

Tax Planning Vs. Tax Advice: Going Deeper On Taxes (Compliantly)

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1

A long time ago in a galaxy far,
far away...

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The Myth:

Financial advisors can't legally give tax advice.

The Reality:

Financial advice has **tax consequences...**
whether we talk about it or not.

So let's actually talk about it.

Good Tax Strategies Add Up To Real Money

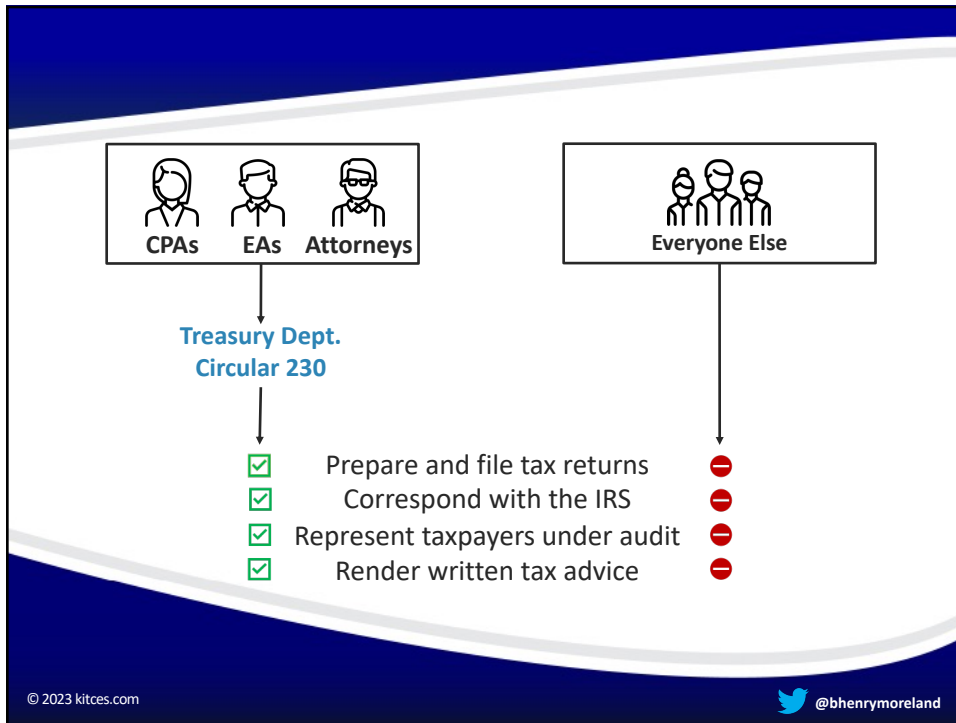
- **Asset location:** 60bps¹
- **Tax loss harvesting:** 20-100bps²
- **Roth vs. traditional (and other) tax timing:** 10%–40% of income recognized
- **Tax decisions (exercising stock options, business entity choice, QBI, etc.):** Thousands per year
- **Review of tax returns:** Priceless

1. Vanguard, "Putting A Value On Your Value: Quantifying Vanguard's Advisor's Alpha" https://advisors.vanguard.com/insights/article/WE_ResPuttingAValueOnValue
2. Financial Analysts Journal, "An Empirical Evaluation of Tax-Loss-Harvesting Alpha" <https://aj.o.mit.edu/wp-content/uploads/2020/07/An-Empirical-Evaluation-of-Tax-Loss-Harvesting-Alpha.pdf>

The Big Question:

How do you provide value by recommending good tax strategies if you're "not allowed" to give tax advice?

Why Financial Advisors Can Give (Most Types of) Tax Advice



How The IRS Defines Tax Advice

“Rendering of written advice with respect to any entity, transaction plan or arrangement, or other plan or arrangement having a potential for tax avoidance or evasion.”

-Treasury Dept. Circular 230

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How The IRS Defines Tax Advice

“Rendering of written advice with respect to any entity, transaction plan or arrangement, or other plan or arrangement having a potential for tax avoidance or evasion.”

“All forms of written material, including the content of an email, given in connection with any law or regulation administered by the IRS.”

<https://www.irs.gov/tax-professionals/frequently-asked-questions#OPRQ4>

How The IRS Defines Tax Advice

“Rendering of written advice with respect to any entity, transaction plan or arrangement, or other plan or arrangement having a potential for tax avoidance or evasion.”

- Business entities
- Trusts
- Retirement plans
- Any plan or scheme the taxpayer could use for tax evasion/avoidance

How The IRS Defines Tax Advice

“Rendering of written advice with respect to any entity, transaction plan or arrangement, or other plan or arrangement **having a potential for tax avoidance or evasion.**”

Evasion = Deliberate failure to pay income taxes owed (Illegal)

Avoidance = Action taken to lessen tax liability (Legal)

But Wait... What Is Tax Avoidance?

- ✓ Roth conversion
- ✓ Donate highly-appreciated securities
- ✓ S-corp election

...are all of these recommendations Tax Advice that will get them in trouble with the IRS if they don't hold the proper credentials?

Tax Avoidance Or (Abusive) Tax Shelter?

“Is this Tax Advice that the IRS will scrutinize?”

- Tax shelters
 - *“(I) A partnership or other entity, (II) any investment plan or arrangement, or (III) any other plan or arrangement, if a significant purpose of such partnership, entity, plan, or arrangement is the avoidance or evasion of Federal income tax” - Sound familiar?*

What The IRS Really Cares About

- Abusive tax shelters (and the advisors who recommend them)
- Listed transactions / transactions of note
 - Required disclosure (including name of advisor)

Listed Transactions / Transactions Of Interest

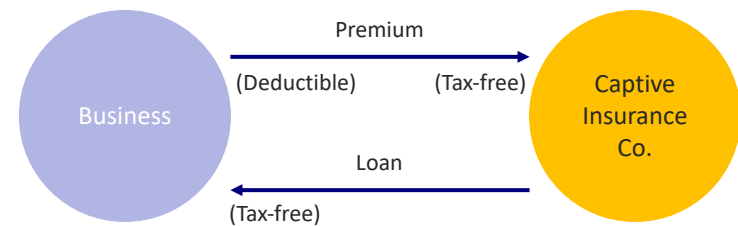
Syndicated Conservation Easements*

1. Promoter raises money from investors to buy land or property
2. Property is appraised at inflated values (>2.5X taxpayer's investment)
3. Development rights are donated to land trust
4. Investors receive a pass-through charitable deduction greater than their initial investment

**Disallowed by 2022 Consolidated Appropriations Act*

Listed Transactions / Transactions Of Interest

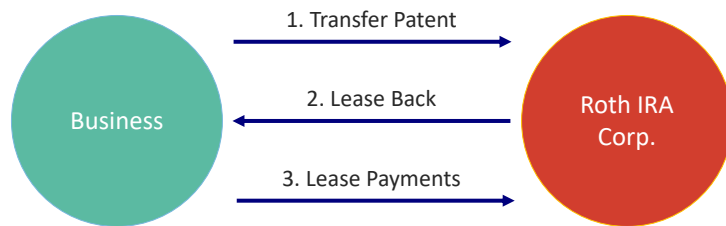
Micro-Captive Insurance Companies*



**Proposed regulations*

Listed Transactions / Transactions Of Interest

Abusive Roth IRA Transactions



Tax "Avoidance" That The IRS Really Cares About

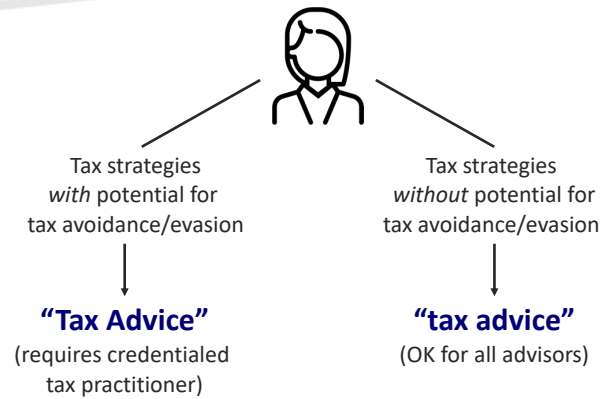


Roth Conversions
Asset Location
0% Gains Harvesting
Deduction Lumping
ISO Exercise
Etc...



Abusive Tax Shelters
Listed Transactions
Transactions Of Interest

The Two Kinds Of Tax Advice



The Bigger Question

If financial advisors *are* legally allowed to give “tax advice”...

Why are so many told that they can't anyway?

Legality Vs. (Financial) Liability

- If a recommendation leads to financial damage (e.g., taxes and penalties), the advisor – and firm – can be held liable
- RIAs' required policies & procedures often don't cover tax advice
- E&O policies typically cover losses from investment advice, but most exclude tax advice from coverage (unless added by separate rider)
- Big firms often take “Lowest Common Denominator” approach – just don't allow advisors to give tax advice in the first place!



Offering "tax advice"
As A Financial Advisor

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Knowing When You're Giving Advice

Two-part rule of thumb:

1. There's a specific recommendation
2. There's a specific plan of action

Defining The Scope Of Your "tax advice"

Three areas to avoid if you're not a credentialed tax practitioner:

1. Recommending potentially abusive tax shelters (e.g., listed transactions) - <https://www.irs.gov/businesses/corporations/listed-transactions>
2. Interpreting laws in new ways (i.e., finding the 'next' tax shelter)
3. Giving written opinions on the legality of a strategy involving either of the above

Managing Your Liability Exposure

1. Fiduciary obligation: Give advice only in areas of competence
2. Review E&O coverage (some plans offer a rider for tax advice/preparation)

Offering Tax Planning (When You Can't Give tax advice)

“Tax Planning” Defined

Factoring the tax impact of a client’s actions
into their overall financial picture

Planning → **Advice** → **Implementation**



Tax Planning In Action

Future systematic Roth conversions in early retirement

- Planning: Running the projected numbers
- Advice: Calculating exact amounts to convert
- Implementation: Moving the money

Tax Planning Vs. Tax Advice

Planning

- Informative
- Forward-looking
- Changeable
- Strategic

Advice

- Actionable
- Immediate
- Concrete
- Definitive

Client Communication And Tax Planning

- Tax advice is in the eye of the client
- Make expectations clear upfront – clients *want* you to make a recommendation, unless they expect otherwise
- Use disclaimers on written materials
- Emphasize that the plan can change
- Direct clients to consult a credentialed practitioner

Technology And Tax Planning

Tax-Focused Projection



Income Solver

COVISUM

Tax Return Review/ Scenario Analysis



fp alpha α

Pro Forma Returns



Bloomberg
Tax



Final Thoughts



Opportunities Exist In Tax Planning And Advice

The numbers, restated:

- Asset location + tax loss harvesting: >100bps
- Tax timing: 10%-40% of income realized
- Other tax decisions: Thousands per year

Opportunities Exist In Tax Planning And Advice



Work With – Not Against – Compliance

- Advisors at small and midsize firms can take the initiative to build a framework beyond “don’t give tax advice”
 - Tax planning example: Define the perimeters of where tax planning can start and end, and where the “handoff” to a CPA or tax professional happens
 - Tax advice example: Develop a “whitelist” of strategies that *can* be recommended to clients – or conversely, a “blacklist” of strategies that *can’t* be recommended

Lean Into Tax Expertise

- Advanced Designations/Education
 - Enrolled Agent (EA) – unlimited practice rights before the IRS
 - Accredited Tax Advisor (ATA) – advanced knowledge in income, estate, and business tax planning
 - Master’s in Tax
- Building network and relationships with CPAs and other tax-forward advisors
 - Local estate planning councils
 - FPA Tax & Estate Planning Knowledge Circle

Thank You!

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