

# The Power of Tax Deferral

## **Why It May Pay to Delay**



The potential benefits of tax deferral  
just grew more compelling

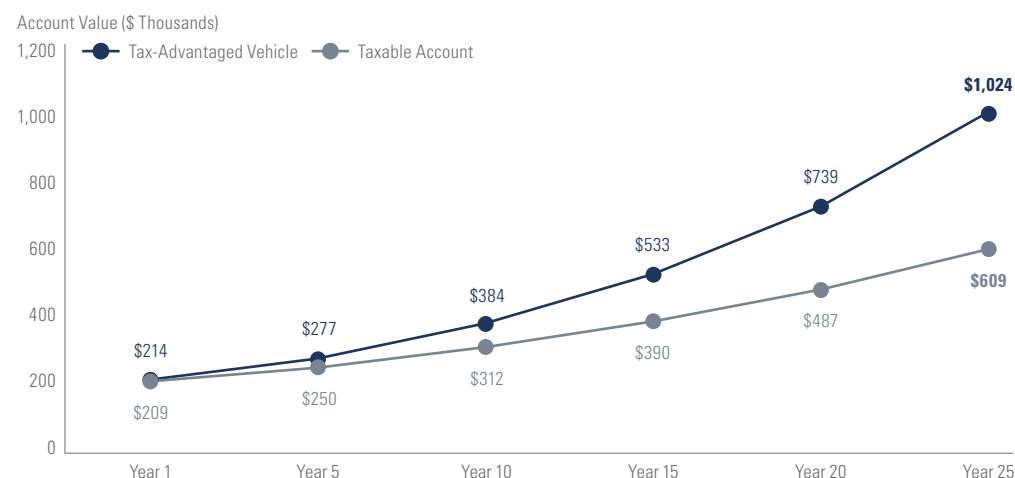
# What is tax deferral and why is it important?

Tax deferral—when an investor succeeds in delaying the payment of taxes to some period in the future—can, in our view, be one of the most important tools in the accumulation and preservation of wealth. The power of tax deferral is straightforward: postponing taxes on any earnings generated within your investment portfolio can allow more of your investment returns to compound over time, resulting in potentially higher long-term returns.

As the hypothetical comparison below shows, a \$200,000 initial investment would gain over \$415,000 more over a 25-year holding period (\$1.024 million versus \$609,000) when owned in a tax-advantaged vehicle versus a taxable account.

## Hypothetical Comparison of a Tax-Advantaged Vehicle Versus a Taxable Account

Growth of \$200,000 account under certain assumptions



Source: GSAM based on hypothetical assumptions (see below).

### Assumptions

- These examples are for illustrative purposes only and are not actual results. If any assumptions used do not prove to be true, results may vary substantially.
- \$200,000 invested with no withdrawals made
- Assumes an 8% return that is net of fees for both accounts and net of taxes for the taxable account
- Fees are 1.25% for the tax-advantaged vehicle and 1% for the taxable account
- Taxes on gains for the taxable account are 60% Long-term Capital Gains tax (23.8%) and 40% Ordinary income tax rate (40.8%). Ordinary income tax rate of 40.8% includes 3.8% of Medicare Surtax. Calculations exclude the impact of state taxes.
- The net returns are 6.75% for the tax-advantaged vehicle and 4.55% for the taxable account
- GROWTH OF \$200,000: A graphical measurement of a portfolio's gross return that simulates the performance of an initial investment of \$200,000 over the given time period. The example provided does not reflect the deduction of investment advisory fees and expenses which would reduce an investor's return.

**Past performance does not guarantee future results, which may vary.**

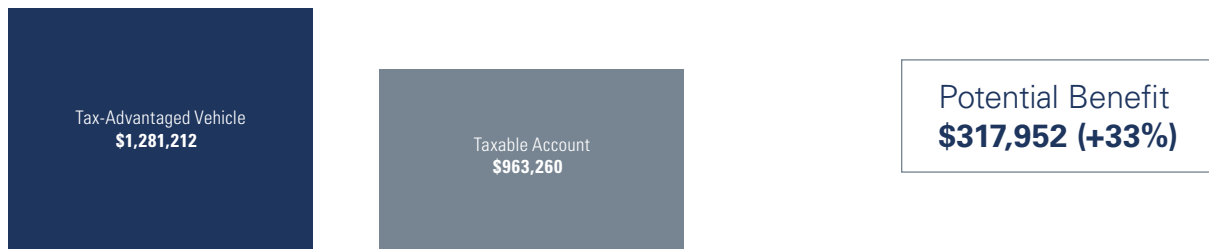
# Implementing tax deferral: the potential for more

While tax deferral can help you accumulate more wealth over time by postponing when you pay taxes, the potential benefits grow larger when you harness tax deferral's power even after you retire. When you continue to use a tax-deferred account through the distribution stage of one's retirement, you have the opportunity to potentially have more: **Income, Money Remaining, and Portfolio Longevity.**

## 1. Income

The Tax-Advantaged Vehicle can enjoy 33% more total income over 25 years despite both accounts withdrawing \$40,000 in year one and increasing that by 2% annually for inflation. This is ultimately because the taxable account ran out of money by the 19th year.

Total Income Distributed (after 25 Years)



## 2. Money Remaining

Even after paying more than \$1.28 million in income over 25 years, the Tax-Advantaged Vehicle still has \$292,991 remaining whereas the Taxable Account balance was exhausted by year 19.



## 3. Portfolio Longevity

If income is needed beyond 25 years, the Tax-Advantaged Vehicle can also offer greater portfolio longevity again because it's starting with a higher amount and able to last 27 years in this scenario.



Source: GSAM based on hypothetical assumptions (see below). These examples are for illustrative purposes only and are not actual results. If any assumptions used do not prove to be true, results may vary substantially. Past performance does not guarantee future results, which may vary.

- This analysis is a continuation of the chart and assumptions on the previous page except annual withdrawals are being made now for 25 years. The Tax-Advantaged Vehicle and the Taxable Account are each taking withdrawals of \$40,000 year one and increasing the withdrawal amount annually by 2% to account for inflation.
- Withdrawals are taxed at 100% Ordinary income tax rate (40.8%) for the Tax-Advantaged Vehicle. For the taxable account, withdrawals are taxed at 60% Long-term Capital Gains tax (23.8%) and 40% Ordinary income tax rate (40.8%) for an Effective Tax Rate of 31%. Ordinary income tax rate of 40.8% includes 3.8% of Medicare Surtax. Calculations exclude the impact of state taxes.

Withdrawals before the age of 59 ½ are considered early distributions from most qualified investment vehicles that qualify for tax-deferral and are usually subject to an additional 10 percent tax. **Risk Considerations: Potential implications of tax-advantaged investing.** Tax decisions may negatively affect alpha generation and pre-tax returns. Large redemptions could potentially force gains realization, negatively affecting the tax efficiency. Deferral of gains may cause new investors to increase the risk of receiving future capital gains distributions. **Past performance does not guarantee future results, which may vary.**

# Asset location: a map to help guide investors to the potential benefits of tax deferral

In today's environment, the concept of "asset location" is becoming more relevant. Asset location is a tax-aware approach to investing in which investors seek to place tax-generating assets in tax-advantaged vehicles, while placing relatively tax-efficient assets in taxable accounts.

We believe a thoughtful asset location strategy can potentially help investors respond to both the changing tax environment and the tax liabilities generated by the recent years of market appreciation.

The potential for price appreciation is an obvious and an often-considered factor, but long-term capital gains already receive some degree of consideration via the significantly lower rate at which they are taxed. We believe investors should also consider the effects of other drivers of taxable events. Two potentially useful indicators include yield, a signal of income distributions, and turnover, indicating the potential for short-term capital gains distributions. These forms of distributions are both taxed at ordinary income rates, and considering them in tandem may be particularly helpful in demonstrating the power of asset location.

## In Our View, Investments Well-Suited for Tax-Advantaged Vehicles Have Historically Had Higher Yield, Higher Turnover

Some non-traditional asset classes, including "satellites" (or diversifiers), have historically had higher yield and turnover than traditional asset classes, which may make them well suited for tax-advantaged vehicles.



Source: GSAM, Morningstar. ©2018 Morningstar, Inc. All Rights Reserved. The yields and turnovers shown are calculated by GSAM as the asset-weighted average of mutual funds (lowest fee share class) in the Morningstar categories. Data as of January 2015 - December 2017. Satellites are long-only asset classes that have attractive return potential and historically lower correlations to traditional or core equity and bonds. Asset classes are represented by US mutual funds (lowest fee share class) in the corresponding Morningstar Categories, all US categories unless otherwise noted: US Large Cap Growth = US Large Growth; US Large Cap Value = US Large Value; US Mid Cap = US Mid Cap Blend; US Small Cap = US Small Cap Blend; International Equity = Foreign Large Blend; Emerging Markets Equity = Diversified Emerging Markets, India Equity, China Region, Latin America Stock; Emerging Market Debt = Emerging Markets Bond; High Yield Bond = High Yield Bond (includes Global and US); Leveraged Loans = Bank Loan; International Small Cap = Foreign Small/Mid Blend; International Real Estate = Global Real Estate; US Real Estate = Real Estate; Commodities = Commodities Broad Basket; Global Infrastructure and MLPs = Energy Limited Partnership, Infrastructure; Alternatives = Multialternative, Long/Short Equity, Long/Short Credit, Bear Market, Managed Futures, Trading, Multicurrency, Market Neutral. For illustrative purposes only. Mutual funds' net realized capital gains must be distributed annually, and average turnover is shown as a proxy for the potential for those capital gains to be short-term in nature. In an effort to distinguish funds by what they own, as well as by their prospectus objectives and styles, Morningstar developed the Morningstar Categories. While the prospectus objective identifies a fund's investment goals based on the wording in the fund prospectus, the Morningstar Category identifies funds based on their actual investment styles as measured by their underlying portfolio holdings and other statistics over the past three years. Goldman Sachs does not provide accounting, tax or legal advice. **Past performance does not guarantee future results, which may vary.**

## **Risk Considerations**

**Equity investments** are subject to market risk, which means that the value of the securities in which it invests may go up or down in response to the prospects of individual companies, particular sectors and/or general economic conditions.

**Equity securities** are more volatile than bonds and subject to greater risks. Small and mid-sized company stocks involve greater risks than those customarily associated with larger companies.

**Bonds** are subject to interest rate, price and credit risks. Prices tend to be inversely affected by changes in interest rates.

Investments in **fixed income securities** are subject to the risks associated with debt securities generally, including credit, liquidity, interest rate, call and extension risk.

Investments in **foreign securities** entail special risks such as currency, political, economic, and market risks. These risks are heightened in emerging markets.

An investment in **real estate securities** is subject to greater price volatility and the special risks associated with direct ownership of real estate.

Investments in **commodities** may be affected by changes in overall market movements, commodity index volatility, changes in interest rates or factors affecting a particular industry or commodity.

**Emerging markets securities** may be less liquid and more volatile and are subject to a number of additional risks, including, but not limited to, currency fluctuations and political instability.

**High-yield, lower-rated securities** involve greater price volatility and present greater credit risks than higher-rated fixed income securities.

Income from **municipal securities** is generally free from federal and state taxes for residents of the issuing state. While the interest income is tax-free, capital gains, if any, will be subject to taxes. Income for some investors may be subject to the federal Alternative Minimum Tax (AMT).

Investments in **master limited partnerships** ("MLPs") are subject to certain risks, including risks related to limited control and limited rights to vote, potential conflicts of interest, cash flow risks, dilution risks, limited liquidity and risks related to the general partner's right to force sales at undesirable times or prices.

**Leverage** increases a fund's sensitivity to market movements. Funds that use leverage can be expected to be more "volatile" than other funds that do not use leverage. This means if the investments a fund buys decrease in market value, the value of the fund's shares will decrease by even more.

**Alternative investments** may employ more complex strategies, investments, and portfolio structures. In doing so, some of these strategies are extremely speculative and may expose investors to a high degree of risks, including but not limited to short selling, leverage risk, counterparty risk, liquidity risk, commodity price volatility risk, and/or managed futures roll yield risk. Such practices may increase the volatility of performance and the risk of investment loss, including the loss of the entire amount that is invested.

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## A long-term partnership

**Seeking to harness the power of tax deferral by deploying tax-advantaged vehicles where appropriate, and understanding the value of asset location, can deliver potentially significant benefits over time.** We believe these potential benefits may be best realized using an investment manager with strong investment capabilities and a long track record of success.

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