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Life Insurance For The Enhancement Of Wealth And The Facilitation Of Its Transfer

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I. Life Insurance: A Zero Sum Game With An Equity Kicker.

A. Life insurance is a pooling of risk by a large number of individuals, all of whom are necessarily mortal, which results in actuarially predictable transfers of previously taxed wealth between participants in the pool. The participants in the pool may be either the individuals whose lives are insured or other persons who are permitted by law to hold contracts of insurance on the life of the insured. The societal value of the product is well recognized. It mitigates the adverse social consequences of the untimely death of an individual upon whom others depend for primary support while offering the incidental economic benefit of the forced savings implicit in whole life and universal life products.

B. The perception of life insurance as a socially worthy zero sum game played with previously taxed dollars has caused the governments who regulate and tax the life insurance product to treat it as something functionally different from bank accounts and portfolio securities accounts. In consequence they have granted various concessions in respect of life insurance in the form of tax relief, freedom from certain creditors' claims and reduced reporting requirements. As the concept of life insurance has evolved, however, from its simple risk pooling origins to its most popular current manifestation, variable universal life insurance, and as life insurance has come to be promoted both as an income tax favored investment vehicle and as a means to achieve secrecy and creditor protection not available in respect of other popular forms of wealth storage, governments and international organizations have predictably begun to react.

C. On account of the important social purposes served by life insurance, whatever the statutory and regulatory response to recent product developments might be, life insurance will remain for the foreseeable future an essential element of personal estate planning regardless of the nationality or place of residence of prospective insureds. Nationality, residence, family status, risk exposure, risk tolerance and individual planning goals will, however, materially impact the propriety of a particular product for a particular individual. In the realm of life insurance selection, one size most definitely does not fit all.

II. Combination of Life Insurance and a Trust.

A. Non-Tax Rationale for a Trust's Ownership of Life Insurance.

There is no necessary coupling of life insurance with a trust, but the two in combination will often produce results that cannot be achieved by one or the other alone. Tax avoidance springs to mind when a trust and life insurance are spoken of in tandem, but there are many powerful reasons unrelated to tax considerations for the legal ownership of a policy of life insurance by a trust. Examples include:

- (1) Protection against unwise raids upon the cash surrender value of a life insurance policy while the insured is still living and protection against the possibility of rapid dissipation of wealth by a survivor of the insured upon policy maturity;
- (2) The spreading of the substantial wealth which may be generated by a matured policy across multiple generations free of the constraints imposed by "forced heirship"; and
- (3) insulation of cash surrender value and death benefit proceeds from an attack by unknown future creditors or by enforcers of a changed government policy.

B. U.S. Federal Estate Tax Avoidance.

The motivating tax reason for causing a life insurance policy to be owned by a trust may be the removal of the value of such policy (whether represented by cash surrender value or the death benefit of a matured policy) from the estate of a person who might otherwise be the policy owner in the absence of the trust. Considerable legislative and judicial effort has been devoted by the United States to the determination of whether the value inherent in a life insurance policy has been effectively removed from the estate of a decedent by the interposition of a trust. The focus has been upon

- (1) whether there has been a transfer of policy itself by the decedent to the trust and if so when,
- (2) the timing, relative to the death of the decedent, of cash transfers intended for the payment of premiums,
- (3) the degree of control over the policy exercisable by the insured or some other party who has an interest in the policy, and
- (4) whether the person by whom the controls are exercisable is the trust's grantor.

C. The Impact of Changing Death Tax Policy.

It is currently uncertain whether the United States will continue to levy federal estate tax which is a species of excise tax. Many jurisdictions of the world eschew the excise tax in favor of an income tax leviable by reason of a deemed disposition upon death. Substantial modern economic theory tends to the view that a consumption tax would be a more economically sensible assessment than the arguably antiquated form of death tax levied by the United States during the past eighty years upon the act of donation. In consequence, the finely honed U.S. gift and estate tax rules affecting the combination of

life insurance and trusts might be a matter of diminishing future importance within the United States context, and unlike certain facets of United States tax law, such as those applicable to controlled offshore corporations, our rules governing retained incidents of ownership in life insurance policies are not likely to be emulated by foreign jurisdictions.

D. Production of Tax-Free Income Through the Trust Life Insurance Combination

Within the last five years the life insurance trust combination has been promoted as a legitimate income tax avoidance vehicle which, if properly structured, may replicate the advantages formerly achievable using a simple so called "grantor trust". Subject to the powerful caveat that technical U.S. income tax rules governing life insurance and trusts do not translate to most other jurisdictions, a further explanation of the income tax advantages attributable to a trust life insurance combination is offered primarily as an illustration of what might be possible through sophisticated planning.

1. On account of the perception of life insurance as a zero sum game played with previously taxed dollars, the United States, as a general rule (subject to numerous exceptions), does not levy income tax in respect of income earned by a policy in advance of maturity; nor does it tax withdrawals against policy basis or borrowing against untaxed inside build up notwithstanding that such borrowings may be repaid out of death benefit proceeds which are not subject to income tax.

2. Under the old grantor trust arrangement (available prior to August 20, 1996) which was sanctioned by Rev.Rul. 69-70, a non-resident alien would fund a living trust. The non-resident alien grantor, by retaining only modest strings of control, caused himself to be the "owner" of the trust's income for U.S. tax purposes. By reason of the sometimes artificial shifting of income achieved by the application to a foreign grantor of the old grantor trust rules, tax free income could be produced for the U.S. beneficiaries of such a trust for so long as the non-resident alien grantor was alive.

3. It is correct that a properly drafted trust which invests in life insurance (in respect of which either the trust grantor or the trust beneficiary may be the insured) can, under carefully controlled circumstances, produce a flow of tax free income for the trust beneficiary which is comparable to what could be achieved under the pre-August 1996 grantor trust rules, and that such stream of tax free income can be maintained even after the decease of the grantor without resort to highly dubious mechanisms such as the "grantor corporation" controlled "Evergreen Trust". It is equally true that such planning is complicated, it entails costs and risks, and it should not be undertaken without a clear understanding on the part of a client regarding such costs and risks.

E. Do New U.S. Income Tax Laws Affecting Trusts Make Stand Alone Insurance a Suitable Trust Substitute

1. The comparison of a common law trust or civil law foundation with a variable universal life insurance policy is a classic case of mixing "apples with oranges". Although some proponents of life insurance, in their enthusiasm for the product, have suggested that customers of multi-jurisdictional financial institutions are being offered trust-like life insurance products in lieu of trust administration and investment services on

account of resistance to new United States tax information reporting requirements affecting foreign trusts, it would be wrong to assume that trusts and policies of variable universal life insurance are interchangeable products. Though it is possible that some U.S. purchasers who might previously have scrutinized the opportunities inherent in offshore asset protection trusts are now more inclined to consider offshore variable universal life insurance on account of the reporting mandates of IRC § 6048, it is dubious whether this is a large market, and it is one in respect of which insurance carriers are likely to incur the same enhanced scrutiny in the future as is presently being directed against trustees by international authorities intent upon curbing money laundering.

2. The evolution of directed multi generational trusts has stretched the parameters of what were formerly regarded as irreducible court elements of a "trust" just as emphasis upon investment strategies and tax avoidance has altered the perception of the fundamental purpose of life insurance. Curiously, the question of the extent to which excessive retained grantor control may serve to core a trust to be treated as a mere agency under the laws of some jurisdictions is analogous to the question of whether excessive policy holder control over investment may jeopardize the recognition of an insurance policy as life insurance for U.S. federal income tax purposes.

3. Numerous other analogies might be drawn between the family trust and a policy of variable universal life insurance, but the essence of a trust remains the protection and conservation of assets subject to the investment management of the trustee, a family committee or a grantor holding reserved powers while the essence of an insurance policy is a socially sanctioned wager between policy holder and insurance carrier regarding the projected lifetime of the insured, which wager has come to be associated with increasingly sophisticated and tax favored ancillary investment activities. In many instances, the sum of a multi-generational family trust and a skillfully designed variable universal life insurance policy is something greater than either of the constituent parts.

III. Product Classification.

Variable universal life insurance is a focal point of modern estate planning, but for an understanding of its merits it is useful to view variable universal life insurance in the context of other forms of insurance which have preceded it and which remain viable, and in some instances preferable, alternatives for achieving certain planning goals.

A. Term Life Insurance.

Term life insurance is a non-cash value species of insurance which offers pure risk protection of a temporary nature. Term insurance is typically sold for periods of 5, 10 or 20 years. It pays out only if the insured dies within the term of the policy. There is no such thing as a "partial loss" in the case of life insurance; but it is incorrect to say that a term policy holder gets "nothing" if he lives too long. What he or his dependants get is loss protection and peace of mind at a premium cost which, in the case of a youthful insured, is very low compared to permanent insurance. Term insurance is not a viable product for intergenerational estate planning, but it is a superior product to variable universal life insurance for providing maximum loss protection when an insured is young and has non-self supporting dependants.

B. Whole Life Insurance.

Whole life insurance is a form of permanent insurance having a promised death benefit, a cash surrender value and a guaranteed premium which is typically level throughout the lifetime of the insured although some policies may provide for later increases at particular benchmark ages to induce younger purchasers of such insurance to buy larger face value policies. Whole life insurance, which is criticized for its high premium costs and lack of investment opportunity, has declined in popularity as individuals have become attracted to universal life and variable universal life by reason of their willingness to shoulder the risks of adverse moves in a carrier's mortality experience and poor investment performance which are borne exclusively by the carrier in the case of whole life.

C. Universal Life.

Universal life, which became popular from the moment of its introduction as a product in 1979, is very flexible in terms of premium payment, permits participation in the investment successes (and failures) of the insurance carrier; and allows the policy holder to pay much lower premiums than those charged for a whole life policy offering an equivalent death benefit; but universal life is sometimes criticized as offering no guarantees to the policy holder. There are in fact guaranties in respect of a universal life policy, but most are limited. The risk which the purchaser takes with universal life in exchange for a premium which is lower than that associated with an equivalent amount of whole life death benefit is that the level premium payment set at the inception of the policy might be inadequate to maintain the stipulated death benefit either because the carrier's investment returns have lagged or its rates for term insurance which represent the risk element to the carrier have increased.

D. Variable Universal Life.

1. Variable universal life has emerged as the current life insurance product of choice because it shares with universal life the flexibility of low premiums (subject to the aforementioned risks) and offers in addition

(a) the right of the policy holder to direct investment in separate accounts which function much like mutual funds, and

(b) the segregation of such separate accounts representing a policy holder's cash surrender value from the general assets of the insurance carrier and its general creditors.

2. For those policies which are intended to qualify as life insurance for U.S. income tax purposes, there is debate about how directly and intrusively a policy holder may exercise control of investment without risking loss of tax qualification. Some commentators caution that de facto investment control by the beneficial owner of a policy of variable universal life insurance may be fatal to the qualification of the arrangement as life insurance, while others argue that there is no substantial judicial support for disqualification on the basis of excessive investment control and that disqualification on such basis would be inherently inconsistent with the premise that variable universal life insurance shifts investment performance risk to the policy holder and away from the

issuer.

3. The separate accounts do provide a degree of protection against the creditors of the issuer, but it would be imprudent to ignore the quality of the carrier on account of the segregation of the individual policy accounts. A weak carrier may be obliged to charge higher amounts for the maintenance of insurance covering the amount at risk, and if a carrier becomes insolvent, it cannot pay the promised death benefit in accordance with policy terms.

4. A purchaser of variable universal life insurance should also understand that such a policy, by reason of its complexity and individuality, entails higher maintenance costs than other simpler forms of life insurance, while subjecting the policy holder to responsibility for maintaining broad asset allocation and imposing upon the policy holder investment performance risk. Such risk is perhaps better appreciated in the year 2001 than it was during the supercharged bull market of the late 1990s.

E. Deferred Cash Value Policies (Also Sometimes Referred to as "Non-Reserve Policy").

Deferred cash value policies are not sold by U.S. carriers on account of strict reserve requirements governing such carriers. Such policies mimic level term insurance save for the fact that they have endowed value if the insured survives the term of the policy. Because it can not by its nature be a source of tax free income during the lifetime of the insured, the deferred cash value policy is seen as a less useful vehicle for intergenerational planning than variable universal life insurance. Nonetheless it represents an interesting niche product for the person whose focus is only upon the death benefit and who dislikes the notion of "outliving" his term policy.

IV. Classification of Insurance Customers By Reference to Tax Status.

Classifying potential customers for a life insurance product on the basis of how they stand vis-a-vis the American Internal Revenue Service risks being perceived as both arbitrary and chauvinistic; but if one is an American trained estate planner, starting from a perspective of how the American Internal Revenue Code would characterize the customer is a sensible concession to the reality that, whatever a customer's motivation for acquiring life insurance, taxes do need to be considered.

A. Will the Policy Be Recognized As "Life Insurance" For Tax Purposes.

1. Anyone purchasing life insurance with the expectation of enjoying the special tax benefits accorded to life insurance must be sure that the governments which exercise taxing jurisdiction over the policy will regard the product as life insurance. Simply because the issuer labels its product life insurance does not end the inquiry; and the fact that one government's tax authority will concur in identifying something as life insurance does not guarantee that other tax authorities will do the same.

2. The U.S. approach to the definition of life insurance might have limited applicability beyond the borders of the U.S., but it is illustrative of how technical and how consequential the exercise of defining life insurance may become. The United States

government, responding to the concern that variable universal life might be a tax advantaged investment product improperly masquerading as life insurance, has created a complex definition of what constitutes "life insurance" for federal income tax purposes.

3. In essence, Section 7702 of the Internal Revenue Code provides that if premiums (particularly heavily front loaded premiums) and cash surrender value are not reasonably related to the risk element borne by the carrier that the insured might die within a particular period of time, the so called insurance "wrapper" will be deemed inadequate, and the policy will be branded non-compliant with the result that annual accretions in cash surrender value are deemed distributed to the policy holder as ordinary income.

4. It is axiomatic that a policy owner who is a U.S. citizen or U.S. resident will care deeply whether his life insurance policy is U.S. compliant, but a non-resident alien in respect of the United States is likely to care whether his policy is U.S. compliant within the meaning of IRC § 7702 only if either

(a) such individual, as policy holder, is contemplating becoming a U.S. tax resident in the future, or

(b) such individual is in the market for a policy in respect of which he intends to make a U.S. child or remoter issue the insured life and potential beneficiary under the terms of a trust.

B. "Tax Magic" of Life Insurance for U.S. Citizens and Residents

1. The "tax magic" of life insurance for U.S. citizens and residents is that

(a) the inside build up in value of a U.S. compliant policy does not subject the policy holder to income tax even when dispositions occur of securities held in the separate account of a variable universal life insurance policy.

(b) Provided the policy is not a "modified endowment contract" (*viz.* a policy which qualifies as life insurance for tax purposes, but whose premiums are nonetheless heavily front loaded), its stored value can be accessed in advance of the death of the insured through a combination of basis withdrawal and borrowing against inside build up without adverse income tax consequence at the time of borrowing or at any future date.

(c) Proceeds payable as a death benefit upon the maturity of a policy are not subject to income tax (notwithstanding that a portion of the policy proceeds might be used to repay the carrier for sums borrowed during the lifetime of the insured).

(d) The value of the policy will not be included in the estate of the person who has funded such policy either at his death or at the death of such other party as might be the "insured life" provided the funder of the policy has not retained incidents of ownership in the policy or made a transfer in trust of same within the 3-year contemplation of death period.

2. None of the tax benefits ascribed to life insurance require that the U.S. citizen or resident go offshore for his purchase, but in individual cases in which privately placed

insurance is desirable and investment strategies are aggressive or unusual, an offshore carrier may offer options not available from a carrier subject to U.S. regulation. If a U.S. purchaser does go offshore, he must be vigilant to ensure that what he is acquiring is in fact an IRC § 7702 compliant policy.

3. One commentator has raised the issue whether a variable life insurance contract issued by an offshore carrier falls within the definition of "variable contract" in the most technical sense. If it does not, the investment diversification requirements of IRC § 817(h) might be avoided. IRC § 817(d) provides that a contract is "variable" if amounts received by the issuer must be allocated to a separate account pursuant to the law of a U.S. State or the District of Columbia, but it is unlikely the IRS would wish to argue (or would accept the argument) that a foreign issuer of a U.S. compliant policy is relieved of the investment diversification requirements of IRC § 817 because the contract of insurance is governed by the laws of a foreign jurisdiction.

4. The tax benefits offered by the U.S. in respect of life insurance are not without costs - - otherwise every high net worth individual in the United States might invest exclusively in life insurance. American tax rules are designed to force the purchase of an insurance wrapper adequate to support a particular level of cash surrender value, and for many persons that will be more insurance than they need or want, the tax benefits notwithstanding. In addition, as noted above, the control which a policy holder may exercise over investment without rendering the policy non-compliant is a subject of ongoing debate, and unless one wishes to be excessively adventurous there must also be adequate investment diversification of separate accounts in accord with a statutory formula.

C. Insurance as a Planning Tool for the Migrant Executive or Entrepreneur

1. The increasing frequency with which executives and entrepreneurs participating in a global economy temporarily shift residence from one jurisdiction to another necessitates consideration of strategies which permit effective acceleration or deferral of income depending upon whether the migrant individual is making a move from a high tax jurisdiction to a low tax jurisdiction or vice-versa. Such planning is not a material consideration for U.S. citizens who are taxed by reference to their nationality, but the United States is nearly unique in its nationality based approach to income taxation.

2. The common place approach to planning for migrant executives assumes that the U.S. is the destination jurisdiction and that its tax rates (which apply to residents in respect of world wide income) are higher than the rates imposed by the jurisdiction from which the inbound executive is arriving (and to which he might return). A rapid comparison of U.S. federal income tax rates against those of members of the European Union and of Japan suggests that in some circumstances an inbound executive or entrepreneur might be better advised to effect recognition after arrival in the United States rather than before.

3. Provided circumstances support the assumption that an inbound executive or entrepreneur should avoid recognition of income while in his temporary place of residence, whether it be the United States or elsewhere, insurance may offer a unique opportunity for legitimate tax avoidance. The United States is not alone in applying

imputation of income concepts to tax residents having controlling interests in investment companies sometimes referred to as "incorporated pocketbooks" or in trusts or trust-like arrangements. Insurance presents an opportunity for the temporary resident because, as previously noted, it is viewed by the many governments as being a socially worthy risk protection device whose investment characteristics are ancillary.

4. For the migrant executive or entrepreneur who envisions temporary residence in the United States, a U.S. compliant policy issued by an offshore carrier may be uniquely suited. The temporary U.S. resident will want a U.S. compliant policy because otherwise he will be forced by IRC § 7702(g) to recognize annually income attributable to increases in the cash surrender value of his life insurance policy so long as he remains resident in the United States. It is fully as important for the migrant person to recognize this risk in respect of a policy of life insurance he has owned for several decades as it is to recognize it in respect of a freshly purchased policy.

5. Although the migrant executive or entrepreneur who has departed the U.S. and terminated his residency may continue to enjoy, regardless of policy issuer, the same liberal tax benefits afforded to U.S. residents and citizens in respect of basis withdrawals and borrowing against inside buildup, it might be the case that the migrant individual has viewed his variable insurance policy as a temporary investment and wants to terminate it after the cessation of his U.S. residence. In such case, there is a material difference between a U.S. issued policy and an offshore issued policy. If a U.S. issued policy is terminated prior to death by a non-resident alien, Rev. Rul. 64-51 provides that gains will be subject to withholding tax at the rate of 30% (unless modified by treaty). By contrast gains realized in respect of a terminated offshore life insurance policy do not incur U.S. federal withholding tax (the residence of the issuing carrier, not the question of whether the policy itself is U.S. compliant, being the determining factor).

6. If a migrant executive plans to make life insurance part of his strategy for being able to create and access investment wealth tax free while resident in the U.S., he should purchase his U.S. compliant policy from an offshore carrier in advance of his acquisition of U.S. residence in order to avoid the one percent U.S. excise tax imposed by IRC § 4371 on premium payments made to foreign insurance companies in respect of life insurance issued on the life of a U.S. citizen or resident.

D. Non-Domiciled Alien Purchasers of U.S. Issued Life Insurance.

1. A special situs altering provision of the Internal Revenue Code, treats the proceeds paid by a U.S. carrier on a policy of insurance on the life of a non-domiciled alien as a foreign situs asset. In consequence, if the matured policy is held by a foreign person at the moment of non-domiciled alien decedent's death, no federal estate tax is assessable on the death benefit notwithstanding that the death benefit is the obligation of a U.S. person. The manifest purpose of this provision is to induce non-domiciled aliens to purchase life insurance from a U.S. carrier. Federal estate tax liability is an important consideration, but for reasons described below, numerous other factors may tilt the balance in favor of the purchase of a policy from an offshore carrier even where the non-domiciled alien has reason to want a policy which is denominated in U.S. dollars and which is also U.S. compliant for federal income tax purposes.

2. The special situs rule in respect of proceeds payable under a policy issued on the life of a non-domiciled alien who has died may not be read to alter the situs of a policy in respect of which the owner dies during the lifetime of the insured and at a moment when the policy has cash surrender value regardless of whether the surviving insured is a non-domiciled alien or a U.S. person. Because a non-domiciled alien holding incidents of ownership in respect of a policy on the life of an insured other than himself will necessarily avoid all exposure to federal estate tax under the general situs limitation rule of IRC § 2103 if the issuing carrier is a foreign person, the non-domiciled alien will be motivated to acquire a policy from a U.S. carrier on the life of an individual other than himself (*viz.* the lives of children or other persons in whom he has an insurable interest) only if the economics of the purchase favor selection of a U.S. issuer. In the circumstance in which the economics favor the selection of a U.S. issuer, the non-domiciled alien will be well advised to cause the purchases of policies on lives other than his own to be effected by an independent trustee acting under the terms of an irrevocable trust which has been funded with cash by the non-domiciled alien settlor.

V. Product Pricing and Flexibility Considerations.

A. Assessments Against Premiums Payable to U.S. Issuers.

1. A sales load in the very general vicinity of 5% is typically charged in respect of the first year's premium for a registered product. A much more modest continuing percentage fee may be assessed in respect of later year premiums subject to an overall cap.
2. State assessments are levied in respect of policies issued by domestic carriers. Such assessments may run from a few basis points to three percent. There are several jurisdictions within the United States which compete as domestic havens by offering significantly reduced state assessment rates.
3. Deferred acquisition charges of between 1% and 1-1/2% of the first year's premium are levied by domestic carriers in order to cover costs attributable to federal amortization requirements. Changes were proposed but not enacted during the Clinton Administration that might have significantly increased DAC.

B. Costs Assessed in Relationship to Cash Value

1. Mortality and expense charges, which are assessed annually and vary significantly among carriers, are intended to compensate a carrier if its estimates regarding the projected lifetimes of its insureds are too long and its estimates of costs to maintain policies are too low.
2. The cost of insurance (the undertaking by the carrier to pay an amount in excess of cash surrender value in the event of the death of the insured) is calculated by the carrier on the basis of its current experience and its desired profit. The risk that an insured will die is frequently spread by the issuing carrier. Most carriers reinsure material portions of the risk they underwrite.
3. Surrender charges may be assessed for any policy terminated other than by death at a

time earlier than the tenth anniversary of policy issuance.

4. Investment management charges are assessed in respect of the various subaccounts maintained in connection with a variable universal life policy. They will vary materially and in proportion to the complexity of the asset being managed.

C. Rationale for Private Placement.

1. A privately placed policy requires a minimum premium investment of \$500,000 to \$1,000,000.
2. Privately placed policies offer several advantages over registered policies including significantly reduced (or no) sales load, a negotiated broker's fee, materially lower mortality and expense charges and lower or no surrender charges; but it is suggested by some commentators that comparable registered products will often cost out on a par with, or superior to, a private placement.
3. A privately placed policy offers the option of negotiating for the insurance carrier's selection of an independent investment advisor favored by the policy purchaser.

D. The Rationale for Purchasing a Policy Issued by An Offshore Carrier.

1. In many instances, the purchaser of life insurance will have no material connection with the United States, and in such circumstances he would have no special reason for purchasing a policy issued by a U.S. carrier unless there were compelling economic reasons for doing so.
2. A policy issued by a non-U.S. carrier (whether or not the policy is "U.S. compliant") will necessarily enjoy certain costing advantages in comparison with a U.S. carrier issued policy and may enjoy other advantages. The policy issued by the offshore carrier will be assessed no state taxes and will bear no deferred acquisition costs; it might have lower expenses owing to less regulation and to more favorable taxation of the carrier itself; but the premium paid on a policy issued by a non-U.S. carrier on the life of a U.S. citizen or resident will bear a 1% excise tax pursuant to the provisions of IRC § 4371; the cost of insurance charged by a foreign carrier may exceed that charged by a U.S. carrier, particularly if a substantial amount of reinsurance is involved; and it is the observation of one commentator that although the policy issued by the offshore carrier will frequently involve lower front end "frictional costs", it may have higher ongoing costs (at least in respect of U.S. compliant policies).
3. Non-cost reasons frequently cited in favor of policies issued by foreign carriers include the potential for obtaining a larger size policy than might be available from a U.S. issuer, greater breadth of choice in respect of investments and more confidentiality. It should be anticipated, however, that confidentiality even in respect of policies issued by offshore carriers will be increasingly challenged by new international initiatives aimed at identification and elimination of money laundering.

VI. Asset Protection.

A. Consistent with the view that insurance is qualitatively different from investment assets, most jurisdictions offer some species of protection against creditor claims, but jurisdictions vary widely among themselves in respect to the protections conferred. There is a general view that certain offshore jurisdictions are substantially more generous than most political subdivisions of the United States in the creditor protections conferred.

B. Effective asset protection against creditors requires long term advance planning by a person who anticipates a potential need for asset protection (last minute implementation of a creditor protection plan will necessarily entail a fraudulent transfer) and an appreciation that a court in a jurisdiction where the beneficial owner of a policy or of matured proceeds resides may take a hostile view to asset protection and refuse to recognize the protections conferred by a foreign jurisdiction either in respect of assets which are returned to the jurisdiction of residence or which can be seized locally by the court as offsets. In addition, life can be made very unpleasant by government authorities for persons who participate in the creation or implementation of products and plans whose manifest purpose is asset protection.

C. Statutory protections against creditors conferred in respect of life insurance are more analogous to homestead protections and protections in respect of certain retirement assets than they are to asset protection achieved through the use of a trust. A person viewing life insurance as a medium for attaining asset protection should, however, take into account that some of the lessons and pitfalls encountered in respect of asset protection trust planning might be applied equally to insurance policies and their proceeds. The asset protection device, whether it be insurance or a trust, will not foil a national tax collector capable of seizing the asset or, if not the asset, a substitute for the asset or the person of the individual accused of evasion; use of insurance to dispossess one's spouse of his or her lawful share of marital assets in the context of a divorce is at best a seamy practice; and the pressures which may be brought to bear upon financial institutions and professionals associated with asset protection products may have the effect of driving persons seeking asset protection into the hands of unscrupulous purveyors and practitioners who, by disappearing with their customer or client's funds, render the issue of asset protection moot.

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