ELECTRONICALLY REPRINTED FROM JUNE 15, 2015

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The WealthManagement.com Magazine for Advisors

Making Next Year's Tax Season a Little Less Brutal

There are a few things that a broad cross section of advisors agree on when it comes to what financial and tax advisors should be contemplating now, and advising for their clients, while this year's experience is still fresh in their minds.

By Chad Smith

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The old adage, "It's not what you make, it's what you keep," reflects a fundamental truth that continues to drive the worlds of investment management and tax advice closer together. At an informal best practices discussion session among many of our advisors and executives preceding our recent annual conference's kick-off on June 16 in Dallas, Texas, one theme repeatedly emerged from our advisor community: The past tax season was particularly "brutal."

Indeed, that was the word we heard most often. In response, we wondered how we might lessen the burden on financial advisors, tax professionals and their clients alike. But as an initial step, we thought it would help to understand what made this past season so difficult.

Broadly speaking, it seems that the causes fell into two major categories:

- First, according to the discussion participants, there was the increasing complexity of the tax code. This problem has been around for a very long time, but in recent years it has only gotten worse. Tax year 2014 was a particularly bad year for added complexity – and generating unwanted surprises.

The Affordable Care Act (ACA) was one of the leading complicating factors, but by no means the only cause. 2014 was the 2nd year of the ACA imposing a Medicare surtax on earned income as well as a further tax on net investment income. Additionally, we saw revised depreciation rules and continued complications with the Alternative Minimum Tax, which caught a number of taxpayers unaware. The list of new and modified regulations for the year was fairly substantial.

- Secondly, our discussion participants emphasized that this past tax season's complexity was also driven simply by "life" itself. Ironically, the improving economy brought a host of complications and new situations that many taxpayers hadn't dealt with in years.

For instance, with the improving employment environment, people were more confident about changing jobs – and that brought the added concern of rolling over their retirement plans. People who were feeling more secure in their jobs were also more sanguine about buying a home, which brings important tax considerations in its wake. And, with the stock market reaching new highs, more Americans were purchasing equities, something they'd shied away from since 2008. Not unsurprisingly, many new or returning investors didn't even know, or remember, that they needed to bring the 1099's from investment accounts for their tax return to be completed.

As a result, we encountered a "double whammy" of complexities in April 2015.

Four Tips to Help Advisors and Clients

So, what shall we do to make next year's tax season less wrenching? There are a few things that a broad cross section of our advisors agree on when it comes to what financial and tax advisors should be contemplating now, and advising for their clients, while this year's experience is still fresh in their minds.

- **Stress the importance of setting up regular, ongoing two-way communication**. Clients should regularly be talking to their tax professional and financial advisor about any important financial transactions, whether buying a home, changing jobs, paying for college or any number of other actions that involve substantial sums of money. In this way, not only will the advisor be able to discuss the feasibility and planning for such events, but can also help guide his or her clients on the tax consequences of their actions – and perhaps to help them consider alternative approaches – even before they pull the trigger on a taxable event.
- **Schedule a fourth quarter meeting.** Before the year is over, make sure that you meet with your clients in order to take tax-savvy actions while they are still available. There are so many things, like harvesting losses to offset gains, that can't be done once the year has closed. In this regard, it's important to point out that clients with complex tax lives need to be working with a tax professional who can also offer financial advice as a licensed advisor. These clients need someone who can help them to plan their actions and mitigate taxes when it is still possible to do so – versus working with a tax preparer, who merely works on their past year's information in the month or two before taxes are due.
- **Clients need a single advisor who sees their whole picture.** Although diversification of assets helps safeguard against risk, financial diversification should not mean diversification of advisors! Without being able to see the entire puzzle, even a well-meaning investment advisor with good ideas may inadvertently make recommendations that simply aren't wise. They may miss important tax advantages or other accompanying benefits.
- **Create a Personal Financial Statement for your client.** To help both the advisor and the client, creating a client's personal financial statement – both an income statement and a balance sheet – can serve as an excellent means to help a client truly understand where all his, or her, assets are, how they contribute to the overall picture, what is the true extent of all the client's expenses and obligations, and what is his actual net worth.

Advisors tell us that all too often, clients don't even know where all their assets are.

Not infrequently, late in the tax season, and after tax preparation has commenced, clients suddenly come back with additional statements they received or with additional records that they didn't realize were relevant. But with a comprehensive personal financial statement, drawn up as part of gaining a holistic financial picture (as mentioned above), both the advisor and client can anticipate what to expect and what to be on the lookout for. That in itself can make the tax season a little less agonizing and prone to surprises. And it makes long-range planning easier, too. All of this points towards the clear benefits of a close collaboration between the tax advisor and financial advisor in order to provide a more holistic approach for the end client. Financial advisors will want to be there when a client meets with the tax advisor, to make sure they are working in the same direction – and to make sure that the tax advisor isn't undermining the financial advisor's recommendations by pointing out missed opportunities or potential pitfalls the advisor was unaware of.

Even more so, it argues for the tax advisor and the financial advisor being one and the same person – to ensure that income on one hand will work most advantageously with tax liabilities on the other.

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