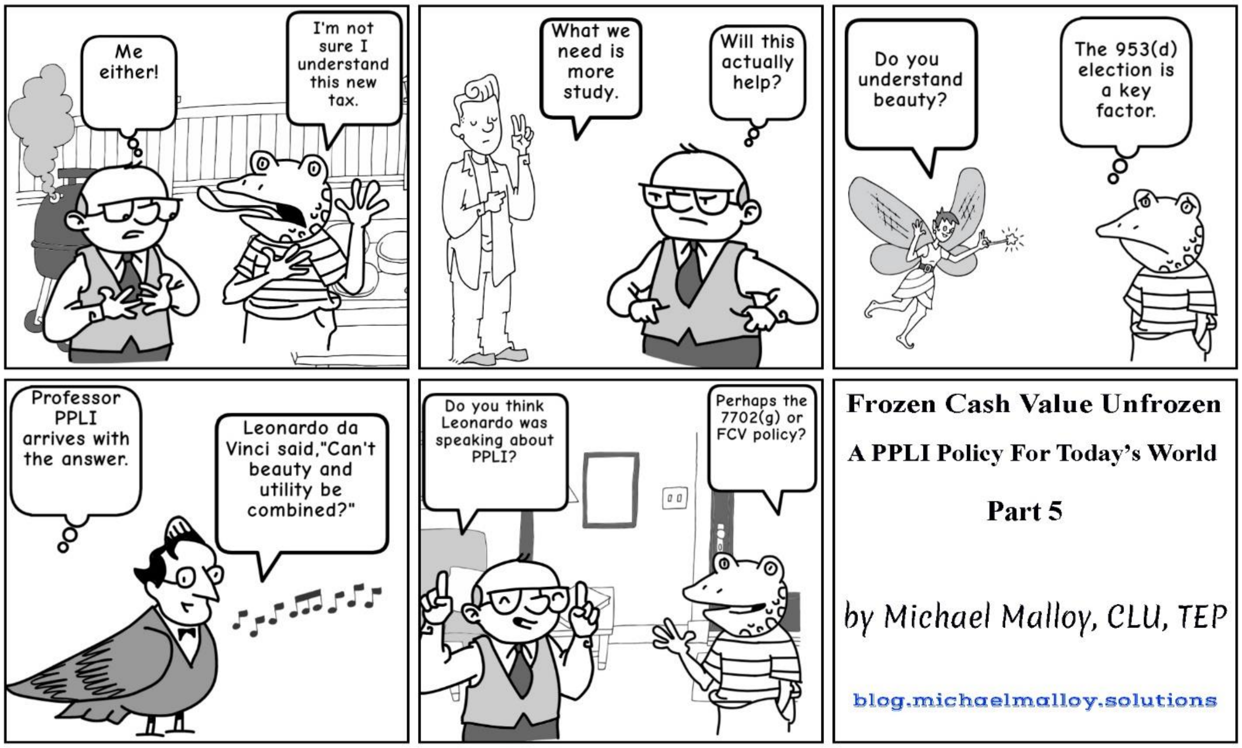
Frozen Cash Value Unfrozen



A PPLI Policy For Today's World

Part 5

Our next few articles will comprise an in-depth look at the five main components of our PPLI Concept Map***: Professor* PPLI meets Leonardo da Vinci.**

Like few profound thinkers Leonardo da Vinci was able to cross-fertilize many disciplines. To name a few art, science, aviation, engineering, music, and elaborate pageants at Italian courts. Many advisors lack knowledge of the outstanding properties of Private Placement Life Insurance (PPLI), because it is a combination of several disciplines: investing, life insurance, asset protection, and estate planning. This inability to grasp the many planning possibilities of PPLI brings to mind this thought of Leonardo:

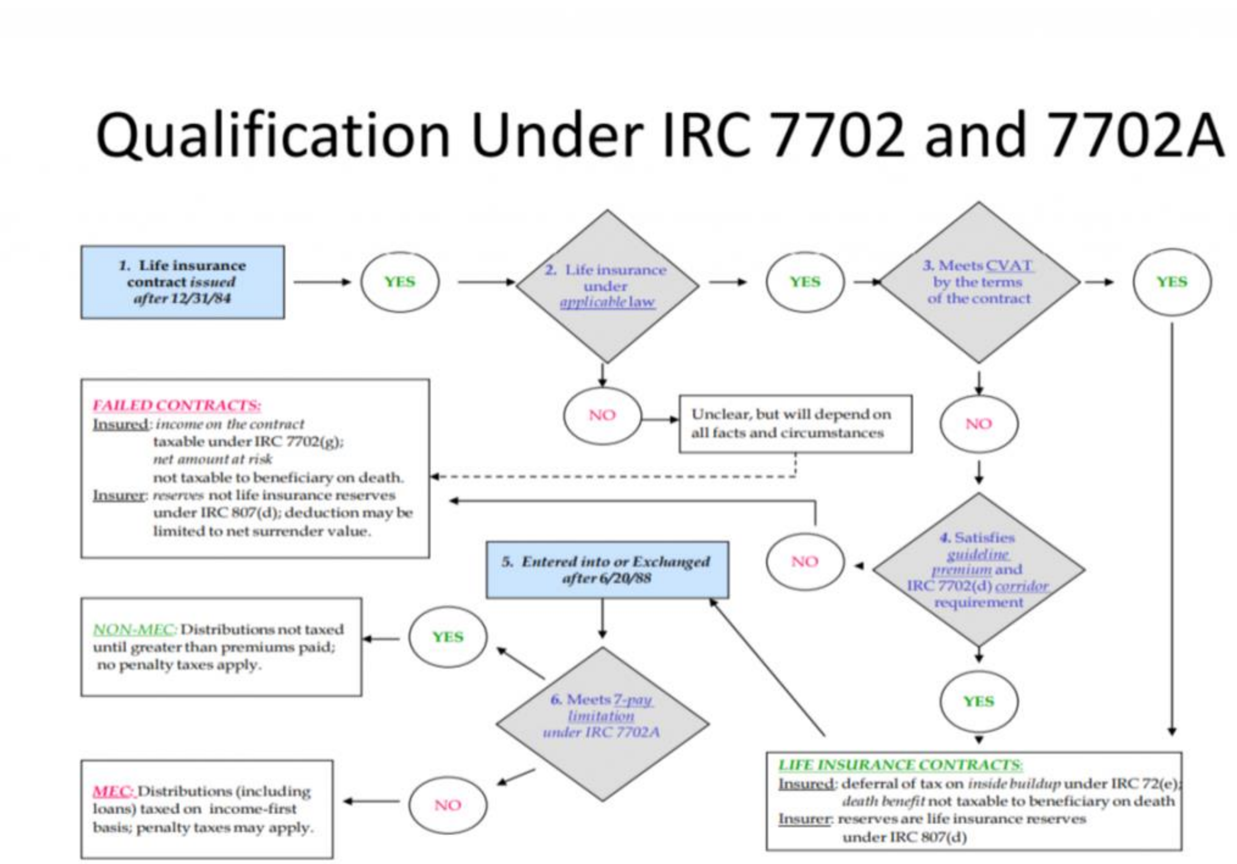
"Iron rusts from disuse, stagnant water loses its purity, and in cold weather becomes frozen; even so does inaction sap the vigors of the mind."

"Cold weather becomes frozen" prefigures one of our main topics, Frozen Cash Value life insurance. Much more on this topic later.

We are also led to the overarching planning concept that informs our ***PPLI planning***, ***Expanded Worldwide Planning*** (EWP) which embodies these six characteristics: privacy, asset protection, succession planning, tax shield, compliance simplifier, and trust substitute.

In this series, our earlier articles spoke about the advantages of using PPLI companies domiciled in locations such as Barbados, Bermuda, and other jurisdictions with insurance codes that enhance the possibilities of structuring assets with PPLI. For those with a connection to the U.S., we stressed the importance of using PPLI companies that have made a ***953(d) election***. We now will add a powerful third element, a PPLI policy that is termed **Frozen Cash Value**. This is a policy that fails to meet the IRS's various cash value tests for code section 7702, and qualifies as life insurance under 7702(g).

Here we have a flowchart courtesy of John Adney, Esq. Davis & Harman LLP Brian G. King, FSA, MAAA Ernst & Young LLP Craig R. Springfield Davis & Harman LLP, Esq. This flowchart was part of their "Life Insurance Boot Camp" presentation



History of the Frozen Cash Value Policy

Let us start at the beginning. To my knowledge the first person to recognize the outstanding potential of using a **Frozen Cash Value policy for wealthy clients** was Prof. Craig D. Hampton. He called his concept The Hampton Freeze, and wrote an article by the same name in *Offshore Investment,* in October 1994. Here is Prof. Hampton's account of his first client presentation using the Frozen Cash Value concept.

"I was visiting a gentleman at his home in the Piccadilly district of London. It was explained to me that his net worth exceeded US$100 million by a substantial margin. I noticed the presence of a computer terminal on a large desk in his den. It was surrounded by reams of paper dealing with offshore investing.

It soon became apparent that his affluence was due to his own efforts when he said to me: "You're a bright young man who obviously knows his craft. But what can you tell me that I don't already know about finances?"

I leaned forward and made this simple statement: "Through the creative use of international life insurance, your financial affairs can be arranged so that you will never have to pay income taxes for the rest of your life!" The gentleman took serious notice, and thus was born The Hampton Freeze."

"The Freeze" Works If You're Too Rich, Too Old, or Not in Good Health.

Frank Suess's article, "**Never again pay income taxes for the rest of your life**," in *The Daily Coin,* speaks further about the FCV policy.

"PPLI to this day, is an important tool in our offering. Over the years, many of our clients have employed this tool, which beyond the tax benefits, effectively integrates the benefits of legal asset protection, global investment flexibility, privacy and generational planning features.

While I am not aware of any insurance carrier, today, offering a PPLI policy called the Hampton Freeze, Prof. Hampton's concept has certainly lived on. Since his article in 1994, a series of products has been created by the industry. These policies are generally referred to as limited cash value policies. The most commonly used product is called a Frozen Cash Value policy. So, the "Freeze" has lived on at least partially.

And, what's most intriguing about it: It's valid to this day! While most other effective offshore income tax planning tools have gone to the wayside over the past years, the Freeze, and the concept presented in Prof. Hampton's article, still works.

You may now wonder how the Freeze works. I recommend you read the article. In brief, it is based on the US tax code ('the Code') and its articles relating to life insurance, primarily in section 7702. While ordinary PPLI policies will have their limitations when it comes to insured persons that are too old or in bad health, and no common products will be available for very large premiums, the Hampton Freeze does not know such limitations.

Let me explain in brief, without boring you with technicalities. The Code defines a number of actuarial rules regarding the cash value and the face amount of life insurance policies. They must meet certain minimum risk coverage (death benefit) levels in order to be tax-compliant.

Therefore, based on actuarial best practices and the limitations of reinsurance levels available internationally, you will not have access to the tax freedom offered if you're too rich. In other words, the limitations of reinsurance are, internationally, at a level of roughly US$40 to US$50 million of life risk. If you're premium is too high, you will not be able get a policy. In order to keep within the actuarial tests defined by the Code, there will not be enough re-insurance available. Thus, no policy. Equally, you will not have access to the tax freedom of PPLI if you're in bad health. You will fail at the medical. And, you are locked out of the world of PPLI if you are too old.

The Hampton Freeze removed those limitations. Thus, the largest policies written today frequently make use of the limited cash value concept born in 1994. We too regularly make use of this planning tool. My utmost respect and gratitude to you Prof. Hampton! Good work indeed!"

To complete our history of the FCV policy, Gerald Nowotny, an excellent commentator on many aspects of PPLI, gives us this note from his article, "**Frozen Cash Value Life Insurance - A sophisticated tax planning solution for ultra-high-net-worth taxpayers**."

"My experience with FCV policies goes back to 1999, when Scottish Life and Annuity offered a FCV policy. The life insurer secured a favorable opinion from a large law firm. In fact, I've reviewed at least four favorable opinions on FCV from large law firms over the course of the last 10 years."

Leonardo and FCV Both Solve Important Issues

Just as a FCV policy will solve many issues facing wealthy clients today, Leonardo solved many issues during his lifetime, even before his contemporaries thought of them as issues! Here is an excerpt from Fritjof Capra's book, ***Learning from Leonardo: Decoding the Notebooks of a Genius***.

"Leonardo da Vinci, the great genius of the Renaissance, developed and practiced a unique synthesis of art, science, and technology, which is not only extremely interesting in its conception but also very relevant to our time.

As we recognize that our sciences and technologies have become increasingly narrow in their focus, unable to understand our multi-faceted problems from an interdisciplinary perspective, we urgently need a science and technology that honor and respect the unity of all life, recognize the fundamental interdependence of all natural phenomena, and reconnect us with the living Earth. What we need today is exactly the kind of synthesis Leonardo outlined 500 years ago."

Commentators of tax issues frequently site 7702(g) as a catchall section of the tax code whereby policies that do not qualify under other sections of 7702 can still have the tax benefits of life insurance.

Michael Kitces's article, "**The Tax-Preferenced Treatment of Life Insurance Policies**," gives us this about 7702(g). His comments echo these commentators, but it is framed in a positive light.

"To further encourage the use of life insurance, Congress has also provided under IRC Section 7702(g) that any growth/gains on the cash value within a life insurance policy are not taxable each year (as long as the policy is a proper life insurance policy in the first place). As a result, if a permanent insurance policy is held until death, the taxation of any gains are ultimately avoided altogether; they're not taxable under IRC Section 7702(g) during life, and neither the cash value growth nor the additional increase in the value of the policy due to death itself are taxable at death under IRC Section 101(a)."

PPLI gives wealthy families many benefits that cannot be achieved by any other type of planning. Please give us the opportunity to structure your assets to achieve these exceptional benefits. Each family situation is unique. Let us help you explore the PPLI potential of your unique situation, so you can achieve these exceptional benefits. ***Contact Us!***

by Michael Malloy, CLU TEP, @ Advanced Financial Solutions, Inc