Spring 2014

Aldersgate Advisors

RESEARCH RECOMMENDATION:

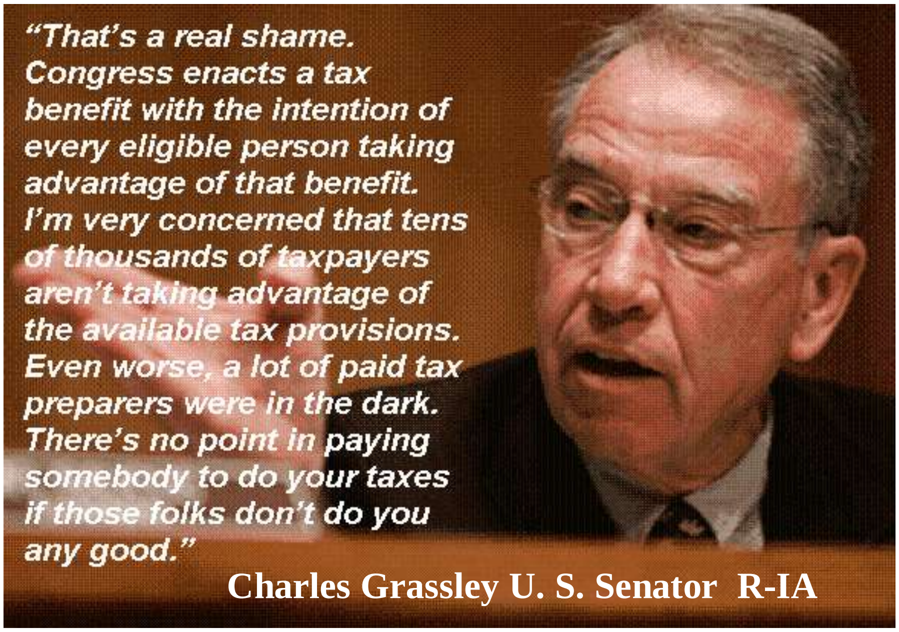
Perhaps The Greatest – Most Predictable – And Most Avoidable – Threat To Wealth Maximization – Overpaying Your Taxes

Are you overpaying your taxes? **Probably, chances are better than 50 /50 and the higher the income, the greater the chance – more than 99.5%!** For example:

- Congress estimates over half of all taxpayers overpay their taxes by not taking advantage of available tax provisions.
- 89% of taxpayers that overpay their taxes use "professional" fee paid tax preparers such as CPA's.
- A report from the Treasury Inspector General for Tax Administration showed that less than half of the eligible taxpayers took advantage of available income tax provisions and found that paid tax preparers didn't know about key changes in the tax code, didn't think their clients would benefit, or used preparation software that led them to believe there would be no benefit.
- Research by the General Accounting Office (GAO) found that 71% of S corporations that used a paid tax preparer submitted returns that contained errors.
- **It's worse for high income earners. The latest available data from the IRS reports that for those earning over $200,000, less than ¼ of 1% take full advantage of all their available deductions.**

What's the cost?

Overpaying taxes can cost millions of dollars over the long run. Tax payers not only loose the actual dollars they over paid in tax the first year – but also loose what those dollars would have earned if they had been properly invested. The opportunity cost.



Charles Grassley U. S. Senator R-IA

Obviously, the greater one's income, the greater potential to overpay taxes – the greater the opportunity cost!

For example, consider the average income of the top 1% of U S tax payers. The average income for the top 1% is just shy of $1,000,000.

The average current effective federal income tax rate – excluding any state taxes -for this group is about 24%, so the average federal taxes paid by the average member of the top 1% is about $240,000.

Analysis of the IRS data suggests the average taxes paid should be about ½ that rate or about 12% or only $120,000 if all available deductions were applied.

With a Return On Investment (ROI) of only 15%, that "extra $120,000 in tax savings invested over five years will compound to just over $240,000 and in ten years to just about another $500,000 to your net worth.

ROI of 15% may seem high to some, but for many entrepreneurs and investors in alternative investments and with the judicial and prudent use of leverage and other sophisticated opportunities, techniques and strategies available and frequently employed by those of the 1%, a 15% ROI would seem very modest to many, and very reasonable to most.

For example consider one entrepreneur that generates a 36% Return On Equity (ROE) in his 40 year old business. $120,000 reinvested in his company at that ROE would grow to about $550,000 in five years and to $2.6 million in ten years. And even if the profitability of this business should slow in the future, there are always other comparable alternative investments.

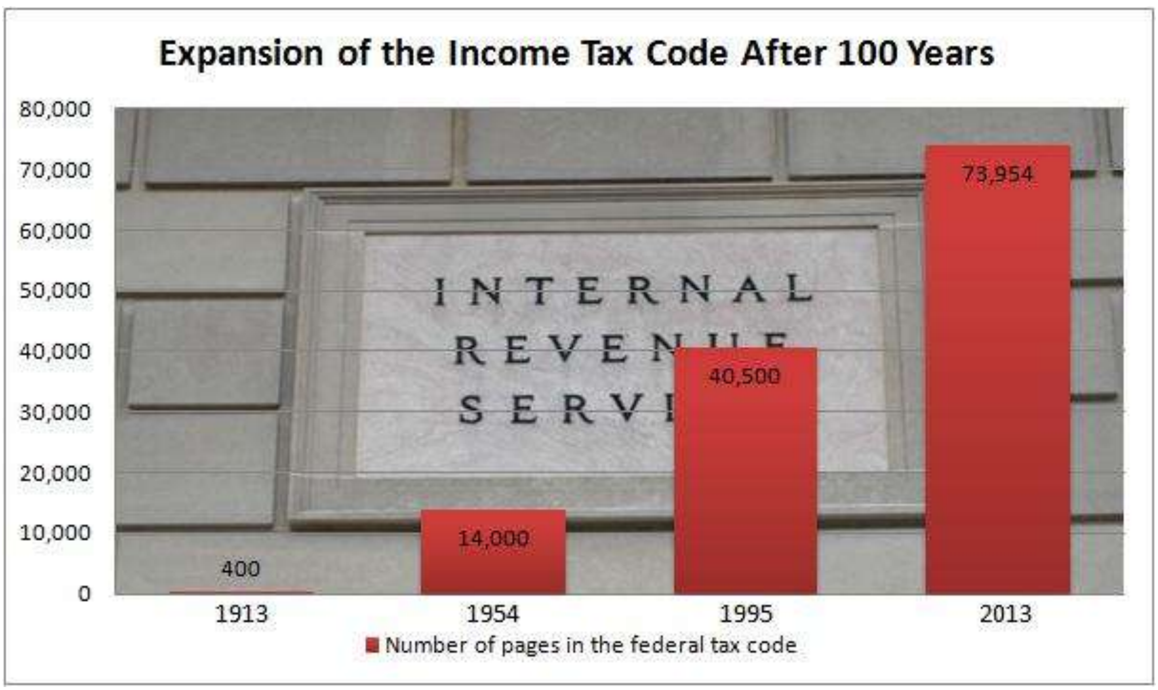
So considering the lost opportunity costs – the costs of overpaying one's taxes can be significant. As in the above example, overpaying taxes of only $120,000 could cost $2,600,000 over the next ten years. The greater your opportunity costs, the more expensive it is to overpay your taxes. By only paying the proper amount of tax – no longer overpaying – and taking those dollars and investing prudently, the dollars that were being used to overpay taxes- can grow and compound over several years to millions of dollars – depending on the average returns received. **<u>And that is each and every year – year in and year out</u>!** Knowing your situation and investment opportunities, you are probably already doing a quick calculation.

So what has 5, 10, 15 years of overpaying your taxes already cost you? Why let it continue?

This needless overpayment of taxes is not only an impediment to wealth creation, but for those of the Christian faith, it is certainly not proper Christian stewardship – "*<u>Then render to Caesar the things that are Caesar's, and to God the things that are God's</u>*." Luke 20:22. How much suffering could Americans' ease by rendering only to "Caesar" that which is actually due the government and then applying a portion of the savings to the charities and causes of their choice?

How is this possible?

You may be wondering how this could happen? How do all of those high income earners that use the best and most expensive CPAs, attorneys, and other advisors overpay their taxes by failing to take full advantage of all the available deductions?



Even with all the continuing professional educational requirements, many tax, legal, and financial advisors are simply being overwhelmed by the rapidly expanding tax and regulatory environment and unable to focus adequately on how the changing tax code may affect some of the more specialized applications.

Most advisors must rightfully prioritize so as to do the most good for the greatest number of their clients and focus on those provisions that will affect the broadest segment of their business. The unfortunate result is the effect some provisions may have upon limited segments of their practice such as yachting or horses for example and some opportunities may be overlooked.

Often it requires a specialist in one of the overlooked areas to bring the benefits of some obscure provision to the advisor's attention. Often advisors feel embarrassed or threatened and fear losing a client when an overlooked opportunity is brought to their attention. However they shouldn't. No one can possibly know everything. We're specialists – multi-disciplined social scientist trained in scientific methods to identify, create, and exploit informational advantages.

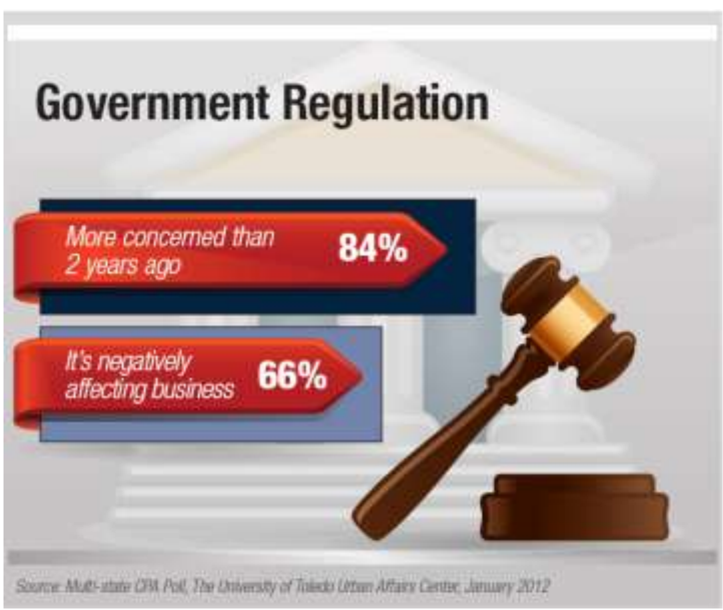
For advisors to spend their limited time searching how every client's passions, lifestyles and investments may be affected by some obscure change in the tax code is probably not practical or realistic. Certainly the larger and more diverse the advisor's practice, the more susceptible to these time constraints and thus the possibility missing or overlooking something.

This is a wide spread problem and no individual or company regardless of the size, sophistication or industry is exempt. Even the largest of professional firms of the most skilled and highly paid CPAs, attorney's, and advisors, can't keep up with the constantly changing and increasing regulatory and tax environment. Data collected by researchers at George Mason University's Mercatus Center shows that the Code of Federal Regulations, where all rules and regulations are detailed, has ballooned from 71,224 pages in 1975 to 174,545 pages last year.

In the ten years between 2001 and 2011, the federal government issued over 38,000 final rules and regulations – and the trend under the current administration shows no signs of slowing."All incentives are to regulate more," said Susan Dudley, the director of George Washington University's Regulatory Studies Center.

But it is not just CPAs that are being overwhelmed. Likewise a similar study of more than 1,000 charitable giving professional advisors including CPAs, attorneys, and financial advisors found a similar result. The study consisted of randomly selected questions posed by a group of professional charitable giving experts.

Consequently the study found that when asking these "professional advisors" about their specific area of expertise – charitable giving- that no group answered more than 70% correct. On average per group, CPA's answered only 30% correctly, financial advisors 45%, and attorneys 65%.



To quote one of the researchers, "Most financial experts are not up to speed when it comes to the mechanics of charitable giving, even though that's what their wealthy clients want. These are the people who are supposed to know this stuff, and they didn't."

Professional tax, legal, and financial advisors have a difficult if not impossible challenge keeping abreast of all the tax and regulatory changes of their practice specialty – much less find the time and resources to focus on the potential effects of only a sub-set of their clientele – yacht owners for example.

It's the rare advisor equally proficient in all of his clients' business and personal lifestyles with the time, resources, and ability to proactively seek out and design strategies that may have no value to other clients or other industries.

Understandably your advisors must prioritize their limited resources to address the needs of the majority of their clients. Not surprisingly, some of the lesser known, newer, or more specialized benefits and strategies may from time to time be occasionally overlooked until brought to the specific attention of your regular CPA, attorney, or financial advisor.

What's the solution?

You probably already have a great team of the finest professional advisors money can buy and are highly confident in their abilities. However no one is immune. We've provided new strategies for a broad range of some of the most sophisticated individuals and entities ranging from corporate executives and entrepreneurs to professional athletic teams and NYSE companies. Simply put, the more diverse and sophisticated your professional and personal pursuits, the greater the possibility your advisors may overlook something.

So could your advisory team possibly be improved? People are creatures of habit, resist change, and tend to find what they are looking for or are prepared to see. If your current team has overlooked something, they may have overlooked it for years and are not likely to find it without some help. Pride and fear can also be factors. Are your current advisors actively looking for ways to make your yacht, art, horses, philanthropic and other business and personal interests more productive and rewarding? If not, perhaps we may find something that's been overlooked. An advisor specializing in your passions could only help.

As consulting managerial economist we provide our clients with competitive informational and financial advantages tailored to fit their unique business and personal pursuits. We don't replace anyone on your team, as we offer a totally different but complimentary skill set. We only make the entire team more productive and profitable for you. The more eyes with different expertise and perspectives you have review your tax and wealth situation, the more likely you are not to miss opportunities.

This point was recently emphasized again by U. S. Congressman Kevin Brady's citation of the policy paper number 130 by David Keating the senior counselor of the National Taxpayers Union, and particularly the section "***Experts Agree They Can't Agree on Tax Bills"*****,** where he reminds the reader of the *Money* magazine tax projects,

"For many years, Money magazine's annual test of tax preparers for a hypothetical household proved that paid professionals often make huge mistakes. In 1998, the last year Money administered the test, all 46 tested tax professionals got a different answer, and none got it right. The professional who directed the test admitted "that his computation is not the only possible correct answer" since the tax law is so murky. ***The tax computed by these tax professionals ranged from $34,240 to $68,912.***

Not one of the CPAs got it right. For just a minimal simple family tax return, the subject tax liability varied by a range of more than 100%. And that was just between a small sampling of just 46 CPAs. (It makes one wonder about the variance in complex tax returns.) He also documents in the policy paper the situation has not improved in recent years but probably worsened.

After all, if tax professionals can offer such drastically different advice on relatively simple tax returns, could it be possible your team may be overlooking something in you complicated and sophisticated businesses and wealth programs? Do they share your passions? Perhaps a fresh set of eyes, with a different perspective may find something valuable. It seems logical the more sophisticated and complicated one's business and financial situation may be, the more easily it may be to over look something.

Recognizing everyone's situation is unique and possible solutions will vary accordingly, we are not providing any tax advice herein. Nevertheless we would expect to be able to show most high net worth tax payers how to reduce their tax burdens from 10 to 50% and thus retain more of their wealth to redirect to more productive, rewarding and satisfying pursuits. For example we have recently demonstrated how **to reduce the taxes on Adjusted Gross Income (AGI) of $3,379,296 and an effective tax rate of 29% down to an effective tax rate of only 12.5%**. In another scenario, we were able to **reduce the 24% effective tax rate on $5,000,455 down to an effective tax rate of only 7.4%.** Any potential tax savings, if available could vary significantly depending on your specific situation, and sources of income, state and country of residence and many other factors.

For more information or to see how we may be of service, please contact us for a free confidential consultation.