Senate Finance Committee
Chairman Ron Wyden

PRIVATE PLACEMENT LIFE INSURANCE: A TAX SHELTER FOR THE ULTRA-WEALTHY MASQUERADING AS INSURANCE

A Democratic Staff Investigation

February 21, 2024

Executive Summary

The Senate Committee on Finance ("the Committee") conducted an investigation into the growing use of Private Placement Life Insurance (PPLI) policies as a tax shelter for the wealthiest 0.1 percent of Americans. The Committee's investigation examined how PPLI policies are promoted to ultra-high net worth clients as a vehicle to avoid billions of dollars in taxes on lucrative investments. The Committee also obtained significant new information from insurance companies to determine the size of the PPLI market and other key metrics, including the average face value of the policies.[1] Prior to the Committee's investigation, no U.S. government entity had conducted an analysis of the PPLI industry to capture the extent to which PPLI policies were being used as a tax maneuver by wealthy investors.

The Committee's investigation found that the PPLI industry is now *at least* a $40 billion tax shelter used exclusively by a few thousand millionaires and billionaires.[2] The Committee's investigation also found that unlike traditional insurance products, PPLI is a niche financial product for the ultra-wealthy that is not available to middle-class Americans. Due to a mix of required premium commitments in the millions, high fees and administrative costs, as well as other statutory requirements, PPLI policies are only available to high-net worth and ultra-high net worth persons.

The Committee's investigation found that PPLI policies are actively promoted to wealthy investors as a means to eliminate income, gift and estate taxes. The Committee obtained pitch decks from leading PPLI providers promoting PPLI products to ultra-high net worth persons as a vehicle to make tax-free investments in hedge and private equity funds. Across the industry, PPLI providers actively pitched clients on using PPLI policies as a tax-advantaged wrapper for the purpose of investing in a wide range of asset classes and bypassing taxes on investment gains and the transfer of wealth to their heirs.

While Chairman Wyden continues to support tax advantages afforded to insurance products to ensure the financial security of working families, the Committee found that the top 0.1 percent of investors are exploiting these advantages as part of the latest "buy, borrow, die" strategy to avoid paying their fair share in taxes. For far too long, the ultra-wealthy have exploited loopholes in the tax code to build dynastic wealth by acquiring lucrative assets like stocks, real estate, or art, borrowing against those assets as collateral to fund lavish lifestyles, and then passing those assets tax-free to their heirs using trusts and other estate planning techniques. Additionally, wealthy heirs benefit from the "step-up" in basis that wipes out any capital gains tax that may be due on the sale of assets they inherit.

The Committee found that PPLI is booming in popularity among the ultra-high net worth community as an attractive option to execute the "buy, borrow, die" tax avoidance maneuver. More to the point, PPLI is the perfect "buy, borrow, die" arrangement. PPLI arrangements involve buying a life insurance policy, borrowing from the policy at extremely favorable rates, and then passing the

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[1] The face value, also referred to as the "face amount" or "death benefit" is the amount that will be paid out to beneficiaries at the time of death of the policy owner. Since death benefits paid from insurance policies are not taxable, this entire amount is transferred to the beneficiaries of PPLI policies tax-free. Accordingly, if the beneficiaries of a PPLI policy are the children of the decedent, this is the amount of wealth transferred to the heirs of a policy owner free of income, gift and estate taxes.

[2] The minimum $40 billion mark for the size of the PPLI market is based on information provided by some of the largest domestic PPLI insurance writers. The actual size of the PPLI market is likely considerably larger because PPLI is offered offshore as well. The Committee's investigation only covers the domestic PPLI market and does not cover offshore policies sold to U.S. persons by foreign carriers. The overall PPLI market for U.S. persons when combining domestic and offshore policies is larger than $40 billion.

benefit to wealthy heirs upon the death of the policy owner tax-free. PPLI accordingly results in a tax-free transfer of wealth while allowing the owner to gain access to cash through favorable lending treatment not afforded to most Americans.

According to new information obtained by the Committee from seven leading PPLI carriers, approximately 3,000 Americans have PPLI policies with an *average* face amount (death benefit) of nearly $13 million. In the case of the three PPLI market leaders, these amounts are substantially higher. For Prudential Insurance Company of America, Lombard International, and Zurich Insurance Group, the average face amount of a PPLI policy was $27.8 million, $17.6 million, and $18.8 million, respectively. For one highly specialized PPLI provider, Investors Preferred, the average face amount of a PPLI policy was a whopping $38 million. The Committee also obtained information regarding the average annual income and net worth of PPLI clients. For one leading PPLI carrier, the average annual income of a PPLI client was in excess of $7 million and the average net worth was well over $100 million. This confirms PPLI's concentration as a truly high-end financial product, as the PPLI segment represents just 0.003 percent of the individuals in the U.S. insurance market.

The Committee's investigation also found that investor control rules designed to curb abuse of PPLI policies are extremely difficult for the Internal Revenue Service (IRS) to enforce due to a lack of reporting requirements. Since PPLI policyholders are not required to disclose their interest in a PPLI policy to the IRS, the ownership of a PPLI policy does not show up on any tax return. The Committee learned that the only way the IRS can detect interest in a PPLI policy is if it happens to come up in the course of an audit. In light of the previous decade's steep decline of IRS enforcement resources and audit rates, the Committee is concerned about the limited oversight of this booming tax dodge for the rich.

As a result of the Committee's investigation, Chairman Ron Wyden will be introducing legislation in the coming months to crack down on the abuse of PPLI policies as a niche tax shelter for a small, elite group of wealthy Americans. This legislation will not affect the tax treatment of the 99.9 percent of insurance policies used by typical families, but will instead strengthen guardrails against the use of PPLI as a tax-free piggy bank for multi-millionaires and billionaires.

Key Committee Findings:

- The PPLI industry is now *at least* a $40 billion tax shelter used exclusively by only a few thousand wealthy Americans.
- Unlike traditional insurance policies, PPLI policies are an ultra-niche financial product that is not available to middle-class families.
- PPLI policies are actively promoted to ultra-wealthy Americans as tax-free hedge and private equity fund investments.
- PPLI policies are actively promoted to millionaires and billionaires as a way to transfer significant wealth to their heirs while bypassing income, gift and estate taxes.
- Guardrails against abuse of PPLI policies are nearly impossible for the IRS to enforce due to a lack of disclosure requirements.
- The IRS should increase scrutiny of the PPLI industry's compliance with investor control rules.
- Legislation is needed to increase oversight of PPLI and curb abuse of these products as tax avoidance by the wealthiest 1 percent of Americans.

Background

The United States tax code offers favorable tax rules to life insurance products in order to help protect the financial security of working American families after the death of a provider. Enacted with the support of bipartisan majorities of Congress, this favorable tax treatment of insurance products is intended to help families cover future expenses such as a mortgage, education costs or income replacement after the insured has passed on. These benefits have existed for over 100 years.

The first major tax advantage afforded to life insurance products is that death benefits paid under a life insurance policy are excluded from taxation.[3] The second is that the tax code allows for life insurance premiums to be invested on a tax-free basis.[4] Frequently referred to as tax-free "inside buildup," this part of the tax code allows for gains from investments made with insurance premiums to accrue over the life of a policy without being subject to taxation. Earnings on assets supporting insurance policies are not taxed until they are withdrawn, and then only taxed to the extent that the amount withdrawn exceeds amounts paid in premiums. Additionally, changes to the tax code in 1984 required that death benefits must exceed the cash value of insurance policies, using either the Internal Revenue Code's cash value accumulation test or the guideline premium and cash value corridor test.[5]

These provisions of the tax code help serve a genuine insurance purpose for the 99.9 percent of the Americans who use life insurance, but certain insurance companies and financial advisors in the early 2000s realized the favorable tax treatment of insurance products could be exploited as a loophole by ultra-wealthy clients as part of a tax avoidance strategy. Accordingly, certain insurance companies and brokers began to sell PPLI policies to ultra-high net worth clients as a customizable life insurance product that could be used to invest in a wide range of financial products while avoiding income, gift and estate taxes. A pioneer in the industry described PPLI as a "tax-advantaged wrapper for hedge funds and other alternative investments" and added that "unlike conventional insurance, PPLI products are tailored to meet the specific investment objectives of high-net worth investors."[6] According to Lombard International,[7] the PPLI market leader, a properly designed PPLI policy can be used to "minimize or eliminate estate taxes" and "defer or potentially eliminate income tax."[8]

PPLI policies differ from traditional insurance products in two key ways. The first is that unlike traditional insurance products, PPLI policies typically require minimum premium

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[3] I.R.C. § 101(a)(1).

[4] I.R.C. § 72(e)(5).

[5] I.R.C. § 7702.

[6] *The Next Step in Alternatives: Private Placement Insurance Can Act as a Tax-Advantaged Wrapper for Hedge Funds and Other Alternative Investments,* Michael C. Crawford and Perry Lerner for Private Wealth Magazine, May/June 2011.

[7] The Committee notes that Lombard International's US and Bermuda business recently rebranded as Axcelus Financial. The report continues to refer to the company as Lombard for clarity in exhibits and attached documents. *Lombard International US & Bermuda Rebrands to Axcelus Financial Following BroadRiver Acquisition,* January 22, 2024, https://www.axcelus.com/2024/01/18/lombard-international-us-bermuda-rebrands-to-axcelus-financial-following-broadriver-acquisition/.

[8] *Private Placement Life Insurance and Split Dollar,* Lombard International, Mar. 13, 2018, screen captured on December 1, 2022 and available online at https://web.archive.org/web/20221201125032/https://us.lombardinternational.com/en-US/Newsroom/Corporate-news/News-2018/PPLI-and-Split-Dollar.

commitments of $1 to $2 million or greater (not including fees and other administrative costs).[9] Additionally, PPLI products can only be issued to individuals who satisfy the definitions of an Accredited Investor and a Qualified Purchaser under federal securities laws.[10] An accredited investor is usually someone with a net worth of over $1 million or an individual income of $200,000 in each of the two most recent years ($300,000 per household), whereas a Qualified Purchaser individually or through a company/trust must own at least $5 million in investments. By statute, PPLI policies are only available to high-income or high-net worth persons.

The second way PPLI differs from traditional insurance products is that, unlike traditional insurance products used by middle-class Americans, PPLI products are highly customizable and offer a far wider range of investment options.[11] While traditional insurance products only allow for policyholders to invest in basic equity and debt funds, PPLI offers a vast range of investment choices that include hedge funds, private equity funds, real estate, private credit, and other options. PPLI policies can even be used to purchase entire businesses. The Committee identified that PPLI providers will often work with investment professionals to set up insurance dedicated funds that either mimic or replicate the underlying investment strategy of certain hedge funds or private equity funds. This tactic is often referred to as setting up a "clone fund." By doing so, a policyholder can receive investment gains from lucrative alternative investments while shielding those gains from the tax liability they would incur by investing outside of PPLI as the ownership vehicle.

Overview of the Committee's Investigation

On August 15, 2022, the Committee initiated its investigation into the growing use of PPLI as a tax shelter for wealthy investors.[12] The Committee's investigation was prompted by public reports that PPLI was "gaining popularity among the very rich for its ability to shield fortunes from taxes."[13] Other reports described PPLI as a "tax-free hedge fund" and suggested that Lombard International, then a subsidiary of private equity giant Blackstone, was promoting PPLI as a way to "invest in hedge funds and avoid paying taxes forever."[14] Lombard's website even stated that it expected PPLI

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[9] Private marketing materials obtained from several PPLI market leaders included as appendices to the Committee's report state that the minimum premium commitment required to open a PPLI policy is $1 or $2 million, depending on the insurer. This amount does not include fees and other administrative costs.

[10] PPLI policies can only be issued to clients who meet the definitions of an Accredit Investor under Rule 501(a)(1)-(8) of Regulation D of the Securities Act of 1933 and a Qualified Purchaser under Section 2(a)(51) of the Investment Company Act of 1940.

[11] Most individual insurance policies purchased by Americans are registered products that offer a preselected group of investment options. Owners have no right to change these investments or the managers of these investments. On the contrary, PPLI allows for owners to develop highly customizable investment strategies and carte blanche choice of asset classes and investment options.

[12] *Wyden Launches Investigation Into Private Placement Life Insurance Schemes,* U.S. Senate Committee on Finance, Aug. 15, 2022, https://www.finance.senate.gov/chairmans-news/wyden-launches-investigation-into-private-placement-life-insurance-schemes.

[13] *The Very Rich Already Have a Plan to Escape Biden's Tax Increase,* Bloomberg, Sep. 2, 2021, https://www.bloomberg.com/news/articles/2021-09-02/richest-americans-have-tax-loophole-that-s-legal-easy-to-exploit-hard-to-close.

[14] *Blackstone woos wealthy with tax-free hedge fund,* InvestmentNews, May 31, 2018, https://www.investmentnews.com/blackstone-woos-wealthy-with-tax-free-hedge-fund-2-74407.

would increase in importance if Congress were to eliminate the "stepped up basis" loophole used by the wealthiest households to transfer assets to their heirs tax-free.[15]

In order to better understand the size and scope of the PPLI market, the Committee sent detailed requests for information to seven leading PPLI providers: **Lombard International ("Lombard"), Zurich American Life Insurance Company ("Zurich"), Prudential Insurance Company of America ("Prudential"), Investors Preferred, John Hancock, Crown Global Insurance Group ("Crown Global")**, and **Pacific Life Insurance Company ("Pacific Life")**. The Committee understands these insurance companies to be the seven largest providers of PPLI policies to U.S. clients. The Committee also sent letters to the **American Council of Life Insurers (ACLI)**, the leading industry trade association, and **Winged Keel Group**, an insurance broker that specializes in PPLI. These entities all cooperated with the Committee's investigation.

These requests were primarily focused on getting information related to PPLI assets under administration, the face amount of the PPLI policies in force, and the number of PPLI policies administered by each company. This was intended to determine the extent to which PPLI policies have proliferated among the high-net worth community and ascertain the typical wealth profile concentrated in these tax-advantaged investment vehicles. Prior to the Committee's investigation, no U.S. government entity had conducted an analysis of the PPLI industry to capture the extent to which PPLI policies were being used by wealthy investors. In a response to the Committee, the leading insurance industry trade association, ACLI, indicated that it did not keep track of PPLI policies in force by its membership. The Committee also requested marketing materials from these companies in order to understand how PPLI policies were promoted to wealthy clients looking to make tax-free investments in hedge funds and other lucrative assets. This request included lists of investment options available to PPLI clients.

Lastly, the Committee held meetings with IRS personnel regarding the enforcement of investor control rules that force PPLI policy owners to surrender any influence or control over investment decisions involving assets held in PPLI policies. Under these investor control rules, if a PPLI policyholder is found to have influenced investment decisions or coordinated with the investment adviser, the policy owner, and not the insurance company, is treated as the owner of the funding [assets] and the income from the investment gains generated by the assets in a PPLI policy will be subjected to federal income taxes. In theory, investor control rules are supposed to serve as the significant guardrail against abuse of tax advantaged insurance wrappers like PPLI.

The PPLI Industry is at Least a $40 Billion Tax Shelter for a few Thousand Wealthy Americans

The Committee obtained new information regarding the total assets under administration ("AUA"), total face amount, and number of PPLI policies in force for the seven largest domestic PPLI providers.[16] Assets under administration refers to the value of the investments made with assets supporting PPLI policies issued by each insurance company. The "face amount," also commonly referred to as the "death benefit," is the minimum amount the insurance company is obligated to pay beneficiaries of the PPLI policy after the death of the policy owner. The face amount is effectively the amount of wealth that will be passed on to the beneficiaries free of income, gift, and estate taxes.

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[15] *Biden's proposed tax plan would increase importance of annuities in tax planning,* Lombard International, Oct. 9, 2020, https://us.lombardinternational.com/en-US/Newsroom/Corporate-news/News-2020/Biden%E2%80%99s-Proposed-Tax-Plan-Would-Increase-Impor-(1).

[16] All statistics included in this report in relation to PPLI assets under administration, face amount of policies, and number of policies in force are sourced directly to responses from insurers to the Committee.

The Committee's investigation found that these seven companies had 3,061 PPLI policies in force at the end of 2022 with $9.5 billion in AUA and a face amount of approximately $40 billion.

Exhibit 1: PPLI Industry Data Obtained from Insurers by Finance Committee[17]

	PPLI assets under administration	Total face amount of PPLI policies	Number of PPLI policies in force	Average face amount
Lombard International	$3,293,000,000.00	$10,600,000,000.00	602	$17,607,973.42
Prudential	$2,620,262,230.00	$10,751,381,934.00	387	$27,781,348.67
Crown Global	$206,000,000.00	$1,077,925,371.00	90	$11,976,948.57
Investors Preferred	$988,267,459.00	$4,000,000,000.00	104	$38,461,538.46
John Hancock	$561,001,092.00	$3,304,698,900.00	982	$3,365,273.83
Pacific Life	$1,200,000,000.00	$7,294,068,949.00	753	$9,686,678.55
Zurich	$585,000,000.00	$2,700,000,000.00	143	$18,881,118.88
TOTAL	$9,453,530,781.00	$39,728,075,154.00	3,061	$12,978,789.66

This data confirms that PPLI is a niche financial product only available to the wealthiest 0.1 percent of Americans. According to this data, at least $40 billion in wealth will be transferred to the heirs of a few thousand millionaires and billionaires while successfully avoiding billions of dollars in federal taxes. This is a shocking concentration of wealth for an ultra-niche segment of the insurance market that represents just 0.003 percent of all individual insurance policies.[18] The PPLI industry is

[17] Data on PPLI assets under administration, face amount of PPLI policies and number of PPLI policies in force is taken from information provided directly to the Committee by Lombard International, Prudential, Crown Global, Investors Preferred, John Hancock, Pacific Life and Zurich. This information is current as of December 30, 2022.

[18] According to the American Council of Life Insurers 2023 Life Insurers Fact Book, there were approximately 133 million individual U.S. insurance policies in force in 2022. Assuming that there are somewhere between 3,000 to 5,000 U.S. PPLI policies in force, the PPLI segment is just 0.003 percent of the entire individual U.S. insurance market.

certainly larger than $40 billion in total face amount of coverage, as the Committee's investigation did not obtain information from all PPLI providers and only covered U.S. issued policies.[19]

The Committee also obtained additional information indicating that the typical PPLI client is in the ultra-high net worth bracket. According to statistics provided by Prudential, the average annual income of a PPLI client typically is in excess of $7 million and the average net worth was well over $100 million:

Exhibit 2: Average Annual Income and Net Worth of Prudential PPLI Clients[20]

Prudential PPLI Client Average Income and Net Worth		
Year	Average Income	Average Net Worth
2019	$7.4 million	$153.6 million
2020	$9.7 million	$150.3 million
2021	$5.88 million	$102.4 million

Other data points confirmed that PPLI policies are only available to and used by extremely wealthy individuals. For one highly specialized PPLI provider, Investors Preferred, the average face amount of a PPLI policy was an astounding $38 million.[21] This aligns with remarks made by the firm's founder in public interviews that it was a "niche life insurance company catering to ultra-high worth clients."[22]

The Committee's investigation also obtained new information from industry leader Lombard indicating that the PPLI industry is growing rapidly in popularity among ultra-high net worth clients.

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[19]This statistic is only based on policies sold to US purchasers within the United States. There is also a thriving off-shore PPLI industry. The size of this market was not part of this study. It is worth noting that there are fewer curbs on potential abuses in the foreign issued market. For example, the rules regarding minimum death benefit to cash value ratios don't apply, and regulatory costs may make the costs of maintaining such policies lower. It may be possible for a person to purchase of foreign issued policy, stuff it full of cash so that the amount at risk, i.e., the difference between the cash value and the death benefit is very low or zero. In short, these so-called life insurance policies may not carry any insurance risk at all and only serve as a way to purchase investments not typically offered under life insurance policies. Treating these policies as life insurance policies under U.S. tax law may be a stretch and the purchaser may be not only passing policy proceeds along to their heirs but doing so under the false impression that the death benefit is tax-fee under section 101(a). This investigation did not attempt to study the offshore market as it is even more opaque than the domestic market.

[20] Letter from Salene Hitchcock-Gear, President, Individual Life Insurance at Prudential Life Insurance Company of America to Ron Wyden, Chairman, Senate Finance Committee, October 12, 2022.

[21] Letter from Alan Jahde, Executive Chair, Investors Preferred to Ron Wyden, Chairman, Senate Finance Committee, February 27, 2023.

[22] *Tier One Interview: Alan Jahde*, Life Insurance Strategies Group, LLC, Dec. 12, 2021, https://www.lifeinsurancestrategiesgroup.com/post/tier-one-interview-alan-jahde.

From 2014 to 2023 when Lombard was owned by the "tactical opportunities" group of private equity giant Blackstone, the value of PPLI assets at Lombard has nearly tripled.[23]

Exhibit 3: Lombard International PPLI Asset Value 2015 - 2022[24]

The total assets under administration ("AUA")[3] listed below is attributable to PPLI products issued by Lombard as of the end of the specified years (except as noted)

Year	AUA
2015	$1.334 billion
2016	$1.363 billion
2017	$1.618 billion
2018	$1.767 billion
2019	$2.143 billion
2020	$2.621 billion
2021	$3.242 billion
2022 (at June 30, 2022)	$3.293 billion

PPLI is Actively Promoted to Wealthy Clients as a Tax-Free Hedge Fund

The Committee's investigation obtained private marketing materials from several PPLI industry leaders detailing the extent to which insurers were promoting PPLI as a tax dodge. The Committee's investigation found that promoting PPLI as a tax-free hedge fund was the centerpiece of the PPLI industry's pitch to ultra-high net worth clients. The use of this promotional tactic was not limited to certain insurers, and reflects an industry-wide practice that also extends to brokers and other financial advisors.

For example, a confidential Prudential brochure prepared for prospective clients stated that what sets PPLI apart is that "underlying investment options include hedge funds."[25] The brochure further added that their PruLife Private Placement VUL product combines the "tax advantages of life insurance with a customizable, growth-oriented solution designed for your specialized needs."[26] The brochure makes clear that investments made through PPLI policies are free from federal income and estate taxes and that policyholders can take out cash via loans and withdrawals "without being taxed."[27]

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[23] Letter from Charles Nachman, President, US and Bermuda at Lombard International to Ron Wyden, Chairman, Senate Finance Committee, Dec. 16, 2022; (In July of 2014, Lombard International was acquired by private equity giant Blackstone. The acquisition was made by Blackstone's "tactical opportunities" group. The following year in 2015, the former Philadelphia Financial Group, Inc. was acquired by Lombard International and became Lombard's U.S. branch, bringing both businesses under Blackstone's control. On August 23, 2022, shortly after the Committee began its investigation, Lombard International announced the sale of its US and Bermuda business to BroadRiver asset management and its affiliated entities.).

[24] Letter from Charles Nachman, President, US and Bermuda at Lombard International to Ron Wyden, Chairman, Senate Finance Committee, Dec. 16, 2022 (The footnote inside the clipped exhibit states "Lombard's aggregate assets under administration (AUA) for PPLI policies represents the total value of investments held by Lombard in its separate accounts supporting the PPLI policies it issues.").

[25] Prudential PruLife Private Placement VUL brochure issued by Pruco Life Insurance Company, included as Appendix A to the Committee's report.

[26] *Id.*

[27] *Id.*

Exhibit 4: Excerpts from Prudential PPLI Brochure[28]

A POWERFUL COMBINATION

Life insurance is often used as part of a tax-efficient wealth transfer strategy. PruLife Private Placement VUL takes this a step further by combining the tax advantages of life insurance with a customizable, growth-oriented solution designed for your specialized needs. It offers:

- **A death benefit that is generally free from federal income taxes**[1] and, if the policy is structured properly, also free from federal estate taxes.
- **Freedom from annual taxation of any cash value that accumulates.** This allows for the potential compounded accumulation of the policy cash value. In addition, you can take out cash value via loans and withdrawals without being taxed.[2]
- **Preferred pricing for qualified purchasers like you.** Preferred pricing means flexible charges, fees, and expenses, allowing more of your premium to be invested into the underlying investment options compared with a traditional policy.
- **An extensive selection of underlying investment options** that drive the potential cash value accumulation. These include exempt (hedge funds) and non-exempt (registered mutual funds) options.

Our experience and capacity for large policies, along with the strength, stability, and longevity of Prudential, make Private Placement VUL life insurance an alternative for your wealth transfer strategy.

THE DIFFERENCE OF PRIVATE PLACEMENT VUL: HEDGE FUNDS

What sets Private Placement VUL apart is that its underlying investment options include hedge funds (including funds of funds). These use a wide variety of investment strategies and may not be correlated to specific market performances.

Hedge fund strategies seek to generate positive returns regardless of market direction. They also have low or no correlation to market benchmarks. Because of this, they may offer greater diversification and lower overall portfolio volatility.[3] You may access these investment strategies through an Insurance Dedicated Fund (IDF) or Managed Separate Account (MSA). Required investment minimum varies based on investment option selected.

THE EFFECTS OF TAXATION

A high-net-worth California resident is invested in alternatives with 75% turnover (75% short-term capital gains/ordinary income; 25% long-term capital gains).

A series of marketing materials obtained from PPLI market leader Lombard also make clear that PPLI is marketed to wealthy clients as an estate planning tool to transfer assets to beneficiaries "income tax-free."[29] It also points out that its PPLI offerings allow for a "tax free transfer of assets at death" and "allows for multiple family members to get maximum dollars into policies and out of the estate."[30]

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[28] *Id.*

[29] Lombard International Private Placement Life Insurance (PPLI) marketing materials, included as Appendix B to the Committee's report.

[30] *Id.*

The Committee also obtained a list of investment options available to Lombard PPLI clients which contains hundreds of funds that include a plethora of hedge funds and private equity funds to choose from.[31] Ordinary life insurance policies that comprise 99% of the individual insurance market are not allowed to choose from such a wide range of asset classes as investment options. These options are a feature unique to PPLI.

Lombard's list of investment options includes 95 insurance dedicated funds and over 350 manager selected funds that include many of the biggest hedge funds and private equity firms in the industry. This list of hedge fund investments available to PPLI policyholders includes, but is not limited to, funds managed by Citadel, Elliott Management, Millennium Management, Farallon Capital, PIMCO, Third Point, and Goldman Sachs.

The list of funds available to Lombard PPLI clients also includes some of the biggest names in private equity such as Blackstone, the Carlyle Group and Bain Capital, and offers funds that focus on specific asset classes like real estate and private credit. Among these options are real estate investment trusts managed by Blackstone and Starwood which are frequently snapping up single family homes across the country.[32]

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[31] Lombard International Life Assurance Company list of PPLI fund investments as of December 31, 2022, provided to Finance Committee Majority Staff on February 10, 2023. This list is included as Appendix F to the Committee's report.

[32] *Wall Street has purchased hundreds of thousands of single-family homes since the Great Recession. Here's what that means for rental prices,* CNBC, Feb. 22, 2023, https://www.cnbc.com/2023/02/21/how-wall-street-bought-single-family-homes-and-put-them-up-for-rent.html.

Exhibit 5: Excerpt from Lombard Brochure Promoting PPLI as "Income Tax-Free" Investment[33]

Private Placement Life Insurance (PPLI) Insurance for tax deferred compounding used in connection with estate planning to transfer assets income tax-free:

- No surrender charges
- Tax free transfer of assets at death
- Flexible structure to accommodate liquidity needs of the policyholder
- Access to cash via tax favored loans for life of policy (with no penalty) from non-Modified Endowment Contract policies
- Allows for multiple family members to get maximum dollars into policies and out of the estate
- Ability to select from a platform of investment options

The private marketing materials provided by Lombard also included an "example of use" slide that features how a Lombard client with a net worth of $50 million could avoid a wide range of taxes by investing $10 million in a PPLI policy instead of investing through a taxable investment vehicle. Assuming a rate of return of 8 percent a year, over the course of 30 years such an investment would successfully avoid over $50 million in potential income, gift and estate taxes.[34] A subsequent

[33] Lombard International Private Placement Life Insurance (PPLI) marketing materials, included as Appendix B to the Committee's report.

[34] Lombard International Private Placement Life Insurance (PPLI) marketing materials, included as Appendix B to the Committee's report.

slide made abundantly clear that PPLI allows for "income tax elimination" and "estate tax elimination."[35]

Exhibit 6: Excerpt from Lombard PPLI Brochure Featuring "Example of Use" by Ultra-High Net Worth Client[36]

Lombard International | Private Placement Life Insurance Overview

EXAMPLE OF USE

Client Background

- 65 year old male with a total net worth in excess of $50 million
- Client lives in Connecticut
- Highest 2022 federal (37%) and state (6.99%) tax bracket and is subject to the net investment income tax (3.8%)
- Existing in-force coverage of $15 million

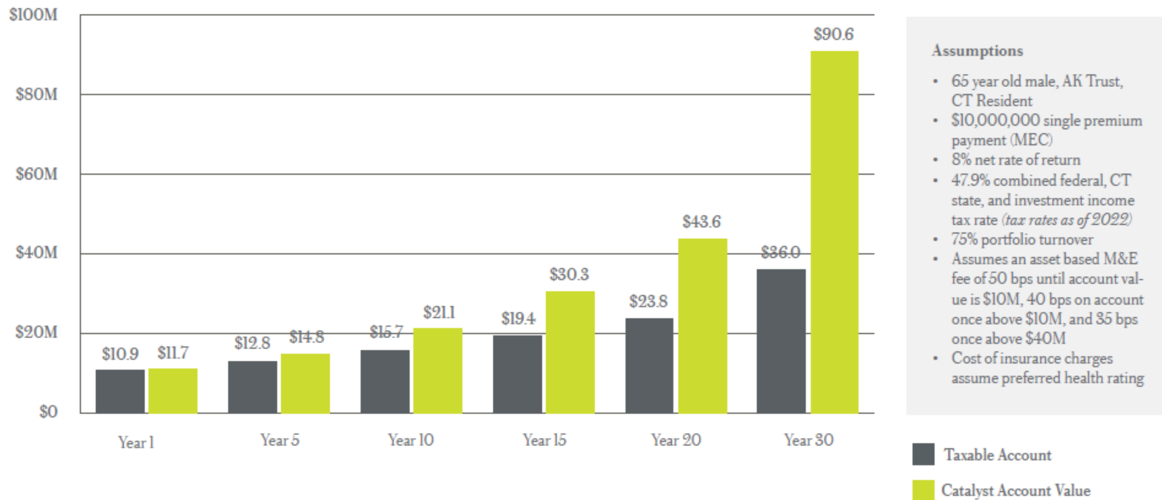
Goals

- Client wants to transfer wealth transfer to future generations
- Minimize burden of taxes on investment growth
- Flexibility to change investment allocations and managers throughout life of structure
- Eliminate K-1s from from underlying issuers

A Solution

- Invest through a Private Placement life Insurance Policy (Catalyst)

TAX COMPARISON



[35] *Id.*

[36] *Id.*

Exhibit 7: Excerpt from Lombard Brochure Discussing how PPLI Products Eliminate Taxes[37]

Estate and Operational Benefits

Income & Estate Planning Benefits	Taxable Investments	Traditional Private Placement Life Insurance	Catalyst Private Placement Life Insurance	Private Placement Variable Annuity
Tax Deferral	No	Yes	Yes	Yes
Income Tax Elimination	No	Yes*	Yes*	Yes (if tax-exempt beneficiary)
Estate Tax Elimination	No	Yes (dependent on ownership structure)	Yes (dependent on ownership structure)	Yes (if tax-exempt beneficiary)
Exempt from Generation Skipping Tax	No	Yes (dependent on ownership structure)	Yes (dependent on ownership structure)	No
Estate Planning Applications	No	Yes	Yes	Yes (if tax-exempt beneficiary)
Protected from Insurance Company Creditors	N/A	Yes	Yes	Yes

Operational Benefits	Taxable Investments	Traditional Private Placement Life Insurance	Catalyst Private Placement Life Insurance	Private Placement Variable Annuity
Annual K-1 Reporting	Yes	No	No	No
Ability to Borrow Against Policy Cash Value	N/A	Yes**	Yes**	No
Ability to Withdraw Principal Tax Free***	No	Yes**	Yes**	No
Provides Death Benefit	No	Yes	Yes	No
Requires Medical Underwriting	No	Yes	No	No

*If policy held until insured's death.
**If life insurance policies structured as non-Modified Endowment Contracts (MEC); if policy is structured as a MEC, principal is withdrawn tax-free last, similar to a variable annuity.
***Withdrawals may be subject to recapture ceiling.

In addition to insurers, PPLI brokers also promote PPLI policies to "ultra-affluent" clients as a tax-free hedge fund to "shield" hedge fund investments from taxation.[38] In a portion of their homepage that was deleted after the company received an inquiry from the Committee, PPLI broker Winged Keel Group indicated that PPLI accounts it services are used to "eliminate taxes on traditional asset class investments, and to help optimize after tax performance of Trust assets."[39]

[37] *Id.*

[38] https://www.wingedkeel.com/what-we-do/private-placement-life-insurance.

[39] https://web.archive.org/web/20230209082615/https://www.wingedkeel.com/what-we-do/private-placement.

Exhibit 8: Screenshot of Winged Keel Group Homepage Describing PPLI as way to "Eliminate Taxes" on Investments

Investment Managers and Hedge Funds Are Setting Up their Own Insurance Dedicated Funds so their Clients Can Invest in "Clone" Funds and Reap Tax-Free Benefits

In addition to insurance companies and insurance brokers, investment managers have also carved out an important niche in the booming PPLI industry. Many establish their own insurance dedicated fund ("IDF") that will provide similar or identical investment returns as their regular funds but on a tax-free basis. In this instance, an investment manager establishes an IDF, then the manager works with a broker and/or a life insurance company and their client. The insurance client then purchases the policy and allocates all of their premium in their investment manager's IDF, effectively replicating a fund investment, but in a form that magically becomes tax-free. An IDF is the latest tool in the toolbox of successful hedge fund managers or specialized market investment managers.

There are also new management platforms to help the investment managers manage their IDFs. IDFs require compliance with regulatory rules and tax laws such as asset diversification rules, and the fund can only be available to purchasers of insurance contracts, hence the name Insurance Dedicated Fund. The management platforms work with the individual advisor to help them set up their fund, they then manage the administrative needs of the fund, and often work to obtain life insurance companies that are willing to offer the IDF as an investment option under their contract. A prime example of this is SALI fund services, which specializes in the creation of "tax compliant IDFs with can be attached to PPLI investment account platforms."[40] SALI claims to administer over 100 onshore and offshore IDFs for 30 life insurance companies for a "broad range of asset managers, from boutique hedge funds to the largest wealth management institutions in the world."[41]

The coordination of these entities in effect creates a circular cash flow. The investor works with an investment advisor/hedge fund manager, which in turn collaborates with an insurance broker like Winged Keel and an insurance company willing to sell the necessary insurance product. The investor purchases a PPLI policy and then selects their manager's own IDF. Ultimately, the

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[40] SALI Fund Service homepage (https://www.sali.com/).

[41] *Id.*

investment manager has the same amount of funds under management, the insurance company and broker get to collect fees, and the owner of the PPLI is invested in the same investments they held before the transaction except now the gains accumulate tax-free.

Very Wealthy PPLI Clients Are Offered Better Terms than Somewhat Wealthy PPLI Clients

According to marketing materials obtained from insurers, the more money in premiums a client commits to a PPLI policy, the lower the fees will be. For example, information provided by leading PPLI provider Zurich shows how fees charged steadily decline as an investor is able to commit more than $10 million, with those investing over $50 million paying half the fee rate of those who invest less than $7.5 million.[42] Additionally, those who invest over $7.5 million get the upfront placement fee completely waived.[43]

Exhibit 9: Excerpt from Zurich "Private Placement Variable Universal Life (PPVUL): Alternative Investment Strategies with Tax Deferral Benefits" Client Brochure

PPVUL Specifications

- Applicant must be both a Qualified Purchaser and Accredited Investor
- Minimum initial premium (investment): $500K per year or a $2M premium commitment
- Upfront Federal DAC Tax of 0.70%
- Upfront PPVUL Placement Fee

Total Premium	Fee
Under $7.5M	2.00%
$7.5M+	0.00%

- Annual PPVUL Fee:

Account Value	Fee
Under $7.5M	1.15%
$7.5M - $10M	1.15%
$10M - $25M	0.90%
$25M - $50M	0.70%
$50M+	0.60%

- Other fees vary by issue state, gender, risk class and age

PPLI Products Allow for Tax-Free Loans Against Investments, Making them an Attractive Option for "Buy, Borrow, Die" Tax Planning Strategies

Loans from life insurance policies are accorded special treatment under the Internal Revenue Code. These loans are excluded from the "below market loan rules" of section 7872 of the Code. As a result, life insurance loans are often offered at very favorable rates. While the contract may call for a market rate of, for example, 4.5 percent interest on the loan, that rate is deceptive. This is because the issuing company continues to credit earnings on the contract based on the full cash value of the policy, including the amount loaned. In many cases the spread between the loan interest rate and the credited rate may be as low as 25 basis points, and in some cases, that amount is reduced to zero. As a result, the favorable loan treatment allows the ultra-high net worth individual access to the cash they used to pay the premium at incredibly discounted rates with no obligation to repay the loan during their lifetime.[44]

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[42] Zurich American Life Insurance Company brochure for qualified purchasers and accredited investors titled "Alternative Investment Strategies with Tax Deferral Benefits: Private Placement Variable Universal Life (PPVUL)," included as Appendix C to the Committee's report.

[43] *Id.*

[44] Loans not paid during the life time of the policyholder are paid from the death benefit by reducing the amount of the death benefit by the amount owed on the loan.

The ability to access cash through tax-free loans is actively marketed to potential PPLI clients as an attractive component of using PPLI as a tax shelter. In a pitch deck to potential clients that touts PPLI as an estate planning tool to "transfer assets income tax-free," Lombard highlights the "access to cash via tax favored loans for the life of policy (with no penalty) from non-modified endowment contract policies."[45] Similarly, Prudential marketing materials discuss that a potential client can "take out cash value via loans and withdrawals without being taxed."[46] As such, it is no surprise PPLI products are rapidly growing as the latest tool in the ultra-high net worth community's "buy, borrow, die" tax avoidance tool box.

Exhibit 10: PPLI for Dummies - How to Use an Insurance Wrapper to Invest in Hedge Funds and Private Equity without Paying Taxes

1. Pay premiums and various fees to open up a PPLI policy. Minimum commitment is generally $1 to $2 million, not including fees and other administrative costs. (Trusts are often used to purchase and hold the policy as that structure is more likely to keep the value of the life insurance policy out of the insured's taxable estate).

2. Use your PPLI policy as the vehicle to invest in the asset classes of your choice: mutual funds, hedge funds, private equity funds, real estate, etc. Brokers and investment advisers will work with you as the policy owner to customize your investment portfolio to accommodate a desired return/risk strategy and preferred list of funds.

3. Once your PPLI policy has made an investment in a hedge fund or other asset classes, the gains from the investment accrue over time inside the policy tax-free (aka inside buildup). For sake of argument, assume a rate of return of about 8 percent a year.

4. Instead of selling the assets or withdrawing funds from the policy (some of which may be taxable), you can take out tax-free loans against the value of the PPLI policy if you need to get access to cash. No need to pay off the loan in full during your lifetime, as your estate or your beneficiaries can pay off the loan once you have passed on.

5. Once you pass away, the entire value of your PPLI policy, including the premiums paid and all the accrued investment gains are passed on to your beneficiaries free of income, gift and estate taxes. As a result, your PPLI policy is a fully legal means to transfer unlimited amounts of wealth to your heirs in a tax-free manner. You've also bypassed any capital gains taxes on the returns generated by your hedge fund or private equity investments.

Investor Control Rules Designed to Curb Abuse of PPLI Policies Are Difficult for the IRS to Enforce Due to a Lack of Reporting Requirements

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[45] Lombard International Private Placement Life Insurance (PPLI) marketing materials, included as Appendix B to the Committee's report.

[46] Prudential PruLife Private Placement VUL brochure issued by Pruco Life Insurance Company, included as Appendix A to the Committee's report.

One of the primary tax guardrails in place to prevent abuse of PPLI policies by the wealthy is the "investor control doctrine" which has been in place for decades. These rules are designed to ensure that PPLI policy owners give up control over investment decisions related to assets held in PPLI policies in order to exclude the assets from the individual's taxable income or estate. According to investor control rules, hands off truly means hands off.

In the 1970s, the IRS began issuing a series of investor control rulings that state that if the owner of a policy significantly influenced or exerted control over investment decisions involving the assets in a policy, the policy owner, rather than the insurance company, would be deemed to be the true "owner" of those assets for federal income tax purposes, resulting in significant tax liabilities.

To be compliant with these rules, the policy owner can choose the broad types of investments and risk profiles, but cannot select or recommend specific investments and cannot communicate directly (or indirectly) with the policy's investment manager or adviser regarding investment strategies. If the policy owner violates the investor control doctrine, the policy owner is deemed the owner of the funding assets, and the deferral or elimination of tax on the "inside buildup" from investment activity in the policy would be lost and the owner would be liable for taxes on income earned by those assets.

The enforcement of investor control rules was the subject of a major tax court decision in 2015, *Webber v. Commissioner (144 T.C. No. 17)*. In the *Webber* decision, the tax court upheld forty years of IRS and Treasury guidance applying the investor control doctrine to determine whether the insurer or the policyholder is the owner of the assets supporting the policy. The case involved an individual policyholder who basically did everything wrong from an investor control perspective. He had two life insurance policies, held in a trust, invested through "single customer separate accounts." A single customer separate account segregates the assets supporting the insured's policy assets from the claims and creditors of the insurance company. As the name suggests, the fund account holds the assets supporting a single policy, or customer. This feature gives the policy owner the ability to influence investment decisions, the selection of investment advisors, and exercise other control over the investments supporting the policy.

The tax court concluded that Mr. Webber had violated the investor control rules through his constant contact with the investment manager of the separate account supporting his two policies. There was evidence that he sent e-mails and engaged in other forms of communication with the account managers directing them to make purchases or sell assets. He also moved assets in and out of his accounts. The evidence was overwhelming according to the court, and Mr. Webber was obligated to pay taxes on all the income earned on those separate accounts during the tax years at issue in the case.

While the IRS clearly has the authority to enforce investor rules, the Committee's investigation found significant cause for concern regarding the agency's visibility into potential violations. As part of its investigation, the Committee's majority staff participated in a policy briefing with IRS personnel regarding the agency's oversight of PPLI products.[47] The briefing was designed to provide staff from the Committee a non-case specific overview of ongoing efforts by the IRS related to enforcement of investor control rules and other potential enforcement campaigns related to PPLI products.

The investor control rules designed to curb abuse of PPLI policies are extremely difficult for the IRS to enforce due to a lack of existing reporting requirements. Individuals who take out PPLI policies are not required to disclose their interest in a PPLI policy anywhere on their tax returns.

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[47] Briefing from IRS personnel for Senate Finance Committee Majority staff on June 7th, 2023.

Accordingly, the only the way the IRS can detect a taxpayer's ownership of PPLI policy is if it comes up in the course of an audit. The IRS currently has an audit campaign related to abuse of PPLI policies underway, but the difficulty the agency faces simply identifying the individuals who hold PPLI policies is significantly hindering that effort. In light of the previous decade's steep decline of IRS enforcement resources and audit rates of high-wealth taxpayers, the Committee is concerned this disclosure loophole is significantly hindering oversight of this booming tax dodge for the rich.

Materials obtained by the Committee from insurance companies and brokers suggest that the lack of reporting requirements is in fact a selling point to potential clients. In promotional pitch decks, several industry leaders touted the ability to "eliminate K-1 reporting requirements" on investments in partnerships.[48] One broker even went as far as to suggest that PPLI could be used to reduce reporting requirements for foreign banks, raising serious concerns about Foreign Account Tax Compliance Act (FATCA) compliance.[49]

Additional Tax Issues Arising From the Use of PPLI Policies

The Committee also examined the use of PPLI to evade FATCA and reporting of offshore accounts. FATCA generally requires foreign financial institutions to report financial assets held by U.S. persons overseas on an annual basis.[50] However, promoters of PPLI routinely tout the benefits of not having clear mandatory foreign financial institution reporting requirements, such as FACTA, for PPLI accounts in making U.S. tax avoidance easier.[51] While accounts held offshore by partnerships and other investment accounts must be reported, PPLI may not be subject to FATCA reporting. For example, by using PPLI as an investment vehicle, no schedule K-1 from a partnership interest will be received as those will be issued to the legal owner of the partnership, the insurance company. Without any information reporting required under FATCA, offshore PPLI transactions are even harder to identify than domestic PPLI transactions. This opacity of the offshore market makes foreign-issued policies an attractive investment. Essentially policyholders are taking investment accounts and partnership interests and turning them into PPLI with the thinnest of insurance wrappers, shielding the activities of the investment account from any information reporting to US tax authorities.

Furthermore, Report of Foreign Bank and Financial Accounts (FBAR) filings do not appear to be a functional substitute for lack of FATCA oversight. FBAR forms are filed with the Treasury

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[48] Lombard International Private Placement Life Insurance marketing materials, included as Appendix B to the Committee's report. (The "Lombard International Catalyst Overview" promotional materials include the "elimination of K-1s from underlying investments" as one of its main "features & considerations.").

[49] *Private Placement,* Winged Keel Group, https://www.wingedkeel.com/what-we-do/private-placement-life-insurance; ("Ultra-affluent families utilize Private Placement Life Insurance and Annuity Investment Accounts to shield traditional and alternative asset class investments from current period taxation. These accounts can optimize after-tax investment returns, eliminate K-1s, enhance creditor protection, increase charitable bequests, *reduce the reporting requirements for foreign financial institutions*, and/or protect foreign wealth from U.S. income tax.").

[50] The Foreign Account Tax Compliance Act (FATCA) generally requires foreign financial Institutions and certain other non-financial foreign entities to either report to the IRS the foreign assets held by their U.S. account holders or be subject to withholding. It also requires U.S. persons to report certain foreign financial accounts and foreign assets to the IRS on their tax returns.

[51] *Private Placement,* Winged Keel Group, https://www.wingedkeel.com/what-we-do/private-placement-life-insurance; ("These accounts can optimize after-tax investment returns, eliminate K-1s, enhance creditor protection, increase charitable bequests, reduce the reporting requirements for foreign financial institutions, and/or protect foreign wealth from U.S. income tax.").

Department not the IRS, giving the IRS limited access to FBAR information. Consequently, the IRS does not have broad access to FBAR filings filed by U.S. owners of offshore PPLI to help it identify potential candidates for audit relating to a PPLI arrangement. As a result, while FBAR information is housed in the Treasury Department, it does not solve the IRS's problem with the lack of transparency relating to foreign-issued PPLI policies.

Conclusion and Committee Recommendations for Action

PPLI is clearly an abusive transaction that is only available to the very wealthiest Americans. Despite PPLI's availability to just a few thousand ultra-high net worth persons, PPLI has recently exploded into a tax shelter worth at least $40 billion. PPLI is brazenly promoted to wealthy investors as a vehicle to eliminate income, gift, and estate taxes on lucrative investments in hedge funds and private equity. Across the industry, PPLI policies are promoted as a tax-advantaged wrapper to invest in a wide range of asset classes and bypass taxes on investment gains and the transfer of wealth to their heirs.

Most Americans use life insurance to ensure that a mortgage is paid or that children can go to college if a primary breadwinner dies prematurely. Similarly, annuities provide longevity insurance so that American retirees can feel safe that they will have a steady stream of income even if they outlive all their other assets. The tax preferences afforded to life insurance and annuity contracts are provided to encourage the purchase of these products, and they do – as evidenced by the more than 90 million American families own some type of life insurance or annuity. These tax preferences must be preserved so that ordinary Americans can protect themselves and their families. Ordinary life insurance and annuity policies used by most Americans have nothing to do with PPLI, an abusive investment product that is only available to the ultra-wealthy.

Congress should close the PPLI loophole, which is a giveaway for multi-millionaires and billionaires. Legislation is needed to eliminate the use of PPLI to side-step U.S. tax laws. The Committee is currently working on legislation that will significantly curb the use of PPLI as a tax dodge for the ultra-wealthy. This legislation will also significantly strengthen reporting requirements for PPLI so that these policies can no longer be concealed from the IRS, whether onshore or offshore.

The Committee's legislation will be guided by the following principles:

- Legislation must address both private placement life insurance *and* private placement annuity contracts to prevent high net-worth individuals from merely shifting assets from a private placement life insurance policy to a private placement annuity contract. The tax preferences for private placement annuities may not be as lucrative as PPLI but they are still very attractive.
- Legislation must provide that PPLI and certain annuity contracts will not be treated as life insurance or annuity contracts under federal tax laws, with the resulting effect being that all earnings of the contract will be taxed currently instead of accumulating tax-free.
- Legislation must provide strong information reporting obligations to make sure these transactions are transparent to the IRS, enabling them to more easily identify abuses. The IRS needs PPLI reporting to enforce compliance with investor control rules and detect instances of abusive transactions or fraud.
- Legislation must provide penalties with teeth to make sure that the parties with the reporting and withholding obligations meet those obligations instead of side-stepping any rules designed to shine a light on PPLI transactions

- Legislation must address both the on-shore and off-shore segments of the PPLI market. Guardrails must be put in place to prevent wealthy U.S. purchasers from simply moving away from domestic PPLI providers to offshore carriers in pursuit of tax avoidance strategies enabled by PPLI.

- Legislation must provide that PPLI policies held offshore by U.S. persons are transparent to the IRS, and must put in place a process for the insurance companies issuing these contracts to provide the necessary information. Legislation must impose a deterrent on purchasing offshore policies so that investors think twice before purchasing a contract from a foreign insurance company.

- Finally, legislation needs to be effective no later than the date of enactment and apply not only to new policies issued after the date of enactment but to existing policies already in force on the effective date.