The impact of disciplined tax efficient management

While taxes shouldn't necessarily drive your investment decisions, they are an important consideration because they can reduce your investment returns over the long-term. One way that may help manage the impact of taxes on your portfolio is to incorporate systematic, year-round tax efficient management activities into your investment approach — the kind offered by tax efficient management overlays.

What are tax efficient management overlays?

Tax efficient management overlays are an investment management approach that seeks to help mitigate the impact of taxes on the overall performance of investments held in a taxable account.

Some tax efficient management overlays engage in management of capital gains by selling positions that will have the lowest expected tax liability during regular portfolio management activities, like rebalancing.

Others may engage in tax loss harvesting, which proactively seeks out positions with unrealized losses, sells those holdings and uses the proceeds to invest in another security to keep your overall strategy intact. If you sell securities at a loss, the eligible losses can be used to offset short-term and long-term gains that are realized when selling other securities, potentially reducing the overall tax burden associated with your investing activities.

Tax efficient management overlays may complement other tax-smart investing techniques, such as using tax advantaged account structures like an Individual Retirement Account (IRA) or traditional 401(k), and other tax-exempt accounts as well as professionally managed investment strategies that include tax management as part of their larger investment approach. The range of options can help you potentially mitigate the impact of taxes on your overall investment return.

What tax efficient management overlay services are available from Merrill?

Merrill offers three distinct Tax Efficient Management (TEM) Overlay Services designed to complement our extensive roster of Merrill and third-party model portfolios, within the Merrill Lynch Investment Advisory Program, including:

Passive Overlay

Tax Efficient Rebalancing (TER)

This service seeks to improve the after-tax value of accounts by executing portfolio rebalancing and other portfolio management activities in a tax-efficient manner. To accomplish this, the service leverages a number of techniques including short-term gain deferral and best tax lot management.

Active Tax Loss Harvesting Overlays

Quarterly Loss Harvesting (QLH)

This service actively seeks to increase the after-tax value of your eligible accounts by harvesting eligible losses upon enrollment and then every 91 days thereafter, where harvested losses can potentially be used to offset gains from other trades which may enhance the overall tax efficiency of your portfolio.

Dynamic Tax Loss Harvesting (DTLH)

This service actively seeks to increase the after-tax value of your accounts by opportunistically harvesting losses on an ongoing basis in eligible Chief Investment Office (CIO) ETF Model Portfolios, where harvested losses can potentially be used to offset gains from other trades which may enhance the overall tax efficiency of your portfolio.

These three overlay services can be used individually, or together, based on your investment objectives and tax management needs.

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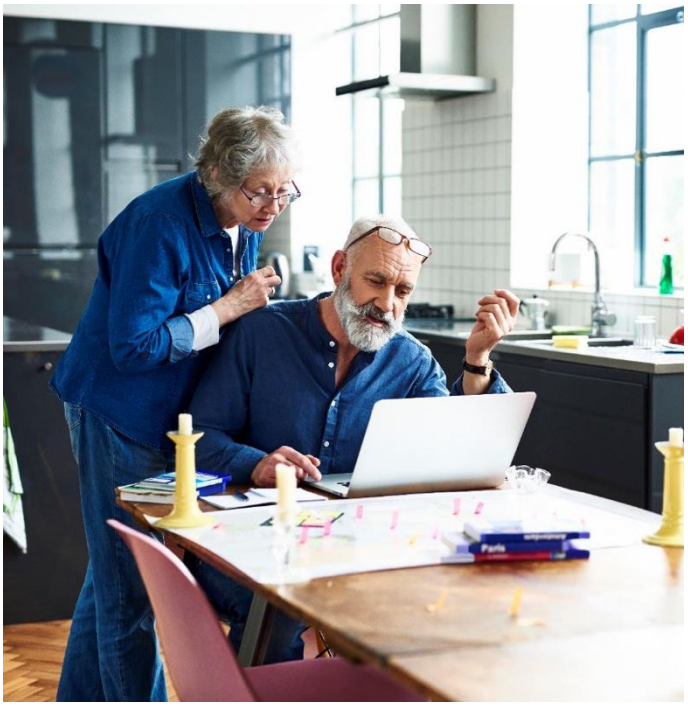
Investment products:

Are Not FDIC Insured	Are Not Bank Guaranteed	May Lose Value

What are the potential benefits of using Tax Efficient Management Overlay Services?

Tax Efficient Management (TEM) Overlay Services available from Merrill seek to enhance the after-tax value of enrolled accounts, while keeping investments aligned with their stated objectives. Depending on the TEM Overlay Service you enroll in, they can help you:

- Potentially reduce the overall amount of gains realized during the year through regular account management activities, such as regular rebalancing and other portfolio management activities.
- Harvest losses in a systematic way in eligible taxable accounts, which may be available to offset long-term or short-term capital gains.



TEM Overlay Services also allow you to delegate responsibility for tax efficient management trading activities to Merrill. Depending on the specific overlay service(s) that you have elected to enroll your account(s) in, Merrill's team of investment professionals will apply these rules-based overlays in a disciplined manner on an ongoing basis. For losses realized by the QLH and DTLH overlay services, you will be able to view a personalized potential tax savings analysis, subject to certain limitations as described in the report, available from your advisor.

You may also direct your Merrill advisor to harvest losses at any time.

How does Tax Efficient Rebalancing work?

Tax Efficient Rebalancing (TER) seeks to help you minimize gains during normal portfolio management activities, like rebalancing or liquidating assets to cover a withdrawal. It does this by selling assets based on tax priority instead of using other rules-based methods like First-In-First-Out (FIFO).

The chart below shows the potential benefit of TER when compared to FIFO. It is shown for illustrative purposes only and is not indicative of any client account activity. The illustration assumes that client accounts will have multiple lots, each with different cost basis, to select from, and that taxable gains would be long-term gains; actual client accounts may not experience these situations and there could be instances when a comparison of FIFO versus TER would not produce a benefit as shown below.

Assuming liquidation of 400 shares of a security with current market price of $50

A FIFO sale would sell 400 shares, all from Lot 1

	Number of Shares	Purchase Price	% Gains
Lot 1	500 shares	$ 43.80	12.4%
Lot 2	400 shares	$ 46.20	7.6%
Lot 3	600 shares	$ 48.70	2.6%
Lot 4	500 shares	$ 47.10	5.8%

This FIFO approach would result in a realized **taxable gain of $2,480.**

A TER sale would sell 400 shares, all from Lot 3

	Number of Shares	Purchase Price	% Gains
Lot 1	500 shares	$ 43.80	12.4%
Lot 2	400 shares	$ 46.20	7.6%
Lot 3	600 shares	$ 48.70	2.6%
Lot 4	500 shares	$ 47.10	5.8%

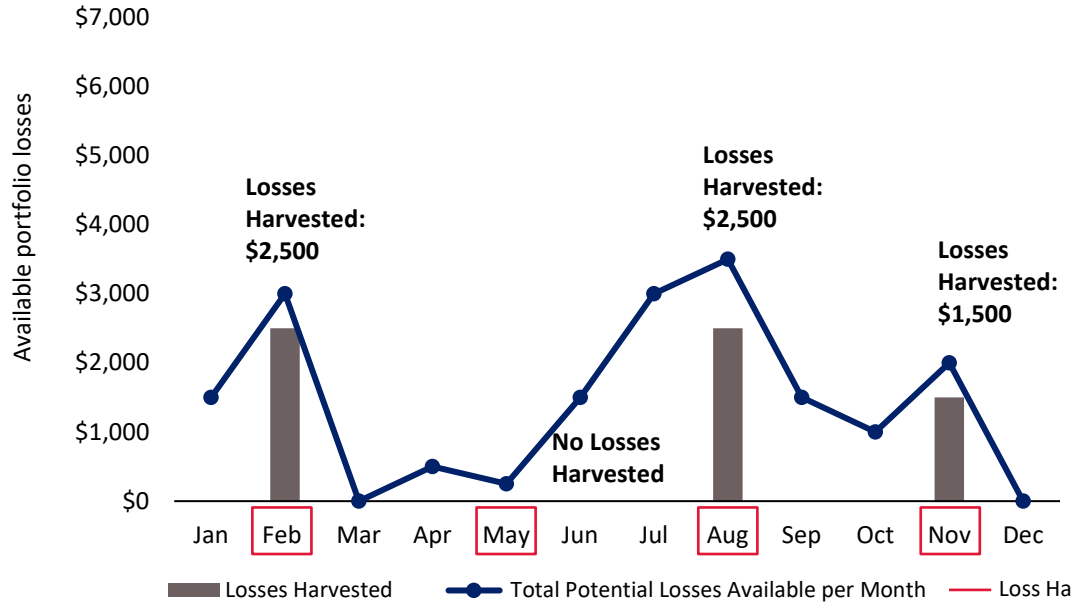
This TER approach would result in a realized **taxable gain of only $520.**

Charts are for illustrative purposes and are not indicative of any investment or actual client account.

How does systematic, active tax loss harvesting, like Quarterly Loss Harvesting work?

Systematic, active tax loss harvesting seeks to capture losses throughout the year, instead of through client directed tax harvesting requests that tend to come at a single point in time — often near the end of the calendar year. The comparison below shows the potential benefit of the Quarterly Loss Harvesting (QLH) overlay service when compared to a year-end client directed request.

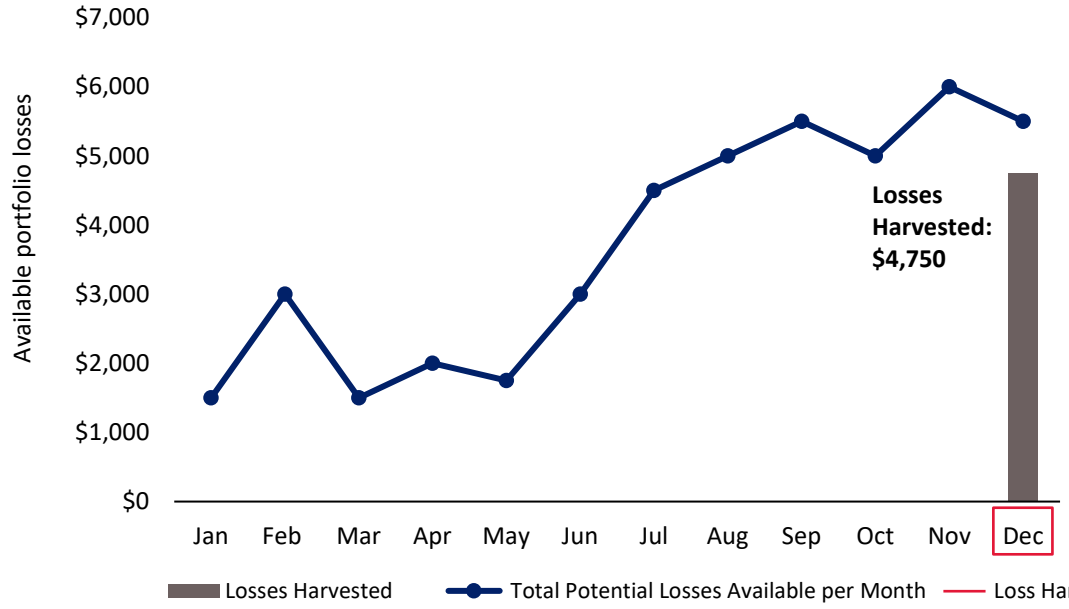
An illustration of the losses realized, when losses are harvested at date of enrollment and then every 91 days



Quarterly Loss Harvesting captures losses every 91 days, potentially increasing the total losses realized in a year.

In this example, harvesting quarterly resulted in $6,500 of realized losses, which may be used to offset capital gains.

An illustration of the losses realized, when client directed harvesting occurs at year-end



Client directed loss harvesting captures losses only when requested, potentially missing out on harvesting opportunities throughout the year.

In this example, harvesting at year end only resulted in $4,750 of realized losses.

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What considerations should you keep in mind before enrolling in a Tax Efficient Management Overlay Service?

When investing, you should carefully consider how each investment can help you pursue your diversification, liquidity and overall investment goals — at a level of risk you are comfortable with. Tax efficiency is only one of the range of factors you should consider for your investment approach.

There are risks and limitations associated with Tax Efficient Management (TEM) Overlay Services. These limitations may result in tax inefficient trades and wash sales. While systematic tax efficient management seeks to help you avoid the disallowance of losses due to the wash sale rules, it is your obligation to monitor transactions across all of your accounts to identify any wash sales or straddles that may occur within or across your accounts. You are responsible for all tax liabilities attributable to the disallowance or deferral of any losses pursuant to the wash sale rules or of any deferral under the straddle rules.

Furthermore, TEM Overlay Services may not be appropriate for your financial situation. If you are taxed at lower aggregate marginal income tax rates, you may be less likely to benefit from these offerings. The risks and limitations are discussed in the Merrill Lynch Investment Advisory Program Brochure in the Tax Matters section.

You should consult your tax and/or legal advisor prior to enrolling in any TEM Overlay Services, as well as on an ongoing basis, to determine whether the wash sale rules, the straddle rules, or other special tax rules could apply to your trading activity.

What is a wash sale?

A wash sale is a transaction where you buy "substantially identical" stocks or securities within 30 days, before or after, of the sale that generated a loss. The tax laws state that you cannot deduct a loss for tax purposes that is subject to the wash sale rules.

How can I determine if TEM Overlay Services are appropriate for me?

Working with your dedicated Merrill advisor is the best way to determine the right Tax Efficient Management Overlay Service, or combination of services. The TEM Overlay Service or Services you select depend on your current tax situation, the investments you hold as well as other personal considerations.

You should also consult your tax and/or legal advisor before selecting a TEM Overlay Service, and on a regular basis after selection. Merrill and its affiliates do not provide legal, tax or accounting advice. You should consult your legal and/or tax advisors before making any financial decisions.

For more details on the suite of TEM Overlay Services available, please refer to the Guide to Tax Efficient Management Offerings.

IMPORTANT INFORMATION

Investing involves risk, including the possible loss of principal. Past performance is no guarantee of future results.

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All recommendations must be considered in the context of an individual investor's goals, time horizon, liquidity needs and risk tolerance. Not all recommendations will be in the best interest of all investors.

For more information about the Merrill Lynch Investment Advisory Program, including our fiduciary responsibilities, you may obtain a copy of the Merrill Lynch Investment Advisory Program Brochure by accessing the SEC website at http://www.adviserinfo.sec.gov.

Managed Account Advisors LLC (MAA), a Registered Investment Adviser and an affiliate of MLPF&S, is the overlay portfolio manager for implementing the Tax Efficient Management Overlays. For additional information and MAA's role, please see the Merrill Lynch Investment Advisory Program brochure.

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