

# **Structuring in Puerto Rico—the best of “the new Switzerland”**

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With the increased pressure on privacy issues in international tax planning, advisors now frequently ask me to assist them with clients who wish to protect their privacy, but also wish to be compliant with The Common Reporting Standard (CRS), and the Financial Foreign Account Tax Compliance Act (FATCA). Our firm now has such a structure which involves structuring Private Placement Life Insurance (PPLI) issued in Puerto Rico.

At Advanced Financial Solutions, we are now resolved to use this structure for clients who have a legitimate need for privacy while in all other respects are compliant in relation to FATCA and CRS, clients that would pass Anti-money laundering (AML), Know your customer (KYC) and other forms of due diligence that are necessary to corroborate this fact.

This white paper is an attempt to give the basic elements of this structure, and why our firm thinks it is a useful tool in preserving a legitimate right to privacy. In Article 12 of The United Nations’ Universal Declaration of Human Rights it states “No one shall be subjected to arbitrary interference with his privacy, family, home or correspondence, nor to attacks upon his honour and reputation. Everyone has the right to the protection of the law against such interference or attacks.”<sup>1</sup>

## **Why Puerto Rico?**

The Commonwealth of Puerto Rico is a territory of the United States. Under FATCA the Intergovernmental Agreements (IGA’s) definition of the United States excludes the

territories. Therefore, US territories do not reciprocate the Automatic Exchange of Information (AEI).<sup>2</sup> “Territory Financial Institutions” in the FACTA regulations also have a special status which exempts them from reporting.<sup>3</sup>

The fact that Puerto Rico is statutorily excluded from existing and future IGAs is significant. This fact gives Puerto Rico a very marked advantage for structuring over no state tax jurisdictions in the US like Delaware, North Dakota, and Nevada.

Comments Richard Cassell of Withers LLP London office, “Some commentators have got very excited about this apparent lacuna in the information exchange network and are pressing clients who want to avoid information exchange to move their structures to the United States. Just move your trust and holding company to Delaware and your home jurisdiction need never know, they are told. Counter intuitively, because the US is not a participating jurisdiction, this in fact means enhanced information reporting unless not only the structure is moved to the United States but also all the investments. Also bear in mind that the FATCA inter-governmental agreements are two-way streets and the United States has spontaneously exchanged information with the United Kingdom and other countries under these agreements.”<sup>4</sup>

The US Secretary of the Treasury, Jacob Lew, wrote a letter on May 5, 2016 to Congress in which he said, “Reciprocity with other jurisdictions is a key component of any successful strategy for combating international tax evasion and ensuring future collaboration with our partners overseas. The President has proposed providing full reciprocity under FATCA in his last three budgets. Congress should enact this proposal as soon as possible.” It is also possible, if Congress does not act, which is the most likely political outcome, that President Obama will implement full FATCA reciprocal reporting through an executive order, which he has done many times during his presidency.

There are also initiatives in the Treasury Department’s Financial Crimes Enforcement Network (FinCen), and under the Bank Secrecy Act (BSA) to require financial institutions to identify beneficial owners. In addition, the Treasury has proposed regulations for foreign owners of domestic disregarded entities to have to file Form 5472. The rules are intended to ensure that owners disclose all transactions with foreign related parties.<sup>5</sup>

What do all these proposals in Washington DC have to do with our discussion? It is likely by one or several of the avenues proposed above that merely establishing an entity in the U.S. in a no state tax jurisdiction like Delaware, South Dakota, or Nevada will not provide the intended result in the near future. This makes the Puerto Rican PPLI solution all the more attractive.

Puerto Rico as a territory of the United States is not a party to CRS, as the United States does not participate in CRS. What is the likelihood of the US participating in

CRS? Our firm agrees with Peter Cotorceanu’s reasoning. “First, most of the data that GATCA (Mr. Cotorceanu’s term for worldwide CRS) requires to be exchanged is not currently reported to the IRS by US financial institutions. Naturally, the USA can’t promise to give data it doesn’t collect.” And, “second, there is little likelihood that the US law will be amended in the near future to allow the IRS to collect the required data. The USA already gets all the data it needs on US taxpayers via FATCA, so it does not need GATCA to find its own tax evaders.”<sup>6</sup> Mr. Cotorceanu also discusses in this same article the political climate in the US and the favorable current environment for the US banking industry. Both of these factors do not favor the US becoming a participant in the OECD’s CRS regime.

Puerto Rico has favorable insurance, tax, and asset protection laws. Puerto Rico’s segregated account laws are on par with similar laws in the United States, Bermuda, the Cayman Islands, and Switzerland. A substantial additional insurance benefit in Puerto Rico is the statutory asset protection provided to the policy owner and beneficiary. In the absence of limited exceptions (the most important being a fraudulent conveyance into the policy) the benefits provided by the policy are protected from any claims against the policy owner or beneficiaries. Puerto Rican law clearly provides that for a policy issued by a Puerto Rican international insurer, neither the investments inside the policy, nor the death benefit are subject to Puerto Rican taxation.<sup>7</sup>

### **Why PPLI?**

Private Placement Life Insurance (PPLI) is essentially an insurance transaction that occurs within a private placement offering. The private placement component adds extensive flexibility to pricing and asset management offerings. Because PPLI is sold through a private placement memorandum, every situation can be individually negotiated and custom designed for the client.<sup>8</sup>

Basically any asset that can be custodied by a reputable trust company can go into the Puerto Rican PPLI structure. Many policies are owned by trusts which can be domiciled in jurisdictions in keeping with the client’s planning needs. In terms of asset management, it is an open architecture model where the assets can be located in multiple jurisdictions with multiple asset managers. PPLI insurance costs generally average about 1 percent of the cash value of the policy.<sup>9</sup> The cost of the death benefit varies with the health and age of the insured person, and generally policies are designed with the lowest death benefit possible. Tax and enhanced privacy benefits outweigh the costs of using a PPLI structure. Asset management fees will depend on the asset manager(s) selected to manage the assets inside the policy. The policy is fully transparent to the client, as all fees and costs are disclosed.

The insurance risk coverage, the death benefit element of the policy, is provided by the same reinsurance companies that reinsure the domestic life insurance market in the

United States proper. The Puerto Rican insurance company retains only a small portion of this risk, as the vast majority is passed onto the reinsurance company. Therefore, in fact one is being insured by the largest insurance companies in the world, Munich Re and Swiss Re. The assets inside the policy are held in separate accounts, so actually the Puerto Rican insurance company functions in some ways more like an administrator rather than a risk transfer vehicle.

These facts are especially important to UHNW clients who clearly wish a secure place for their assets, especially if they involve multiple generations. In the Puerto Rican insurance company, one is not only receiving an experienced administrator of the various components of the policy, but also a rigorous compliance officer in that they perform the AML, KYC to assure that the transactions meet best practices in due diligence. In conversations with Puerto Rican insurers, our firm has found that the companies practice high standards of due diligence, in that they wish to protect their favorable structuring position, and not have it run afoul due to less than a very high standard of client due diligence.

In the Puerto Rican PPLI structure, assets grow free of income and capital gain taxes, and if structured correctly free of estate tax.<sup>10</sup> In many situations dynasty trusts planning can be quite effective using this structure. If the proper structure is employed, the client can have access to the cash value inside the policy. Some families utilize multiple policies for different planning needs.

## Conclusion

Basically one is using this structure to avail clients of Puerto Rico’s unique position in relation to legitimate enhanced privacy. PPLI is the ideal vehicle to accomplish this aim due to its excellent tax advantages and added layers of asset protection and confidentiality, as the insurance company is the deemed owner of the underlying policy assets.<sup>11</sup>

As with any cross-border structure, we only take clients with local representation from qualified advisors. Our team approach does not guarantee success, but does insure that clients receive the best and most comprehensive advice possible to achieve their goals.

## Endnotes

1. Also of interest is Section I, Article 8 of the EU Convention of Human rights: "1. Everyone has the right to respect for his private and family life, his home and his correspondence. 2. There shall be no interference by a public authority with the exercise of this right except such as is in accordance with the law and is necessary in a democratic society in the interests of national security, public safety or the economic wellbeing of the country, for the prevention of disorder or crime, for the protection of health or morals, or for the protection of the rights and freedoms of others."
2. Mark Morris, <http://www.the-best-of-both-worlds.com/fatca-reciprocal.html> Article 1 Definitions 1. For purposes of this agreement and any annexes thereto ("Agreement"), the following terms shall have the meanings set forth below: a) The term "United States" means the United States of America, including the States thereof, and, when used in a geographical sense, means the territory of the United States of America, including inland waters, the air space, the territorial sea thereof and any maritime area beyond the territorial sea within which the United States may exercise sovereign rights or jurisdiction in accordance with international law; the term, however, does not include the U.S. Territories. Any reference to a "State" of the United States includes the District of Columbia. b) The term "U.S. Territory" means American Samoa, the Commonwealth of the Northern Mariana Islands, Guam, the Commonwealth of Puerto Rico, or the U.S. Virgin Islands.
3. CFR-2013, title 26, vol 12, sec 1, 1471-4
4. Richard Cassell, [http://www.martindale.com/government-law/article\\_2220012.htm](http://www.martindale.com/government-law/article_2220012.htm)
5. Mark Morris, <http://www.the-best-of-both-worlds.com/usa-not-crs-solution.html>
6. Peter A. Cotorceanu, "Hiding in plain sight: how non-US persons can *legally* avoid reporting under both FATCA and GATCA," *Trusts & Trustees*, Vol. 21, No. 10, December 2015, page 1054
7. Office of the Commissioner of Insurance, Commonwealth of Puerto Rico, International Insurers section, <http://ocs.gobierno.pr/enocspr/index.php/aseguradores-internacionales/laws-and-regulations>
8. Insurancenewsnet.com, *Registered Rep*, "What is PPLI?" <http://insurancenewsnet.com/oarticle/powerful-private-placement-life-insurance-strategies-with-trusts>
9. See Insurancenewsnet.com, *supra*, "PPLI Costs," See Kirk Loury, *The PPLI Solution: Delivering Wealth Accumulation, Tax Efficiency, and Asset Protection Through Private Placement Life Insurance* (2005), page nine
10. See Insurancenewsnet.com, *supra*, "Zero Tax Dynasty Trusts"
11. Wikipedia, Private Placement Life Insurance, "PPLI Outside the USA" section, [https://en.wikipedia.org/wiki/Private\\_placement\\_life\\_insurance](https://en.wikipedia.org/wiki/Private_placement_life_insurance)

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