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SumNEWS

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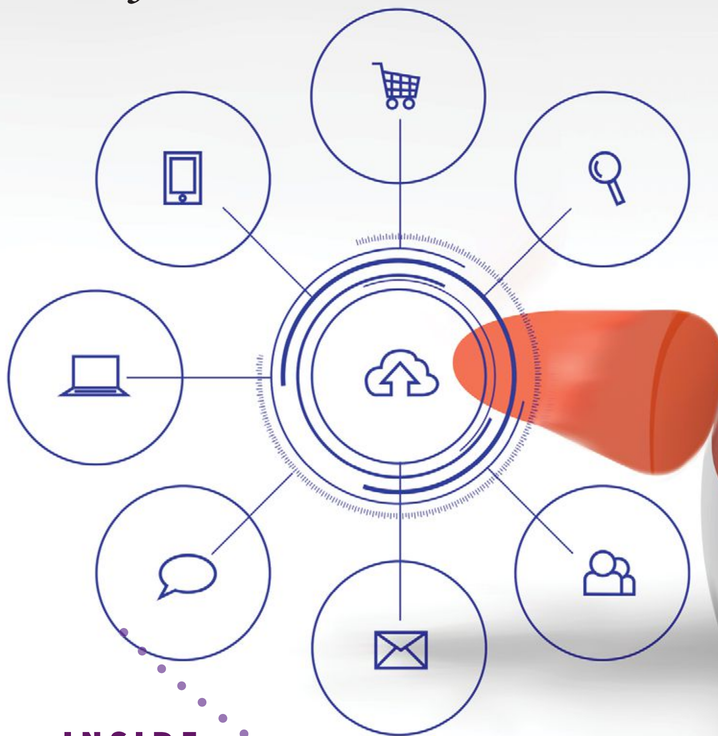

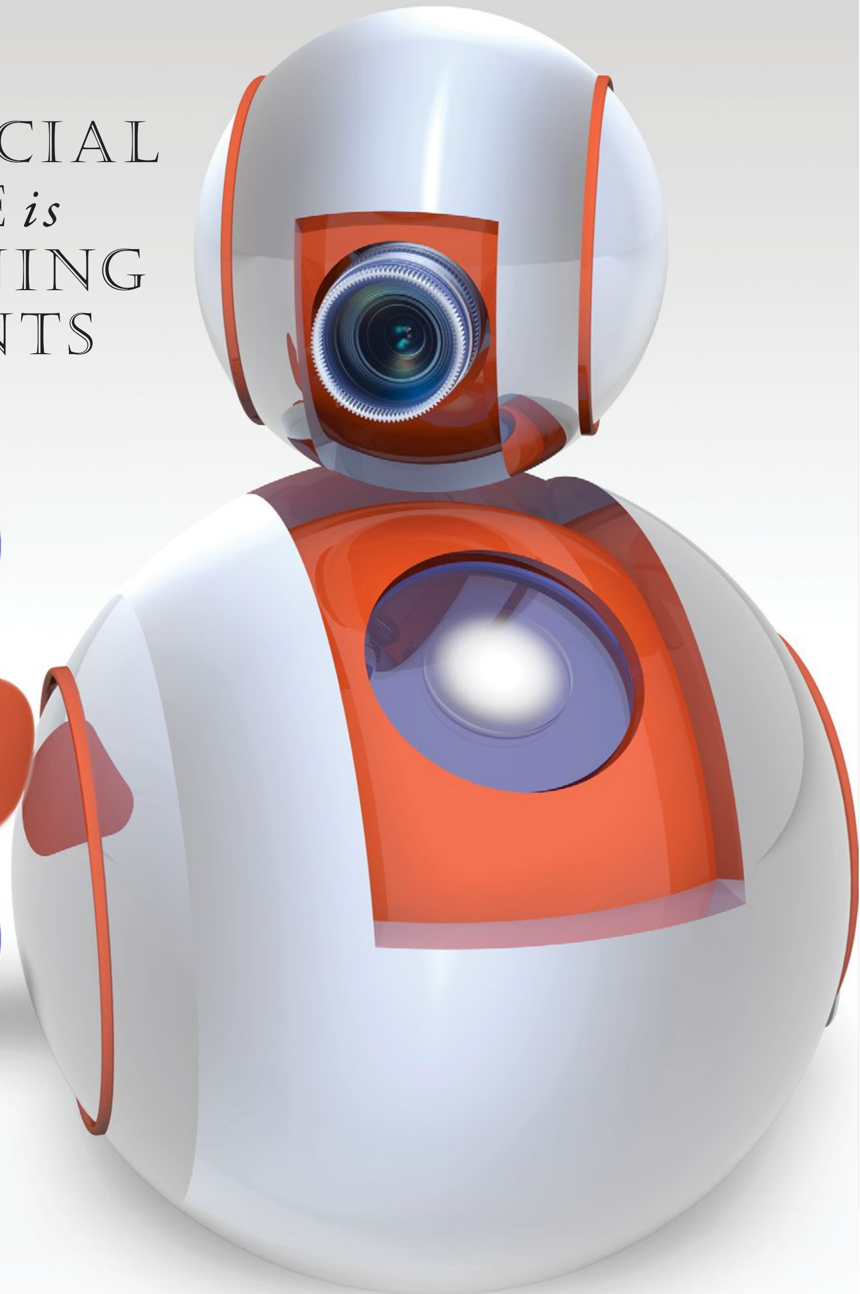

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Does Your Client Need a CFP Referral?

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Does Your Client Need a CFP Referral?

By Daniel J. Flanagan, CPA/PFS, CFP, AEP

Whenever I meet with a CPA, I jokingly tell them I'm a "recovering CPA" having worked in public accounting for eight years prior to moving over to the wealth management side in 2000.

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At some point in the conversation, most CPAs ask me: "How would I know whether my client is getting sound investment advice, unless the client complains?" Actually, as a CPA, you are in the best position to be able to tell if your client would benefit from a referral to a Certified Financial Planner (CFP). The clues are in the federal tax return.

Here are three signs that your client is/is not receiving quality investment guidance – which should prompt the CPA to refer the client to a qualified CFP.

Signs that your client is/is not receiving quality investment guidance

1 INTEREST AND DIVIDEND INCOME

If your client has significant taxable interest income (line 8a) there may be ways to reduce their taxes. One way might be to invest in municipal bonds (federally tax exempt) in taxable investment accounts.

Like interest income, ordinary dividends (line 9a) are taxed as ordinary income tax rates (as high as 39.6%) while qualified dividends (line 9b) are taxed at the lower capital gain tax rate (15%). Another way to avoid taxes on investments whose return is mostly ordinary income (interest and ordinary dividends) is to "locate" these investments in tax deferred accounts.

2 CAPITAL GAINS

Capital gains (line 13) is definitely one of the major areas that can cause client's income tax liability to rise. Of course clients and their advisors need to be cognizant of the tax consequences of realizing capital gains on a client's portfolio. They also need to stay on top of mutual fund capital gain distributions.

I learned early in my career that clients do not like tax surprises. Imagine having to pay taxes on your portfolio in a year when the market is down. That's exactly what happened to a prospect of mine. In 2015, "market" returns were muted with the Standard & Poor's (S&P) Index 500 up 1.28%. When their income tax return was complete they were surprised to learn they owed taxes because of capital gains. Their financial advisor explained this was due to capital gain distributions from mutual funds. One way to minimize capital gain distributions is by monitoring the reported capital gain distributions on funds owned by your client, attempting to "swap out" of the fund before the distribution is paid and reinvest the proceeds in a similar fund (large cap for large cap), while steering clear of any wash sales rules. In this prospect's case, their financial advisor could have sold out of the fund, harvested the loss and avoided the capital gain distribution. In any event, as long as the financial advisor is communicating properly with the client and the CPA there should not be any surprises.

3 SELF-EMPLOYED RETIREMENT

As you know, for clients who are self-employed, a great way to save for retirement while saving some money for income taxes would be to contribute to a SEP IRA. If your client is self-employed and does not have a retirement plan you may consider an introduction to a CFP who can set it up.

Liquidity events and life changes like marriage, divorce, death of a loved one or retirement, should prompt you to consider making an introduction to a CFP.

What if my client does not work with a CFP?

Another question I am often asked by CPAs is when their client, who doesn't work with a CFP, might benefit from such a relationship. As a CPA, you are again in the best position to tell. Liquidity events and life changes like marriage, divorce, death of a loved one or retirement, should prompt you to consider making an introduction to a CFP.

Conclusion

It may be enough to say that if your client's CFP isn't reaching out to discuss tax-minimization based on a desired investment strategy that the client may be better served elsewhere. CFPs should be communicating with each client's CPA to periodically update them on investment related income tax issues, so that there are no surprises at year end. CPAs who notice red flags on a client's income tax return related to an investment portfolio should consider introducing their client to a CFP who is tax sensitive. In the end, you'll be serving your clients well. ◆

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