12TH ANNUAL

IAA ADVISER ADVOCACY DAY

JUNE 13, 2019

Making Advisers' Voices Heard on Capitol Hill

IAA INVESTMENT ADVISER ASSOCIATION

Restore and Extend Advisory Fee Deductibility and Favorable Treatment for Pass-Through Businesses

Two provisions of the 2017 Tax Cuts and Jobs Act (TCJA) unfairly disadvantage investment advisory firms and their clients. The IAA seeks to restore and expand the deductibility of investment advisory fees as an itemized deduction. The IAA also seeks to make the 20% deduction for pass-through businesses available to owners of advisory firms.

Advisory Fee Deduction Should be Restored and Expanded

Many Americans lack confidence about their ability to afford a secure retirement and even those who are confident may be unrealistic in their views.[1] Further, studies show that few Americans have developed a comprehensive retirement plan.[2] For these reasons, tax policy should encourage taxpayers to employ the services of an investment adviser.

Investment advisers, as fiduciaries, help their clients develop retirement plans, save for retirement, invest prudently to reach their goals, and produce better retirement outcomes. Because advisers are typically compensated with a small percentage of a client's portfolio value (advisers do not sell products or earn commissions), the adviser's interests are closely aligned with the client's.

However, TCJA repealed the investment advisory fee deduction as part of its elimination of itemized business deductions. This has resulted in the unintended consequence of effectively increasing the cost of advice to investors and discouraging use of advisers. It also put investment advisers – who are almost exclusively fee-based – at a tax disadvantage relative to commission-based broker-dealers.

The basic principle that income should be reduced by expenses associated with that income – including advisory fees – was reflected in the Internal Revenue Code until TCJA.

Restoration of the deduction paired with the removal of the pre-existing 2% Adjusted Gross Income (AGI) floor[3] will allow a broad swath of American taxpayers to benefit from the deduction and encourage them to seek investment advice for a secure retirement.

20% Pass-Through Deduction Should be Extended to Advisory Firms

The pass-through provision has serious detrimental consequences as well. Owners of advisory firms that are pass-throughs are allowed to deduct 20% of their income only if they make less than $157,500 filing an individual tax return or $315,000 if they file jointly. Above that income threshold, the deduction is not available to investment advisers as they are deemed to be ineligible "specified service" businesses.

This provision erroneously penalizes the many owners of successful investment advisory firms with bona fide profits over and above wage income. It has created difficulty in their attracting capital, decreased their firms' valuations, produced succession planning challenges, and incentivized them to convert to more complex ownership structures.

This provision also deserves reconsideration because it was intended to spur the creation of new employment opportunities and the investment advisory industry is a powerful provider of high-quality jobs to the economy. In fact, investment advisers now employ some 835,000 non-clerical workers, a 16% increase over the past five years.

[1] Employee Benefit Research Institute, *Retirement Confidence Survey Summary Report* (2019).

[2] Fidelity Investments, *Retirement Mindset Study* (2019).

[3] The tax code was amended in 1986 to create a 2% floor on all miscellaneous itemized deductions to reduce the potential for abuse caused by extensive taxpayer recordkeeping demands and the accompanying administrative complexity for the IRS. The advisory fee deduction, however, does not present the same concerns or potential for abuse because custodians and advisers are subject to recordkeeping rules that ensure investors receive quarterly statements that clearly show the average deducted advisory fees. The 2% floor also effectively made the deduction available only to high net worth individuals.

For additional information:

Neil Simon, *Vice President for Government Relations*
neil.simon@investmentadviser.org

Karen Barr, *President & CEO*
karen.barr@investmentadviser.org

Gail Bernstein, *General Counsel*
gail.bernstein@investmentadviser.org