Tax-Based “Snapshots” Throughout the Year

A Better Approach to Quarterly Estimates and Investment Decision-Making

By Jason Fastiggi, CPA, Partner

Taxpayers with passive and/or investment income often struggle to accurately assess their quarterly estimated tax filing and payment obligations for both federal and state income tax purposes. In addition, investment decisions during the year often proceed in the absence of real-time, tax-driven input. The solution would clearly be real-time, tax-based, and cost-effective financial data being available throughout the year.

Estimating Quarterly Tax Obligations

Approaches to assessing quarterly estimated tax payment obligations have traditionally revolved around either the “safe harbor” method, based upon the taxpayer’s prior year liability, or alternatively the use of current GAAP or IFRS financial data. Both approaches often fall short. Although the safe harbor method can eliminate late payment penalties and interest, it does not ensure that investment capital is being deployed with maximum efficiency throughout the tax year. An approach which relies upon current GAAP or IFRS data does not take into account tax-based adjustments, which renders the results inaccurate by definition.

The traditional non-tax based methodologies referenced above will often lead to the economic overpayment or underpayment of quarterly estimated taxes, which will in turn inhibit an investor’s ability to properly allocate capital and make timely investment decisions throughout the year. The result is often a misallocation of capital from quarter to quarter, with a consequent reduction in annual after-tax investment returns. Clearly, neither is in the best interest of investment managers or investors.

The Answer? Interim Tax-Based “Snapshots”

Certainly, investing and/or trading results have always been, and will remain, a moving target. No one can predict the future or how a given tax year will ultimately wind up. That being said, what if an investor could receive, at any point in time, a year-to-date tax-based “snapshot” of his or her portfolio results? Such a snapshot would yield two primary benefits. First, it would remove the guesswork from the process of quarterly estimated tax payments. More importantly, it would enable maximizing the proper allocation of investment capital throughout the year... leading to better real-time tax-based decision-making and enhanced overall investment returns.

Why use a tax-based approach? Because numerous adjustments are necessary in order to compile tax results from underlying book/GAAP/IFRS data. Such adjustments include, but are not limited to, aggregate versus layering allocation methodologies, fill-up and/or “stuffing” provisions, wash sales, constructive sales, straddles, etc. The ultimate tax-based numbers which will actually appear in an investor’s Form K-1 for a subject tax year will typically differ markedly from the underlying book/GAAP/IFRS data. Utilizing interim year tax-based snapshots will help bridge this gap between the underlying book and true tax-based data.

Having real-time, interim, tax-based data at their fingertips, investment managers will make better investment decisions, investors will appreciate the transparency of a tax-based interim Form K-1, and both will benefit from the resulting enhanced investment returns. It’s a win for all stakeholders.

Contact Us

Need help in monitoring your tax liability at any given time of the year? Reach out to your client services team at PKF O'Connor Davies or Jason Fastiggi, CPA, Partner at jfastiggi@pkfod.com.

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