Are you looking for more tax efficiency in your portfolio?

Consider the tax savings a low-cost tax-deferred variable annuity may provide.

Affluent investors often hold the bulk of their liquid investments in taxable accounts, rather than in tax-advantaged vehicles such as 401(k) plans, IRAs, 529s, etc. If this is your situation and you find you are subject to relatively high marginal income tax rates, there’s a good chance you could benefit from deferring taxes on any investment that generates large distributions that can be taxed at ordinary income rates, such as short-term capital gains or certain types of interest and dividends.

One way to do this is to replace those investments held in taxable accounts with suitable alternatives held in tax-advantaged accounts. To the extent that you can fund employer plans, IRAs, and similar accounts, you should generally do so before considering other options. If taxable accounts constitute most of your portfolio, however, this process can go only so far because of certain limitations on tax-advantaged accounts. Even if you are eligible to make contributions to a tax-advantaged account, the investment options it offers may not be comparable to what is offered in a taxable account.

A low-cost tax-deferred variable annuity such as the Fidelity Personal Retirement Annuity®, however, may give you the investment options you want with the tax-deferred advantages you need.

Is a tax-deferred variable annuity right for you?

A tax-deferred variable annuity is not for everyone, but, generally speaking, the more questions on the next page that you answer “yes” to, the more likely it is that you should consider reallocating certain assets to a tax-deferred variable annuity. However, it is important to keep in mind that with a tax-deferred variable annuity, all gains are taxed as ordinary income upon withdrawal (plus any Medicare surtax, and state and local taxes), and a 10% IRS penalty may apply to withdrawals taken before age 59½. Also, unlike a taxable account, you’re subject to an annual annuity charge, which is 0.25%¹ for the Fidelity Personal Retirement Annuity. You may also find tax efficiency by investing in a tax-sensitive equity fund within a taxable account.

¹Clients are eligible for an annual fee of 0.10% if (1) the contract is purchased with an initial purchase payment of $1,000,000 or more on or after September 7, 2010, or (2) the contract value has accumulated to $1,000,000 or more on or after September 7, 2010, and at that time we are offering the contract to new applicants for 0.10%. See prospectus for additional details.

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Answer these five questions to see if a low-cost tax-deferred variable annuity could be right for you.

1. **Do you have large holdings in tax-inefficient assets?** Certain investors with “highly tax-inefficient” assets may benefit greatly from a low-cost tax-deferred variable annuity. Tax-inefficient assets are defined as those assets with relatively low tax efficiency—those that tend to deliver most or all of their total returns in forms that are heavily taxed.

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<th>WHICH ASSETS ARE TAX INEFFICIENT?</th>
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<td><strong>Fixed-income investments</strong></td>
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2. **Are you currently subject to high marginal income tax rates?** Generally speaking, the higher your marginal income tax rate, the more you should consider the potential advantage of tax deferral offered by a tax-deferred investment. As a rule of thumb, if you fall into one of the top federal income tax brackets—currently 32% or above—you may fit this description. Also, in some cases—depending on the state you live in—even if you are in a lower federal tax bracket, you still may be subject to a combined marginal income tax rate that is relatively high. Residents of New York City, for example, often fit this description. Allocating assets to a tax-deferred annuity may also help reduce your yearly income taxes, potentially avoiding the alternative minimum tax.

3. **Do you expect lower income taxes in retirement?** There are some reasons you may see lower income taxes at retirement, including:
   - You move to a state that has much lower taxes than your current state
   - You anticipate receiving less ordinary income than in previous years
   If either of these situations applies, then an annuity may not only defer, but also help reduce, your taxes over the long run.

4. **Do you have significant liquid assets held in taxable accounts?** If you have significant assets in taxable accounts, or are likely to see sizable increases in your taxable accounts, you may benefit from tax deferral.

5. **Are you at least 10 years away from taking income in retirement?** The advantage of tax deferral is proportional to the amount of time available before the assets are withdrawn from the deferred account. In general, if you won’t need access to this money for at least 10 years, you may be a good candidate for a low-cost tax-deferred variable annuity. Moreover, if you are planning to use an income bridge (such as a bond ladder or period-certain annuity) to cover all expenses during the early part of your retirement, you may also benefit from a low-cost tax-deferred variable annuity, even if retirement is closer than 10 years.
Guide to the potential tax efficiency of equity investments.

While no indicator of the future potential tax efficiency of equity investments can be 100% accurate, the descriptions shown in the following chart are generally reliable. In all cases, investors should consider the potential tax implications of selling assets in a taxable account to purchase a tax-deferred annuity. Note that the redemptions from the taxable account may produce gains subject to taxes, and those taxes may outweigh any potential deferral benefit. Please also note: Deferred variable annuities have additional expenses not found in taxable accounts, which affect performance.

| Real Estate Investment Trusts (REITs) and REIT funds | REITs are required to distribute nearly all their earnings, and they’re distributed in the form of ordinary income, so REITs and REIT funds are generally among the most tax inefficient of all equity investments. They should be among the very first equity assets that an investor considers for replacement into a tax-deferred annuity. |
| Small-cap funds relative to large-cap funds | Small stocks that grow tend to leave small-cap indexes and therefore need to be sold by small-cap funds. As a rule, small-cap funds generally see higher levels of capital gain distributions — and thus lower levels of tax efficiency — than do otherwise similar large-cap funds. |
| High-yielding equities and funds | Most high-yielding common stocks, such as utilities, are generally tax efficient (relative to other assets that make taxable income distributions), as they typically distribute most of their income in the form of Qualified Dividends, which, for many taxpayers, are taxed relatively lightly. However, for higher-income taxpayers, Qualified Dividends are subject to tax 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. |
| Indexed and tax-managed equity funds | With few exceptions, indexed equities are very tax efficient. Also, explicitly tax-managed equity funds tend to be fairly tax efficient. However, REIT index funds are still very tax inefficient, and small-cap index funds tend to be less efficient than large-cap index funds. |
| Separately managed accounts (SMAs) | If an SMA is managed with an eye to tax efficiency, the manager may be able to harvest tax losses and use these to offset gains. Otherwise, an SMA may be no more tax efficient than an ordinary actively managed equity mutual fund. |

A Hypothetical Example: Adrian

Adrian is a 46-year-old dentist with a thriving practice. He has been in dentistry for more than 20 years and has saved up a considerable nest egg for retirement. He plans to wind down his involvement in the dental practice over the next few years and to work more on his real estate ventures.

Currently, Adrian estimates that his net worth is about $3.25 million. Approximately $2.5 million of his assets are tied up in his practice and real estate investments; the remaining $750,000 or so is currently held in cash. Given the illiquidity of his practice and real estate investments, Adrian’s advisor recommends that he keep $500,000 of the $750,000 in cash as an emergency fund, but suggests investing the remaining $250,000 to support his lifestyle after he stops receiving income from the dental practice in 20 years or so.

The advisor suggests that the $250,000 be invested fairly conservatively, despite the long time horizon—in a taxable bond fund. He suggests that Adrian also consider a tax-deferred account, such as a low-cost tax-deferred variable annuity, to help defer taxes on this investment. Adrian is currently subject to a marginal federal income tax rate of 32%, but he anticipates that he’ll be in a much lower tax bracket in 20 years. Because of this anticipated reduction in his marginal tax rate, by using a tax-deferred account, such as a low-cost tax-deferred variable annuity, Adrian may be able to not only defer his taxes but reduce them as well. But to be conservative, the advisor decides to run his analysis on the assumption that Adrian’s tax rate does not change.
The chart below compares the projected values following liquidation, in 20 years, of Adrian’s proposed investments in a taxable bond investment under two scenarios: one in which it is held in a taxable account and one in which it is held in a tax-deferred account, such as a variable annuity with a 0.25% annual annuity charge.

This hypothetical example is not intended to predict or project investment results. Your actual results may be higher or lower than those shown here. Assumptions include: $250,000 investment, 20-year time horizon, 0.25% annual annuity charge for the tax-deferred variable annuity (VA), marginal federal income tax rate of 32% for the entire period, and a 6% annual rate of return (equivalent to a 5.74% net annual rate of return for the VA) with the gain assumed to derive entirely from income (characterized for tax purposes as ordinary income). Investments that have the potential for a 6% annual rate of return also come with the risk of loss. This rate of return is not guaranteed.

The year-by-year liquidated value after federal income taxes have been deducted for the VA at the 5.74% and –0.25% (0% less 0.25% annual annuity charge) net annual rates of return shown above are: $259,750/$249,375 for year 1, $270,058/$248,752 for year 2, $280,958/$248,130 for year 3, $292,483/$247,509 for year 4, $304,669/$246,991 for year 5, $317,554/$246,273 for year 6, $331,177/$245,648 for year 7, $345,582/$245,044 for year 8, $360,813/$244,311 for year 9, $376,918/$243,210 for year 10, $393,946/$243,165 for year 11, $411,951/$242,602 for year 12, $430,989/$242,196 for year 13, $451,118/$241,365 for year 14, $472,401/$240,767 for year 15, $494,906/$240,185 for year 16, $518,700/$239,585 for year 17, $543,860/$238,986 for year 18, $570,462/$238,388 for year 19, and $598,590/$237,792 for year 20.

The year-by-year liquidated value for the taxable account at the 6% rate of return shown above is: $260,200 for year 1, $270,816 for year 2, $281,865 for year 3, $293,366 for year 4, $305,335 for year 5, $317,793 for year 6, $330,758 for year 7, $344,253 for year 8, $358,813 for year 9, $373,918 for year 10, $393,946 for year 11, $414,050 for year 12, $434,705 for year 13, $455,659 for year 14, $477,042 for year 15, $499,918 for year 16, $524,383 for year 17, $550,383 for year 18, $576,270 for year 19, and $604,270 for year 20.

In the taxable account, it is assumed taxes incurred on the income are paid annually from the income itself, with the remainder reinvested. For the VA, it is assumed that all income—less the 0.25% annual annuity charge—is reinvested and it is assumed the investor liquidates the VA at the end of the time period, and pays taxes on the gain out of the proceeds. If the assets in the VA were liquidated entirely in one year, its proceeds may increase the tax bracket to the marginal federal income tax rate of 40.8% (37% ordinary income tax plus 3.8% Medicare surtax), which would minimize and potentially eliminate any savings of the VA. To avoid this, the VA would need to be liquidated over the course of several years or annuitized, which would lengthen the deferral period.

State and local taxes, the 3.8% Medicare surtax, inflation, and fund and transaction fees were not taken into account in this example; if they were, performance for both the taxable account and the VA would be lower. This example also does not take into account capital loss carry forwards or other tax strategies that could be used to reduce taxes that could be incurred in a taxable account; to the extent they apply to your situation, the comparative advantage of a VA would be diminished. Lower tax rates on capital gains, dividends, and interest income would make the taxable investment more favorable. Changes in tax rates and tax treatment of investment earnings may impact the comparative results. Consider your current and anticipated investment horizon and income tax bracket when making an investment decision, as the illustration may not reflect these factors.

VAs are generally not suitable for investors with time horizons of less than 10 years, as, in most cases, there is little to no advantage over a taxable account for the first 10 years of the investment.

The analysis suggests that using a low-cost VA would yield significant benefits for Adrian. After 20 years, his taxable bond investment would potentially be worth about 7.6% more after liquidation if held in the annuity. The analysis was conducted using a marginal federal income tax rate of 32% for the entire time period.

For more information on how a tax-deferred variable annuity may help your personal situation, please contact a Fidelity Annuity Specialist at 800.544.2442 or visit Fidelity.com.