

Asset protection and staying in control: wealth planning with Swiss insurance

Maehala R. Nathan*

Abstract

Trusts continue to play an important role in asset protection planning. But annuities and life insurance, and in particular Swiss annuities, are a viable alternative in many cases. Furthermore, the combination of both structures, in most cases can result in benefits that go beyond that of a pure trust structure or a sole annuity. The mechanics of these advantages are examined in this article.

Introduction

Asset protection has often been viewed as synonymous with trusts. Trusts are not only traditional estate planning tools, but are often used in asset protection planning since the key characteristic of a trust is the separation of legal ownership and beneficial interests in property and this can work favourably to shield wealth from unjustified claims. Some countries even have passed specific legislation to make trusts established under the laws of their jurisdictions particularly suitable for asset protection purposes. Famous examples are the Cook Islands and Nevis. Many other jurisdictions, for example The Bahamas and, more recently, Antigua & Barbuda, have enacted specific legislation to attract such trust structures.

However, the ability to stay in control is probably the most important reason why Swiss and Liechtenstein insurance structures, such as annuities, should be considered in many cases for asset protection planning. Unlike a trust, the policy owner does not have to actually give up control over his or her assets in order to protect them. Besides this factor there are many other good reasons for considering an annuity instead of—or in addition to—a trust: Swiss and Liechtenstein insurance contracts, in particular, when properly set up, are fully protected not on the basis of an individual arrangement but, such as in case of Swiss annuities, based on an insurance law of more than 100 years

of history, clear precedents and a politically extremely stable jurisdiction with an efficient, strong court system.

The essence of an annuity

Generally, an annuity is a contract whereby a person (in this context, normally an insurance company) will commit to pay an income for life or a specified period of time, or to pay a lump sum at a particular time in the future (in the latter case, the arrangement is called an endowment policy).

An annuity, in this context, normally involves four parties: The insurance company, the policy holder, the insured person, and the beneficiary (or beneficiaries if there is more than one). It is a contractual arrangement whereby the policyholder enters into an agreement with the insurance company and receives cover for him/herself and/or other persons (beneficiaries) in return for either a lump sum (one-time) premium, regular premium payments or a combination of both. The policyholder may be a legal entity such as a company or foundation, and a trust can also be the policyholder. The insured person is the one whose life the insurance covers. This may or may not be the same person as the policyholder, but it must be a physical person.

The beneficiary is designated by the policyholder to receive the specified capital or annuity payments. The beneficiary can also be a legal entity or a trust and need not necessarily be a physical person.

The most important use of annuities in asset protection planning is to place and to accumulate wealth in a protected policy. But even if an annuity is set up with the primary goal of protecting the assets placed with the insurance company, in order to avoid negative tax consequences or to benefit from any tax advantages, an annuity or life insurance policy must comply with the tax regulations in the policyholder's and beneficiary's country of residence (i.e. where he or she has his/her main tax residence). For example, a certain minimum duration of the policy may be required or the insurance must include a certain amount of life cover besides the investment component.

* Maehala R. Nathan, Swiss Insurance Partners AG, Zurich.

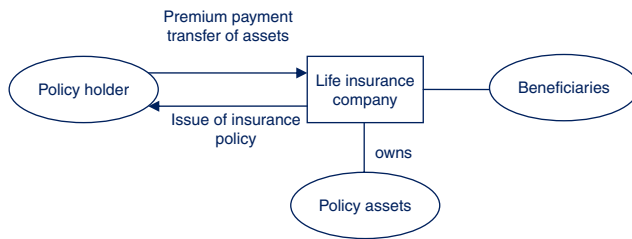


Fig. 1 Overview of contractual relationships in an annuity.

Income and capital gains on assets placed in a life insurance policy are not taxed at Swiss or Liechtenstein life insurance company. In both countries, no tax is deducted from the policy proceeds, i.e. the proceeds are paid net to the beneficiary or back to the policyholder, as the case may be.

The assets paid into an annuity or life insurance policy do not constitute a gift as they are normally recognized as a premium payment. Furthermore, in some countries these assets will not form part of the policyholder's estate for inheritance purposes, since the nature of the policyholder's interest in the assets is not that of an owner or trust settlor, but rather of a contractual partner and holder of an insurance policy.

Similarly, where there are wealth (net asset) taxes, often assets placed in a properly structured insurance policy will not be subject to these taxes either. Finally, capital accumulated in life insurance policies upon expiry is not subject to tax in some countries, and even if it is, only at a very low rate.

A secure investment

Both in Switzerland and Liechtenstein the government regulates all insurance business by enforcing probably the strictest regulations known in the industry. Of particular relevance to international investors is the fact that life insurance companies are required to maintain a security fund which covers all their obligations plus an additional security margin. This fund is segregated from the company's operating assets. Therefore, even if a Swiss or Liechtenstein insurance company were to go bankrupt (which has so far never happened in history—a worldwide unique situation), the funds placed in an annuity or life insurance will not be included in the bankruptcy and are safe and protected from that point of view as well.

By contrast, assets placed in trusts are of course much more vulnerable since trust companies are generally less

strictly regulated (or not regulated at all, depending on the country), and much depends on the sound management and integrity of the trustees. Of course, if the trustee is carefully chosen and monitored (perhaps with an appropriate protector in place who will make sure to keep an eye on all activities within the trust, approve distributions, has the right to veto certain decisions by the trustees, etc.), then these potential problems can be largely avoided. However, this requires appropriate planning and a set up that is much more complex and more expensive to maintain than insurance.

No need to relinquish control

A client who is interested in protecting his/her assets by placing them into a trust has no choice but to give up control over the assets, if the asset protection of this trust arrangement is to be effective. This is often a tough choice to make and a classic problem with trusts, as a trust can in principle only be validly established if the settlor effectively hands over the assets to the trustee and gives up ownership and control over those assets.

It appears that with trusts, quite fundamentally, retaining control over assets placed in trust, and properly establishing an effective trust, are mutually exclusive. This is absolutely essential in case the trust should serve to protect the assets placed in trust.

This, however, is very different with Swiss and Liechtenstein annuities. It is probably the most important difference when comparing annuities with trusts for asset protection: the assets placed in an annuity remain, in principle, under the full control of the investor (policy holder), yet at the same time the effective protection is as strong as—or arguably even stronger than—in the case of a trust. The control is only somewhat diminished if beneficiaries are designated on an irrevocable basis; otherwise, the investor has full control over the policy and the underlying assets.

The investor can change beneficiaries or relinquish the policy at any time, and depending on the specific insurance product chosen, can decide to receive a lump-sum payment or roll over the policy into a new one at maturity, or may have a choice of switching currencies, deciding on investment strategies, designating an independent investment advisor to manage the assets in the policy, and so on.

Asset protection and staying in control

Most of these choices are available while the applicable asset protection provisions remain in force and protect the underlying assets to the fullest extent. It is clear that no trust structure can match this flexibility and the retaining of control by the “owner”.

This control does not result in the investor being exposed to a requirement to exercise the control in favour of a creditor by being able to irrevocably designate a third party (trust or foundation for example) as beneficiary.

The world's most solid asset protection

The most important advantage of a Swiss annuity over an international trust is however the strength of asset protection. Although this is particularly relevant to clients with US exposure, more than ever successful individuals and families around the world are seeking to protect their wealth from unjustified lawsuits and claims. Business owners and professionals with high potential liabilities (e.g. medical doctors, surgeons, attorneys and accountants), as well as developers and chief executives of publicly quoted companies, are practically forced to implement some form of asset protection planning as an essential part of their private wealth planning. Even in countries with less litigious societies and more balanced legal systems, where lawsuits are still less common compared to the US, asset protection planning becomes increasingly important.

Traditionally the trust has been the tool of choice in this regard, but Swiss and Liechtenstein annuities are in fact also ideal vehicles for clients in need of effective asset protection solutions. Even if requirements are complex and require more sophisticated planning, as in the case of large estates, tailor-made annuity and life insurance contracts can provide the same kind or even better flexibility than trusts, with generally stronger asset protection.

The asset protection provisions in Switzerland are similar to those in several US states, which provide very strong protection of annuity policies. Historically, these protection provisions were introduced into law for the same social importance, to provide a safe vehicle to safe guard ‘nest egg’ or family assets so that it is available in all circumstances (e.g. a bankruptcy of the breadwinner of the family). These provisions were introduced at a time where a general social security system did not exist and there was a clear need to protect owners and beneficiaries of annuity and life insurance policies.

While these asset protection provisions are very strong in some US states to protect annuities, from a US perspective, a foreign or Swiss annuity, in particular can prove to be more effective. This is on one hand, and for the most part, because of the simple fact that by placing one's assets into a vehicle in a foreign jurisdiction, that in itself makes those assets much harder to reach and will involve searches abroad and the hiring of foreign attorneys, etc.

This constellation—which of course applies generally to any structure set up outside one's home country including international trusts and bank accounts maintained abroad—already acts as a strong deterrent.

Furthermore, the asset protection provisions in Switzerland relating to insurance contracts are based on Federal law and have been tried and tested up to the highest court in Switzerland, the Federal Supreme Court in Lausanne. It is needless to say that Switzerland, having one of the most solid and reliable legal systems, is an almost ideal jurisdiction in which to place one's assets.

In Switzerland, full asset protection is provided if you purchase an annuity policy from a Swiss insurance company and designate your spouse and/or descendants as beneficiaries, or irrevocably designate any other third party (for instance a legal entity or a trust) as a beneficiary. Swiss law then protects the annuity against any debt-collection procedures initiated by the policyholder's creditors and excludes it from any Swiss bankruptcy procedures.

Unlike the designation of another third party as a beneficiary, in the case where a spouse and/or descendants are so designated, it is irrelevant whether the designation is irrevocable or revocable. The insurance policy will continue to be protected from the policyholder's creditors even if the designation of the spouse and/or descendants is revocable.

These asset protection provisions are almost identical in Liechtenstein, although of course there are almost no precedents in the courts due to the fact that Liechtenstein's insurance industry, although very solid as well, has only very recently been developed.

Anti-avoidance laws and tax exemptions

Many countries today have anti-avoidance provisions in place regarding the taxation of assets placed into trusts and income derived from such trust assets.

However, this is far less the case for annuity and life insurance policies.

The social benefits of insurance, such as the idea of protecting families from poverty at the time where widespread social security was not yet in place in developed countries, have caused governments around the world to support the use of life insurance and annuities by providing asset protection and tax benefits for the policy holders and beneficiaries.

With trusts one of the key problems is that the settlement of property into a trust often triggers gift taxes. Annuities and life insurance on the other hand are contracts and require the payment of premiums to insurance companies, which normally do not trigger gift taxes. Often the payout of the benefits are tax exempt, whereas, actual or deemed distributions from trusts are taxed, sometimes at prohibitive rates because distributions may be qualified as gifts from third parties, or because of laws specifically designed to discourage the holding of assets through trusts, triggering high taxes.

Conclusion

The combination of insurance and trusts can in many instances achieve benefits that go beyond the use of just

a trust or just an insurance structure for asset protection and tax planning purposes. Annuities are attractive from various perspectives: not only are they a very safe form of investment, but offer truly unique asset protection, which is particularly relevant to American investors but also increasingly important to wealthy individuals and families elsewhere in the world who wish to protect their assets effectively: annuities and life insurance may also offer tax advantages depending on individual situations.

doi:10.1093/tandt/ttm116

Maehala R. Nathan

Swiss Insurance Partners AG
Neustadtgasse 12
8024 Zurich
Switzerland

Tel: +41 44 266 22 66

Fax: +41 44 266 22 67

Email: maehala.nathan@sip.ch