FAMILY WEALTHREPORT

GUEST ARTICLE: Charles Lowenhaupt On What the New Tax Law Means for Families of Significant Wealth

Charles Lowenhaupt

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Charles Lowenhaupt, founder and chairman of Lowenhaupt Global Advisors, regularly writes for ***Family Wealth Report*** *and is a familiar face in our industry. We are delighted to share his thoughts about the US tax legislation that was enacted late last year. Readers who wish to respond and add their own views can email the editor at* *tom.burroughes@wealthbriefing.com*

The new tax law is provoking a lot of discussion about what families of significant wealth should do if they want to be "tax wise." With so much conversation taking place across the country, I'm reminded of the man who once came to our office wanting to save taxes.

He had invested a small amount in a friend's business many years earlier and when he came to see us, his interest was to be sold for almost a billion dollars. He said he had come to us to help him save taxes, and I said we could do that . I observed that he was telling me what he didn't want his wealth for – taxes. I then asked him to tell me what he wanted his wealth for. "What is your wealth for?" He responded: "What are my options?"

The new tax law is just one more new tax law. We have seen many, many new tax laws over the 110-year history of our firm. No matter what the details, the issue always comes back to the most important question: What is the wealth for?

Evaluating the impact

While everyone is trying to decipher the new tax laws, there are some early conclusions that wealthy families might reach even before the regulatory bodies issue their guidance and accountants, lawyers and other advisors weigh in.

First, this law will affect individuals and their families of significant wealth in widely different ways. Where your wealth is invested will determine how you are impacted. Is your wealth in carried interests, real estate, or stocks and bonds? Do you have active businesses held in pass-through entities? These are all critical questions that must be answered to evaluate the impact. The strategies will not be "one-size-fits all."

It may be the foolish taxpayer who moves out of asset classes that have benefitted the family over many years to enter other classes in which they have no expertise simply to save taxes. The world is littered with old "tax shelters" that people bought by selling common stocks which had been in the family for years and which would have gained many times in value.

Second, everyone has an increased lifetime exemption for gifts, estates and generation-skipping tax. In advising families of significant wealth, we have always seen that gifts, particularly tax-free gifts, prove great estate tax savings. Although an additional $5 million dollar exemption may be relatively small for very wealthy individuals, the opportunity to make gifts should not be minimized. Some of the largest trusts we see were those created by wealthy ancestors between 1926, when a gift tax was repealed, and 1932, when the gift tax was reinstated. Whole family fortunes were protected and enhanced in these trusts. They grew and protected family wealth over the past 90 years – all free of any gift or estate tax. It's interesting to note how frequently we find trusts created in 1932, when the gift tax was about to return.

Third, despite what we may read in media commentaries, charitable giving will still be an effective strategy to reduce income, gift and estate taxes. Split-interest trusts, such as charitable remainder trusts and charitable lead trusts, remain tax favored for gift and estate tax purposes. Capital gains taxes can still be avoided on gifts to charity. Foundations and charitable lead trusts have income "excluded" from the donor's income so the income of those trusts is effectively "deductible" regardless of whether the donor itemizes his deductions. In 1969, Congress believed it repealed the ability to create charitable lead trusts, but many of the brave souls who went to the drawing board to recreate those trusts in the

1970's have seen their private wealth grow dramatically without gift, estate or generation-skipping tax. One such trust, funded with $2 million dollars in 1980 to distribute $130,000 per year to charity for 35 years, was worth over $100 million when the charitable annuity terminated and today remains in trust for grandchildren without gift or estate taxes.

The big picture

While tax strategy is clearly important, taxes are secondary in managing significant wealth. The primary consideration should always be making the wealth do what it is for. Wealth is not for "preservation" or "enhancement" by reducing taxes. Ensuring that individuals can be all they can be, encouraging family functionality, and tying wealth to community should all lead the wealth strategies of ultra-high net worth individuals and families.

Gifts and trusts can allow financial security for children and grandchildren, so that they can get on with life and become all they can be. Regardless of tax deductions, philanthropy ties wealth to community and is inherently supportive of family functionality. It makes the wealth do what it is for! Saving estate tax is really incidental to those goals.

Investments should be profitable and should help a family build an understanding of its wealth and its legacy. Governance structures need to be designed to accomplish a client's purposes. Again, tax savings should be a secondary not primary purpose.

The Sixteenth Amendment to the Constitution introduced our modern tax laws in 1913. In the past century, those laws have become increasingly complicated, increasingly less rooted in economic theory, and increasingly more difficult to use as a base for long-term planning. Yet wealthy families have continued to face the same issues they have faced as they address wealth's purposes – encouraging individual achievement, supporting family functionality, and supporting community.

Taxes can be a hindrance to wealth providing its full benefits. However, letting a tax tail wag the wealth dog will ultimately diminish those full benefits. Wealth should be managed strategically to realize those benefits rather than merely to save taxes.