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Family Wealth Series - Post # 9
Philanthropy and Social Wealth

At the very outset of this Family Wealth Series, I suggested maintaining accumulated family wealth in the family as a tool to help family members reach their full potential. But what about charity?

Philanthropy and Social Wealth

Everyone likely accepts the idea that thoughtfully incorporating charitable giving into a family's philosophy and regular activities can help establish shared values, as well as expand life experiences and stimulate connections with diverse people and places of the world. In Warren Buffett's "sink or swim" limited inheritance approach, the vast majority of accumulated wealth goes to charity. However, just giving most of the family wealth to charity may have absolutely nothing to do with sharing values or providing enriching life experiences to the succeeding generations.

My suggestion is to use charitable planning in an inclusive and positive way within the family, and design it to work synergistically with the goal of maintaining generational wealth. Rather than limit or "right size" the family's portion of the accumulated wealth, consider the merits of flipping that approach to the charitable portion. The general approach would be to favor family first, for the reasons described in prior posts, but preserve and incorporate charitable planning and philanthropy to achieve personal and family goals. Typically, these goals fall into three categories.

1. Faith Determined

For millennia, individuals have been giving guided by faith based principles. Even today, a religious connection appears to motivate greater charitable giving to both religious and secular charities. A 2013 study found that among religiously affiliated Americans 65% made charitable gifts compared to 56% of those claiming no such affiliation.[1]

[1] Alex Daniels, Religious Americans Give More, New Study Finds, The Chronicle of Philanthropy (November 25, 2013).

2. Project Determined

Perhaps the greatest motivator of charitable gifts and philanthropy is the desire to achieve a specific goal. At any given time, the family – together or individually – can make gifts to achieve charitable goals that are meaningful to them. Even though I am not suggesting that the family set an arbitrary amount aside for charity, an idea promoted by some of the world's billionaires (as mentioned in Post #1 relating to the Charitable Pledge), the family is always free to give as much as desired to achieve their chosen objectives. So the family is not foreclosed from charitable gifts, but rather than giving arbitrary portions of the family's accumulated wealth, I suggest giving to projects and activities that the family identifies from time to time. This basis for charitable giving is more organic, often closely-related to the individual's values, and likely to provide the greatest emotional gratification.

3. Tax Determined

In many cases an individual will be incentivized towards charitable giving because of available tax breaks. In effect, charitable planning can allow the family to keep control of "social" wealth that otherwise is frequently paid to the government in the form of income or estate taxes. For example, a plan that I recommend is to transfer the bulk of family wealth during the wealth holder's lifetime – typically through trusts – because it is far more efficient for gift and estate tax purposes,[2] it avoids cliff events (see Post #6), and it mitigates the "Prince Charles Effect" (see Post #7). With substantial family wealth transferred during his or her lifetime, the wealth holder can then leave the remaining estate to charity (usually a pre-established private family foundation that the family controls) and completely avoid all estate taxes, federal and state. If the estate tax is 50%, which is the approximate effective rate of taxation in DC and Maryland (at maximum rates), the cost to the family of this "remainder-to-charity" plan is 50% of those assets because the other 50% would have been paid to the government in estate taxes. In other words, every dollar remaining in the estate that is given to a family foundation only costs the family 50 cents. This remainder-to-charity plan therefore allows the family to keep control (through the family foundation) of the entire

[2] Over the past two years, my law partner, Lester B. Law, and I prepared an extensive economic modeling approach and gave presentations at many of the largest continuing legal education programs around the country to other estate & trust lawyers proving the economic benefits of lifetime giving. *See e.g.*, Franklin & Law, *Never Pay Estate Taxes - The Annual Taxable Gift Approach with a CLAT Remainder*, 46th Annual Estate Planning Seminar, Estate Planning Council of Portland, Oregon (January 20, 2017); Franklin & Law, *Extraordinary, Efficient, Elegant, Evolutionary: The Annual Taxable Gifts Approach and Testamentary CLAT Remainder*, 51st Heckerling Institute on Estate Planning (January 11, 2017).

remaining estate including the social wealth, which otherwise would have been paid to the government.

However, these remainder-to-charity plans, or any large charitable gift upon death, can be structured to potentially provide generational benefits – i.e., they can work synergistically with the goal of maintaining family wealth. In my article *The Intermediary CLAT Alternative to the Residuary Estate Family Foundation Gift,*[3] I suggested an alternative to leaving the remainder of the estate directly to the family foundation. An intermediary charitable lead annuity trust will pay the estate remainder to the family foundation over a number of years, yet have the same federal estate tax benefit as a direct bequest. This approach helps maintain generational wealth because the Intermediary CLAT allows for the possibility of a reinfusion of wealth to the succeeding generation. A reinfusion that comes at no estate tax cost. The transfer to a CLAT also provides a framework in which family members could purchase private company interests or other illiquid assets from the ancestor's estate without running afoul of the self-dealing rules and perhaps provide a little more privacy.

The CLAT would receive the ancestor's remaining assets and pay an annuity to the family foundation over a period of time, say 20 years. The annuity payment would be determined as a fixed percentage of the fair market value of the property transferred into the CLAT on the ancestor's death. The annuity payments would be designed to have an aggregate present value (based on the applicable IRS interest rate) equal to the fair market value of the remaining ancestor's estate. A 100% charitable estate tax deduction is available for the aggregate present value of the annuity payments. After the annuity payments end, upon conclusion of the 20-year term, the CLAT remainder passes to the children or to trusts for their benefit. The remainder interest held by children would have a zero value upon the ancestor's death and therefore cause no transfer tax (meaning no gift, estate or GST tax). This allows for a possible reinfusion of wealth to the family in 20 years or so at no transfer tax costs. Moreover, the children could control and administer the CLAT and could take a reasonable trustee's fee for doing so. Amazingly, we illustrated in the *Intermediary CLAT* article, through Monte Carlo simulations, that this approach also enables the

[3] Franklin & Birchfield, Vol. 39, No. 3, ACTEC Law Journal, 355 (Winter 2013 [actually published Jan. '15]).

family foundation's endowment to be larger at the end of the CLAT term than the endowment would be with a direct bequest.[4]

Therefore, it is entirely possible to promote a symbiotic relationship between substantial charitable giving and family wealth – a relationship that is beneficial to both the family and charity. I firmly believe that charity is better off in the long-run if a family is able to maintain the bulk of its wealth (staving off the "shirtsleeves to shirtsleeves" in three generations dynamic and/or the preemptively negative limited inheritance approach), because this enables the family to continue providing substantial support to charitable causes into the future. Of course, this long-run approach can be thoughtfully used by the family to teach values, expand life experiences and stimulate connections with diverse people and places of the world.

Post #10 will explain why "positivity" should be at the core of your family wealth and inheritance planning. Post #10 will also conclude this Family Wealth Series of posts!

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[4] This approach has other benefits too. Rather than flooding the family foundation with a large bequest that may overwhelm its existing operation, staging the large charitable bequest over a period of years allows the family foundation time to grow its operation to match its larger endowment.