

Using insurance wrappers for asset protection and tax planning

by George Rosenberg, Ari Rosenberg and Niv Goldstein

In this article we provide a brief summary of the advantages associated with the use of insurance wrappers for both asset protection and tax planning purposes. Such advantages became even more relevant in light of the recent change in the Israeli Tax Ordinance-1961 (Ordinance) pertaining to the taxation of trusts (Trust Amendment) which cancelled the favourable tax regime provided to foreign settlor trusts. We suggest an optimised structure for obtaining both asset protection and beneficial tax planning by combining trusts and insurance wrappers.

By 'insurance wrapper' we refer to a life insurance policy 'wrapped' around the policy owner's investment portfolio that is owned and controlled by the insurance company until payment in accordance with the terms of the policy. A typical insurance wrapper enables a person to purchase a life insurance policy, either on his own life or on someone else's, by paying a premium – usually a onetime premium consisting of the total investment portfolio – which accumulates income at favourable, or zero, tax rates. The portfolio could be commingled with the premium-sourced investments of the insurer, or in some cases, in a segregated account, with the policy owner directing the applicable investment policy.

When the insurer pays out the insurance proceeds in accordance with the terms of the policy, these will be comprised of the investment portfolio plus the income accumulated thereon – 'the savings component' – and an additional fixed amount calculated on the basis of the premiums paid in accordance with the relevant actuarial tables – 'the risk component'.

Insurance wrappers as an asset protection instrument

The effect of insurance wrappers as an asset protection instrument is rooted in Israeli law. Section 147 of the *Israeli Inheritance Law – 1965* (Inheritance Law) states that amounts payable in consequence of a person's death under insurance contracts, because of his membership in a pension fund or benefit fund or on similar grounds, are not part of his estate, unless it was stipulated that they should accrue to the estate. Section 13 of the Israeli *Insurance Contract Law-1981* states that if the policy holder *irrevocably* elects a beneficiary, any transfer or pledge of the rights of the policy holder will be subject to the prior written consent of the beneficiary, and the debtors of the policy holder will not be allowed to register a lien on such rights. It is worth mentioning that the Tel-Aviv District Court recently ruled that even if the policy holder had not irrevocably elected a beneficiary, the rights of the beneficiaries supersede the rights of the debtors who registered a lien prior to the demise of the policy holder (2155/09 *Tadmir Aguda vs. Yael Yaron and others*). As this case is still subject to the Supreme Court review, we will not further discuss in this article instances where the beneficiaries were not irrevocably elected.

In light of the above, the funds payable upon the death of a policy holder are not part of his estate and the right of the beneficiaries of such policy, if elected irrevocably, supersedes the right of the debtors of the policy holder. Thus, insurance wrappers provide a very effective instrument for asset protection purposes because they take the funds payable under the risk component out of the insured's estate and

further provide protection to the beneficiaries against potential claims of the insured's debtors. The question of whether the *saving component* shall be protected by potential claims of the insured's debtor in the same manner was left unsettled by the Israeli jurisprudence.

Insurance wrapper as a tax planning instrument

For the limited purpose of this article, and only by way of a brief overview, the taxation of insurance wrappers can be divided into two phases. During the lifetime of the policy, the *income* earned in the insured's investment portfolio with the insurer is not subject to Israeli tax, unless the portfolio invested under the policy includes Israeli assets which produce Israeli sourced income. In other words, the only tax liability in respect of the investment income during the lifetime of the policy would be that of the insurer in the jurisdiction in which it is resident.

Following the insurance event and the maturity of the policy, the Ordinance provides that "a sum received upon the death of the insured only on the risk component included in the life insurance policy, exclusive of a sum received or derived from the savings component" is tax exempt, provided the beneficiaries are relatives of the insured (spouse, brother, sister, parent, grandparent, offspring, offspring of spouse, and a spouse of any of the above, including an offspring of a brother or a sister and a brother or a sister of a parent, and a trustee in relation to the settlor of a trust), and provided the premium was not deducted as an expense by the owner, and provided the insurance is not within the framework of several kinds of employment-linked funds (Section 9(19) of the Ordinance). The non-exempt risk component (i.e., where the beneficiary is not a relative of the insured or the premium was deducted as an expense by the policy owner) is subject to the regular graduated prevailing progressive income tax rate – currently up to a maximum of 48 percent.

The profits derived by an individual from the savings component of the life insurance policy (assimilated in the Ordinance to a 'savings plan') are taxed, upon payout, in the same manner as interest income is taxed under the Ordinance in provident funds or savings plans, i.e., at the rate of 25 percent, except in special cases.

In conclusion, during the lifetime of the policy, the policy holder obtains a full tax deferral with respect to the saving component as long as such component does not include Israeli assets, and upon the maturity of the policy the risk component is in most cases tax exempt assuming it meets the preconditions provided above.

Optimising the structure by combing trusts and insurance wrappers

In order to obtain an even stronger structure for asset protection purposes, we propose a solution based on the combination of trusts and insurance wrappers (Proposed Solution). In accordance with our Proposed Solution, a trust will be settled and the trustee of such trust (Trust and Trustee respectively) will purchase an insurance wrapper with the trust funds. The Trust will be both the holder of the insurance wrapper and the beneficiary of such insurance wrapper. When the policy matures, the proceeds will be paid to the Trust and the Trustee may then distribute to the beneficiaries of the Trust in accordance with the relevant terms of the trust deed.

This Proposed Solution will obtain another asset protection aspect, since the funds under the Trust will not only be protected from potential claims of the debtor of the settlor by virtue of Section 3 of the Israeli Trust Law-1979 which states that “No recourse can be had against the assets of the trust except for debts accruing in respect of the assets, or debts arising from the acts of the trust”, but also by virtue of the funds being vested in an insurance product and thus under the control of the insurer (preferably in a foreign jurisdiction) who is subject only to the terms of the underlying insurance policy and the applicable law.

In addition, as previously mentioned, following the Trust Amendment which subjects foreign resident trusts with Israeli beneficiaries to taxation on their yearly income, such Proposed Solution will obtain a tax deferral on the income generated by the saving component of the insurance wrapper and will allow the trustee to report and pay the applicable taxes only when the policy underlying the insurance wrapper matures.

George Rosenberg and Ari Rosenberg are partners, and Niv Goldstein is a senior associate, at Rosenberg Abramovich Keren-Polak Epelman. Mr G. Rosenberg can be contacted on +972 3 608 1451 or by email: george@rosak-law.com. Mr A. Rosenberg can be contacted on +972 3 608 1451 or by email: ari@rosak-law.com. Mr Goldstein can be contacted on +972 3 608 1451 or by email: niv@rosak-law.com.