Tax Planning for U.S. Investors
Doubling Net Return on Investment

Prepared by:
David E. Richardson
Mid-Ocean Consulting Ltd.

Gary S. Wolfe
THE WOLFE LAW GROUP

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David Richardson began his professional career in the investment business over 20 years ago, working for one of Canada's preeminent investment houses; Walwyn, Stodgell, Cochrane and Murray (now Merrill Lynch Canada).

In 1987 he joined the Bank of Bermuda in Bermuda as Portfolio Manager, where he personally oversaw the management of in excess of $350 million for the Bank's top tier clientele. From there he moved to the Bank of Bermuda's wholly owned trust subsidiary, Bermuda Trust Company serving as Assistant Manager and Director of Americas' marketing activities.

A move to the Cayman Islands in 1996 saw new responsibilities for MeesPierson, the near 300 year old Dutch merchant/private bank (now owned by ABN AMRO), serving as Head of Private Banking by successfully establishing that capability there.

Following that, he and his family moved to Nassau, to serve as Managing Director for MeesPierson (Bahamas) Ltd. and Chairman of Lighthouse Capital Insurance Company (Fortis' insurance affiliate in the Cayman Islands), directing marketing and strategic affairs for the Companies.

2003 through 2005 saw new tenure at Oceanic Bank and Trust Limited, as President of the Bank's Insurance Specialty Unit.

Since 2005, he serves as President and CEO of Mid-Ocean Consulting Ltd., which guides both institutions and individuals on sophisticated international structuring and private placement insurance related strategies. He has personally overseen the placement over a half a billion dollars of private placement premium.

In 2009 Mid-Ocean advised the Lighthouse Capital group in the formation of US Commonwealth Life A.I.; the first international life insurance carrier of its kind, based in Puerto Rico and now with assets in excess of $US 1 billion.

Mr. Richardson has authored and/or co-authored a number of articles on subjects relating to U.S. and international taxation and asset protection, including Asset Protection Revisited and most recently U.S. Tax Planning for Passive Investments published by the American Law Institute in 2013.

He is a graduate of the ABA sponsored National Trust School at Northwestern University as well as possessing a number of present and past professional affiliations including a Member of STEP, the ITPA and the Bahamas International Insurance Association.

For more information please visit www.mid-oceanconsulting.com.

THE WOLFE LAW GROUP

Gary S. Wolfe has over 34 years of experience, specializing in IRS Tax Audits and International Tax Matters including: International Tax Planning/Tax Compliance, and International Asset Protection.

As of January 2017, Gary Wolfe has internationally published 17 books and 110 articles. Gary has received 20 international tax awards from five different Global expert societies in LONDON/UK including being voted one of the 100 leading world's law firms with votes from over 150,000 voters in over 160 countries with the following award: Global 100 (2016) (KMH Media Group) - CA/US International Tax Planning Law Firm of the Year.

For more information please visit our website: gswlaw.com

Gary S. Wolfe, A Professional Law Corporation
6303 Wilshire Blvd., Suite 201
Los Angeles, CA, 90048
Tel: 323-782-9139
Email: gsw@gswlaw.com

Tax Planning for US Investors:
Doubling Net Return on Investment (ROI)

By David E. Richardson and Gary S. Wolfe

US investors (incl. US resident citizens, Green Card holders or income tax residents under the substantial presence test and *any US citizen located abroad*) face significant US Income, Estate and Gift tax issues on their investment portfolios namely:

1) Imposition of Federal and State (e.g. CA) “blended income tax” rates up to 55%;

2) 2017 US Estate & Gift Tax of 40% (after personal exemption of $5.49m or, combined $11.26m for husband and wife).

3) Risk of creditor attachments (>1 million lawsuits filed yearly in California; plaintiff’s attorneys look for “deep pocket defendants” who hold assets titled in individual names or closely held entities).

4) US world wide information reporting requirements for undisclosed foreign bank accounts (FBAR filings/FinCen Form 114 for foreign (offshore) bank accounts over $10k; failure to file is an annual 50% penalty, which can be up to 300% if non-tax compliant for 6 years. Willful FBAR violations failure can also result in a 10-year felony for each year FBAR not filed.

5) Foreign Account Tax Compliance Act (FATCA) is reporting by foreign banks on US account holders (adopted 3/10, effective for tax years thereafter). Form 8938 is a separate tax filing due (attached to Form 1040) for foreign financial assets over $50k. Thus taxpayers with foreign bank accounts over $50k have to file both the FBAR and the FATCA filing (Form 8938) or risk multiple civil and criminal tax penalties.

Consider this;

US investors can virtually double their net after-tax return on investments. How? By the compliant elimination of US Income, Estate and Gift taxes on the investment portfolio income with minimal or no reporting. It can, has, and is being be done by many US investors, both domestically and abroad.

In 2006 the Wall Street Journal came out with an article in which they disclosed a "trade secret"; the wealthy use Private Placement Life Insurance policies for investment tax planning (and not for Estate Tax planning). A tax-exempt Private Placement Life Insurance Policy (PPLI) acts as a “tax free wrapper” for investment income (i.e. the annual earnings including interest, dividends, capital gains are not subject to tax reporting or US income tax if held in the cash value portion of the tax compliant life insurance policy (per IRC Sec. 7702). Like a tax-free municipal bond, they are by definition (and Congressional decree) tax-exempted.

For over 10 years, I and my colleague and co-author, David Richardson of Mid-Ocean Consulting (Bahamas), an acknowledged expert in this tax area, have been utilizing and refining this planning. We co-wrote an article in 2013 entitled: *US Tax Planning for Passive Investments* (published by the American Bar Association/The Practical Tax Lawyer). In it we describe these tax features and the attendant asset protection benefits (absent a fraudulent conveyance). And assuming the PPLI is issued under Puerto Rico Law (which is a US territory wherein the FBAR rules do not apply) and further assuming the policy is owned by a single member US LLC (California recommended due its favorable asset protection statutes for LLCs), no Form 8938 FATCA reporting is due.

We have since added a new component to further enhance the planning. The strategy that we have developed effectively replaces a commercial annuity with a private annuity in order to fund arguably the "best type" of variable life insurance in the US, that is, insurance that provides a tax exempt death benefit, and also full tax-free access during life time; a so-called Non-Modified Endowment Contract or "Non-MEC". With this policy design, which typically requires funding over a 4-5 year period, the private annuity allows for cost effective, low friction funding mechanism that we feel is a better alternative to the commercial annuity. It is quick to implement, cost effective, and flexible with robust asset protection.

The international insurance carriers we favor for US clients (or non-

US clients with a US nexus) are located in Puerto Rico.

Notwithstanding the compliant nature of the planning, PR is a US territory that exempts onerous "offshore" reporting, that could otherwise trigger an audit. Clients can name their own investment manager and custodian to hold and manage the policy segregated assets that are bankruptcy remote by virtue of being legally segregated under local statute. They may not however, direct or control investments held in the policy separate account (re: Webber vs. IRS). Rather, investments must be managed by an independent, third party manager. Insurance fees are generally fractional versus US domestic general account alternatives, with policies amortizing set up charges and fees typically in only the first or second year.

How does it actually work?

1) A Private Annuity contract is established in Nassau with a newly established, dedicated International Business Corporation (“IBC”) which contracts with the client. The Bahamas offers excellent confidentiality and asset protection laws i.e. a 2-year statute of limitations to contest a transfer as a fraudulent conveyance and, disclosure of any financial matter is a crime in Nassau. Note- the Bahamas will neither hide tax cheats nor provide sanctuary for debtors looking to defraud creditors, but it can be a haven for legitimate and compliant tax planning and asset protection.

The Private Annuity is funded with monies contributed by the US client (min. $5m) that are sent to a major international bank. The contract itself includes the following material terms: the annuity payment receipt may be current or deferred; the annuity may be fully collapsed at any time upon written notice to the annuity company. Also by mutual consent, an investment manager and custodian is appointed who holds and manages the annuity assets that are placed in a legally segregated account (to make it both creditor exempt and bankruptcy remote). If the annuity policy is governed by Puerto Rico law, the annuity corpus/earnings are exempt from 3rd party creditor attachment on day-one of the agreement- again with the proviso that there was no prior claim against those assets in particular, or, the creditor did not attempt to make themselves insolvent.

The annuity corpus and earnings compound tax deferred until withdrawn as an annuity payment (which is only partially taxable i.e. the basis portion of the annuity payment is tax-free). The annual earnings are not reported until withdrawn, which minimizes risk of IRS tax audit.

2) The annuity payout for each of the five years necessary to fund the PPLI is directed to a US irrevocable trust with an independent trustee (such trustee cannot be spouse, parents or children but can be nephew/niece, brother/sister-in-law, or trusted advisor). We do not recommend institutional trustees due to the complexity of the planning. As stated previously, up to $11.26m may be contributed to the trust US Estate and Gift Tax free, so any amount up to this may also be used to fund the PPLI. The trust and PPLI can be funded *in excess* of $11.26m, but any excess will be included in the Grantor's taxable estate (see below for exception).

3) The trust may be an “intentionally defective grantor trust” such that the trust income is taxed to the Grantor (and does not require separate Fiduciary Income Tax Filings e.g. Form 1041) and reported on the grantor’s Form 1040 tax return annually. The trust corpus is exempt from US Estate and Gift tax but as stated, income inures to the Grantor. That said, the life insurance policy (PPLI) owned by the trust (and also the policy beneficiary) ***does not produce any taxable income during lifetime****.* And upon death of the insured, the death benefit proceeds are paid out to the trust as death beneficiary completely US Income, Estate and Gift tax-free. The trust may then distribute to US (or non-US) beneficiaries in whole or in part with no incidence of US taxation. At this point, the trust may make a partial distribution and decide to rollover funds in a new policy and thus extending the tax-free compounding on these assets.

The tax status of the trust as an intentionally defective grantor trust is confirmed by specific trust provisions e.g. unsecured loans, grantor ability to substitute trust assets and others as cited under the IRC. In addition, if the trust is an intentionally defective grantor trust then the Grantor may “sell “ assets to the trust without imposition of capital gain tax and no income tax recognition for “interest” received on the asset sale.

3) Upon death of the insured, the insurance pays to the trust the death benefit. Said death benefit is received as the tax-free proceeds of life insurance (re: IRC 101 a i)- this includes: Initial corpus + growth + “true” insurance component, less any prior loans (if any) which may be repaid or more commonly netted off. As noted above, the trust can freely distribute this amount in whole or in part, out of the Grantor’s Estate (and therefore not part of probate) and thus free of any taxation to either the donor or donee.

In sum, with careful planning and timely* execution, a US investor can:

- *Effectively double investment returns by eliminating current and future US Income and Capital Gains Tax*

- *Eliminate the corpus and all future growth from US Estate Tax*

- *Place assets beyond the reach of unforeseen creditors*

- *Minimize reporting on international investments*

- *Reduce audit risk*

- *Contractually retain the flexibility to modify or even terminate the arrangement*

* Tax planning and asset protection strategies are ineffective unless initiated *prior* to the imposition of tax, or a challenge e.g. lawsuit, divorce, IRS audit etc.