

# High-End Life Insurance Policies Lured Offshore by Relaxed Rules

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You don't have to go offshore to buy a private placement life insurance policy, but sometimes it helps.

Several offshore jurisdictions have more flexible rules for PPLI arrangements that wouldn't be allowed for policies issued in any U.S. state, yet the policies are still able to provide generous tax benefits to U.S. residents.

"There are people who are willing to be very aggressive about the kind of tax planning that they can do offshore, where . . . transparency is quite low," said Andrew Granato of Yale Law School and Yale School of Management, coauthor of a recently released [draft research paper](#) on cash value life insurance.

"Frozen cash value" life insurance, a type of offshore PPLI that is consistent with the laws of a foreign jurisdiction but is designed to fail legal tests for life insurance under [section 7702\(a\)](#), is an example of the aggressive planning taking place offshore, Granato said.

"Not everyone in the estate planning world thinks that this would hold up in court," Granato said.

Frozen cash value policies can be issued from many offshore jurisdictions, including Bermuda, the Cayman Islands, and Puerto Rico, said Mark H. Leeds of Mayer Brown in New York. However, he said he has not worked with any domestic insurers that can issue frozen cash value policies.

Leeds said that under [section 7702\(g\)\(2\)](#), which forms the basis of frozen cash value, the amount treated as excludable death benefits — that is, death benefits not included in income — is equal to the excess of the amount the beneficiary receives at death over the amount already included in income.

The Biden administration [released a proposal](#) to curtail the tax benefits of frozen cash value life insurance policies, and the Senate Finance Committee's Democratic staff [released a report](#) in February that found that "PPLI policies are actively promoted to millionaires and billionaires as a way to transfer significant wealth to their heirs while bypassing income, gift and estate taxes."

Other reasons to use offshore carriers for PPLI include better protection from creditors, acceptance of nonliquid (or "in kind") premiums, and the ability to move assets with an investor's existing advisory team, according to Michael Malloy of EWP Financial, a risk management consultant with experience arranging offshore PPLI policies.

## Insurable Interest

All U.S. states require that the policyholder have an insurable interest in the person they are trying to insure, a spokesperson for the American Council of Life Insurers told *Tax Notes*. This typically includes having a familial connection with the person and getting their consent before a policy is issued.

Interview notes and letters from lawyers to the IRS in the Tax Court case *Schlapfer v. Commissioner*, [No. 419-20](#) (2023), indicate that Ronald Schlapfer, the taxpayer and owner of an offshore PPLI policy issued by Swisspartners Insurance Co. SPC Ltd., told the IRS his policy was intended to benefit his nephews in Switzerland. However, the PPLI application and policy don't appear consistent with that claim, according to *Tax Notes*' analysis of unsealed court records.

Schlapfer initially named himself as the policyholder on the PPLI policy, which insured not his life but the lives of three older relatives: his mother, his aunt, and his uncle, aged 79, 83, and 75, respectively, at the time the policy was issued in September 2006. The primary beneficiaries on the policy were Schlapfer and his wife, and the secondary beneficiaries were their four children. None of Schlapfer's nephews were named as beneficiaries of the policy.

The insured life and PPLI policyholder don't have to be the same person, and they often aren't.

The insured life for a PPLI policy is chosen based on when an investor wants the "death liquidity event" to occur, Malloy said. The choice of insured "depends on when you want the policy to cease" and pay out the accumulated gains to beneficiaries, he added.



# THE STRUCTURE PPLI POLICY

The taxpayer in *Schlafher v. Commissioner* 1  
PPLI structures often involve multiple jurisdic-  
tions.

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“There are a million reasons why” an investor might insure an older relative, according to David Mickelson of Hannahlu Ventures LP, a broker who arranges life insurance policies. The reasons include passing family businesses to the next generation, as well as investors wanting to get a tax-free return of both the cash value they invested in the PPLI policy and the growth in that investment when the older insured dies.

The ability to do the latter is “completely facts-and-circumstances-dependent” and will vary among insurance carriers, Mickelson said.

Allan Rosenzweig of Evergreen Life Ltd., a Bermuda-based life insurance company that markets PPLI to U.S. customers, said one reason policyholders might insure older relatives is because there is a limit, set by insurance companies, on how much insurance is available on a given life. For example, he said, on a policy for a 50-year-old man, a policyholder would likely be capped at \$50 million to \$60 million total for the initial premium.

“What people will do is they’ll say, ‘OK, so let’s find other family members whose lives we can insure.’ And so the family office will put \$200 million in, but you’re going to have a series of policies on the husband and the wife and three children and the parents’ parents and whoever else they can find,” Rosenzweig said. He added that it may be cumbersome to insure everyone in a family based on the carrier’s requirements.

However, a life insurance policy that is funded too quickly can become a modified endowment contract (MEC), which means the policyholder loses some of the income tax benefits of a non-MEC policy, including the ability to take out tax-free loans against the policy.

If an owner wants a policy to be structured as an MEC, the fastest way for a beneficiary to access the cash value of the policy in a tax-efficient manner would be for the insured to die, according to Brandon Avergon of Rampart Consulting Group, which advises clients on PPLI policies.

“In that scenario, an older person might be preferable as the insured. But that’s not something I’ve seen in practice, at least not in the United States,” Avergon said.

“Offshore carriers, not all of whom are reputable, are more likely to do things like that because they don’t have to follow the 7702 ratios,” Avergon said. “They can establish policies with far lower amounts of insurance than are U.S.-compliant.”

A “confidential executive summary” from Paragon International Insurance Ltd., a defunct Belize insurer connected to former Belize attorney general Glenn D. Godfrey, says that a PPLI “policy intentionally structured as a MEC is often the perfect structure for a wealthy client concerned about income taxation, asset protection, international diversification and estate planning.” The leaked document was obtained by the International Consortium of Investigative Journalists.

## Ownership

At some point between Schlapfer's policy issuance and May 2007 — the timeline was disputed and not resolved in court — he transferred ownership of his offshore PPLI policy to the three older relatives it insured.

In the same letter to Swisspartners, Schlapfer instructed the insurance company to make the existing beneficiary designations irrevocable. The irrevocable designations ensured that when the insured relatives died, Schlapfer and his wife would get back Schlapfer's investment in the PPLI policy, plus any accumulated gains on the policy investments, tax free. Schlapfer also directed that he be given power of attorney to act on behalf of his insured relatives regarding the policy.

The policy documents in the court records show that Schlapfer's instructions were implemented by Swisspartners, with the policy transfer and irrevocable beneficiary designations effective on the same day in May 2007. Under the terms of the policy, once beneficiaries are designated as irrevocable, their consent is required before a policyholder can withdraw or borrow funds from the segregated account or terminate the policy.

As a result, there doesn't appear to have been any time during which the older relatives as policyholders could have extracted funds from the policy without Schlapfer's authorization and consent.

In November 2007 Schlapfer arranged for the hedge fund within the original policy to distribute \$3.5 million of its value of more than \$7.5 million into a new PPLI policy, according to the court documents. That policy listed the same older relatives as insureds and as policyholders. The beneficiaries were the Schlapfers' four children, who would receive 20 percent each, and Schlapfer's three nephews, who would share the remaining 20 percent equally.

Correspondence from Ronald Schlapfer's attorneys to the IRS indicates that he also held power of attorney over the new policy, and email correspondence among facilitators setting up the new policy supports that assertion. In connection with sending out the application for the new policy, one wrote, "We have now prepared the insurance application for Rony's new policy (attached). When you next speak with Rony, could you please ask him whether the matter has already been discussed with Nelly, Frieda and Otto?" (translated from German, referring to Schlapfer's aunt, mother, and uncle, respectively).

The new policy assets were earmarked for investment in a newly formed entity domiciled in Dubai, held by a Belize company that was, in turn, held in the PPLI policy segregated account in the name of a Cayman Islands insurer, the court documents show.

Schlapfer's lawyer, Scott D. Michel of Caplin & Drysdale Chtd., said in an email that neither Schlapfer nor his representatives would comment on the case.

## Bermuda's 'Private Acts'

In Bermuda, large PPLI providers such as [Crown Global Life Insurance Ltd.](#) and [Philadelphia Financial Life Assurance Co. \(Bermuda\) Ltd.](#) (which became Lombard International Bermuda and is now

Axcelus Financial) have obtained tailored legislation called “private acts.”

Rosenzweig said that as an international insurance jurisdiction, Bermuda passed “lowest common denominator” legislation that satisfies the basic needs of insurance companies serving clients in multiple jurisdictions like the United Kingdom, the EU, and the United States.

Bermuda has a system allowing the Parliament to approve legislation that supplements or modifies the general Bermuda insurance law solely for the policies of that insurance company, according to Rosenzweig.

Many Bermuda insurance companies have used private acts to allow acceptance of in-kind premiums, expand what constitutes an insurable interest, ensure protection from creditors, and change reinsurance payout requirements.

Under those companies’ private acts, the definition of a policyholder’s insurable interest goes beyond what is defined in the Bermuda Life Insurance Act of 1978 to include the life of a grandparent or great-grandparent; a trustee or settlor of a trust; or any director, officer, or employee of an entity that is the policyholder.

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