLOSSARY OF TAX TERMS

Understanding the tax considerations related to investment strategies requires familiarity with key tax-related terminology. Below is a list of commonly used terms in tax-aware investing and their definitions.

Capital Gains Tax: A tax levied on the profit realized from the sale of a capital asset, such as stocks, real estate, or business interests. Long-term capital gains, applicable to assets held for more than one year, are taxed at preferential rates of up to 20% plus the 3.8% net investment income tax, whereas short-term capital gains are taxed as ordinary income at rates up to 37% (IRC § 1(h)).

Gain Deferral: Postponing the realization of capital gains so that returns compound on a pre-tax basis. AQR's research shows that gain deferral, especially of short-term gains on long positions, is the main source of the tax benefit of tax-aware long-short strategies (Krasner & Sosner, 2024).

Net Capital Loss Realization: The realization of capital losses in excess of capital gains within a strategy, which can offset realized gains elsewhere in an investor's portfolio. In long-short factor strategies, net losses arise mainly as a byproduct of active turnover combined with gain deferral (AQR, 2026f).

Trader Fund: A fund engaged in substantial, regular, and continuous trading with the intent to profit from short-term price changes, which takes the position each year that it is engaged in a trade or business. Its expenses are deductible as business expenses, and its net ordinary losses are business losses that may offset other income, subject to the excess business loss limitation; capital losses retain their capital-loss limitations. Trader status is distinct from a Section 475(f) mark-to-market election (Sosner & Steblea-Lora, 2021).

Excess Business Loss Limitation (IRC Section 461(l)): A statutory limit on the amount by which a noncorporate taxpayer's business losses may exceed business income and gains in a given year; wages are not treated as business income for this purpose. For 2026, the threshold is \$256,000 for single filers and \$512,000 for married couples filing jointly, with any excess losses carried forward as a net operating loss (Rev. Proc. 2025-32).

Wash Sale Rule (IRC Section 1091): A statutory rule preventing taxpayers from claiming a tax loss on the sale of a security if they repurchase the same or a substantially identical security within 30 days before or after the sale.

Net Operating Loss (NOL) Carryforward (IRC Section 172): A provision allowing business losses that exceed annual limitations to be carried forward into future tax years, where they can offset up to 80% of taxable income.

Listed Transaction / Transaction of Interest: Categories of reportable transactions that Treasury designates by published guidance. Participants and material advisors must disclose them on Forms 8886 and 8918, and failure to do so carries significant penalties. Notice 2026-62 states that the strategies it identifies may be designated in future guidance (Internal Revenue Service, 2026a).

Tracking Error: The volatility of a strategy's return relative to its benchmark. In tax-aware long-short strategies, tracking error is intentional, because the portfolio must differ from the benchmark to outperform it, and higher tracking error and leverage expand both expected excess returns and tax benefits (AQR, 2026g).

IX IRS TAX CODE PROVISIONS RELEVANT TO AQR STRATEGIES

Several key sections of the Internal Revenue Code (IRC) govern the taxation of capital gains, trader funds, and loss limitations. These provisions are essential for understanding the tax benefits and constraints associated with AQR's tax-aware investment strategies.

IRC Section 162(a) – Trade or Business Expenses: Allows the deduction of ordinary and necessary expenses of carrying on a trade or business. Fees of a trader fund are deductible under this section; fees of an investor fund are miscellaneous itemized deductions, permanently disallowed under Section 67(g) (Sosner & Steblea-Lora, 2021).

IRC Section 461(l) – Excess Business Loss Limitation: Limits the amount of net business losses that can be applied against nonbusiness income, such as wages. Made permanent, with a reset inflation base, by the One Big Beautiful Bill Act of 2025 (Internal Revenue Service, 2026b).

IRC Section 465 – At-Risk Rules: Limits a partner's deductible losses to the amount the partner has at risk, which excludes nonrecourse partnership liabilities.

IRC Section 475(f) – Trader in Securities Election: Allows a trader, including a trader fund, to elect mark-to-market accounting, under which gains and losses on covered securities are recognized annually as ordinary income and losses (Sosner & Steblea-Lora, 2021).

IRC Sections 988 and 1256 – Currency and Regulated Futures Contracts: Section 988 generally treats foreign currency gains and losses as ordinary, with an election available for capital treatment of certain forward contracts; Section 1256 marks regulated futures and certain other contracts to market annually with 60/40 long-term/short-term capital treatment. The interaction of these sections in mixed-character straddles is a subject of Notice 2026-62 (Internal Revenue Service, 2026a).

IRC Sections 1091, 1092 and 1259 – Wash Sales, Straddles and Constructive Sales: Anti-abuse rules that disallow or defer losses on substantially identical or offsetting positions and require gain recognition when risk is substantially eliminated. These rules look through entity wrappers in many circumstances (AQR, 2026b).

IRC Sections 1211 and 1212 – Capital Loss Limitation and Carryover: Limit the deduction of net capital losses against ordinary income to \$3,000 per year (\$1,500 for married individuals filing separately) and allow unlimited carryforward of unused losses.

IRC Sections 1221 and 1222 – Capital Assets and Holding Periods: Section 1221 defines capital assets, and Section 1222 distinguishes short-term from long-term capital gains and losses based on holding period, which determines the applicable tax rates.

IRC Section 7701(o) – Economic Substance Doctrine: Codifies the judicial doctrine under which a transaction is respected only if it changes the taxpayer's economic position in a meaningful way apart from federal tax effects and the taxpayer has a substantial non-tax purpose for entering into it.

X ILLUSTRATIVE TAX CALCULATIONS

The scenarios below illustrate the tax arithmetic using assumed figures. They are not projections of the results of any AQR strategy or of any Robertson client account.

SCENARIO 1

BUSINESS SALE AND NET CAPITAL LOSSES

A high-net-worth investor sells a business for \$100 million, generating a capital gains tax liability of about \$24 million at the 23.8% federal rate (assuming a near-zero cost basis). The investor has two options for reinvestment:

1. **Investing in a Traditional ETF:** This results in full capital gains recognition and an immediate tax payment of about \$24 million, leaving \$76 million to invest.
 2. **Investing in a Tax-Aware Long-Short Account:** Assume for illustration that the account realizes \$25 million of net capital losses in the year of sale. The taxable gain falls to \$75 million, the federal tax to about \$17.9 million, and the amount remaining invested rises to about \$82 million. If the account realized \$50 million of net capital losses in the year of sale, the taxable gain would fall to \$50 million, the tax to about \$11.9 million, and the amount remaining invested to about \$88 million. Net capital losses realized in later years would offset other capital gains in the investor's portfolio or carry forward indefinitely. The actual amount and timing of losses depend on the strategy's leverage, tracking error, and market conditions.
-

SCENARIO 2

TRADER FUND ORDINARY LOSS APPLICATION

Assume an investor filing jointly invests in a fund that takes the position that it is a trader fund and is allocated \$2 million of net ordinary losses for the 2026 tax year. The tax treatment would be:

- \$512,000 deduction against nonbusiness income, such as wages, in 2026 (married filing jointly limit, assuming no other business income or losses) (Rev. Proc. 2025-32).
 - Remaining \$1.488 million carried forward under NOL rules, offsetting up to 80% of taxable income in future years (IRC § 172).
 - For comparison, under the 2025 threshold of \$626,000 the current-year deduction would have been \$114,000 larger; the One Big Beautiful Bill Act's inflation-base reset shifted that amount into future years.
-

SCENARIO 3

TAX-EFFICIENT WITHDRAWAL FROM A TAX-AWARE LONG-SHORT ACCOUNT

An investor with \$10 million in a tax-aware long-short account needs cash after several years. Rather than liquidating the account, which would realize the deferred gains on the long book, the manager sells positions whose realized

gains can be offset by realized losses elsewhere in the portfolio, so that the withdrawal is made with little or no net taxable gain while the remaining portfolio keeps its tracking error, leverage, and expected return. In AQR's published hypothetical simulations, such annual withdrawals beginning in year two accumulated to about 102%, 124%, and 139% of initial capital by year ten for 150/50, 200/100, and 250/150 strategies, and after-tax wealth per dollar at year ten was only modestly lower than without withdrawals. Withdrawal capacity generally increases with the strategy's tracking error and leverage, and an adaptive withdrawal process manages gain realization better than a fixed schedule (Krasner, Liberman, Sosner & Brenner, 2026).

XI KEY RISK DISCLOSURES FROM AQR'S PUBLIC MATERIALS

The following disclosures, drawn from AQR's public website and published research, outline important legal, tax, and financial considerations related to AQR's tax-aware strategies. Investors should consult with tax professionals before making investment decisions based on tax implications (AQR, 2026h).

1. Tax efficiency is subject to market conditions and individual tax circumstances. The realized tax benefits associated with a tax-aware strategy may be less than expected or may not materialize due to the economic performance of the strategy, an investor's particular circumstances, prospective or retroactive changes in applicable tax law, and/or a successful challenge by the IRS. In the case of an IRS challenge, penalties may apply (AQR, 2026h).
2. Trader fund status is a position the fund takes each year and may be challenged by the IRS. If a fund were treated as an investor rather than a trader, its fees would generally not be deductible and prior deductions could be disallowed (Sosner & Steblea-Lora, 2021).
3. Like any investment strategy designed to generate pre-tax returns, tax-aware investment strategies are subject to the risk of pre-tax returns meaningfully underperforming expectations. The tax-aware aspects of a strategy may result in partially forgoing pre-tax returns or incurring losses that a tax-agnostic strategy would not have incurred (AQR, 2026h).
4. Tax benefits do not substitute for pre-tax returns. AQR states that if a long-short strategy's expected alpha is negative after financing costs, trading costs, and fees, tax benefits alone do not justify the strategy, and that it should be evaluated first as a risky active investment (AQR, 2026a; Liberman, Sosner & Freitas, 2026).
5. Hypothetical and simulated performance has inherent limitations. The research results cited in this paper are historical simulations of model strategies published by AQR, do not reflect actual trading, are gross of management fees unless stated, and would have differed under different assumptions; actual results will differ (Liberman, Krasner, Sosner & Freitas, 2023; Krasner, Liberman, Sosner & Brenner, 2026).
6. AQR's product materials are intended for investment professionals and sophisticated investors and are not reproduced in this paper; prospective investors should obtain and review current materials, including the fund's private placement memorandum where applicable, directly from AQR through their advisor.

A scenic landscape featuring a calm lake in the foreground, reflecting the surrounding environment. In the background, there are steep, rocky mountains under a cloudy sky. The foreground and middle ground are filled with trees displaying vibrant autumn foliage in shades of orange, yellow, and green. A large, gnarled tree branch with yellow leaves hangs down from the top of the frame, framing the scene. The overall atmosphere is peaceful and natural.

SUPPORTING MATERIAL

REFERENCES AND DISCLOSURES

The public sources cited in this paper, the important disclosures that govern it, and the disclosure of Robertson's relationship with AQR.

References	48
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