Swiss annuities and life insurance versus asset protection trusts

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The merits of using an insurance policy as an alternative to a trust are sometimes overlooked, but this article, concerned with Swiss insurance policies for asset protection purposes, underlines this valuable option. Marco Gantenbein's second article, concerned with annuities and life insurance as safe investments, will follow in the next issue of Trusts & Trustees (Volume 12, Issue 2, December 2005/January 2006).

Introduction

The special advantages offered by Swiss insurance policies in terms of asset protection represent the main theme of this article, which shows that Swiss annuities and life insurance policies can, in many circumstances, offer very attractive alternatives to asset protection trusts. The advantages are based on specific features of Swiss insurance law which makes Swiss annuities interesting alternatives to more complex, more costly and less secure asset protection structures such as trusts. Although this feature is particularly relevant to American investors, in other countries too, wealthy individuals and families are increasingly looking to protect their assets from frivolous lawsuits and unjustified claims.

Swiss annuities and life insurance can also be forms of investment that offer tax advantages, in many cases allowing significant relief from income, capital gains and inheritance tax. The capital accumulated in life insurance policies is not taxed in several countries when the policy expires, or then only at a very low rate.

Fixed and variable insurance policies

Annuities and those life insurance policies which have an investment component can be divided into fixed and variable products. The term "fixed" means that the life insurance company guarantees the principal and a certain definite return on the investment, whereas in a variable annuity or life insurance contract the value of the insurance policy depends on the underlying investments which can be chosen more or less freely by the client. Such underlying investments typically consist of a portfolio of funds, stocks and bonds, but in specially structured insurance contracts may also include other assets, including unquoted shares of private companies and real estate.

Generally, Swiss insurance policies can be tailor-made in almost every respect to suit the most individual needs.

Parties involved in a life insurance contract

A Swiss life insurance contract usually involves the four parties:

- The **insurer** (ie, the Swiss insurance company) issues the policy and provides coverage in return for the payment of either a lump sum or of regular payments, or a combination thereof.

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- The **policyholder** enters into a contract with the insurer and receives coverage for him/herself and/or other persons (beneficiaries). A legal entity such as a company or foundation, but also a trust, can be the policyholder. This is confirmed in the insurance policy, which is a document issued by the insurer. As the contracting partner, the policyholder owes the insurance premiums that need to be paid to the insurer in return for providing insurance coverage.
- The **insured person** is the one whose life the insurance covers. This can, but need not be, the same person as the policyholder, but it must be a natural person.
- The **beneficiary** or **beneficiaries** are those persons who are designated by the policyholder to receive the specified capital from the insurer at either a specified date in the future or in case of the insured person's death, depending on the type of insurance contract. Also, the beneficiary can be a legal entity or a trust and must not necessarily be a natural person.

Life insurance is often arranged through an insurance broker who advises the insured person and policyholder and liaises between the contractual parties. Brokers are remunerated with commission paid by the insurance company. In most countries, insurance brokers must be licensed to carry on business: in Switzerland this will be the case by 2006.

The person insured under a Swiss life insurance contract must be a natural person. However, legal entities (companies, foundations, etc) may be beneficiaries and policyholders.

Estate planning

Many lawyers and estate planning practitioners have reservations with regard to designating a spouse and/or children as beneficiaries of a Swiss annuity if this is large and/or purchased by large estates. It is argued that, while the asset protection aspect of the annuity may be attractive, the estate planning limitations can be a hindrance.

However, as mentioned already, a trust or a legal entity such as a foundation may also be named as an irrevocable beneficiary of a Swiss annuity on the insured person's death. Accordingly, the concerns may be alleviated by naming the individual's estate planning trust or family foundation as the beneficiary.

Asset protection

Overview

One of the important advantages of Swiss annuities and life insurance is the strong protection it offers to assets placed into any insurance contract of this kind.

A non-Swiss resident (hereafter referred to as the "policyholder") may purchase a life insurance policy from a Swiss insurance company and designate his/her spouse and/or descendants as beneficiaries of the policy, or irrevocably designate any other third party (for instance, a legal entity such as a trust) as a beneficiary.

"Even if a foreign judgment or court order expressly decrees the seizure of the policy or its inclusion in the estate in bankruptcy, the policy may not be seized in Switzerland ..."

Swiss law then protects the insurance policy against any debt-collection procedures initiated by the policyholder's creditors and excludes it from any Swiss bankruptcy procedures.

Even if a foreign judgment or court order expressly decrees the seizure of the policy or its inclusion in the estate in bankruptcy, the policy may not be seized in Switzerland or included in the estate of the bankrupt party.

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.

Creditors may seize the policy or have it included in the estate of the bankrupt party only if its purchase or the designation of the beneficiaries is regarded as a fraudulent conveyance under Swiss law. This is the case if the policyholder has designated the beneficiaries less than one year before the initiation of debt-collection proceedings ultimately leading to a bankruptcy decree against the policyholder or to the seizure of the latter's assets.

The same applies if the beneficiary has been designated with the clear intent to damage creditors or to give some creditors preferential treatment and the designation was made within five years of the date of debt-collection proceedings resulting in a bankruptcy decree or the seizure of the policyholder's assets.

However, the creditors then have to prove not only the policyholder's intent but also that the beneficiary was aware of the intent to defraud. Such intent obviously cannot be proved when the beneficiaries were designated at the time the policyholder was solvent and no creditors had yet asserted any claims against the latter that could have rendered him or her insolvent.

If the policyholder has designated his/her spouse and/or descendants as beneficiaries, the insurance policy will be protected from creditor claims irrespective of whether the designation is revocable or irrevocable. The policyholder may therefore designate his/her spouse and/or descendants as beneficiaries on a revocable basis and later revoke this designation before the policy expires if there are no threats from any creditors at that time.

When the insurance policy expires, the policyholder will usually be able to collect the proceeds accruing from the policy, extend the existing policy or roll the proceeds over into a new policy. If a creditor appears or the holder becomes insolvent at the time of expiration, this protection would cover an extended policy but not a new one.

Protection under duress

An insurer may receive a letter from the policyholder revoking the beneficiary designation (in response to a foreign court order to revoke a past beneficiary designation in order to include the relevant assets in a foreign bankruptcy estate). The insurer may then conclude that the instruction received from the policyholder does not express the latter's true intent, but was forced upon him or her by the foreign judge or court.

In these circumstances, the beneficiaries should inform the insurance company. The Swiss insurance company can then only act upon the holder's instructions if the latter's actions are deemed not to have been made under duress. If there is any evidence that the holder has been forced to issue an instruction, the insurance company must refuse to act upon it.

Protection in case of bankruptcy

If the policyholder becomes bankrupt, he/she continues to be protected because ownership is then automatically transferred to the beneficiaries. Any instructions from the original policyholder that are forced upon him/her must now be ignored; only the latter's beneficiaries, as the new owners, may now instruct the insurance company.

Fraudulent conveyance

A policyholder's creditors may, however, seize the policy in the above cases if they can prove that the irrevocable designation of a third party or the designation of the spouse and/or descendants as beneficiaries is deemed to be a fraudulent conveyance within the meaning of Article 285 et seq. of the Swiss Debt Collection and Bankruptcy Act (Bundesgesetz über Schuldbetreibung und Konkurs; Loi fédérale sur la poursuite pour dettes et la faillite).

In most cases, the purchase of an insurance policy and the designation of beneficiaries are considered a voidable preference under the Swiss rules relating to fraudulent conveyance. In general, all transactions carried out by a debtor during the five years prior to the seizure of assets or the opening of bankruptcy proceedings are voidable if the debtor's intention, apparent to the other party, was to place his/her creditors at a disadvantage or to give preference to certain creditors over others.

Special protection for foreign policy owners

It should be noted that Swiss law deems the rights under an insurance contract between a foreigner and a Swiss insurance company to be located at the latter's domicile.

However, if the policyholder and beneficiaries rights are embodied in a policy that must be considered as a security, a creditor could claim that the latter could be seized in accordance with the debt-collection and bankruptcy rules of the country in which it is deposited.

After all, securities are normally subject to the debt-collection and bankruptcy law of the country where they are deposited. However, this problem may be circumvented if the insurance policy is deposited in Switzerland.

All debt-collection and bankruptcy procedures taking place in Switzerland are based solely on Swiss bankruptcy rules. This means that life insurance policies are then protected in accordance with Swiss law even if the debt-collection or bankruptcy law in the debtor's domicile would not afford him/her such protection.

Specifically, only the Swiss rules on fraudulent conveyance apply here, so the designation of beneficiaries cannot be avoided by creditors unless they prove that the conditions for fraudulent conveyance described previously are met. This remains true even if the purchase or designation was a voidable preference under the rules relating to fraudulent conveyance applicable in the debtor's domicile.

Accordingly, the creditors of a non-Swiss resident may not – in Switzerland – seize or include in the bankrupt's estate any life insurance policies that are protected under Swiss law even if they have a judgment or a bankruptcy decree that is enforceable in Switzerland, unless they can prove that the designation of the beneficiaries of the insurance policy is a voidable preference under the Swiss rules relating to fraudulent conveyance.

"A foreign judge or court may order a policyholder to revoke a past beneficiary designation in order to include the relevant assets in the foreign bankruptcy estate."

A foreign judge or court may order a policyholder to revoke a past beneficiary designation in order to include the relevant assets in the foreign bankruptcy estate.

The policyholder may comply with such an order or judgment by informing the insurer that he or she revokes this designation. The question then arises whether, under Swiss law, the insurer has to comply with an instruction forced upon the policyholder by a foreign judge or court.

If a third party has been irrevocably designated, an insurer will not comply with the policyholder's instruction because this would contradict this irrevocability status.

Tax aspects

Properly structured insurance contracts can offer tax advantages

In most cases Swiss annuities or life insurance contracts offer some tax planning benefits, and in some cases can offer significant relief from income tax and from inheritance tax.

Naturally, in order to benefit from any tax advantages, a life insurance policy must comply with the tax regulations in the policyholder's country of residence (ie, where he or she has his/her main tax residence). For example, a certain minimum duration may be required or the insurance must include a certain amount of life cover besides the investment component.

Income and capital gains on assets placed in a life insurance policy are generally tax-free in the hands of the life insurance company. No tax is deducted from the policy proceeds ie, the proceeds are paid net to the policyholder (or beneficiary, as the case may be). The

assets paid into a life insurance policy do not constitute a gift as they are generally treated as a premium payment.

Furthermore, these assets do not generally form part of the policyholder's estate for inheritance or wealth tax purposes, since the nature of the client/policyholder's interest in the assets is not that of an owner but rather of the holder of an insurance policy. Finally, capital accumulated in life insurance policies is not taxed in several countries when the policy expires, or then only at a very low rate.

Tax exemption in Switzerland

Under Swiss law, both variable and fixed annuities are treated as life insurance policies and are consequently exempt from Swiss income and asset taxes.

Swiss life insurance and annuities are also exempt from the 35% federal withholding tax.

US excise tax not applicable

Unlike many other foreign annuities (for example those issued in Liechtenstein or other low-tax jurisdictions), Swiss annuities are exempt from the one per cent US excise tax on the purchase of foreign annuity and insurance premiums.

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This exemption derives from the adoption of a new Swiss-US Double Tax Treaty in 1998 and applies to premiums paid by a US citizen to an insurance company domiciled in Switzerland.

Income from variable annuities may be tax-deferred in the US

As a rule, foreign fixed annuities no longer enjoy tax-deferred status in the United States. US tax rules regard a Swiss fixed annuity as a debt instrument ie, a "promise to pay a certain sum" in addition to being an insurance contract.

The owner of a Swiss fixed annuity (as well as other foreign annuities regarded as debt instruments) consequently pays tax on the accrued income, including currency gains if the annuity is denominated in a foreign currency.

In the view of most tax experts, the loss of tax deferral means that distributions prior to the age of 59.5%, including loans against the policy, are not liable to the 10% penalty for early withdrawals. So tax-free withdrawals may be taken from a Swiss fixed annuity whenever the policyholder chooses.

On the other hand, income from foreign variable annuities may be tax-deferred. The tax-deferred status of Swiss variable annuities has consequences for early withdrawal in the same way as US contracts. However, the former offer a combination of asset protection, a choice of asset allocation strategies based on an investor's risk profile and other needs, as well as tax deferral for US investors. They consequently represent ideal long-term investments that use the power of compound growth for a retirement portfolio.

Other advantages

No reporting requirements

Swiss insurance companies do not report to any government - Swiss or foreign - if the policyholder is not resident in Switzerland. Thus neither the initial purchase of the policy, nor individual payments, nor interest or dividends earned, nor any other information will be reported and all transactions are kept strictly confidential and private between the policyholder and the insurance company.

In addition, insurance contracts are not subject to reporting in many other countries apart from Switzerland as they are generally viewed as an (insurance) contract rather than a reportable investment.

Liquidity

Swiss annuities offer instant liquidity. All capital, plus all accumulated interest and dividends, is freely accessible. Depending on the type of annuity, a minimal penalty in case of withdrawal applies only to an initial period of usually up to one year. So if funds are needed quickly, they are available and not tied down for a fixed period of time. Furthermore, all Swiss banks will accept Swiss life insurance policies as collateral for loans.

No-load investment

Swiss annuities are generally arranged on a no-load basis, so there are no additional charges or costs and the investment can be cancelled at any time without loss of principal or accumulated interest and dividends.

No forced repatriation of funds

Swiss insurance policies would escape any forced repatriation under any exchange controls that may be imposed in future, because they are regarded as a pending contract between the investor and the insurance company.

Conclusion

The Swiss insurance industry has an impeccable track record. It offers sophisticated products and services that are attractive to international clients as a safe investment vehicle and as a compliment – or even as an alternative – to trust structures.

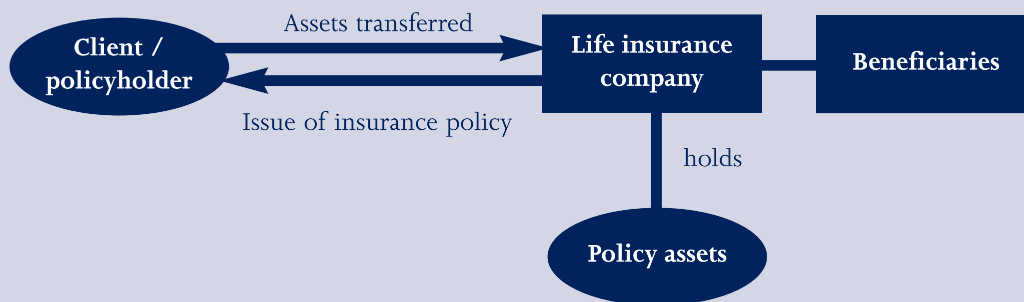
Swiss life insurance and annuities are very attractive from various perspectives: not only are they a very safe form of investment, they also offer unique asset protection, which is particularly relevant for American investors, but

also increasingly so for wealthy people elsewhere in the world who wish to protect their assets legally. Depending on the individual situation of the investor, investments in Swiss annuities and life insurance may even offer tax advantages. All of these advantages are available in the environment of legal and economic stability that Switzerland offers, and that is second to none in the world.

Asset Protection: Swiss Life Insurance Policy v Asset Protection Trust

Benefit	Swiss Life Insurance Policy	Asset Protection Trust
Owner retains full control	Yes	No
Privacy	Yes	Yes
Foreign jurisdiction	Yes	Only if trust assets are not invested locally
Liquidity	Yes	Depending on the investment decisions of the trustee
Tax-free locally	Yes	Variable, depending on trust domicile
Established legal principles	Yes	Variable, depending on trust domicile, location of trustees and trust assets
Simple and inexpensive	Yes	No

Tax aspects



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