

Life Insurance and the Asset Protection Trust

In the United States, earnings within a life insurance policy grow tax free, cash values can be withdrawn without penalty, and death benefits may be paid out tax free upon the death of the insured. When combined with an asset protection trust the investment retains its high level of flexibility while also receiving the benefit of premium protection from creditors.

The type of insurance most often used in conjunction with an APT is commonly called Private Placement Life Insurance (PPLI). One of the unique features about PPLI is it is a customized policy where the client can, within certain parameters, choose the investment manager and the investment direction. All the policy premiums minus insurance costs and commission are placed in a separate account managed by the nominated investment manager. Essentially the value of the policy is the value of the investments plus any additional value resulting from the death benefit.

Since a PPLI policy contains large amounts of investment funds the level of asset protection provided to the policy is very important. Life insurance already receives a level of asset protection in the US against the claims of creditors. Such statutory protection may operate both during the life of the insured and after their death. It may protect the insured's interest in the policy, the beneficiaries interest in the proceeds, interest's of other parties in the policy or a combination of the foregoing. In a number of states the protection may be limited to a set amount and in all states there are exceptions enabling creditors to attack policy assets.

Comparably, an APT established in a jurisdiction with strong asset protection laws provides a much higher level of protection for life insurance. The APT will protect all the policy assets from any attack before and after the insured's death.

Using an APT also has tax and estate planning advantages. There are a number of transfer tax planning opportunities that can be exploited using the combination of PPLI and an APT, including the reduction of transfer tax liability through an alternative premium paying arrangement.

The standard APT for US citizens is classified as a US grantor trust. In general, all income earned by a US grantor trust is taxed in the hands of the grantor (client) each financial year. Therefore, the trust can be described as tax transparent or tax

neutral since its tax liability is transferred to the grantor.

By wrapping the APT assets inside a PPLI policy there is no income tax liability to pass onto the grantor. This structure will be especially relevant to an APT holding large amounts of investment funds under discretionary management. The benefits are potentially even greater if investments are made in what would otherwise be tax-inefficient investments such as hedge funds, which have a far greater potential return if they are not subject to tax.

The PPLI policies are only available to high net worth individuals. To purchase the policy requires the payment of large upfront premiums typically all paid in the first 5 years of the policy. To purchase such a policy in a highly regulated jurisdiction such as the US can require large minimum premium commitments of approximately US\$20 Million over 5 years. Comparably, offshore jurisdictions like Bermuda, one of the largest insurance industries in the world, have created a cost effective environment to purchase PPLI for as little as US\$5 Million paid over five years.

The insurance costs and commissions for PPLI are relatively insignificant especially when the policy is purchased offshore. The cost of PPLI purchased offshore is in most cases under 1% per annum. There are also upfront insurance commissions to consider of approximately 1% of the premiums paid. Other costs include the cost of employing specialist US counsel who will be responsible for dealing with a broad range of issues including the life insurance planning and tax compliance. This cost is usually charged on a time cost basis or can be negotiated as a fixed charge.

To conclude, PPLI can be used in conjunction with an APT to optimize returns on long term investments, ensure those investments are protected and further the clients estate planning and wealth preservation goals. It is an option well worth exploring when assisting a client with their estate planning and wealth preservation strategy.

NOTE: This article provides a brief summary of how life insurance can be used in conjunction with an asset protection trust (APT) to enhance the performance of the investments made within the APT. The reader should be aware that this is only a summary and many other advantages exist. For further information please contact CIT.