

FIDELITY INSTITUTIONAL ASSET MANAGEMENT®

## Adopt a Tax-Efficient Investment Strategy

### Consider a tax-deferred variable annuity

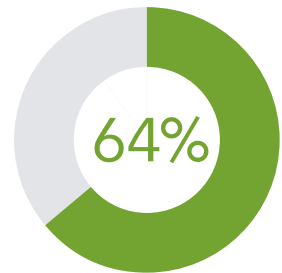
Tax laws have resulted in higher taxes for many. Now may be a good time to develop an investing strategy to help reduce your tax liability.

#### What generates tax inefficiency?

The types of accounts and investments, and how the investments are managed, may affect the tax efficiency of assets. Assets that produce income and short-term capital gains (most bonds other than municipals and U.S. savings bonds, as well as some equity funds) can be the most tax inefficient.

If you have broad exposure to these types of assets, consider relocating some into a tax-deferred account, such as a variable annuity.

Please note that any funds sold in a taxable account may be subject to capital gains taxes if they have appreciated above their cost basis. This should be considered before selling funds from a taxable account to fund an annuity.



of Americans are concerned about not having enough money for retirement.<sup>1</sup>

A variable annuity can provide tax-deferred growth and a guaranteed stream of income.<sup>2</sup>

HIGHER TAX EFFICIENCY	MEDIUM TAX EFFICIENCY	LOWER TAX EFFICIENCY
<ul style="list-style-type: none"> <li>Equity index funds (other than REITs)</li> <li>Equity index ETFs (other than REITs)</li> <li>Equity income funds*</li> <li>Equity income ETFs*</li> <li>Tax-managed equity funds</li> <li>Equity separately managed accounts</li> </ul>	<ul style="list-style-type: none"> <li>Bond funds with large U.S. Treasuries allocations**</li> <li>Typical actively managed equity funds*</li> <li>Equity income funds*</li> <li>Equity income ETFs*</li> <li>REIT funds</li> </ul>	<ul style="list-style-type: none"> <li>High-turnover equity funds</li> <li>Mortgage bond funds</li> <li>Corporate bond funds</li> <li>Leveraged loan/floating rate bond funds</li> <li>U.S. high-yield bond funds</li> <li>Emerging-market bond funds</li> </ul>

Keep in mind that with a deferred variable annuity, earnings are taxed at ordinary income tax rates upon withdrawal and if taken prior to age 59½ may be subject to a 10% IRS penalty.

The relative tax efficiencies of these investments are generalizations and are not universally accurate. Each investment should be considered individually for the benefits of being held in a taxable or tax-deferred account.

\* Equity income funds and ETFs typically distribute most of their income in the form of qualified dividends, which for many taxpayers are taxed relatively lightly, allowing most equity income funds to be considered high-tax-efficient investments. However, for higher-income taxpayers, qualified dividends are subject to taxation at a rate of either 18.8% or 23.8% (including the Medicare surtax on investment income), which may make them less efficient for those investors.

\*\* Applies to investors who are subject to high rates of state/local taxes on investment income; for other investors, these bond funds should be considered as having lower tax efficiency.

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## How tax efficient is my current investing strategy?

The following questions can help you assess the level of your tax exposure. If you answer yes to three or more, you may benefit from a more tax-efficient strategy.

T

### **Ten years or more until retirement?**

The longer your money stays in a tax-deferred account—like a 401(k) or variable annuity— the longer the period of time it can potentially grow.

A

### **Assets largely held in taxable accounts?**

If you are subject to a relatively high marginal income tax rate and have assets in taxable accounts, you may benefit from tax deferral.

I

### **Income tax subject to high marginal rates?**

In general, higher marginal rates apply if you are in one of the top three federal income tax brackets (currently 32% and above) and/or pay high state or local taxes.

L

### **Lower anticipated income taxes in retirement?**

You expect to pay lower taxes in retirement. Maybe your income will be reduced or you plan to move to a state with lower taxes.

S

### **Significant exposure to highly tax-inefficient assets?**

Tax-inefficient assets tend to deliver most or all of their total returns from investments that are taxed at a relatively high rate.

## Strategies to consider

Consider these three strategies to help you maximize your tax benefits to increase your savings.

- 1 Invest in tax-free investments or investment vehicles.**

Consider converting a pretax-deferred account to a Roth IRA. While you may benefit from tax-free withdrawals from a Roth, there will be a tax liability at the time of conversion. You could also consider investing in municipal bonds, which are generally exempt from federal tax.
- 2 Allocate investments to tax-deferred accounts.**

Putting investments in a trust may help lower federal tax liability, but be sure to consult a tax professional to determine if there are any estate tax implications. A simpler investment option may be a variable annuity, which allows you to defer taxes while increasing the growth potential of your assets. Keep in mind that variable annuities have additional expenses not found in taxable accounts that will affect returns.
- 3 Look for deductions.**

Tax-loss harvesting allows you to use capital losses to reduce taxable income in certain situations. Charitable giving can also provide an opportunity to save on taxes by using the deductions to offset income and estate taxes.

## Current federal tax rates

### Top tax rates

The top marginal income tax rate is 37% for single filers with taxable incomes above \$518,400 (\$622,050 for joint filers).

### Capital gains

The top rate for long-term capital gains and qualified dividends is 20% for single filers with taxable incomes above \$518,400 (\$622,050 for joint filers).

### Medicare tax

The 3.8% Medicare tax applies to single filers with modified adjusted gross income (MAGI) above \$200,000 (\$250,000 for joint filers). The tax applies to net investment income, including interest, dividends, capital gains, rents, royalties, annuities, and passive business income.

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<sup>1</sup> Gallup Analytics. Survey conducted April 6–10, 2016, on the Gallup U.S. Daily survey, with a random sample of 1,015 adults, aged 18 and older, living in all 50 U.S. states and the District of Columbia.

<sup>2</sup> **Guarantees are subject to the claims-paying ability of the issuing insurance company.**

**Investing in a variable annuity involves risk of loss. Investment returns and contract value are not guaranteed and will fluctuate.**

**Please note that while a proxy for a fund in a taxable account may be available in a tax-deferred variable annuity, it will almost certainly not be exactly the same fund and therefore the pretax, pre-fee returns will differ, potentially by a significant margin.**

**Before investing in an annuity, there are a number of factors that need to be reviewed with a licensed agent to determine product suitability. In addition to tax efficiency, there are other important considerations to take into account.**

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