Let's Talk About Fees...

They're no longer tax deductible.

> "Yes, you have to pay taxes, *but you don't have to pay the excessive fees.*"

Fees have always been an important consideration for investors. The net return you receive from your investments will be whatever your investments returned, minus fees and taxes. Up until 2017, however investors have had some relief in that fees from financial advisors were deductible for those that itemized.

A standard practice for us was to bill a clients taxable account for their overall relationship so they could deduct the fees as a line item. That in essence, gave them some relief to the fees that they paid. The tax cuts and jobs act put in place in 2018, removed that deduction. Even if a client decides to itemize, under the increase standard deduction, the deduction is not available.

Take Barry Client for an example. Barry is in the 25% bracket and his $1 Million portfolio returned the exact same in 2017 as it did in 2018. Let's say 6.5% after tax before fees for both years, and his total fee for both accounts 1.5% (the average listed by Vanguard).

In 2017, Barry's ability to deduct financial advisors' fees allowed him to increase his return by 0.375, giving him a net return of 5.375% his $1 million at the end of the year totaled $53,750

In 2018 Barry's ability to deduct is gone so his net is $50,000...

No big deal you might say.... $3,750, until we compound that over 20 years. The difference then comes out to be $210,328 ($2,922,968 versus $2,712,640). You can see how this will get worse for clients in higher brackets with larger balances!!

But what can you do about it...? Yes, you have to pay taxes, but you don't have to pay the excessive fees.

The answer in my opinion lies in the way you leverage the experience of your advisor. Most large brokerage houses are encouraging advisors to promote the "advice and guidance" not the investment selection or the bottom-line performance against their benchmark. This in my opinion is where the issue lies. Advice and guidance is important, and I believe every client needs a plan, but it's not something that should cost the client a percentage of their assets. It should be a one-time fee, not unlike a tax return or an estate document.

Separate out the investment management fee, and the planning fee. Identify what you're paying for each and measure what value your or your client is receiving for that service. Planning, advice and guidance is subjective. The fee you pay versus the value you receive will be different for every investor. Some clients have a lot of moving parts while others are plain vanilla. The fee for the plan and ongoing advice should reflect that, based on time spent not a percentage of assets.

As for the investments, that provides an easier measuring stick. However your client is allocated, (from conservative to aggressive) there is a benchmark that we can measure against. The goal of the investments should be to beat the benchmark net of fees. Now let me say that's hard to do. Near impossible over time, some would say, but that does not mean it shouldnt be the goal.

By measuring against the benchmark (on a consistent basis – quarterly), you can not only identify how much value your Advisor is providing, but trends. If you're consistently underperforming (or outperforming), it gives you a reason to dig deeper.

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In summary, for the CPAs out there. Due to tax law changes, Investment fees will have a greater impact for your HNW clients. There is a way to measure the value they are receiving. If you have any further questions, please feel free to contact my office.

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