Learning from Philanthropy: Tax Avoidance Strategies by the Ultra-Wealthy

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Summary
Philanthropy has been used as a tax avoidance strategy since its inception. This article details the history of such strategies, which have evolved as tax law changed, primarily in the USA. The contemporary era of philanthropy is dominated by strategies that further the privatization and financialization of public goods, such as education.

Keywords
Philanthropy
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UBS Optimus

Navigating domestic tax regimes through philanthropy has long been a feature of wealth management for the ultra-rich. Andrew Carnegie blazed the trail during the Gilded Age (1870s-1900s). Although a proponent of progressive inheritance taxes in the USA, Carnegie opposed federal income taxes. He believed he was better suited to allocate funds to charitable causes then either the government (through social services such as education) or the recipients of his aid (through higher wages; see Carnegie, 1901, p. 12-13). In the decades before the federal income tax was enacted by Congress in 1917, Carnegie pledged to give away his wealth, similar to the contemporary “Giving Pledge” signed by Warren Buffet, Bill Gates, and Mark Zuckerberg (among other billionaires).

Philanthropy by ultra-rich individuals funded social services the government could (or would) not provide at the time. For instance, although public schools were funded by state taxes as early as the late 1800s, it was not until 1965 with the passage of the Elementary and Secondary Education Act that the Federal government began funding public schools. When the federal income tax was being debated in the early 1900s (primarily to fund war efforts), Senators worried that taxing the wealthy would reduce philanthropic contributions, which had funded myriad private educational institutions after the Civil War. If people such as Carnegie had to pay income tax, Senator Henry F. Hollis opined, then “wealthy men will be tempted to economize, namely in donations to charity” (Congressional Record, 1917). The logic was simple: a reduction in charity because of taxation would increase the burden on the government to finance public services it had until that point not funded. This logic has persisted over time (see Eleanor, 2000, p.21).

The solution to the perceived problem of what I call “philanthropic loss” was to create tax exemptions on income for money donated to charity. For every dollar donated to charity in 1917, a 15 percent deduction could be claimed on one’s income taxes. The deduction rose to 30 percent by 1954 and – for taxpayers who contributed over 90 percent of their taxable income to charity (easy to do if one includes capital gains) – unlimited deductions were allowed in 1964, which decreased to 50 percent by 1974. Today, cash donations receive a 60 percent deduction on one's gross income while appreciated assets fetch an additional 30 percent deduction. The message was clear: if philanthropy reduces the fiscal burden on the government, then the government would reduce the tax burden on those who donate.

Tax exemption for donations allowed for new wealth management strategies. Carnegie is again exemplar. Despite his pledge, he was unable to donate all his money before death. Although a verbal supporter of inheritance taxes, he nevertheless made specific decisions near the end of his life to avoid the 40 percent tax that awaited his estate the moment he died. At the direction of lawyer Elihu Root, he founded the Carnegie Corporation of New York, a charitable trust, where all of his unspent money (save a few tens of millions of dollars that went to his family) could be invested for eternity (Nasaw, 2006, p.800-1).

Little did Carnegie realize that starting a charitable trust was an opportune strategy to protect family fortunes generation after generation. Carnegie's friend, John Rockefeller, followed suit by starting his foundation in 1913. In 1938, Henry and Edsel Ford opened theirs. By donating to a foundation, wealthy individuals "avoided more in taxation than they would have received in proceeds for selling shares of stock" (Duquette, 2019, p. 560). As one retired philanthropy adviser recounted of the time:

> *[Taxes] were extremely important because I could give away securities and end up with the same amount of money, after tax, as if I sold them. And if I gave them away, they went where I wanted. If I sold them, they went to the U.S. Government (Cited in Odendahl, 1990, p. 63).*

Receiving a tax break was not the only benefit from giving to charity. Here the Ford Foundation is a case in point. Henry and Edsel Ford not only started the Ford Foundation to avoid taxes, but also to protect their interests in the Ford Motor Company, which Henry had founded in 1903. By donating Ford Motor Company stock to the Ford Foundation, Henry and Edsel (and later their children) maintained voting power in the company, a new reason for the ultra-rich to "give" to charity. Taxes were avoided and corporate power maintained.

Arguing philanthropic donations serve the interests of the rich more than the poor is admittedly a cynical position to take, especially when considering the good works of charity worldwide (see NORRAG Special Issue 04). The argument finds purchase, however, when considering donations in eras when tax benefits for philanthropy no longer matter. President Ronald Reagan's tax reforms in 1981 and 1986 reveal just that: the self-interest of those who give. As taxes were lowered, especially for high earners, the incentive to donate stock (and claim an income tax exemption) instead of selling it (and pay capital gains taxes) evaporated. It was financially prudent not to donate. Between 1980 and 1990, donations by the top 0.1 percent decreased by 50 percent. Overall, donations by 1993 decreased to their lowest point since 1971. When income taxes are so low that the charity exemption is no longer valuable, the ultra-wealthy stop giving.

What then can we learn from the current era? In the world after the 2008 global financial crisis, economic power rests in the hands of financial institutions and the disruptive potential of Silicon Valley tech companies (see Hudson, 2015). These two groups have, like their predecessors, altered philanthropic giving and tax avoidance strategies. With low taxes on ultra-rich individuals and rising inequality, a Second Gilded Age has arrived (Piketty, 2020). There are two recent trends connected to education worth mentioning.

First is the rise of social impact bonds, which finance projects that aim to solve various problems facing society. Often these bonds fund private sector solutions at the expense of public services such as education. The logic is decidedly financial and captures the outcomes attitude of Silicon Valley: investors provide capital for a given project with agreed-upon targets by which to measure success. If the project meets the targets, investors are repaid the principal with interest by an outcomes funder, typically a charitable organization or government. These bonds supposedly reduce the risk on governments and charitable organizations because they only pay for outcomes, not the up-front capital investment of social programs. But the price for the outcomes is expensive because the investors earn a financial return. Moreover, the anti-government attitude is clear: financial instruments better solve social problems than government services. Social impact bonds have therefore furthered the privatization and financialization of public goods such as education.

The Swiss multinational investment bank UBS has pioneered these bonds in the field of education. In one such Development Impact Bond, UBS investors earned a 15 percent return on an investment that funded a non-governmental organization, which operates low-fee private schools, to enrol more girls in Rajasthan, India. The first bank to include a philanthropic arm (UBS Optimus) inside its corporate governance structure, UBS has created a wealth management strategy for the wealthy of today who treat international development like a tech problem: focused on impact, financial returns, and the prestige of supposedly disruptive solutions. "We want to be most things to wealthy people," said John Mathews, head of private wealth management and ultra-high-net-worth individuals for UBS Wealth Management Americas, "not all things to all people" (quoted in Sorvino, 2016).

The second trend is more nefarious. Here the non-profit status of philanthropic foundations is abandoned for designation as a limited liability company. The Chan Zuckerberg Initiative (CZI), established in 2015, has done just that (Reiser, 2018). Built on the fortunes earned from Facebook, CZI has pioneered a disruptive philanthropic strategy that maintains much of the tax benefits of traditional charities while forgoing the legal public disclosure requirement of non-profits. Power is thus concentrated in the hands of Facebook founder, Mark Zuckerberg, and his wife, Priscilla Chan, with limited public oversight. These undemocratic legal manoeuvers within the world of philanthropy are telling, especially coming from a billionaire whose 2010 donation to support Newark public school bypassed public oversight by channelling money through a foundation where then-Newark Mayor Cory Booker was a board member. Russakoff (2015) called this "one of the thornier questions surrounding private philanthropy in public education" (p. 65).

Wealth management strategies by the ultra-rich provide important insights into different eras of taxation and attitudes towards public education. Carnegie is emblematic of the Gilded Age's rapid economic growth, limited tax regimes, and vast inequality. The Fords symbolize the golden era of philanthropy tied to American corporate prowess during and after World War II when taxes were high. The relative absence of well-known philanthropic families in the 1980s captures the neoliberal turn where trickle-down economic theory proved supreme. Finally, UBS Optimus and CZI capture the current moment dominated by finance, disruption, and the search for impact. Despite these changes, the logic of philanthropic loss continues. Government intentionally forgoes tax revenue by allowing charitable tax deductions, hoping wealthy individuals donate not in self-interest, but out of the goodness of their heart. History teaches otherwise.

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