Fostering Discipline Is Paramount

PPLI Joins 'Two Sides of the Same Coin'

To be thorough and open to new possibilities at the same time requires discipline: embracing '***two sides of the same coin***.' In the PPLI structuring of ***wealthy international families' assets***, ***Advanced Financial Solutions, Inc***. strives to achieve this aim. For each new case we exam similar PPLI cases that we have handled in the past. For the specific knowledge that we will need for new cases which we might lack, we have an excellent resource of professional advisors worldwide that can be easily contacted to supply this missing knowledge for a successful PPLI structure to be created.

For our analogous examples we have one from the area U.S. tax planning and how it affects U.S. beneficiaries of ***Foreign Grantor Trusts***, and strangely enough, one from high-fashion. This example shows us what happens when the 'two sides of the same coin' turn out to be the same thing, and--to change this analogy--the coin loses its luster by turning out to be a copy. In a humorous vein, you can view this also as social media bringing transparency to haute couture.

Before we share the above material, we are pleased to give you this description of PPLI from *International Life Insurance* edited by David D Whelehan, JD in the chapter, "**International Life Insurance An Overview.**"

"This product is for the wealthy, "accredited" investor. They are usually very large single premium structures. It is classified more as an institutional product, as the charges and fees are quite low in comparison to retail products described above. Another advantage is investment flexibility as they generally can be invested in things not permitted in a general account retail product, like hedge funds and private equity.

Premiums and benefits can also be paid in "kind," as opposed to in cash. In addition, the policyowner can select his, or her, own Investment Manager for just the single policy to invest according to the policyowner's general directions. The Custodian of the underlying assets in the fund can also be selected by the policyowner. Private placement products are tailored to meet specific objectives of the client, but are carefully designed to be compliant with local tax laws, so as to enjoy the tax treatment desired."

In the *STEP Journal* Melvin A Warshaw and Lawrence M Lipoff discuss a key change to the US Tax Cuts and Jobs Act of 2017, and assess what it means for advisors to trustees of foreign grantor trusts. **They conclude that due to recent changes in U.S. tax law that a *properly structured PPLI* provides an excellent solution for U.S. beneficiaries of foreign grantor trusts.**

A Simpler and Safer Strategy

"In a previous two-part article,[1] we presented US tax advisors with our highly technical analysis of a key change in the foreign tax provisions of the US *Tax Cuts and Jobs Act of 2017* (the Act) impacting how trustees of foreign grantor trusts

(FGTs) traditionally hold US-*situs* portfolio assets that potentially benefit both US and non-US heirs of a non-citizen, non-resident (NCNR) of the US."

Trustees must analyze whether their existing single foreign corporation (FC) strategy is still viable and, if not, what steps they should take to address this US tax law change. Some advisors suggest a second FC and others a two-tier or three-tier FC structure. Leaving aside that planning variations relying on different entity structures may be one option, we believe that offshore[2] private placement life insurance (PPLI) may offer a far simpler and safer strategy.

Under pre-2018 US tax law, trustees of FGTs generally relied on a single non-US holding company to shield the NCNR grantor of an FGT from US estate tax on US-*situs* portfolio assets. Following the death of the NCNR, the trustees would effectively eliminate this FC by filing a post-death, retroactive (so-called 'check-the-box') election within 30 days of such death. Gain recognition would be avoided on the historical pre-death unrealised appreciation of the US portfolio assets, prior to elimination, i.e. liquidation, of the FC, as well as pre-2018 controlled foreign corporation (Subpart F CFC) passive income tax and related tax compliance. Plus, the US heirs would achieve a basis step-up in the underlying US portfolio assets equal to their fair market value (FMV) on the date of the election.

The Act repealed the 30-day retroactive election for tax years after 2017. Under current US tax law, a post-death 'check-the-box' election for the trust's FC could cause US beneficiaries of the trust to inherit the historical pre-death unrealised appreciation in the US-portfolio assets and incur cumbersome US tax compliance. Further, if an FC is a CFC for even one day during the tax year, there could be potential phantom income for the US beneficiaries of the trust now encompassing the new US 'global intangible low taxed income' (GILTI) regime.

Continuing a single FC

The single FC structure continues to be effective in preventing imposition of US estate tax on the US portfolio assets held by the FC. If most of the NCNR's trust beneficiaries are US persons (citizens or residents),[3] the trustees and US advisors must anticipate that there will now be US income tax and US tax reporting on historical appreciation of the assets held in the single FC that would eventually be recognised by the US beneficiaries after the NCNR's death. If most of the trust beneficiaries are not US persons, it may be possible that the single FC will lack sufficient beneficial ownership by US persons to qualify as a CFC.

Side-by-side FCs

Another approach suitable for families with both US and non-US persons as beneficiaries is to have the trustees of the FGT create a second FC, which would own only non-US-*situs* assets. The original FC would own only US securities. The non-US portfolio assets owned by the second FC would be earmarked to benefit solely non-US persons as trust beneficiaries after the death of the NCNR. The US portfolio assets owned by the existing FC would be earmarked for the US beneficiaries. There would be no US estate tax on the non-US assets owned by the second FC. A retroactive check-the-box election could be filed for this second FC effective on the day before the NCNR's death.

Some US advisors advocate relying exclusively on entity structuring to convert a single FC into a multi-tier FC structure involving at least three FCs. Prior to the NCNR's death, the trustees of the NCNR's FGT would create two FCs. These two FCs would then together equally own the shares of a third lower-tier FC. The US portfolio assets would be owned by the lower-tier FC. Following the death of the NCNR, the lower- and upper-tier FCs would be deemed liquidated for US tax purposes (by filing check-the-box elections) in a carefully scripted sequence as follows.

1. First, the upper-tier FCs would each file a check-the-box election for the lower-tier FC, effective one day prior to the death of the NCNR. This results in a taxable liquidation of the lower-tier FC without current US income tax on the historical pre-liquidation unrealised appreciation inside the FC. However, the upper-tier FCs' basis in the underlying US securities held by the former lower-tier FC will equal the FMV of such assets on the date of the deemed liquidation of the lower-tier FC.
2. Second, two days after the NCNR's death, both upper-tier FCs will make simultaneous check-the-box elections. The inside basis of the US portfolio assets previously held by the lower-tier FC prior to its deemed taxable liquidation would be stepped up or down to the FMV of such assets on the day after the death of the NCNR.

Advocates of this highly complicated, carefully scripted entity structure and serial liquidation strategy for US portfolio assets indicate that, if successful, the results should be comparable to the results under prior law. However, this is not without some new tax and reporting risks, as noted above, nor does it address the question of what the independent significant non-tax business purpose for 'each' of the three FCs would be.

Offshore PPLI

Assuming the NCNR is insurable, advisors should seriously consider the possibility of their NCNR clients, with significant US portfolio assets, and US persons as potential beneficiaries investing in certain types of offshore PPLI policies that in turn invest in US assets.

Purchasing an offshore US tax-compliant PPLI policy will result in no US income tax recognition in the annual accretion in the cash value growth of the policy. Holding the policy until death is equivalent to receiving a US basis step-up at death on the death benefit that is payable in cash. In planning for the US beneficiaries of the NCNR, if the revocable FGT were named as owner and beneficiary of the PPLI, this trust could be structured to pour over at the death of the NCNR to a US dynasty trust organised in a low-tax jurisdiction with favourable state trust laws. This structure will ensure that the death benefit pours over to a US domestic trust that will not become subject to foreign non-grantor trust (FNGT) tax rules.

A non-admitted offshore carrier obviates CFC status for the policy and policy owner by making a certain special US tax code (s.953(d)) election to be treated as a US domestic carrier. Aside from avoiding CFC status for the policy and its owner, making this special election causes the carrier to absorb US corporate income tax and administrative costs to comply with US informational tax reporting. The hidden benefit of an offshore carrier making this special US tax election is that it enables such a carrier to claim a special deduction of reasonable reserves required to satisfy future death benefits. The offshore carrier simply absorbs the cost of US income tax compliance including its responsibility for CFC and passive foreign investment company (PFIC) reporting. There is no look-through of an insurance policy to its owner for the purposes of applying the PFIC rules. So long as the NCNR avoids any control over the selection of specific investments made by the policy owner for the policy, investor control should not be a concern.

Our conclusion is that current US tax law provides clear support for the proposition that the PFIC and CFC rules should not apply to a US tax-compliant policy issued by a foreign carrier that files a special (s.953(d)) election with the Internal Revenue Service. This will result in the tax-free inside growth in the PPLI policy that, if held until the death of the NCNR, will result in no income tax on the death benefit.

We believe that purchase of an offshore PPLI policy by the NCNR through an FGT that pours over to a US dynasty trust is an efficient, safe and simple solution that allows an NCNR to invest in US portfolio assets, and leverages that investment and all subsequent growth tax-free into policy death benefit available to US beneficiaries after such death."

From the *Wall Street Journal,* we share "[Fashion Industry Gossip Was Once Whispered. Now It's on Instagram]" by Ray A. Smith.

"Shortly after designer Olivier Rousteing showed his fashion collection for Balmain in Paris last September, French designer Thierry Mugler posted on Instagram.

Mr. Mugler, famous in the 1980s and early '90s for power suits and the George Michael "Too Funky" video, posted a series of side-by-side images comparing his past ensembles to Mr. Rousteing's new looks. Next to a Balmain black, one-shouldered jacket-dress with white lapels, Mr. Mugler posted his own similar design from 1998 with the comment: "Really?"

Along with Balmain's dress featuring a graphic, webbed print, Mr. Mugler, who now goes by the first name Manfred, attached his own webbed design from 1990. "No comment!"

The episode surprised Mr. Rousteing. "Oh my God, I'm so sorry for him, seriously," said 33-year-old Mr. Rousteing about 69-year-old Mr. Mugler in an interview. He denied copying the designer.

In the past, copycat allegations rarely reached beyond fashion industry gossip—or sometimes courtrooms—and rarely made it to the wider public. Now with Instagram, fashion's favorite app, accusations spread much faster and to a wider audience. Eagle-eyed accusers can post comparison pictures and add arrows and circles to zero in on the alleged offense immediately after a fashion show, now that runway images are beamed out in real time.

High-end fashion labels are increasingly being called out on social media for copying other designers or designs, leading to back-and-forth exchanges, lawsuits and expensive apologies.

Instagram accounts, including Diet Prada, have formed to focus on designers and retailers whose creations some feel look too much like other designers' past work. Since its 2014 launch, Diet Prada, which isn't affiliated with Prada, has amassed more than 960,000 followers. The Fashion Law blog and CashinCopy Instagram feed also name and shame copying."

If you are looking for a bespoke solution to your asset structuring needs, we welcome you to *contact us*. You will also benefit from our conservative and fully compliant methodology of using PPLI as the centerpiece of the structure. You will be pleasantly surprised to experience 'two sides of the same coin.'

[1] M. A. Warshaw and L. M. Lipoff, 'How to Navigate the Choppy Seas for Foreigners With U.S.-Based Heirs: Part I', *Trusts & Estates* (June 2018), and 'Non-Citizen, Non-Resident Options for Life Insurance', *Trusts & Estates* (August 2018)

[2] All uses of 'offshore' and 'foreign' are given from the perspective of the US.

[3] All references to 'US persons' in this article refer to citizens and residents only.

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