The rich can use offshore life-insurance policies to pass down everything from stocks to yachts to their kids tax-free. Here's how it works and why the Senate is targeting it.

Hayley Cuccinello Oct 12, 2022, 2:30 PM

Now is a prime opportunity for rich Americans to transfer their wealth to their children and save on taxes. Johnny Greig

Life insurance is probably the least sexy area of financial planning. But for the richest of the rich, policies can slash tens of millions of dollars off their tax bills.

Private-placement life insurance is a little-known tax-avoidance tactic. When structured correctly, PPLI policies can be used to pass on assets from stocks to yachts to heirs without incurring an estate tax.

"In the US, people sell life insurance as a middle-class way of structuring assets," Michael Malloy, a wealth advisor who has specialized in PPLI for 20 years, said. "But PPLI is a completely different animal."

Being a member of the richest 1% is not enough to make PPLI worth your while. These offshore life insurers in jurisdictions such as the Cayman Islands and Bermuda typically require at least \$5 million as the up-front premium. Malloy advises that clients have at least \$10 million in assets to make PPLI worthwhile. His clients usually hold at least \$50 million in assets.

PPLI is legal, though it recently has come under political scrutiny. Sen. Ron Wyden began an inquiry into the industry in August.

US clients usually use PPLI for the purposes of lowering tax liabilities, while those in the Middle East or Latin America are often looking to use trusts to conceal information about specific assets from corrupt governments, Malloy said.

"Clients don't want an organized-crime ring bribing an underpaid tax official to get information on their family," he said.

US taxpayers are required to report to the IRS only the cash value of a foreign life-insurance policy, not the assets within the trust.

Here is how it works, according to Malloy

In short, an attorney sets up a trust for a wealthy client. The trust owns the life-insurance policy that's created offshore.

With PPLI policies, the assets put into the trust are treated as premiums. The assets must be diversified — typically with at least five different asset classes — and can include stocks and business interests, as well as tangible assets like yachts and real estate.

Depending on the client's age, nationality, and other factors, the death benefit can, in theory, max out at \$100 million, Malloy said.

If structured correctly, the benefit and the assets in the policy are passed to the children without incurring an estate tax. A 40% federal estate tax applies to estate values topping \$12.06 million for single people and \$24.1 million for married couples.

Unlike with policies from US insurers, clients can cancel their policies without paying a massive surrender fee. The assets also grow within the trust tax-free. The cash value of the PPLI policy assets is held in a separate account, and this cash can be disbursed to the policy holder or invested. Investing in hedge funds is a popular use of PPLI assets.

But there's a catch. Policyholders have limited control over investment decisions. They cannot give directives to the asset manager to buy a certain number of shares in Apple, for instance.

It also requires a small army of professionals, including trust and estate attorneys, asset managers, custodians, and tax advisors. Since PPLI is relevant only to the ultrawealthy, few in wealth management or law are familiar with it.

"There's no questions on the CPA exam or the bar exam about PPLI, and asset managers are kind of skeptical," he said. "They think you're going to take assets away. Actually, the assets become stickier and get more alpha because the client pays less tax."

Sen. Ron Wyden is scrutinizing PPLI

But PPLI is getting attention on Capitol Hill. Wyden, the chair of the Senate Finance Committee, launched an investigation into PPLI on August 15. His first target is Lombard International, a Blackstone-owned wealth manager, which Wyden described as "one of the market leaders in the PPLI industry."

"I am concerned that these insurance vehicles are being used without a genuine insurance purpose to invest in hedge funds and other investments while avoiding billions of dollars in federal taxes," Wyden wrote in a letter to Lombard requesting information.

Wyden said he was concerned that PPLI was being used not only as a tax shelter but also for "various offshore tax evasion schemes." He pointed to Swiss Life, Switzerland's largest insurance firm, which pleaded guilty in May 2021 to using PPLI policies to help US taxpayers conceal assets from the IRS to evade taxes.

Late last month, Wyden expanded his inquiry to Prudential Financial, Zurich Insurance Group, and the American Council of Life Insurers.

Lombard told Insider the firm and its member companies "fully comply with all applicable legal, regulatory and fiscal requirements in the jurisdictions where they conduct business." Prudential told Insider it's reviewing Wyden's letter. Spokespeople for Zurich and the ACLI said they were preparing a response to the inquiry.

America's rich have successfully dodged most of the tax reforms proposed during the Biden presidency. Most recently, the Manchin-Schumer bill was revised to preserve the carried-interest tax loophole that benefits private-equity and hedge-fund managers.