Structuring Portable Insurance Solutions for International Clients

Simon Gorbutt LL.M. TEP

Life assurance, widely regarded as a robust and established wealth planning tool, combines many of the advantages of direct investment with tax mitigation and estate planning. This article looks more closely at the structuring of life assurance solutions for international clients and the safeguarding of such advantages across borders.

Background

Life assurance incorporating an investment element offers numerous benefits. One of the most common is the deferral of taxation on assets to which the contract is linked, as compared to direct ownership of those investments. Depending on the country where the contract is held, access to the capital invested may be tax-advantaged - one example being the annual tax-deferred entitlement in the UK to five per cent of premiums paid. In certain jurisdictions, distributions from the policy (on surrender, death of the assured or survival of the latter to a predetermined date) are subject to tapered or minimal taxation and in the issuer's country of establishment the underlying insurance funds may be tax neutral and enjoy access to double taxation treaties. There are also ample non-tax benefits that include flexible transfer of wealth to successive generations, enhanced asset protection, a degree of legitimate confidentiality and investment flexibility. But what happens to the benefits of this variety of life assurance contract on a change of residence?

In the European Union, the introduction of the Life Directives (now the Consolidated Life Directive[1]) has opened the market to the provision of life assurance across borders. A more coordinated interpretation of life assurance products has also brought about comparable tax treatment in a number of Member States. However despite apparent harmonisation, on acquiring residence in a new jurisdiction one cannot always assume that the tax efficiency and benefits enjoyed by the client in his country of departure will continue unaltered. Case law (as referred to below) is testament to this and only recently a new European Commission Expert Group was established to evaluate the extent of the legal nuances, with a focus on barriers to trade[2]. Suffice it to say that any move involving a non-EU element requires some additional thought.

Context

An appreciation of the legal and fiscal context in which the life policy operates is crucial to being able to plan effectively. As with many wealth management or investment products, a multitude of regimes may be in play.

Of considerable importance is the country where the policyholder resides, given that this will determine the primary personal tax measures applicable to the policy at inception, for its duration and on termination. Consequently, a change of residence implies a change of tax regime for the holder, although taxes in the country of origin can also continue after departure and the timing of the move may have an impact. In addition, the client's home jurisdiction will determine provisions of general good, consumer protection and other rules of mandatory application to be satisfied by the insurer. These apply alongside the broader civil framework applicable to the holder and his contract, which will govern assignment or gifting of the policy for example.

Where the policyholder is habitually resident in the European Union, Article 7 of Rome I[3] provides that the insurer and holder may opt for the contract to be governed by the law of the holder's country of residence (this is also the default position in the absence of any election by the parties). If the holder is not a national of his country of residence, he and the insurer may choose to apply the laws of the country of nationality. Alternatively, if the country of residence offers greater choice of law (such is the case in the UK), that greater choice can be exercised. This is significant, as the contract will govern the relationship with the insurer and

the interaction of the policy with the surrounding legal and tax framework. While certain providers are known to impose the governing law of their jurisdiction of establishment by default, others consider it prudent to align the contract with the legal regime of residence of each client. A third country legal regime would be a rare choice, not only as it renders the contract unwieldy but also as it may prove untenable if the only reason for the choice is avoidance of otherwise applicable rules.

Although uncommon in the UK - the Contracts (Rights of Third Parties) Act 1999 is consistently carved out - one of the key characteristics of contracts of this type is their accommodation of beneficiary nominations. These ensure the distribution of policy proceeds to specified individuals, or classes of individuals, on termination. The country of residence of those individuals must always be considered so as to ensure the optimum tax treatment of funds they might receive. Similar, although non-tax, considerations apply to the coverage of lives assured in third countries by non-locally established carriers.

The tax profile of the contract's linked investments, particularly where structuring insurance solutions with assets in multiple jurisdictions, requires careful planning and the extent of any control the policyholder retains over the acquisition and disposal of assets deserves equal consideration. In certain countries (Germany included) investor control will render the contract only as effective as if the client held the linked investments directly. In others (such as the UK) deeming provisions will generate unforeseen gains, whereas in others still (Sweden is one example) control is acceptable and indeed common.

The insurer's country of establishment will also be home to its principal regulator and, as such, prudential rules encompassing licensing, asset protection, solvency and permissible investments stem from here. Although unlikely to be affected by policyholder migration, the relative significance of these provisions to the holder might evolve with a change of residence. Taxation of the carrier and its insurance funds is also determined by the issuer state.

Supranational or third party regimes may be relevant at times. We have already mentioned the EU legal framework. Foreign or 'exported' obligations (such as FATCA[4]) can always come into play.

Structuring for portability

Against this background, consider a French resident and domiciled client who holds non-UK assets via a life policy. He plans to reside for a short while in the UK. With no other, or otherwise minimal, offshore income and gains, he will not need to consider the remittance basis. His intention is to benefit from access to clean capital (accumulated prior to UK residence) via policy surrenders, without generating any UK tax on the policy before he retires abroad again. These elements of UK planning are well known. However, to achieve his objectives the client will, among other steps, need to reflect on the classification of the policy for UK income tax purposes.

Whilst in France, policyholder control over investment and reinvestment of underlying assets is limited, the equivalent UK provisions are different and rigorous. The personal portfolio bond (PPB) rules in ITTOIA[5] provide that for every year that a policy is classified as a PPB, a 15% deemed gain applies to it regardless of actual investment performance, and in addition to other gains. A policy will be a PPB where the holder or any connected person is able to influence underlying asset selection and where the assets available to be selected are not confined to prescribed categories. To avoid unwanted and significant additional tax liability, the holder is therefore counselled to implement a series of essential but manageable changes with his adviser and insurer and, if necessary, restructure linked assets prior to a charge arising.

Alternatively, consider a UK resident and domiciled individual who has sold a successful business and invested the proceeds in a life policy. The policy caters to his needs well in the UK and he now wishes to take up residence in Sweden. Insurers today offer a range of life cover options. For example, on death of the life

assured the policy terms might provide for distribution to the beneficiary of the contract's net asset value (NAV), plus life cover calculated as a percentage of NAV. Whilst in the UK there is no strict requirement for life cover (Fuji Finance Inc v Aetna Insurance Co[6]), the position differs in Sweden. There, policies providing cover outside established parameters risk being treated as asset management contracts and taxed at 30% on gains, rather than achieving tax deferral in line with domestically recognised *Kapitalförsäkring*. This was recently put to the test, in a case where the life cover on a Bermudan contract was deemed inadequate[7]. Suitable tailoring therefore ensures that, among other prerequisites, on arrival in Sweden the risk element meets local conditions for life assurance.

As with any planning, timing is essential. Subject to double taxation treaties, taxes are capable of following the taxpayer for a time after physical departure from a country. For example, for the departing UK domiciliary, inheritance tax on non-UK assets can continue to be relevant for three years, such as on policy assignments and other relevant transfers of value while abroad. Conversely, provided a Swedish resident subscribes his policy at the correct moment then capital gains tax, which would ordinarily remain relevant for as many as ten years subsequent to departure, will not follow him.

Similarly, where tailoring needs to be applied to an existing contract (i.e. where it is unadvisable for a new contract to be subscribed), the changes should be made judiciously and limited to those that are necessary. Any fundamental reconstruction of policy terms could, depending on the jurisdiction in which it is made, give rise to unplanned taxation.

Conclusion

Clients are increasingly likely to change their residence at some point, whether for personal or occupational reasons, and recent economic and political volatility and widespread tax changes only encourage the demographic shift. Cross-border planning is therefore especially relevant today. London alone is home to the second largest number of high net worth individuals[8] (expected to increase by 36% over the next 10 years)[9], 32.3% of whom are currently UK resident but not domiciled[10]. Tax changes under the new French government may heighten the tide toward the UK, while UK resident nationals who have accumulated substantial wealth may be looking to retire abroad. In Europe and further afield, there is comparable movement.

Legal and fiscal regimes differ and even in the EU, where harmonisation continues, there is a level of inconsistency. Life assurance remains a tool of choice for effective wealth management and tax planning, and given the substantial benefits to be gained from a truly portable solution, guidance from specialist advisers and insurers with access to multi-jurisdictional expertise is indispensable.

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[1] Directive 2002/83/EC of the European Parliament and of the Council of 5 November 2002 concerning life assurance [2002] OJ L345/1

[2] Commission Decision of 17 January 2013 on setting up the Commission Expert Group on a European Insurance Contract Law [2013] OJ C16/6

[3] Regulation (EC) No 593/2008 of the European Parliament and of the Council of 17 June 2008 on the law applicable to contractual obligations (Rome I) [2008] OJ L177/6

[4] The US Foreign Account Tax Compliance Act of 2010

[5] Income Tax (Trading and Other Income) Act 2005, Part 4, Chapter 9

[6] [1997] Ch 173

[7] RÅ 2008 ref 54

[8] Those with net assets of USD 30 million or more

[9] Knight Frank, The Wealth Report 2013

[10] Wealth X, World Ultra Wealth Report 2012 - 2013