EWP & Tax Shield-Part 3

Expanded Worldwide Planning-EWP and Tax Shield

Private Placement Life Insurance (PPLI) in Action

PPLI Benefits U.S. Persons with Real Estate--Part 3

The universality of Expanded Worldwide Planning (EWP) is not to be denied. This is objectified by *Wikipedia.* In the first sentence of their page on *International Tax Planning,* **Expanded Worldwide Planning** (EWP) is featured.

We are taking a cue from *Wikipedia.* Over the next few weeks, we will feature one of the ***six principles*** of Expanded Worldwide Planning (EWP). The six principles are: privacy, asset protection, tax shield, succession planning, compliance simplifier, and trust substitute. Today we feature the tax shield.

PPLI Benefits U.S. Persons with Real Estate

The benefits of using PPLI for U.S. persons investing in real estate in the U.S. are substantial. Why don't more U.S. persons take advantage of these benefits? At ***Advanced Financial Solutions, Inc.***, we maintain that it is because of profound misunderstandings about the **Investor Control Doctrine** and the diversification requirements of variable contracts under IRS code section 817(h).

Ironically, these misunderstandings have been clarified by the Webber decision, Webber v. Commissioner, 144 T.C. No. 17 (June 30, 2015). In the popular press, and in many tax journals, this same Webber decision was interpreted as the 'nail to the coffin' for PPLI.

Let us explore how the Webber decision makes it clear that in a properly structured PPLI policy, U.S. real estate can be held and still be fully compliant with the IRS. We will do this through the lens of what the Webber decision tells us about the Investor Control Doctrine and the diversification requirements of variable contracts under 817(h).

These are the key points of the Webber decision that support the inclusion of U.S. real estate in a properly designed PPLI policy:

✦The egregious flaunting of what is known as the Investor Control Doctrine by Jeffrey T. Webber, William Lipkind, his attorney, and the manager of his Insurance Dedicated Fund (IDF) (Butterfield Bank) has blinded advisors and their clients to an essential point in the tax court's decision. Judge Lauber, the presiding judge, found no objection to the private companies and other investments that were placed as in-kind premium in the two PPLI policies that were in question. There is nothing in the rules regarding PPLI either before or after Webber which would prohibit the use of private company securities, actively operated and closely business interests, and real estate enterprises within a policy IDF or Separately Managed Account (SMA).

✦The Tax Court's key issue was the fact that Mr. Webber was on the board of every company in which the policy invested, invested his own funds from his personal wealth and his IRAs, and that he negotiated the terms of every loan on behalf of the company and then gave the instruction to Mr. Lipkind and Butterfield Bank. The court states, "The record includes more than 70,000 emails to or from Mr. Lipkind, Ms. Chang (Webber's accountant), the IDF Investment Manager, and/or Lighthouse (the insurance company) concerning petitioner's "recommendations" for investments by the separate accounts. Mr. Lipkind also appears to have given instructions regularly by telephone."

✦IRC Sec 817(h) provides a detailed overview of the investment diversification requirements of variable insurance products. The regulations address a wide range of investment alternatives that are not found in retail variable life and annuity products such as direct investment in real estate, and commodities.

✦Treasury regulations 1.817.5 provide very detailed guidance on the investment diversification rules. The regulations interpret these rules for investment asset classes such as real estate, and allow for a period of time to meet the diversification requirements of IRC Sec 817(h). For non-real estate accounts, the regulations provide for a one-year period to meet the diversification requirements. Real estate accounts provide for a five-year start up period and a two-year liquidation period.

✦The court states: "The "investor control" doctrine posits that, if the policyholder's incidents of ownership over those assets become sufficiently capacious and comprehensive, he rather than the insurance company will be deemed to be the true "owner" of those assets for Federal income tax purposes. In that event, a major benefit of the insurance/annuity structure--the deferral or elimination of tax on the "inside buildup"--will be lost, and the investor will be taxed currently on investment income as it is realized."

✦It is clear from reading the Webber decision that, if Mr. Webber had followed the very language stated in his policy, his PPLI structure would have worked, and complied with the Investor Control Doctrine and the diversification requirements of 817(h). The court record reads: "As drafted, the Policies state that no one but the Investment Manager may direct investments and deny the policyholder any "right to require Lighthouse to acquire a particular investment" for a separate account. Under the Policies, the policyholder was allowed to transmit "general investment objectives and guidelines" to the Investment Manager, who was supposed to build a portfolio within those parameters."

PFIC + Subpart F + GILTI = All Redefined with PPLI

Distributions from a properly structured PPLI policy are distributions from a life insurance policy. Like all policies, both U.S. and issued in other jurisdictions around the world, the distributions are subject to the tax code sections that apply to life insurance.

In a properly structured policy, one can withdraw all basis in the policy, which are the premiums paid, tax free, and take very low cost loans to withdraw the remaining funds. The costs of these loans is equivalent to an administrative charge, and is usually in the range of 25 bps. When the policy is held until the death of the insured life, the amount of the loan is merely subtracted from the death benefit, therefore, the loan need not be repaid.

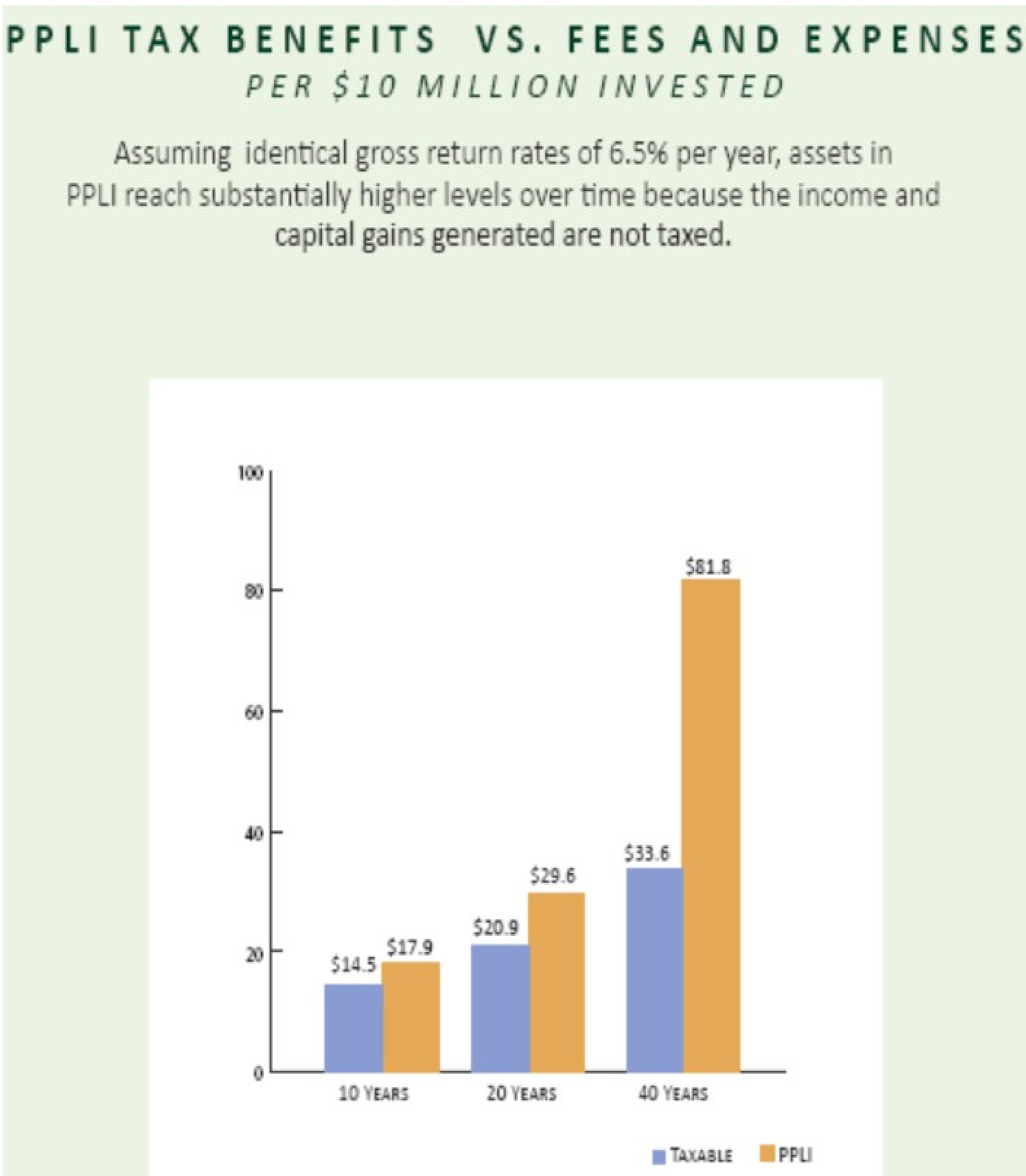
The **2017 Tax Cuts and Jobs Act** (TCJA), has brought an increase in taxation for those who have subpart F income. Just like Passive Foreign Investment Company (PFIC) income, subpart F income can be structured inside a PPLI policy, and, therefore, shielded from tax. PPLI has been used for many years to shield PFIC income.

TCJA gave us a new section of the tax code, **Section 951A**. For those who have an interest in a controlled foreign (CFC), particularly if they are not C corporation shareholders, there is a new opportunity to use a PPLI structure to shield this income from tax. Section 951A gives us Global Intangible Low-taxed Income (GILTI), which if held in other than a C corporation, has very unfavorable tax consequences that can be greatly mitigated by using PPLI.

Hedge Fund Life Insurance

One distinct benefit of a PPLI policy is the ability to place tax inefficient investments like hedge funds into a tax-friendly environment. Some advisors have even coined the term, Hedge Fund Life Insurance, to highlight the advantages of combining hedge fund investments and life insurance into one tax-advantaged asset structure.

The numbers tell the story well on the chart below.



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The chart compares a taxable investment to one held in a PPLI account over the long-term. The very clear winner is the PPLI account. Even over a ten year period there is more than $3M more in the PPLI account. The chart does not even show the death benefit which is always more than the cash value account. In a properly structured policy, the death benefit is also tax-free, making a PPLI asset structure the undeniable victory in the quest for tax efficiency.

Conclusion

Let us summarize the tax advantages of holding investments in a PPLI asset structure:

✦Tax-deferred "inside build-up" of policy cash values. The industry has preserved the tax preferred treatment of life insurance for decades.

✦Non-recognition of capital gains. The policyholder has the ability to switch investment options within the product without triggering taxation. Life insurance separate accounts are legally the owners of the investments within variable insurance products. The life insurer receives a reserve deduction equal to its investment income.

✦The option of tax-free access to policy cash values through a partial surrender of the cash value and low-cost policy loans. A policyholder may take a partial surrender of the cash value and recover his tax basis in the contract first. Policy loans with a net cost of approximately 25 basis points per annum also receive income tax-free treatment.

✦The policy's basis is its cumulative premiums. Once the policyholder has recovered his basis in the contract, the policyholder has a contractual right to a policy loan which allows the policyholder to borrow up to ninety percent of the policy cash value.

✦Income tax-free death benefit. The policy cash value grows on a tax-free basis. The policyholder can access investment gains within the policy on a tax-free basis during lifetime, and beneficiaries receive the death benefit income-tax free.

✦Estate tax-free death benefits through the use of third party ownership of the policy, such as an irrevocable life insurance trust (“ILIT”). IRC Sec 2042 provides that as long as the insured does not retain any incidents of ownership within the policy, the death proceeds will not be included in the taxable estate of the decedent.

Look no further if you wish to achieve the utmost in privacy, asset protection, and tax efficiency. You have arrived when you implement a PPLI asset structure. Please ***contact us today*** to let us know how we can assist you in creating your own bespoke PPLI asset structure.

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