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CIM Commentary – Tax Alpha Explained

What is “Tax Alpha”?

Clinton Investment Management (CIM) calculates tax alpha as the capital losses harvested, divided by the market value of the assets under management, multiplied by the maximum capital gains tax rate of 23.8% (20% plus 3.8% net investment income tax), for a given period. In essence, the tax alpha we generate is the amount our clients save, annually in taxes, that they would have been forced to pay otherwise, assuming they have gains to offset each year*.

In a dynamic environment increasingly focused on tax efficiency, the definition of “Tax Alpha” is essential to understanding the actual value a given muni manager delivers. To this point, what many managers say and what they do may not necessarily be the same thing. For example, quantifying the amount of losses harvested, as many managers do, is not Tax Alpha. Rather, Tax Alpha is the amount of capital gain avoided. A manager who states only the amount of losses harvested may be significantly overstating the actual Tax Alpha they achieved.

Is Your Current Muni SMA Manager Willing to Document Their Tax Alpha Generation?

Marketing literature from several prominent municipal bond industry peers claim to actively harvest tax losses within their Separately Managed Account (SMA) municipal bond portfolios but you are unlikely to find this data documented anywhere. Beyond this fact, many of these managers outline minimum thresholds for net benefits to be realized for their client portfolios, (benefits net of transaction costs), before engaging in tax harvesting, limiting the degree to which they ultimately deliver on this promise.

We would strongly encourage investors and advisors to challenge municipal bond managers who make ambitious claims regarding tax-loss harvesting, if they are unwilling to document the actual Tax Alpha they claim to deliver. If managers will not document, in their marketing literature, the tax alpha they generated, what they say and ultimately do may not be the same thing.

Where Can I See CIM's Composite Level Tax Alpha Generation?

You can find our Tax Alpha on the front page of our strategy fact sheets. CIM prominently and transparently displays the Tax Alpha we generate on our SMA strategy fact sheets, whereas competitors may simply claim, in casual conversation, losses they generate on a theoretical, rather than documented basis. For example, the 2025 year-end tax alpha for our Municipal Credit Opportunities strategy composite, with over \$2.6 billion in assets under management, was 36 basis points. This net tax benefit proportionately offset the annual management fee we charge.

What is CIM's Tax Loss Harvesting Philosophy?

At CIM, tax harvesting is deeply embedded in our investment protocols and actions. We proactively engage in tax swaps throughout the year. This contrasts with the approach that may be taken by peers who may delay such actions until they are forced, by the advisor or the client, to do so, or they wait until the final few weeks of the calendar year, when secondary market liquidity and depth are typically more limited. CIM's active Tax Optimization Protocol (TOP) has generated meaningful tax alpha for clients over the past five years, while also preserving core portfolio characteristics and objectives.

CIM also seeks to avoid common pitfalls associated with tax loss harvesting, such as selecting problematic or ineligible replacement securities, holding bond sale proceeds in cash for extended periods, or ignoring transaction and opportunity costs associated with these swaps.

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* Tax-loss harvesting is any transaction resulting in a capital loss. Although realized capital losses can potentially offset capital gains, reduce taxes paid, and enhance after-tax returns, individual results will vary dependent upon an investor's actual tax rates, the presence of current or future capital loss carry forwards, and other investor specific tax circumstances. Tax-loss harvesting may not achieve actual value creation.