What Investment Advisory Fees Are Deductible and How to Take Them?

Q: What type of fees are deductible in a clients' investment account?

A: An asset management fee is a tax-deductible expense. **This would include manager and advisor fees**. It does not include trading costs or other fees related to the purchase of a specific holding (these get added to cost basis).

Q: Where does my client report the fee on their tax return?

A: List the fee on Schedule A under the section called "Job Expenses and Certain Miscellaneous Deductions." **The ability to enjoy tax savings via Schedule A depends on three factors**. First, the client is itemizing deductions and not just using the standard deduction. Second, Schedule A provides tax savings only to the extent that deductions exceed 2% of Adjusted Gross Income. Furthermore, Miscellaneous Deductions are a "tax preference item" for purposes of calculating the Alternative Minimum Tax. If the AMT applies to the client, some or all of these deductions could be disallowed.

Q: On IRA money that is in DIAS, are the fees tax deductible when automatically deducted from the account?

A: Most likely. Tax professionals debate whether an asset management fee is a deductible expense for IRA accounts. Many agree that the fee is deductible, just as it is for regular accounts. **Some tax preparers disagree**, however, and suggest that the fee is only deductible if the IRA generates taxable income for that year. Many also suggest that the fee is only deductible if paid with money outside of the IRA.

Q: Can the IRA fees be deducted from the non qualified accounts or any other account?

A: Yes this can be done and many times suggested (see Ed Slott discussion on next page).

PLEASE SEE THE NEXT PAGE FOR SPECIFIC THOUGHTS ON DEDUCTING IRA FEES

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IRA Fee Deductibility

IRS Private Letter Ruling 201104061 - Here, the IRS ruled that wrap fees on both traditional IRAs and Roth IRAs could be paid directly by an IRA owner and not be a deemed IRA contribution. “The ruling also confirms that trustee fees for IRAs are deductible, under Revenue Ruling 84-146, covering Section 212 of the tax code,” says **Robert Keebler**. Section 212 deductions are expenses related to investment activities. As such, they are included as miscellaneous itemized deductions, which are deductible to the extent they exceed 2% of adjusted gross income.

The recent ruling, which came in the form of a letter to an investment firm released by the IRS on **January 28, 2011**, reiterates a position the IRS has taken before. As is typically the case with the so-called private letter rulings, the name of the company that requested the ruling is not released, and the findings only apply to that particular letter writer. But this isn’t the first time the IRS has taken this position, says **Bob Trinz**, an analyst with the Tax & Accounting business of Thomson Reuters. “As a practical matter, you can do this,” he said.

That presents planning opportunities that are especially potent for Roth IRA holders, says **Ed Slott**, an IRA expert and editor of Ed Slott’s IRA Advisor, a newsletter. **By writing their check to their money manager from outside funds, they avoid depleting the funds in their tax-sheltered account**. And the fees they pay can be deductible as miscellaneous expenses. That means they aren’t deductible until they exceed 2 percent of adjusted gross income, but these fees can be significant. For example, someone with a $1-million IRA paying 1 percent of assets under management to their adviser would pay $10,000 a year in fees.” By paying that from outside, you’ve added $10,000 to your IRA that would otherwise have been spent on fees,” says Slott. “And the tax deduction is like gravy.” Not everyone will choose to write the separate check. If you’re close to the withdrawal-phase of retirement, it might make sense to let your adviser pull her fee from within the account. That’s because money withdrawn from a tax-deferred IRA is subject to income tax. Paying the broker directly from within the account wouldn’t necessarily create a taxable event; pulling the money out first and then writing the check would cause a taxable distribution to you.

Q: When are the fees tax deductible and when are they not tax deductible? What part of your answers are black and white verses operating in the gray area?

A: The only gray area is deducting fees in the IRA, which the IRS clarified in 2005 and now again in 2011 via a PLR which is good enough for us at all levels. You may find a CPA or Attorney that would look to be ultra conservative and say that a PLR is not good enough, they want actual Internal Revenue Code, which is too conservative for me; or even worse try to position with this with your client as trusted advisor!

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Q: Can the client deduct the fees directly from the IRA account? If the client does this, are the fees deductible?

A: Yes, you can withdraw the fees from the IRA account. However, if you do this the fees are not deductible.

Q: If the client has a Roth IRA does this change anything?

A: Again, if the fees are taken directly from the Roth IRA, then they are not deductible. Just like regular IRA fees, these should be paid from an outside non qualified account to achieve maximum deductibility potential.

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