

Asset Protection Revisited

By David Richardson, Mid-Ocean Consulting Ltd.

U.S. taxpayers with unreported income face asset seizures under jeopardy tax assessments. David Richardson (Mid-Ocean Consulting) has written the following article on planning that could exempt assets from such a seizure.

Absent major tort reform, wealthy Americans (and increasingly, HMW individuals internationally), may actually see an increase in litigation from the current high levels; already far higher than any other country in the world on a per capita basis. The likely increase will result from the recent economic turmoil that has permeated just about every corner of the economy.

Added to which, future increased taxation to pay for and support Congressional stimulus packages is clearly in the offing. Meaning even absent litigation, the client faces asset erosion from increased investment and income taxes.

One of the most effective ways to preserve assets is by effecting international structuring that is at once legitimate and compliant (from a reporting and tax perspective) but distances asset ownership from the client and would-be creditors. Yet in a non-adversarial way with solid economic rationale. A key element in this structure is international variable life insurance that is offered in a variety of credible financial jurisdictions like Bermuda, Bahamas, The Cayman Islands, The Isle of Man and others.

Such policies are akin to their domestic counterparts by adhering to the same US tax code (7702 et al) but offer distinct advantages. First the similarities:

- ***Policies may be funded with single or multiple premiums***
- ***Policy assets are invested in client chosen investments- mainly a set menu of mutual funds***
- ***Growth of such assets are income tax exempted during lifetime***
- ***Policy death benefits are income tax exempt at death***
- ***The policy's cash surrender value (CSV) may be accessed during lifetime also income tax exempted***

Now the dissimilarities and thus advantages that apply to some, if not all, international carriers:

- ***Policies may be bought with premium in-kind i.e. assets***
- ***Clients may chose their own investment manager to manage policy investments***
- ***The manager may choose virtually any investment class including stocks, bonds, mutual funds, hedge funds, private equity etc.***
- ***Generally, fees are fractional compared to domestic offerings***

In terms of asset protection, some jurisdictions (like some US States) exempt insurance polices from the claims of creditors; most notably Bahamas and the Cayman Islands. In fact Cayman has recently updated their insurance legislation such that it fully protects the premium(s), the growth on the premium and the death benefit from the claim of creditors putting the greatest clarity in this section of the applicable law of any jurisdiction. In addition the Cayman Segregated Account Statute (7 (8) c) legally segregates the assets of one policy from another, while also keeping them legally distinct from the insurance company's general assets and liabilities; yet further protection.

Interestingly, Puerto Rico, as a quasi-US/offshore jurisdiction has recently enacted law (2011) that immediately exempts assets placed into a policy issued by an international P.R. carrier, provided that those assets or monies were not subject to any prior or current claim. This offers very substantial, statutorily provided protection that must be respected by every other U.S. State Court and judge. Also as a U.S jurisdiction for reporting/information purposes, a U.S. taxpayer would also be free from any additional FBAR/FACTA reporting obligations in owning a PR issued contract.

Regardless of the jurisdiction of issuance, such policies are very often held by trusts for estate planning and dispositive reasons. The domicile of the trust can also be an additional layer of protection for the reason that most jurisdictions have a "fraudulent disposition" period to help establish objectively if the assets settled in trust were done so purposely to defraud creditors of the settlor. The Bahamas by example has a 2-year conveyancing Statute. What this means, in the case of the Bahamas, is that if the assets have been in the trust for +2 years, it's presumed that they were *not* placed there purposely to defraud a creditor. Can a creditor still come forward and lay claim after 2 years? Yes- but the burden of proof is heavily on that creditor.

What happens if the trust is challenged before the 2-year period? The burden of proof, though somewhat lower, is still on the creditor to establish that those assets (in particular) were placed in trust and are rightly his or hers.

In either case under certain tracing claim actions the trust *may* be permeated. It can happen. In this situation, the courts could award the trust assets to the creditor. That is, specifically it would order non-exempted assets to the creditor. In the Bahamas, as we have noted earlier, insurance is such an exempted asset and therefore the courts would be unable to assign it to the creditor.

The other relevant point is that in court, the debtor now has a cogent, commercial argument for having established the structure in the first place; to make and hold international investments in the most tax efficient manor that is at once both transparent and compliant. This, as opposed to other structures where the intent is clearly to avoid or even evades liabilities- contingent or otherwise.

In closing, doing asset protection, as most things in life, can be done by degrees. Some structures offering better protection than others. That said it is our opinion that a trust, established in a good Common Law jurisdiction, offering a balanced conveyancing period (neither too long, not too short) and owning an international variable life insurance policy, acquired from a good company (in the better jurisdictions) offers perhaps the best asset protection. The combination also provides significantly effective income and estate tax mitigation; a not insignificant by-product and advantage.

Having said all this, nothing is inviolate. A very determined creditor could challenge such a structure, notwithstanding the significant burden of proof, and substantial cost. At the very least then such structure should offer the client effective means of settling with such a creditor with terms that favor the former over the latter.
