
MEMORANDUM

RE: INTERNATIONAL TAX COMPLIANCE
 FOREIGN ASSETS (U.S. TAXPAYERS)
 #1: IRS TAX AUDIT STRATEGY

Private placement life insurance is a *pre-emptive* IRS audit tax strategy that transforms taxable ordinary income and capital gains into tax-free income (with no income tax reporting required under current U.S. Law). Please reference IRS Private Letter Ruling 200244001 (May 2, 2002).

For U.S. Persons with investment income, private placement life insurance provides for compliant, tax-free compounded earnings (Please see: 10/18/06 Wall St. Journal article, attached).

A private placement insurance policy is variable in nature, which allows the insurance company to invest the majority of the premium(s) in a legally separate, segregated account to be managed by either an investment manager of the client's choosing or the insurance company itself. There are no guarantees when it comes to the investment performance (as it varies, so does the death benefit but with a fixed minimum).

The income tax benefits are:

- 1. Assets inside a life insurance policy grow and compound income tax free.**
- 2. Death benefit paid income tax free.**

Domestically in the U.S., investors have traditionally used the tax benefits of variable life insurance policies to invest in mutual funds. In contrast, *international* private placement life insurance policies allow users to invest in a wider range of investments including hedge funds, private equity, derivatives, and real estate investment trusts (there are functionally no restrictions on the types of investments that can be held and managed inside the policy).

Other benefits include the following:

1. Short-term capital gains (41% Federal/California income tax): exempt from income tax.
2. Bond interest (taxed at 41% ordinary income rates Federal/California): exempt from income tax.
3. Policies in certain jurisdictions (e.g., Cayman Islands): exempt from creditor attachment.
4. IRS audit risks are minimized since assets held under a qualifying life insurance policy are neither subject to income tax, nor is there any required income tax reporting (under IRC §72(e)(5)). In addition to the substantive tax and reporting benefits, for audit purposes there would be no presumed IRS tax avoidance, due to the fact that life insurance has been granted an “angel exception” (i.e., is an IRS approved transaction) (IRS Revenue Procedure 2004-65, 2004-66, 2004-67, 2004-68).
5. Policy lifetime withdrawals may be tax-free and not subject to tax reporting (as either a return of premium/basis or a loan). The Modified Endowment Contract (“MEC”) rules may or may not apply depending on policy design.

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