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Advisors Caution About Going Independent Under Tax Reform

By Cyril Tuohy
InsuranceNewsNet

Financial advisors warned against hastily restructuring businesses toward self-employment to take advantage of the proposed changes to the tax code.

"There's already an exodus of financial advisors going independent, but I don't think it should spur any advisor to go independent simply for the tax benefit," said financial planner Kashif A. Ahmed, president of American Private Wealth in Woburn, Mass.

"Independence is not for everybody, even though it's sold as such," Ahmed said.

A tax reform bill in Congress cuts taxes by $1.5 trillion over 10 years.

The House is expected to vote on it today with the Senate voting on it later today or tomorrow, *The Wall Street Journal* reported.

Under the Tax Cuts and Jobs Act of 2017, owners of pass-through entities will be able to deduct 20 percent of their income if they make less than $157,500 filing an individual tax return, or less than $315,000 if they file a joint married return.

Above the threshold set out in the bill, the deduction would not be available for financial advisors.

The tax bill, therefore, creates an incentive for advisors to become self-employed.

That has led to debate about whether advisors and brokers might be tempted to recast themselves as a small business or as independent advisors.

Pass-throughs include S corporations (S Corps), limited liability companies (LLCs) and sole proprietorships where income passes through to the owners' individual tax returns and is taxed at the same rates that apply to personal tax returns.

The highest tax bracket for individual filers in the new bill is 37 percent, down from 39.6 percent.

Going independent is a big step, said financial planner Allan Katz, a fee-based and commission-based planner with Comprehensive Wealth Management Group in Staten Island, N.Y.

"If you are below some of those (income) thresholds, you are probably not ready to go independent anyway," said Katz, who became independent in 2002.

Advisory Fee Deductions

Democrats and other critics of the tax plan have railed against it as a tax giveaway to big corporations and the wealthy.

President Donald Trump, however, has announced he's ready to sign the bill and offer U.S. taxpayers the most sweeping tax reform in a generation.

Before he does, though, another change proposed by the tax overhaul is the repeal of the investment advisory fee deduction.

Repealing the investment advisory fee deduction means consumers paying advisors through a commission get better tax treatment than consumers who pay advisors a fee, according to Michael Kitces, partner and director of financial planning research at Pinnacle Advisory Group.

Some advisors maintain that repealing the deduction is bound to infuriate some clients who will no longer be able to itemize and deduct investment management fees.

The inability of employee, or captive, advisors to deduct expense fees where all such expenses are deductible could nudge advisors toward independence, experts also said.

Tax expert and financial planner Howard Erman said that, for most advisors, differences between the tax treatment of fee-based and commission-based income don't amount to much. Those differences would not be enough to galvanize an advisor to set out for the horizons of self-employment.

"That's not going to incentivize people," said Erman, owner of Erman Retirement Advisory in Seal Beach, Calif. "The Department of Labor (fiduciary) rule is more impactful in in our business."

The tax reform bill contains lots of other financial nuances that advisors will have to sift through with their tax experts. But Katz warned that saying, "Wow! A tax break! I'm going independent," isn't the right approach.

Laws and political leaders change. Advisors may like changes to tax laws today but may not like changes to tax law in the future, he said.

In the end, the government will find ways to raise revenue.

"One way or another, they are getting us," he said.

InsuranceNewsNet Senior Writer Cyril Tuohy has covered the financial services industry for more than 15 years. Cyril may be reached at .

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