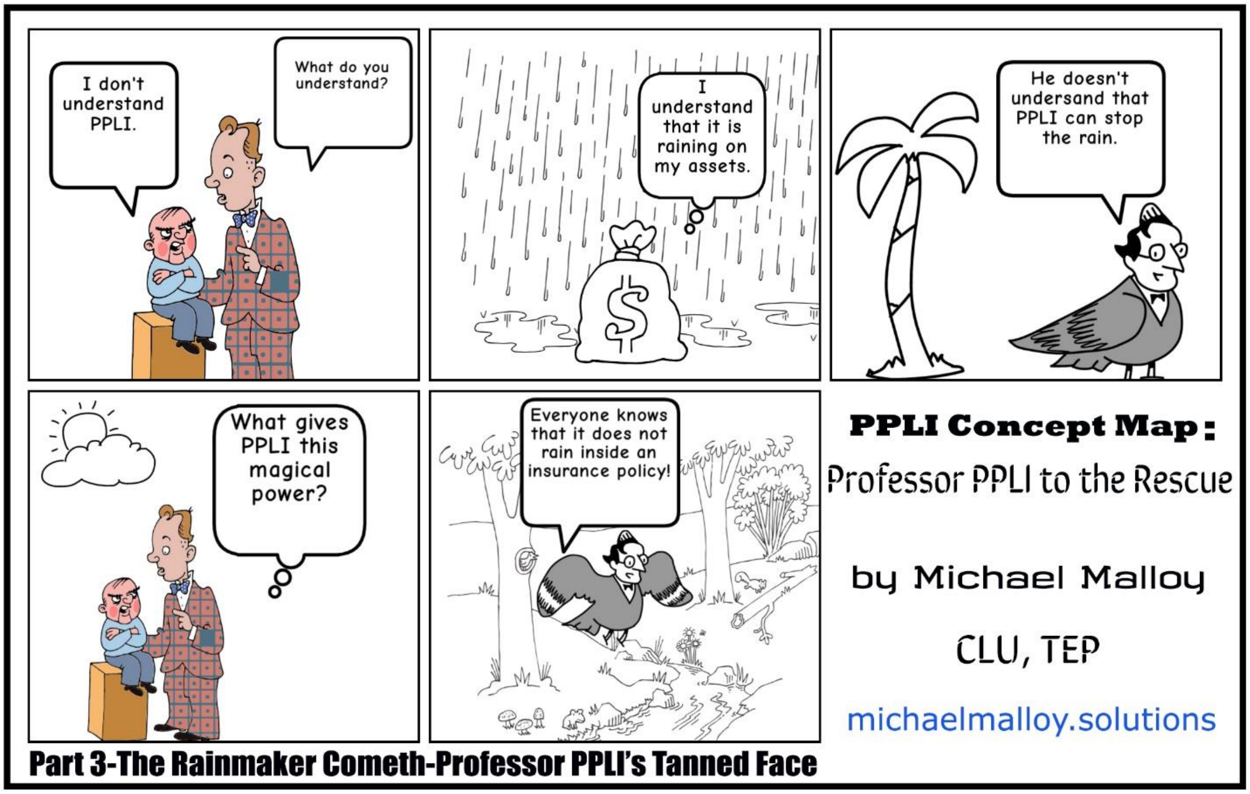
The Rainmaker Cometh



Professor PPLI's Tanned Face

Part 3

*Our next series of articles will comprise an in-depth look at the five main components of our **PPLI Concept Map: Professor PPLI to the Rescue.***

Professor PPLI has arrived to educate our advisor on what PPLI can accomplish for this frustrated client. We continue our analogy of rain, and cast Professor PPLI in the role of the rainmaker, which the *Cambridge English Dictionary* defines as "someone who makes a lot of money for a company or who helps someone or something to succeed." This is an apt description of Professor PPLI. As you will find out, Professor PPLI has a studious approach to the tax savings and tax compliance benefits of PPLI or **Private Placement Life Insurance**.

It is not raining in the third panel of the Concept Map which includes a palm tree. In this article, we will explore how the rain exits and how "PPLI can stop the rain." Frequently wind can accompany rain, but it also can blow it away.

Before we detail how “PPLI can stop the rain.” Please enjoy a memorable passage from Charles Dickens on the wind from his novel ***Martin Chuzzlewit***. Think of this wind as the same wind that blew the rain away. This rain that so disturbed the client’s assets in frame two of our Concept Map.

“An evening wind uprose too, and the slighter branches cracked and rattled as they moved, in skeleton dances, to its moaning music. The withering leaves no longer quiet, hurried to and fro in search of shelter from its chill pursuit; the labourer unyoked his horses, and with head bent down, trudged briskly home beside them; and from the cottage windows lights began to glance and wink upon the darkening fields.

Then the village forge came out in all its bright importance. The lusty bellows roared Ha ha! to the clear fire, which roared in turn, and bade the shining sparks dance gayly to the merry clinking of the hammers on the anvil.

Out upon the angry wind! how from sighing, it began to bluster round the merry forge, banging at the wicket, and grumbling in the chimney, as if it bullied the jolly bellows for doing anything to order. And what an impotent swaggerer it was too, for all its noise; for if it had any influence on that hoarse companion, it was but to make him roar his cheerful song the louder, and by consequence to make the fire burn the brighter, and the sparks to dance more gayly yet; at length, they whizzed so madly round and round, that it was too much for such a surly wind to bear; so off it flew with a howl giving the old sign before the ale-house door such a cuff as it went, that the Blue Dragon was more rampant than usual ever afterwards, and indeed, before Christmas, reared clean out of its crazy frame.

It was small tyranny for a respectable wind to go wreaking its vengeance on such poor creatures as the fallen leaves, but this wind happening to come up with a great heap of them just after venting its humour on the insulted Dragon, did so disperse and scatter them that they fled away, pell-mell, some here, some there, rolling over each other, whirling round and round upon their thin edges, taking frantic flights into the air, and playing all manner of extraordinary gambols in the extremity of their distress.

Nor was this enough for its malicious fury; for not content with driving them abroad, it charged small parties of them and hunted them into the wheel wright's saw-pit, and below the planks and timbers in the yard, and, scattering the sawdust in the air, it looked for them underneath, and when it did meet with any, whew! how it drove them on and followed at their heels!

The scared leaves only flew the faster for all this, and a giddy chase it was; for they got into unfrequented places, where there was no outlet, and where their pursuer kept them eddying round and round at his pleasure; and they crept under the eaves of houses, and clung tightly to the sides of hay-ricks, like bats; and tore in at open chamber windows, and cowered close to hedges; and, in short, went anywhere for safety."

Now contrast this chaotic and disruptive wind to the placid palm tree next to Professor PPLI in panel three of our Concept Map. Here is a description of palm trees from ***Wikipedia***.

"Palms are among the best known and most extensively cultivated plant families. They have been important to humans throughout much of history. Many common products and foods are derived from palms. In contemporary times, palms are also widely used in landscaping, making them one of the most economically important plants. In many historical cultures, because of their importance as food, palms were symbols for such ideas as victory, peace, and fertility. For inhabitants of cooler climates today, palms symbolize the tropics and vacations."

In January and February when walking the sometimes icy New York City streets, you are apt to encounter the sun tanned face or two on the crowded sidewalks. It is difficult not to have a pang of jealousy. You know that this lucky person has just returned from a pleasant Caribbean island where palm trees abound, and the bitter cold winter wind is not felt. At this time in the Caribbean, the temperatures are usually ideal--not too hot or too cold. This balance reminds us of the ***six principles of Expanded Worldwide Planning (EWP)***, and how these six principles together with PPLI achieve such outstanding asset structuring results.

In the STEP Journal, Simon Gorbutt TEP, Director of Wealth Structuring Solutions at Lombard International Assurance, demonstrates how the six principles of EWP solve many common issues for wealthy clients. (Note in this article that the term "investment-linked life insurance" is used for PPLI.)

"Bill Gates once said that 'with great wealth comes great responsibility'. Gates was referring to philanthropy, but, for many wealthy clients, the responsibility they feel is twofold: to their communities, but also to their ultimate beneficiaries, to ensure that wealth is not unnecessarily eroded before it reaches them. Wealthy clients cite succession and inheritance issues as their greatest concern in terms of wealth creation and preservation in the coming years.[1] In an age of political turmoil and where globalisation and digitalisation make all manner of personal and professional change swift, ensuring the continuity of one's legacy can be challenging, as can finding a single vehicle that delivers the flexibility and longevity clients require. However, life insurance may be that vehicle."

Preservation

Mobile lifestyles are fast becoming the norm: a third of wealthy clients hold a second passport or nationality, 22 percent plan to buy another home in a foreign country in the next year and 41 per cent send their children overseas for education.[2] However, every connection with a new country brings a risk that existing wealth structures will be rendered ineffective. A mainstay of planning in one jurisdiction, such as an excluded property trust for a UK resident non-domiciliary, may not survive elsewhere: on a move by the settlor or beneficiary to France, the trust attracts reporting obligations and, potentially, tax. Spain and other countries that have not ratified the *Hague Convention of 1 July 1985 on the Law Applicable to Trusts and on their Recognition* may disregard it entirely. And the issue is by no means exclusively European: acquisition of US taxpayer status by a non-US resident can require a client to contend with two tax regimes simultaneously, and investment options may be constrained – e.g. by punitive tax and reporting associated with passive foreign investment companies (PFICs). While there is likely no panacea, investment-linked life insurance can go a long way towards alleviating these concerns.

Importantly, life insurance is not a uniquely civil- or common-law creation. As such, its treatment in law and tax is reasonably uniform, and a well-structured insurance policy will be immune to a move between civil- and common-law jurisdictions. Whether unchanged or with subtle amendments, it can continue to defer tax on linked investments across borders and even in the hands of dual or multi-tax residents. Further, policy assets are owned by the insurer, rather than the policyholder – a distinction that grants the policyholder exposure to investments, such as PFICs, that might otherwise be taxed unfavourably. Similarly, policy investment gains may be protected on emigration, given that, in some countries (e.g. Spain and France), life insurance is not subject to exit tax. In the meantime, the policyholder retains access to their preferred investment managers, appointed by the insurer.

Transition

Over time, life can be complicated not only by travel, but also through the gradual dispersal of family, wealth and other interests – not to mention death, separation and remarriage, and the extended families that can follow. When the time comes for assets to pass to the next generation, these intricacies can frustrate intentions. At death, a matrimonial property regime may apply and should be dealt with first. If time has been spent in various locations, assets are widely distributed or the residence and domicile of a client no longer match, there is scope for more than one succession regime to apply. Some jurisdictions recognise the concept of a deceased's estate, while elsewhere succession is direct. Others apply forced-heirship rules, and then there is the prospect of double taxation. While the landscape has seen some simplification, e.g. with the EU Succession Regulation (the Regulation)[3] and enhanced European cooperation in matrimonial property matters,[4] it can be hard to ensure assets reach the right hands.

One of the attractive features of life insurance is the possibility to designate beneficiaries to whom some or all policy proceeds are paid directly when the contract ends. Amounts transferred in this way are generally excluded from the estate of the deceased and are therefore not subject to probate. In some cases, such as in Sweden, a beneficiary can automatically become the new policyholder when the holder dies. At European level, life insurance is a notable exclusion from the scope of the Regulation.[5] This is not to say that a life policy in force at the holder's death cannot be subject to the Regulation, but it provides comfort that payments to beneficiaries will be made immediately, rather than being gathered in and distributed with the broader estate. In this context, it is also significant that, regardless of the number and location of a policy's linked investments, the policy remains a single asset with a single *situs*.

There can be little comfort, however, in assets reaching their destination if their value by that time has dissipated. Life insurance is not only subject to a specific legal framework, but also usually sits under a specific head of taxation. As a result, proceeds, on withdrawals or termination, can be taxed more lightly than direct investments and direct inheritance. In France, for example, death proceeds of a policy funded prior to the assured's 70th birthday are taxed at beneficiary tax rates of 20–31.25 per cent, rather than at succession tax rates of up to 60 per cent. Even where reduced tax rates are unavailable, a life policy might be paired with high death cover from the same provider to meet, rather than mitigate, the liability.

If there is concern that when assets change hands they will be consumed by family disputes or further taxation, bespoke policy terms can reduce this risk: a couple in Spain has the option to take out joint life policies, each spouse naming the other as beneficiary should they be the sole survivor. After an initial term, the sole survivor receives a contractual right to end the policy and take the proceeds. However, the spouses can agree at the outset that receipt of this right will be delayed by a term of years or be invalidated by family disputes or remarriage during this time. Succession tax is not due until the right is received. Crossed policies such as these can smooth the transition of wealth and offer time to plan before a tax bill can arise.

Control

Two of the primary reasons wealthy individuals are concerned about intergenerational wealth transfer are that children will not know how to handle the investments and that they will be irresponsible with the money.[6] Having earmarked wealth for the next generation, retaining control over how it is applied can be difficult, particularly overseas. A life policy could solve the conundrum.

In the UK, for example, where beneficiary designations are uncommon, a gift of a foreign life policy to an individual is not chargeable to income or capital gains tax and, for a domiciled (or deemed-domiciled) client, is potentially exempt for inheritance tax purposes. If there is concern that a child or grandchild may be insufficiently mature to handle the value transferred or share the family's wealth management objectives, policy terms can be tailored before the gift so that, for a period of time chosen by the donor, the policy cannot be brought to an end and withdrawals are prohibited or capped. Elsewhere, beneficiary designations can bestow a form of veto right: although not unique to Belgium, Belgian insurance law provides that an accepting (irrevocable) beneficiary must consent to certain policy transactions, including withdrawals of policy value by the holder. A grandparent who gifts a policy to a child but is irrevocably designated a beneficiary in first rank will possess a veto right during their lifetime over access to the policy value, which value will then inure to the benefit of the child, and ultimately the grandchild as beneficiary in second rank.

Connection

Of course, circumstances may dictate that a combination of solutions or an addition to an existing vehicle is required. In this context, the incorporation of an insurance policy can enhance the efficiency of a larger plan and expand the available investment options. A practical example is the addition of US-style insurance and annuities to foreign non-grantor trusts to limit the effect of the accumulation and distribution rules.[7] Similarly, should a beneficial owner spend time in a jurisdiction that disregards a foreign entity, such as a trust, or treats it as transparent (attribution rules in South Africa, or tainted protected settlements in the

UK), a life policy held by the entity and compliant in the beneficiary's country of residence can preserve tax deferral and investment flexibility.

Conclusion

As families and their wealth gradually disperse, and business and personal relationships evolve, even established planning tools can be rendered inefficient or, worse, obsolete. While no structure will weather all eventualities, the flexibility inherent in life insurance and the breadth of its recognition make it an attractive candidate for completing a modern wealth and succession plan."

- *The Wealth Report 2016*, Knight Frank
- As above, note 1
- *Regulation (EU) No 650/2012*
- *Council Regulation (EC) 2016/1103* and, in relation to registered partnerships, *Council Regulation (EU) 2016/1104*
- art.1(2)(g), subject to point (i) of art.23(2)
- As above, note 1
- See Danilo Santucci, 'Distribution and Throwback, Part 2', *STEP Journal* (Vol25 Iss10), pp.34–35

In our next article we will discuss in more detail how the six principles of EWP in conjunction with PPLI give "magical powers" for structuring assets to achieve exceptional outcomes for clients. Let us know how we can accomplish the same for you!

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