

## MAKING HEDGE FUND PROFITS TAX EFFICIENT

Some investors are "wrapping" their hedge fund in an insurance policy. Private placement variable life insurance is a policy that invests the premium dollars in hedge funds. "Because the hedge funds are in a life insurance policy, the money grows tax deferred," says Frank W. Seneco, president of **Seneco & Associates, Inc.**, a life insurance specialist based in Connecticut. "We're able to access the monies without tax implications through efficient withdrawals and policy loans to the affluent investor."

In the last few years, the use of proprietary insurance companies and related structures has provided a way for the wealthy to invest in hedge funds in a tax-efficient way. "The wealthy face all sorts of risks that should be managed such as disability, business continuation, and liability," says Gary L. Rathbun, president of **Private Wealth Consultants Ltd.** in Toledo, Ohio. "Managing these risks is well beyond the reach of traditional insurance, but hedge funds can be part of the solution because they allow the affluent to invest the premiums."

### HEDGE LEVERAGE

While high-end investors take advantage of the successful managers and returns of hedge funds, they are also finding that many hedge funds are tax inefficient. Many managers are looking to generate the best returns they can and are not always sensitive to the tax implications for their wealthy investors. However, that is starting to change.

As the hedge fund market continues to mature, and as the competition for investors continues to heat up, some hedge fund managers are becoming more attuned to the tax implications of their investment strategies. This is not a purely upside proposition, however: When investment decisions are tempered by tax considerations, the returns may fall off. As a consequence, hedge fund managers and investors alike have to weigh the fine line between profit-making and tax efficiency.

BY RUSS ALAN PRINCE AND HANNAH SHAW GROVE

Leveraging a variety of tax strategies can be effective in making hedge funds more tax efficient, too. "By looking at an affluent client's total financial picture, it's possible to zero out what would be owed on hedge fund profits," says Arthur A. Bavelas, CEO of **Resource Network Ltd.** of New York. "Sometimes, the tax bill is pushed way into future years, and this strategy continues until the affluent have losses on some other investment to offset the gains. Another way to eliminate the taxes owed is working with the hedge funds to create side pockets that can be used in a multi-national tax arbitrage strategy."

There is a caveat, however. The viability of any of these approaches is dictated by the hedge fund investor's particular financial and personal situation. That is, none of these approaches is available off-the-shelf and each requires a specialist to implement.

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